CIBC CAPITAL MARKETS IN CONVERSATION WITH NEWGEN ASSET MANAGEMENT

COVID-19 and the road ahead

Our Prime Services Group is joined by leading industry experts to discuss the COVID-19 crisis from navigating change, to the recovery, and future impacts of the pandemic.

NewGen was founded to offer investors an alternative to traditional long-only investment strategies. With approximately 1 billion in AUM (across three strategies and SMAs), Newgen strives to deliver a truly unique return stream with minimal correlation to other asset classes. The firm employs active fund management strategies driven by a fundamental research process designed to identify market inefficiencies. The strategies consistently adhere to a disciplined risk management framework to minimize downside volatility and preserve capital. Newgen's diverse investor base is comprised of Institutions, Family Offices, Retail Advisors and High Net Worth Individuals.

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"The Crisis" – March/April 2020

When did the impact of COVID-19 hit the firm? What was your immediate procedures as it pertains to your fund strategy?

Despite COVID-19 gaining traction in mainstream media towards the start of 2020, markets did not react until the third week of February when the virus began to rapidly spread beyond China's border. The TSX Composite went from posting a record close on February 20th to an extreme 37% correction over the subsequent 22 trading sessions, which included 5 days of declines that were greater than 5%. Every correction is different, but our Fund's strategy is always consistent – we actively shed risk to preserve capital. Our liquidity profile enables us to do so effectively. To quantify this, we took gross exposures from 120% to a low of 35% in the NewGen Equity Long/Short Fund and from 135% to 40% in the NewGen Alternative Income Fund. That represented an unwind of over $475 million in positions.

How much of what you were hearing in the news and through media were you taking into account as it pertains to forecasting what was to come?

Over the last several years, markets have become increasingly difficult to predict, as evidenced by the considerable underperformance of specialist macro strategies. While understanding the macro picture is a critical component of our investment decisions, it is far from the primary driver – i.e. fund flows and the macro backdrop can contradict each other for extended periods of time, so focusing on just the macro can be very painful. We prefer to react to the constant cues from the market. Since our strategies are predominantly fundamentally based, we de-risk when fundamentals take a back-seat. As sensationalist headlines and images triggered market hysteria, fundamentals became irrelevant so the best course of action for us was to shed risk until some semblance of calmness returned.

How did your clients react? Was there influx of calls, questions, concerns?

We are very fortunate to have strong relationships with our clients, and benefit from a diverse investor base (high-net worth individuals, family offices and investment advisors). We have always cultivated an openness of dialogue and transparency with our investors. They especially appreciated this during the crisis and were also comforted by the fact that we took decisive action to preserve capital during the onset of the extreme volatility. Of course, there were initially some smaller redemptions, but nothing overly material. We subsequently received some meaningful inflows from a few of our larger existing institutional clients, which was a good vote of confidence.

How did your firm react? Did your Business Continuity Plan kick in immediately? Any new procedures in place as a direct result of COVID-19?

Canadian regulations require that registrants have BCP's in place, but this was the first time that ours was truly tested. It was a fairly seamless transition for our team, with most of our employees still productively working remotely. Fund management lends itself well to this flexible office dynamic, although we do miss face-to-face interactions. There have subsequently been a few minor tweaks to our BCP, but it was extremely comprehensive to begin with.

How was your March and April relative to benchmarks or peers?

For March and April, the NewGen Equity Long-Short Fund LP (F Class) was -3.77% and +4.46%, respectively, while the NewGen Alternative Income Fund was -7.62% and +5.28%, respectively. Since our Funds are absolute return focused there is no benchmark, but by comparison the TSX Composite Index was -17.38% and +10.79% in March and April, respectively.

Are clients demanding more liquidity today then in previous years? Are your clients demanding anything today in terms of risk protection that they would not have asked about in previous years?

We launched the NewGen Equity Long-Short Fund LP (current AUM ~$645 million) in 2012. That Fund has monthly liquidity and a 5-day notice period, although we capped this fund to new investors in 2019. At the beginning of 2019, we then launched the NewGen Alternative Income Fund (current AUM $280 million) as a "liquid alt" with daily liquidity and a daily notice period. The initial AUM growth of this fund was considerably larger than our OM, and I suspect that part of this success is due to investor liquidity preferences.

What's the biggest takeaway from that time period you'd like to highlight today?

The biggest take a way for our firm was the importance of being liquid. We capped the AUM of the NewGen Equity Long-Short Fund LP for this very reason. Hedging strategies can be effective, and we do employ these in our portfolio; however, they tend to be fairly costly and can limit portfolio upside. Liquidity, on the other hand, costs nothing and when combined with a nimble and reactive strategy it is the most effective first line of defence.

"The Future"

What has this taught the world, and where do we go from here?

This has reminded the world to never be complacent with the stock market. The market is constantly evolving and investors need to always stay disciplined and be ready to adapt. Prior to the correction there was a large shift towards passive strategies during a period of benign volatility, in effect removing a large element of price discovery. Then during the crisis, many active managers fared far better than their more passive peers, both on protecting the downside and on capturing the market rebound. We believe that we are returning to a period where active managers will continue to prove their worth.

Will corporate offices look different for the foreseeable future. Do we see a need for change as it pertains to what an "office" used to look like versus what it will look like going forward?

We think it will be a slow transition back to some form of normalcy in the traditional workplace. However, humans are inherently social beings so I suspect most people will be eager to return to an office environment. Businesses thrive through their internal culture and that's impossible to build without some form of personal interaction. As it pertains to NewGen, our strategies rely on creative thinking, which can only be achieved by sitting in a room together, and our relationships are best cultivated through face-to-face meetings. Some industries will surely be able to successfully operate remotely, and many will be eager to do so for cost savings, but we do expect an eventual return to the office as the most productive setting for companies to grow.

What has this changed about your own investment process as it pertains to detecting "unforeseen" risks?

While we successfully navigated through this crisis, the experience gained from living through every correction is invaluable and better prepares us for the next. Our investment process has not really changed as a result, although we are looking at ways to supplement our portfolios with more creative low-cost hedging strategies to protect from future black swan events.

What are you seeing as a firm as the biggest product demand from new or existing clients today?

The launch of "liquid alts" has been very successful in Canada, so we expect to continue to utilize these structures for our upcoming fund launches. While there are many great ETFs and traditional mutual funds for retail investors to choose from, our funds will continue to target areas of the market and investment attributes that are generally inaccessible to them. As a result, we expect continued demand for our funds since they are highly complementary to any portfolio. The main downside to "liquid alts", is that they are generally not attractive structures for institutional investors, so we have been offering segregated managed accounts for these pools of capital.