Navigator Global Investments Limited

Transcript : March Performance Update Call

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Company Representatives:	Sean McGould (CEO)
	Amber Stoney (CFO)
	J Scott Perkins (Managing Director of operating subsidiary, Lighthouse Investment Partners)

A Stoney	I think we might get started. Thank you everyone for joining the teleconference. My name is Amber Stoney and I'm the CFO and Company Secretary for Navigator. We decided to schedule a call on the back of an ASX release made this morning in relation to March performance and an update withdrawing earnings guidance for FY20. The call will mainly relate to performance as that's what we released this morning, and our CEO, Sean McGould is on the line so he'll have some remarks and then we can open it up for questions. Also on the line is Scott Perkins, who's the Managing Director of Lighthouse business, and he will also be available to answer any questions. So with that, we'll have the call in Silent Mode while Sean makes his remarks, and then I'll open the call so anyone can ask any questions. Thanks [Pause to correct technical difficulty].
S McGould	Thanks everyone for taking time this morning to be brought up to date on the performance for March and the first quarter. I'll start of with just some comments about the performance and then we can talk a little bit about the business. So when we look at January and February the results were okay across the board in both the multi-strategy portfolios and the long/short portfolios as well. In March we saw a big divergence in those portfolios and that showed up in the results obviously here. The results in March ,although we always want to make money, in the equity portion of the portfolio we were able to control the risk much better, and very similar to what we saw back in the 2002, we were able to cut the risk exposure fairly aggressively in the first week of March. In the multi-strategy portfolios we saw some divergence in strategies particularly around options trading, merger arbitrage and credit strategies, which tend to be more relative value strategies, both long and short. I'll go into a little bit more details on those strategies. So, the last 2 days of February were where we really started to see some unusual activity in terms of US volatility. Some of the strategies that had protected us in January and February started to become more volatile. In those last 2 days of February, and in the first week of March in our long/short and multi-strategy portfolios we started we started to reduce the risk of the equity portion of the equity portion of the portfolio,

thinking that other relative value strategies would tend to hang in a little bit better and be influenced by other factors as well. The equities typically in these types of situations are a little bit more efficient to take risk off, especially if you need to do it the markets tend to be functioning. In our equity portfolios we tend to be very well matched between what we are long and short in different sectors, so its not typical that you would see a big divergence between what you're long and short or any type of factor risk we try to avoid.

Unfortunately, March 16 was probably the worst day I've seen in my hedge fund career in terms of relative value strategies. We saw very large liquidations across all hedge fund strategies, particularly in long/short equity it was very, very acute in terms of negative alpha production that we saw on that day. Because we had de-risked prior to that event it didn't impact the portfolios as much, but it did have a large impact on our merger arbitrage portfolio. Some of the losses were as bad as what was experienced back in 1987 when there was a stock market crash then. Also, we began to see credit spreads widen out fairly dramatically and we saw volatility shoot up to over 80% annualised in the US. At one point that week volatility was realising 140%, which obviously is quite unusual. So some of that we took pretty dramatic risk management measures, and started to reduce risk. Unfortunately, we locked in some of those losses by doing that, but we thought that was prudent to try and preserve capital and we really had never seen a day before like March 16. Any of the relative value strategies were hit fairly hard, including credit for that entire week. We did start to see stabilisation in the equity portfolios on the 18th of March, and started to see much more normalised behaviour, and actually saw positive performance in the equity portion of the portfolios for the last 10 trading days of March.

Things did normalise there, some of the relative value strategies spreads started to normalise towards the end of the month, and some the merger spreads started to normalise.

What we did not see normalise was things in the options relative value space. When we look back over the last 20 years some of those strategies helped to protect us in the options space very, very well. What was unique about this time period was that the volatility was much higher in US markets than it was in foreign markets, particularly in both China and Europe. Some of the protection that we have on again is relative. When we've seen these types of stress periods in the past we have typically seen Asian volatility, in particular, go higher than US volatility, and about 90% of the months when we have these strategies on they have produced profits and they have produced profits in stressful time periods. Unfortunately, that week of March 16 was not one of those time periods when this worked and we saw some of the worst losses that we've seen in that strategy over the last 20 years.

In addition, we have strategies that would benefit from single stock volatility being higher than index volatility, and unfortunately that also wasn't the case in that week of March 16. So we did not see single stock volatility in terms of total volatility, as I mentioned having an index realise volatility of 140%, its hard for individual stocks to exhibit that much higher volatility than the index. Some of those strategies came back in the last part of March, but as I mentioned we needed to do some risk management and risk mitigation. One of the things that really surprised us this time, particularly within the options space, and again within the credit space, was just a lack of liquidity and large bid/offer spreads. In one of the option strategies that we used that actually performed in March, had a rougher time in the last 2 days of February but actually performed well in March, is in listed S&P Put options. Again, it did make money in March, but at one point up to 25% of the value of that strategy was being absorbed in bid/offer spread. And this is on listed index equity options. If someone had asked me prior to March I would have said Euro dollar options are probably the most liquid option market in the world, I would have put S&P listed equity options probably in the top 5 markets as well, but in March that really wasn't the case and bid/offer spreads were extremely wide, especially as implied volatility went up to 80% and it became much harder to risk manage that portfolio as well as other option portfolios. So the losses within the multi-strategy portfolio were very much contained to options, relative value, credit and merger arbitrage spread. Other strategies performed as expected and we will continue to concentrate on those strategies going forward.

As I mentioned, the equity portfolio was more normal in the second half of March, similar to what we saw in 2008 it took about 2 weeks to get the portfolio where we wanted it to be, this time we did it a little bit quicker than that and we were able to avoid losses on March 16 in that strategy. So, we're happy with the performance there. Going forward one of the hardest things would be for our equity portfolios if the markets just suddenly went higher in things that hadn't performed well such as airlines or hotels, or things like that rallied 30-40%, very, very quickly. That would not be a good thing for the equity portfolio, however we have seen some of that the past 2 days in the US and the portfolio was not adversely impacted by that. So, we expect that the markets will remain at a higher volatility than normal going forward and we certainly don't think they will annualise at 80% volatility that we saw in March, but really any time that we look at US equity markets and volatility is above 40%, there is still a lot of risk in those markets and the markets tend to be directionless. So even though we've had a rally over the past 2 days, or at least yesterday and then it faded a little bit in the close today, we don't think that a sustained rally is in the offing until we see volatility start to normalise and we start to see credit spreads normalise.

Looking at the credit markets, Investment Grade credit has really come back strongly, we certainly have some exposure there. Other less liquid credit and particularly in the mortgage space, and whether that's agency, so home mortgages in the US, or commercial mortgages in the US, really have not come back and the markets there have been quite difficult. We think there is good value in those strategies and we have deployed more capital at the end of the month from our multi-strategy portfolios into both those strategies. Right now liquidity conditions have not improved on the month and probably won't improve until again we see greater improvement in the corporate credit market. The corporate credit market in the US is open, and we've seen some investment grade deals done. We've only seen one or two high yield deals done but the bank loan market is very difficult right now. One company just issued some bank loans yesterday at about a 16% yield, so the compression/expansion of yields, and just the decrease in pricing we have seen continue here in April although certainly not at the same rate of speed that we saw back in March. We do not use significant amounts of leverage on anything that's credit related or mortgage related, so there was no forced selling into those types of conditions, however I would say what has created some of the illiquidity in the credit markets in the US has been forced selling by leverage structures. Whether those are REITS that are levered, mortgage REITS, or other types of structures, CLOs (collateralised loan obligations) or whatever the case may be, the pressure was extreme for liquidity and deleveraging withing the Repo market last month.

We are going to continue to focus the capital where we believe the returns are best. We have liquidity within the portfolio which enables us to do that. Risk levels are still lower than what they would have been, certainly back in March, and that's justified due to the high level of volatility. The only strategy that we have taken out of the portfolio has been the options related strategy, and its not that I don't believe that those strategies can work, the issue is just the liquidity within the options space and being able to manage that within a specified range of outcomes. So in each of our managed accounts we have risk thresholds that the portfolio managers need to start deleveraging the portfolios into and in the options space that just wasn't possible to stay within those thresholds within March. Any strategy that we look at and that we observer where the risk management is going to be difficult going forward, we just exclude from our portfolio. We've seen those strategies work well over our careers, but unfortunately they did not work well in March.

Similar to 2008, clients will certainly need liquidity, and we mentioned in the update we do think there will be redemption activity. We know of clients that need liquidity to meet capital calls in private equity, to rebalance equity portfolios as well. We don't have enough good information to provide at this time and our conversations with our clients are ongoing at this time.

In a bit of positive news, we have had 2 significant conversations on the platform side, and one new client beside what we disclosed back in February that want us to launch some managed accounts for them late in the 2nd quarter (June quarter). We think that's a very good sign, and typically it takes these types of time periods for that activity to come out, but we're happy with the progress that we've made there.

Our focus right now, our focus for really since February, the focus has been twofold. It has been on the portfolios, which has taken nights, days and weekends to get the portfolios where we want them to be set.

Our concentration has been put on the portfolios and managing the risk s and trying to set the portfolios up for opportunity. The second major effort has been on communication with our clients. We always get high marks with our clients for transparency and the granularity of detail that we can provide, certainly when there are losses we might be one of the first groups describing what some of those losses are. The conversations aren't always easy, but we do get high marks for the honesty, the transparency and I think our clients appreciate that.

The focus in the short term will stay on both of those areas as a priority, to make sure that the portfolios, we can try and maximise the returns going forward from here and that we can answer and help our clients in any manner to understand what we are doing, understand how the portfolios are set up now, and how they will fit into clients' portfolios going forward.

It's really been an around the clock effort by the team in the midst of the coronavirus outbreak as well, so we're working under unusual conditions. Everything has functioned fine operationally, but there are really only six of us in any of our offices, all down in Florida. Everyone is working remotely and that has worked fine. Another thing that made some of the risk management difficult in March was just having the dealing community spread out at their homes around the world, where I think prices could have been facilitated a little bit better had trading been still been organised, particularly in the US and particularly in the US volatility desks.

We continue to work through this situation, and as we noted in our release, we will updated the AUM figures and give some estimates of redemption activity that we know at that time next week, when we have better guidance to give. Right now, the focus is on the operating aspects of the business. With that, Amber I think we can open it up for any questions unless Scott, there are any comments that you'd like to make.

J Perkins — Sean, nothing additional to add, other than we are currently conversations with clients, talking about performance, engaging to get their thoughts at this point, so again we'll have more information next week.

A Stoney — We'll open up now for questions.

P Chippindale — Hi Amber, this is Phil Chippindale from Ord Minnett. A couple of questions. So Sean, firstly can you just talk a little bit more about how much of Lighthouse's AUM is captured within the multi-strategy category?

S McGould — Yeah Phil. If we look at how we would classify the platform business that would be about 20%, another 30% would be in the equities business and about 50% is in the multi-strategy business. Of the multi-strategy business about 55% is equities as well.

P Chippindale — Ok thanks. Can you just make a comment, you did touch on it in some ways, but I'm just after a bit more of a direct comment about performance since the end of March. I know it's only been a few days, but in the first week of April, can you make a bit of a comment about

	how performance has changed since then and particularly in terms of relative value.
S McGould	Phil, we haven't seen major changes. In things like merger arbitrage, things are a little bit better, in credit its flatish as there hasn't been a real change there. And then in equities its been slightly positive. I would say the volatility of performance, Phil, has really calmed down. On the days when the market was really going down the first part of this month, performance was actually a little bit stronger in the equity part, simply because the last few days has benefited some of the stocks that have been hit the hardest. So the portfolios, the equity portfolio right now is actually acting better on down days or when we think there is more rational expectations of things going forward. We think with the virus this will be a long path to recovery and our portfolio managers understand that earnings guidance is extremely difficult and they are not seeing signs of improvement in a number of companies so they are not really taking a massive amount of risk. Generally performance has been flat to slightly up.
P Chippindale	Great, thanks. Just in terms of the outflows, can we turn to that for a minute. In terms of your expectations, and I understand that we'll get more detail next week, but can you sort of give us an indication, are you expecting more outflows to come from the commingled side or are you thinking its more the customised portfolio side of the equiation.
S McGould	I think for performance related reasons, absolutely it will come the multi-strategy part of the portfolio. As we discussed, when we get into timeframes like this and there is a demand for liquidity, it depends on the client situation as well. If a client needs to rebalance into equities or they have capital calls either from private equity or venture capital it can really come from any part of the business. That's a little bit of what we saw back in the 2008 timeframe. I think the difference this time around, Phil, is that our clients are dealing with a lot of uncertainty in their own portfolios. They're dealing with remote working conditions, they're dealing with everything all of us are dealing with, so we have been speaking with our clients regularly since the first part of March, so we've had in some cases numerous conversations with them, but as Scott mentioned, there aren't any firm conclusions right now other than knowing that from our conversations there is a liquidity need, even regardless of performance just to meet some of those rebalancings or capital calls.
P Chippindale	Okay, one final one from me. Just on the platform business you referred to a new client outside what was disclosed in February looking to come on board late this quarter. Can you just tell us is that a new client to Lighthouse completely, or is this an existing client looking to come on the platform as well.
S McGould	It's a new client to Lighthouse completely.
P Chippindale	Thanks very much, I'll let someone else ask a question. Thank you.
M Hancock	Hello, Mark Hancock here. Can I just clarify that question on the asset allocation. You're saying that the equities are 55% of that 50% of multi-strategy assets?

S McGould	Correct.
M Hancock	So, are you saying, and they've held up basically well, so are you saying that the problem in the performance area is 45% of the 50%?
S McGould	Ah, yes Mark. There were still some losses in the equity area, but much less than what we would have thought given how far the markets moved and given how poor the alpha production was for a period in March. So there were losses, but the vast majority of the losses occurred within that 45% of the portfolio, within the relative value piece of the portfolio. Yes, that's correct.
M Hancock	Based on these performance returns, its hard to see that you could possibly recoup them going forward, and you've damaged the 3 and 5 year numbers, almost possible permanently for these products.
S McGould	Well, I think that Mark in terms of the equity products that's no the feedback that we're getting, and I think Mark with the multi-strategy products I think that clients realise which portion of the portfolio held up and which didn't, and that may be more the focus of some of those multi-strategy portfolios in the custom mandates going forward. But yes, I'm very disappointed with the results, you know there is nothing to be happy about there. But you know certain parts of what we do and things that are very liquid I think that we can do a very good job of, and in other areas Mark, you're right we will not make up those results from the same areas where lost it in, because we've taken certain parts of the portfolio out Mark.
M Hancock	I'm assuming that you're going to have to make some change to the business to adjust for this new environment given what's happened, and you have to take costs out again in another round of rationalisation?
S McGould	Well, I think Mark we've got to first see what our clients are telling us and absolutely the business will be focussed on, and always has been focussed on, what we believe we can risk manage in any situation. So 100%, if that ends up being more equity focused and certain other strategies, then that's what we're going to focus on and do what we think we can be competitive in and do what we do well. Yes, there will actually be changes from these results, and I think clients will demand that, and that, yes, we will have to make changes within the business.
M Hancock	Just to clarify, if the Diversified Fund was down 18%, and that included 55% of equity allocations, the other strategies must have been abysmal, worse than 50%.
S McGould	Well, the equity piece Mark, as well as when you factor in leverage. So yes, the strategies in the options space were very, very bad, but the equities weren't without loss. So yes, some of the strategies performed very poorly, the poorest by far were the options related strategies, and those would have cost about half the losses on the month.
M Hancock	Sorry, I missed that bit.
S McGould	I said the volatility of the option strategies would have cost about half of the losses on the month.

M Hancock	Is that right, just that alone? Yep.
A Stoney	Does anyone else have any questions? No, okay, last opportunity. Well if there are no other questions I guess, Sean is there anything else you wanted to say I closing?
S McGould	No, I mean our focus again is on the portfolios and the clients and we will have more information, Amber, next week when we release the AUM and any additional information that we have at that time.
A Stoney	Well thank you, and thanks everyone for taking the time. I know it was reasonably short notice, but we thought it was important that we had an opportunity to present. Thank you, and enjoy the rest of your day.
	END CALL