Invest X

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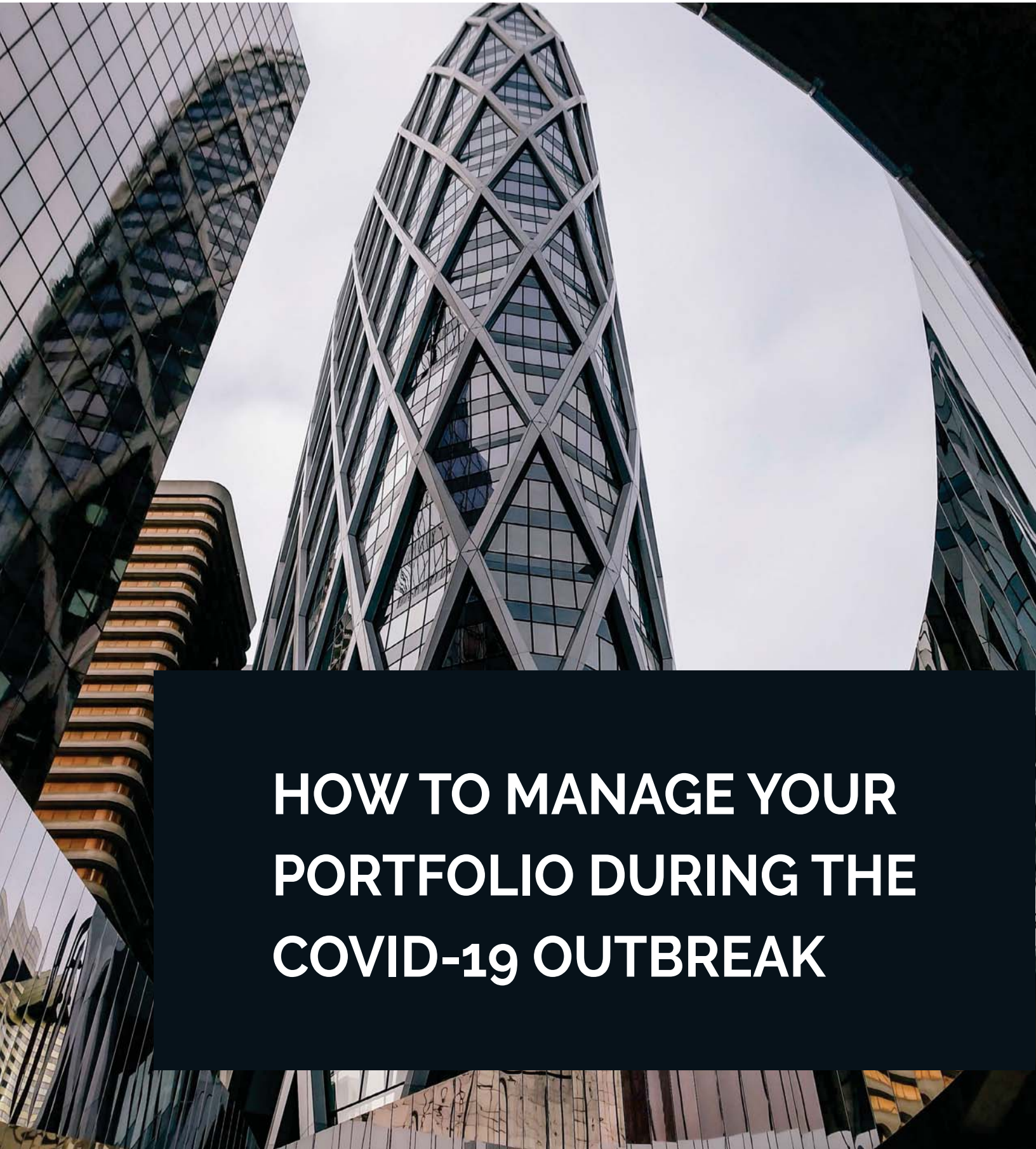


HOW TO MANAGE YOUR PORTFOLIO DURING THE COVID-19 OUTBREAK

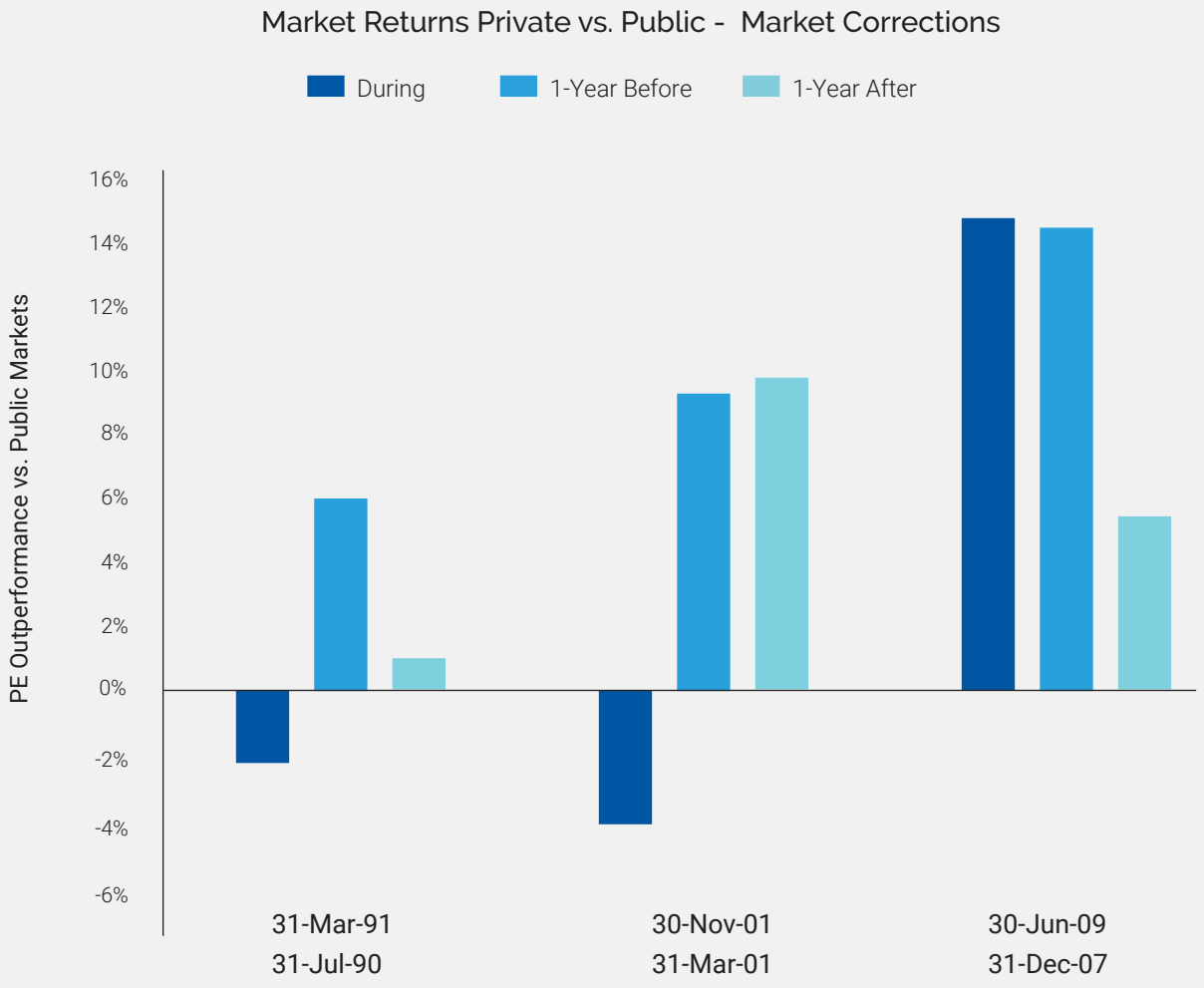
Since December 2019, there have been more than 120,000+ COVID-19 cases with over 4,000 deaths globally resulting from the virus.

The widespread outbreak of the virus has negatively impacted the global stock markets with approximately $9 trillion being erased from the markets in nine days on growing fears of a market downturn.

On Monday (March 9), a 15 minute trading halt was imposed on the NYSE, NASDAQ and TSX, due to a decline of more than 7%.

While the public markets are experiencing significant volatility as they attempt to price in the impact of the COVID-19 outbreak and potential global crisis, the private markets don't experience the same daily and weekly swings.

The chart below provides a breakdown of how the private markets have performed during times of economic uncertainty when compared to the public markets.



SOURCE: https://www.cambridgeassociates.com/private-investment-benchmarks/

> "The widespread outbreak of the virus has negatively impacted the global stock markets with approximately $9 trillion being erased from the markets in nine days on growing fears of a market downturn."

Private Equity Versus Public Equity in a Downturn

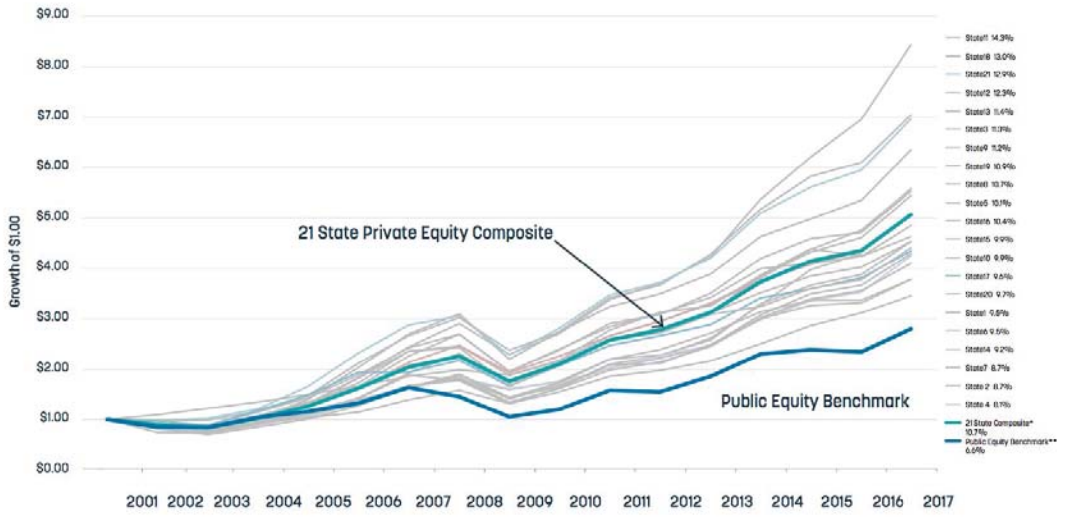
Private Equity Outperforms the Public Sector

Private equity (PE) has historically outperformed public markets during downturns. iCapital Network, a New York City-based financial institution, highlights how significant historical data points to PE's outperformance actually increasing during distressed periods through deploying capital more effectively and avoiding short-termism and its negative consequences[1].

A report generated by Cliffwater[2] examined PE investment programs at U.S. state pension plans over the 16-year period ending June 30, 2016, encompassing two bear markets and two bull markets. During this period, PE outperformed public equities by 440 basis points annually on average across the 21 pension plans studied.

These strong relative returns were even more pronounced during bear markets than in years of economic growth[3]. When the broader economy was stronger, PE outperformed by an average of 290 basis points; however, during weaker economic times, this increased to 660 basis points.

Exhibit 1:
Private versus public equity performance in U.S. state pensions



Fiscal Years ending June 30
*An equal-weighted average of all 21 state funds who reported private equity returns in annual CAFRs for June 30 fiscal years 2002-2017.
** A public equity benchmark weighted 70% to the Russell 3000 Index (6.8% annualized return) and 30% to the MSCI ACWI ex US Index (5.9% annualized return), with assigned weights reflecting Cliffwater's judgment of the US and non-US content of a diversified private equity portfolio.

Source: Cliffwater, "An Examination of Private Equity Performance among State Pensions, 2002-2017," updated May 2018. 2017 is the most recent data available. For illustrative purposes only.

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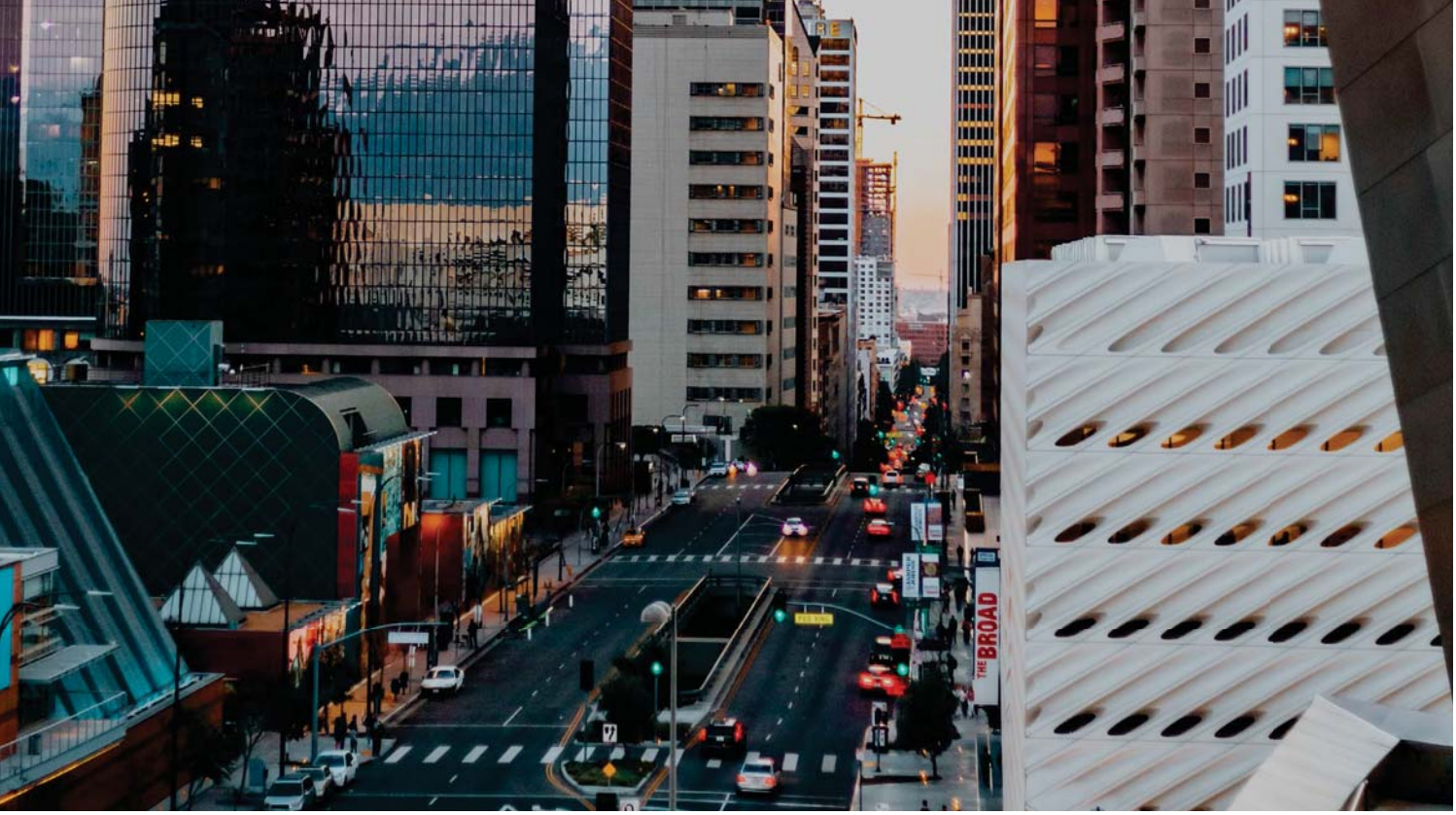
[1] https://www.icapitalnetwork.com/insights/blog/how-private-equity-performs-in-a-downturn/

[2] Cliffwater, "An Examination of Private Equity Performance among State Pensions, 2002-2017," updated May 2018.

[3] The study notes 2002-03 and 2008-09 as the bear market years.



How Illiquidity Can Be an Advantage

During market downturns, the illiquid nature of PE investing is paradoxically an advantage. The longer holding periods insulate investors from widespread panic and irrational decision making.

iCapital emphasizes that "panic selling" comes with an expensive price tag as investors will often sell their assets below market value and on fears that their valuations will drop even more.

Private Equity Investments Reduce Risk

PE investments are valued based on funding rounds and what people are willing to pay for the company in a secondary sale. Most investors in private equity are portfolio managers managing multi-billion pensions, hedge funds, and VC funds with a long-term focus and diversified portfolio. Valuations are derived more from company fundamentals and long-term vision that day to day market sentiment.

Research from the CFA Institute[4] demonstrates that returns in the private markets are more stable and reduce risk when compared to the public markets during a financial crisis. The report was done at the earliest possible time during the life cycle of a PE firm and pattern of returns in order to accurately measure how the 2008 financial crisis impacted funds that were active during that period.

[4] https://www.cfainstitute.org/en/research/cfa-digest/2016/06/private-equity-throughout-the-financial-crisis-digest-summary

How InvestX is Taking Advantage

A financial crisis represents a potential buying opportunity for the InvestX Global Equity II Fund. Although investors in private markets typically do not fire sale shares out of fear, there are a few opportunities created by distressed sellers, which InvestX is actively seeking. Here are some factors we consider:

Buy Shares from Distressed Equity and Hedge Funds

In sharp declining markets, the value of those shares can exceed the regulatory threshold in very short periods of time requiring quick exits of illiquid securities. When investors must sell illiquid securities quickly, there tends to be a large discount due to a shortened period to close and the lack of multiple bidders. The fund has to sell positions quickly to be on side with regulators to a very small audience of buyers.

InvestX is actively looking for shares in high quality companies we know from distressed sellers.

Companies with Strong Fundamentals

During an economic downturn, investors will want to consider companies that can ride out the market volatility with strong sustained fundamentals from long-term contracts with high value enterprise customers. This particular quality led the InvestX team to invest in Palantir and Dataminr. Both companies have contracts lasting years with 50%+ of their revenue generated from various U.S. government organizations, like the Department of Defense and Central Intelligence Agency. Investors will also want to look at companies with a strong backlog of revenue from high value customers that enable these companies in making more long-term strategic capital investments.

These companies may present themselves at a discount as market volatility increases. Investors who have cash sitting on the sidelines can use this opportunity to buy some of the top private equity names in the world at a significant discount to both public and private comparable companies.

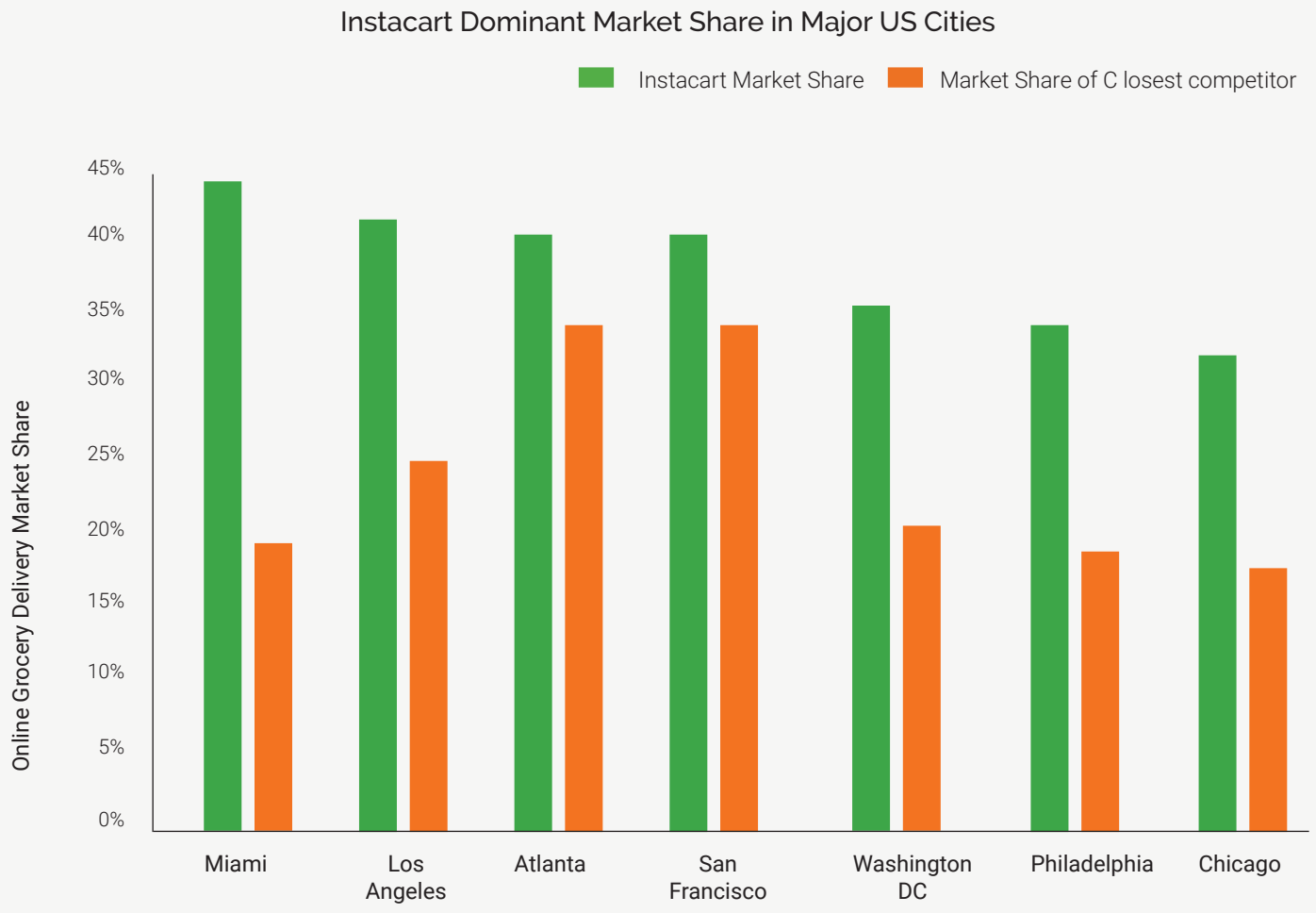
The InvestX investment team is able to identify and act on these opportunities through their network of private companies and investors. This network opens up access to financial information of private companies in our due diligence process - a key factor in the InvestX 5-Factor Formula.

Benefiting in a Downturn

An economic crisis provides an option to buy into investments that are benefiting from environments such as the current COVID-19 outbreak. These are companies whose growth is accelerated and protected during a crisis.

Take Instacart, for example, a grocery delivery service InvestX has invested in. After several months of testing, the company introduced on March 6 the "Leave at My Door" delivery feature to customers across North America. Instacart said that over a one-week period, it noticed an increase in consumer adoption and customers electing to opt in for that service. After rolling out the service, Reuters reported sales of Instacart increased 10-fold and as much as 20 times in states such as California and Washington, where the COVID-19 outbreak has been the most widespread.

Companies with valuations larger than $1 billion with minimal debt allows the ability to manage operations without capital constraints. In the event of a cash flow shortfall, companies can dip into their balance sheet without taking on debt. When it comes time to access debt, lending to these companies is less risky because many have substantial amounts of revenue and some already generate free cash flow.



SOURCE: https://csimarket.com/Industry/Industry_Financial_strength.php

When to Liquidate

Selling public equity during a financial crisis is most often based on fear, however high-quality companies with strong balance sheets are more likely able to weather the storm. The same can be said for pre-IPO companies, therefore reasons to exit from your investments shouldn't be fear-driven.

Don't Mistake Distress for Discount

In fear markets, over time some investors may start to sell their positions at a significant discount to previous funding rounds. This may be an opportunity to add to our high-quality names, but it is important to stay away from distressed companies. In the public markets, this is referred to as a value trap as companies may seem too cheap to pass on.

The InvestX investment team reviews financial information of these large Pre-IPO companies to determine if they may have difficulty navigating a potential crisis.

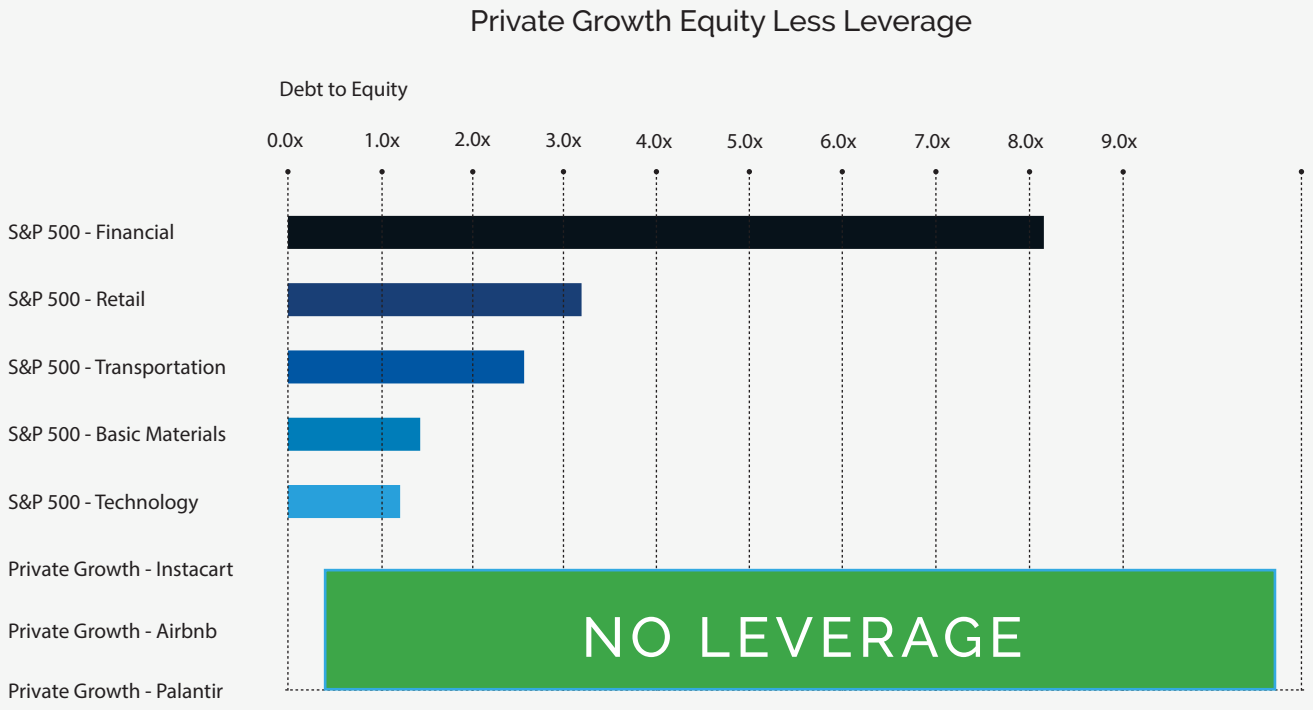
Cyclicality and Fickle Consumers

Companies in cyclical sectors like retail, financial services, and travel and transport may find it difficult to navigate a potential crisis due to their reliance on discretionary spending. These companies often rely on a business model of infrequent purchases from customers instead of more predictable consumption from larger businesses.

Companies may depend on deeper discounts and increased marketing spend to keep customers coming through the door; however, at a certain point capital starts to dry up and the prospects of a downgrade in the value of the company becomes more evident.

Cash Crunched

Leverage stifles companies focused on growth and will often be a last resort capital infusion. If a company has overspent and under received, it runs into a cash crunch and needs outside capital. The company can go back to its private backers and raise equity, it can tap into the debt markets or it can end up forcing an IPO.



SOURCE:https://csimarket.com/Industry/Industry_Financial_strength.php

In Conclusion

During times of economic uncertainty, it's easy to get caught up in the panic and make irrational, fear-based decisions. However, approaching investments with a long-term approach leads to wiser investment choices.

Times of volatility presents opportunity in the private markets due to its longer investment horizon while providing investors the chance to make significant returns. If investors have access to financial information and can see that the fundamentals drive the company's value, investors can pick up these private equity names at significant discounts.

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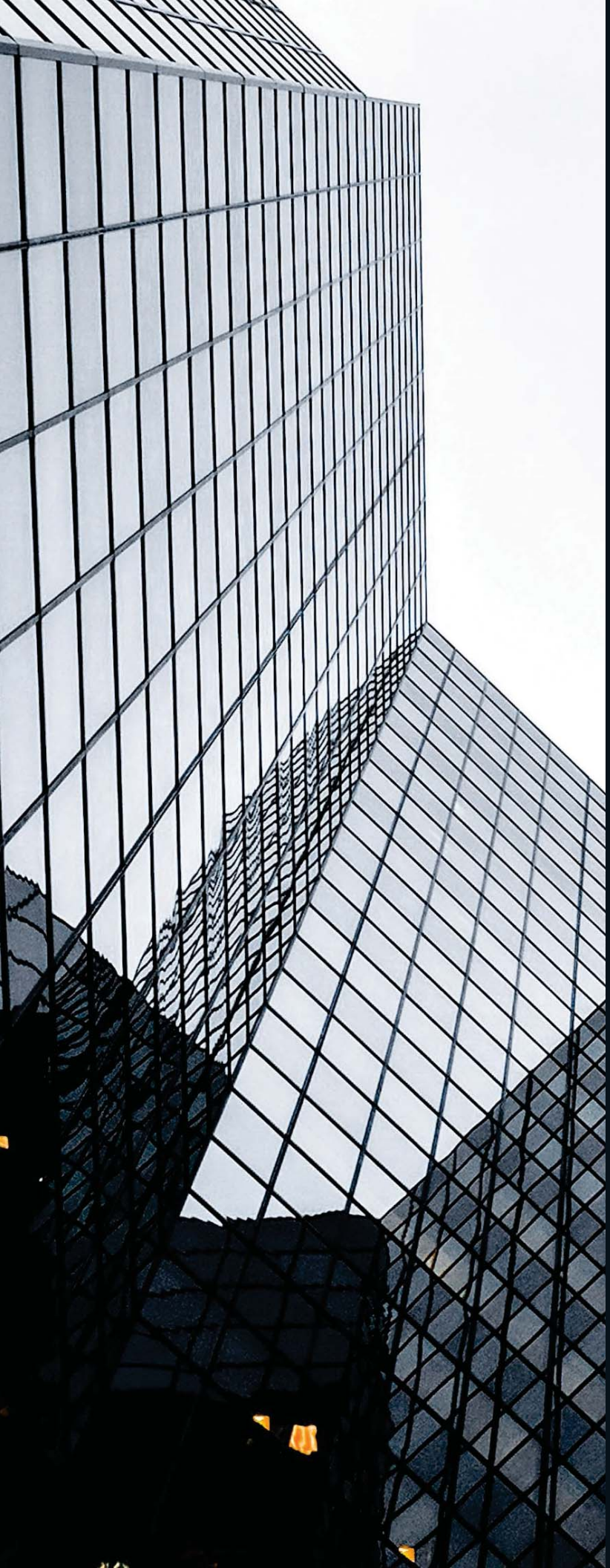

The InvestX Trading Platform provides opportunities to both invest and if necessary liquidate positions in pre-IPO companies.

If you would like more information regarding your investments or managing your portfolio, please contact us.

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