THE WEEKLY BRIEF
By LYXOR CROSS ASSET RESEARCH

9 SEP 2019

Hedge Funds Could Help Deal With The Uncertainties

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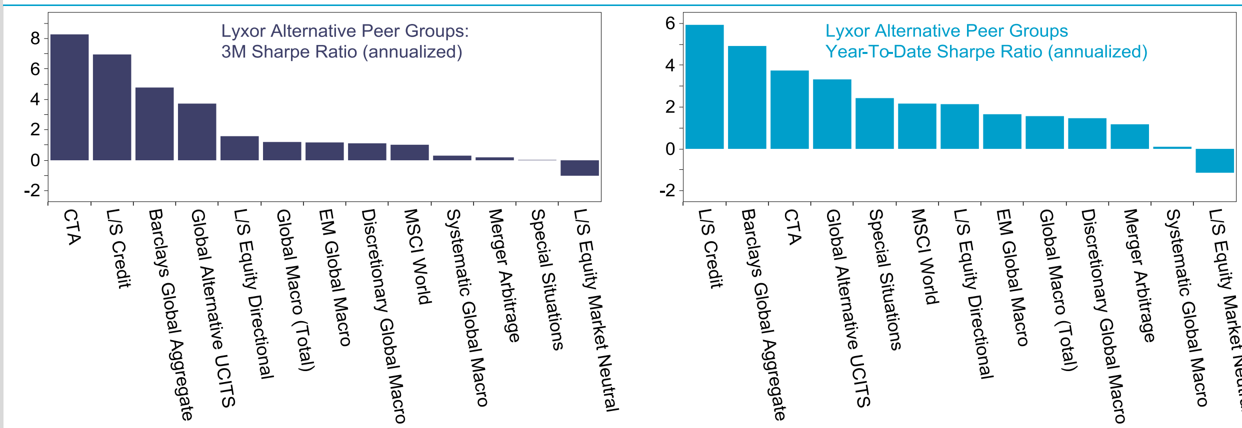
Despite colossal headwinds related to trade tensions, the Brexit deadlock and the manufacturing recession, asset prices have been incredibly buoyant so far this year. Equities are recovering from the August drawdown and are approaching late-July record levels. The asset class could deliver the highest yearly returns since 2013 (MSCI World +18% year-to-date). Meanwhile, global bond benchmarks are on track to deliver their best year since 2000 (Barclays Global Aggregate +8.8% year-to-date).

In this context, hedge funds are also posting robust returns. The Lyxor Global Alternative UCITS Peer Group was flat in August, leaving year-to-date returns close to +5% in USD terms. Performance in recent months was led by CTAs, which delivered impressive returns (+3.7% in August; +16.2% year-to-date as of September 3rd). Considering the higher volatility of CTAs, the picture on a risk adjusted basis is slightly different with L/S Credit leading the pack. It has an annualized Sharpe ratio of 6 so far this year (vs. 3.3 for our Global Peer Group).

As we are head into Q4 2019, we turn more defensive. U.S. trade tariffs on USD 250bn of annual imports from China are set to increase to 30% from 25% starting October 1st. Manufacturing new orders continue to signal a contraction and the Michigan survey signals an erosion in consumer confidence which might hurt private consumption, the last engine of U.S. growth. In our view, the risks are highly asymmetric.

In this context, hedge funds might help with dealing with the ongoing uncertainty. Merger Arbitrage and Market Neutral L/S are attractive despite their underperformance so far this year. We also reiterate our O/W stance on L/S Credit and EM Global Macro, as a stance in favor of carry strategies in a low bond yield environment. Meanwhile, high beta strategies such as Directional L/S Equity (U/W) and Special Situations (N) are likely to feel the brunt of the equity market volatility. With regards to CTA and Global Macro (N), we are reluctant to add to the former after the recent rally. Yet, it provides protection against a reversal in stock prices and/or adverse Brexit developments thanks to short GBPUSD positioning. Finally, within Global Macro, we prefer EM-focused strategies (O/W) to leverage our view that the Fed will materially ease monetary policy in the coming months. We anticipate two rate cuts from the FOMC before year-end (September 18th and December 11th).

Hedge funds are on track to deliver buoyant risk adjusted returns this year



MSCI World and Barclays Global Aggregate in total return, FX hedged. Excess returns calculated vs. Fed Fund rate. Sources: Macrobond, Lyxor AM

PERFORMANCE

CTA's prolong winning streak through the end of summer

Lyxor UCITS Peer Group Performance

	Last Week*	MTD**	YTD**	# of funds
CTAs	1.5%	0.5%	16.2%	25
Bloomberg Barclays Global Aggregate Bond Index	0.4%	0.3%	9.6%	
Global Macro	0.3%	0.1%	4.1%	41
Global Lyxor UCITS Peer Group	0.3%	0.0%	4.9%	241
L/S Credit	0.2%	0.0%	5.4%	30
Event-Driven: Merger Arbitrage	0.0%	0.0%	2.2%	23
L/S Equity Market Neutral	-0.1%	0.0%	0.5%	31
Risk Premia	0.2%	-0.1%	3.0%	21
L/S Equity Directional	0.4%	-0.1%	5.2%	63
Event-Driven: Special Situations	0.1%	-0.2%	5.6%	7
MSCI World	1.4%	-0.5%	15.7%	

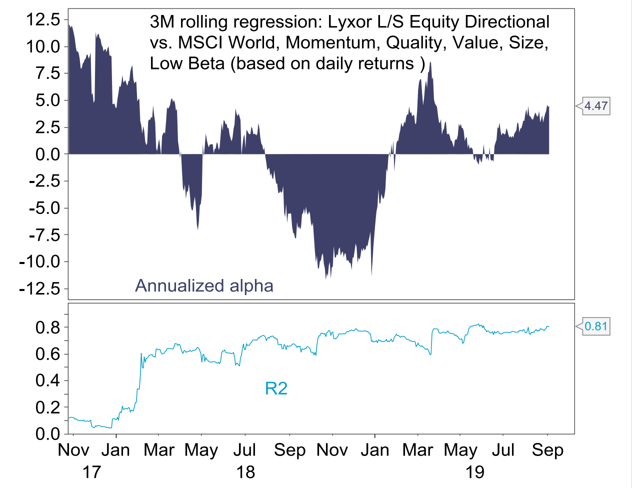
*Last Week: August 27th to September 3rd. Source: Lyxor AM

Fueled by the rally in equity and bond markets, CTAs outperformed last week (+1.5%). Their net long position on both equity and bonds edged lower lately, due to the rise in volatility on both asset classes.

The Global Lyxor UCITS Peer Group, which pools together 241 strategies, was up +0.3% last week. Along with CTAs, Global Macro also performed reasonably well (+0.3%) on the back of the performance of discretionary (+0.4%) and Systematic Macro strategies (+0.8%). The latter has benefitted from the rebound in stock prices and the rise in bond yields.

Directional L/S strategies were up last week (+0.4%) and interestingly, they were also resilient in August (-0.2%) on the back of their more defensive positioning. Finally, Market Neutral L/S and Merger Arbitrage continued to lag, both in August and last week.

L/S Equity strategies were remarkably resilient in August



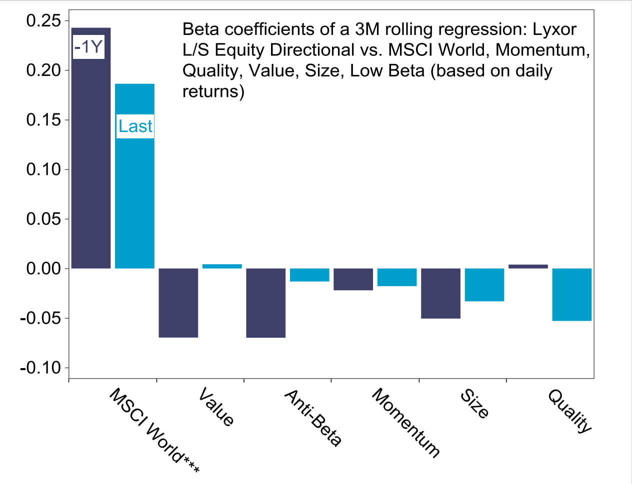
Dow Jones Market Neutral risk factors. Source: Dow Jones, MSCI, Macrobond, Lyxor AM

L/S Equity strategies were quite resilient in August despite the equity market turmoil. The Lyxor L/S Equity Directional Peer Group was down -0.24% last month. Directional strategies even managed to outperform Market Neutral L/S Equity strategies (-0.29%), which is unusual in such market conditions.

In the meantime, the MSCI World (total return, FX hedged) was down almost -2%. With a market beta that has stabilized below 20% since May, the performance of Directional L/S Equity strategies should have been around -0.4%.

Alpha conditions have thus materially improved in recent months. Based on a 3-months rolling regression of daily returns, we estimate an annualized alpha close to 4.5% at present, which is significant.

Along with a lower market Beta, Directional L/S strategies have reduced "style" biases in their portfolios



Dow Jones Market Neutral risk factors. Source: Dow Jones, MSCI, Macrobond, Lyxor AM

Over the last year, directional L/S Equity strategies have significantly reduced their market beta in an increasingly uncertain environment, from 25% to 18%. This helped them navigate the turmoil last month.

Based on our estimates, such strategies also appear to have reduced their portfolio biases. A year ago, their short positioning on the low beta risk factors was harmful and at present, they do not appear to be significantly exposed to risk factors such as small caps, value, quality, momentum, and low beta in the U.S.

Nonetheless, we note that Directional L/S strategies have increased their exposure to defensive sectors. But rather than allocating to traditional defensive / yield sectors such as Real Estate and Staples, they have increasingly allocated to nontraditional defensive sectors such as Aerospace & Defense, Software, and Interactive Media services.

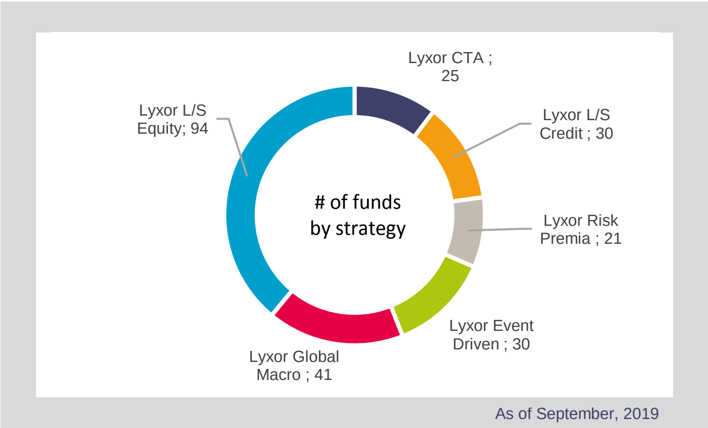
METHODOLOGICAL APPENDIX

The information contained in this report on the performance of onshore hedge funds is based on publicly available information. The universe of underlying funds is relatively stable but varies depending on the criteria of inclusion presented below. It is based on an unbiased selection from our hedge fund analyst team.

Performance is calculated on a weekly basis, as of end-Tuesday, using an arithmetic average (equally weighted average).

Regarding share classes used in these peer groups, we selected the primary share class as referenced in Bloomberg. Non-USD share classes are hedged in USD based on hedging costs available on Bloomberg.

Lyxor Hedge Fund Peer Groups: number of funds by strategy



- 241 strategies across the main categories in the industry
- USD 233 billion of assets under management

Criteria of inclusion

The criteria of inclusion are fourfold:

i) We only include UCITS strategies;

ii) Assessment by Lyxor’s Hedge Fund selection team based on funds’ materials or manager interaction;

iii) We only include strategies with assets under management of at least USD 50 million; and

iv) We only include strategies with at least a one-year track record.

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