

– MONTHLY HEDGE FUND STRATEGY COMMENTS –

– MAY 2008 –

Market Overview

Bonds no more a safe Haven

– Stagflation fears weigh on equities and on Bonds

This month witnessed a radical change in the market environment, as for the first time since the start of the year, both equities and bonds suffered drawbacks.

Indeed, while previous “risk aversion” events expressed themselves via flight to quality to bonds, this time, rising inflation worries prevented interest rates from falling. Stagflation fears – the combination of low growth and rising consumer prices – simultaneously pressured expected earnings per share and led to a strong revision of the future path of Fed Funds. At the end of the month, the market was attributing a 50% probability to a 25 bps Fed hike in October. Interestingly, while previous upward shifts in interest rates had been more strongly felt in the shorter end of the curve, this time the shift was parallel, so that the yield curve remained more or less unchanged on the month.

The Fed did nothing to prevent this change in expectations. The latest Fed statement insisted on elevated inflation trends and, more crucially, on rising inflation expectations, underlining that “uncertainty about the inflation outlook [had] increased”. This was interpreted as a shift to a more neutral stance, so that the April 30th 25 bps cut to 2.0% was seen as bringing an end to the easing cycle.

– Commodity prices were the real market driver

Surging oil prices brought additional strong support to the stagflation theme – oil broke through the \$ 135 barrier intra-month on a EIA oil stock slump. As is the case for gold – up 4.1% this month – oil is seen as an inflation hedge. Additionally, the inverse correlation between the US dollar and oil prices remains very true. With the short dollar theme now equating to the new risk aversion hedge, commodities find implicit support in a still very uncertain environment.

– High intra-month volatility on equity markets

At the current juncture, rising gasoline prices are a major threat for the US economy ... and therefore for equity markets. The latter's -0.4% range bound performance on the month is very misleading. Markets rallied by close to 3.0% at the start of the month, before closing in on a 3.6% drawdown. The financial side of equity indices suffered again, as Brokers and Insurers announced that further write-

downs were on the agenda and that they would need to raise further capital. Moreover, on the macro front, good news at the start of the month –durable goods ex-transport were solid in April and job destructions remained limited – were counterbalanced at the end of the month by plummeting consumer confidence and surging household inflation expectations.

These up and down trends were reflected in the VIX, which dropped to its lowest levels since the start of the year (16.30 on the 15th of May), before rising back to 19.64.

– ASSET CLASSES PERFORMANCE –				
	May	MTD % / bp	YTD % / bp	
S&P 500	1,400.38	1.07%	-4.63%	
Eurostoxx	3,182.53	-1.69%	-13.61%	
Russell 2000	748.28	4.48%	-2.32%	
MSCI Emerging	49,651.13	1.55%	-3.39%	
US Treasury 10Y rate	4.06%	33.15	3.65	
Euro 10Y rate	4.41%	28.2	7.4	
EUR/USD	1.56	-0.44%	6.66%	
USD/JPY	105.51	1.54%	-5.62%	
Oil (WTI)	127.35	12.24%	32.68%	
Gold	887.10	2.54%	5.82%	
VIX	17.83	-14.24%	-20.76%	

Source: Bloomberg

– ALTERNATIVE STRATEGIES PERFORMANCE –		
	May*	YTD
Lyxor Hedge Index (Composite Index)	1.95%	1.16%
Lyxor L/S Equity Variable Bias Index	2.23%	-0.40%
Lyxor L/S Equity Long Bias Index	2.72%	-3.50%
Lyxor L/S Equity Short Bias Index	-1.83%	3.17%
Lyxor L/S Equity Market Neutral Index	1.15%	0.03%
Lyxor L/S Equity Statistical Arbitrage Index	2.29%	5.17%
Lyxor Special Situations Index	3.15%	2.32%
Lyxor Merger Arbitrage Index	2.50%	2.76%
Lyxor Distressed Securities Index	0.74%	-5.28%
Lyxor Convertible Bonds Arbitrage Index	0.90%	-0.24%
Lyxor Fixed Income Arbitrage Index	-1.49%	-13.08%
Lyxor L/S Credit Arbitrage Index	0.71%	-2.09%
Lyxor Global Macro Index	1.10%	5.93%
Lyxor CTA Long Term Index	2.50%	9.86%
Lyxor CTA Short Term Index	2.35%	7.00%

Source: S&P

(* MTD returns are based on performance from the last estimated NAV of the previous month until the last estimated NAV of the reported month. YTD returns are from December 31, 2007 through May 30, 2008.

The Lyxor Hedge Fund Indices are asset-weighted hedge fund index based on the performance of Hedge Funds that belong to the Lyxor Platform.

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– MONTHLY HEDGE FUND STRATEGY COMMENTS –

– MAY 2008 –

CTA Long Term +2.50% MTD, +9.86% YTD
CTA Short Term +2.35% MTD, +7.00% YTD

– A mixed start but a happy month end

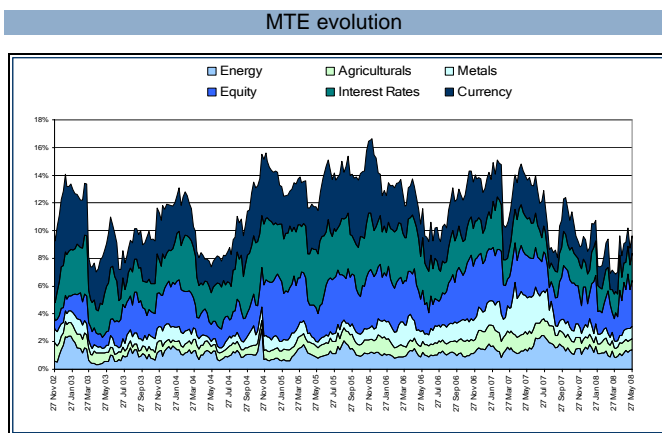
The storyline in May was a rally on energy and equities, intra month reversals on metals, and a sell off in the bond markets.

CTAs posted a brilliant performance for both long term and short term funds.

Dispersion between CTAs is high with performances ranging from -6.38% to +9.14%.

All the short term funds were up this month again, as they managed to reverse their exposure frequently and profit from the markets volatility, especially in equities, metals and agricultural.

Medium-term trend-followers did also well and fared much better than in April. Even if intra month reversals, especially in metals and interest rates, offset some of the gains, many of them managed to finish the month with a brilliant performance.



Source: Lyxor

The overall Margin to Equity increased progressively throughout the month from around 9.05% at the beginning of the month to 9.66% at the end of the period.

CTAs increased their exposure to interest rates. The overall MTE became net long, as many funds increased their long exposure.

The Margin-To-Equity on equity has been decreased slightly from 3.45% to 3.32%. The overall margin to equity to this sector went from net short to net long.

Margin to Equity on commodities has been decreased and it came mainly from the energy book as many funds reduced their long exposure.

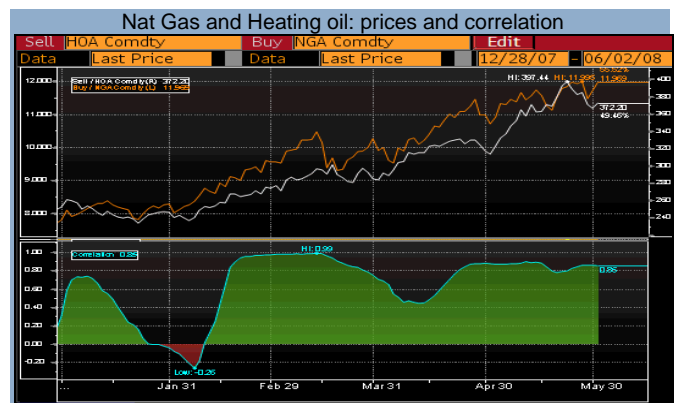
CTAs are still net long on Energy and Agricultural but became net short on metals.

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Commodities and interest rates were the main performance drivers of the month. Equities also contributed to the performance especially at the end of the month, as most of the funds became long on this sector.

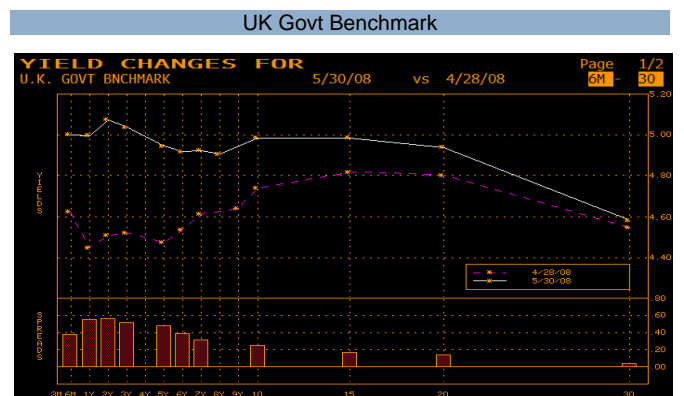
Despite the oil price breaking all-time highs, most food and metals prices came off their recent grounds, Wheat and Sugar prices have already fallen by almost 30% in the last three months, while all metal prices have dropped well below the heights reached in Q1.

Despite these discrepancies, the commodities sector posted good performances, thanks especially to CTAs established long exposure to energy.



Source Bloomberg

Inflation figures released in various countries this month raised a few concerns. Interest rates rose very quickly, especially in the Anglo-Saxon world. Thus, last month saw a re-pricing in fixed income markets following a significant sell-off in treasuries, with the US benchmark 10Y bond going through the 4%-level. This hurt many long term CTAs that were still short on this sector. On the other side, short term CTAs managed to change their exposure and participate to the rally.



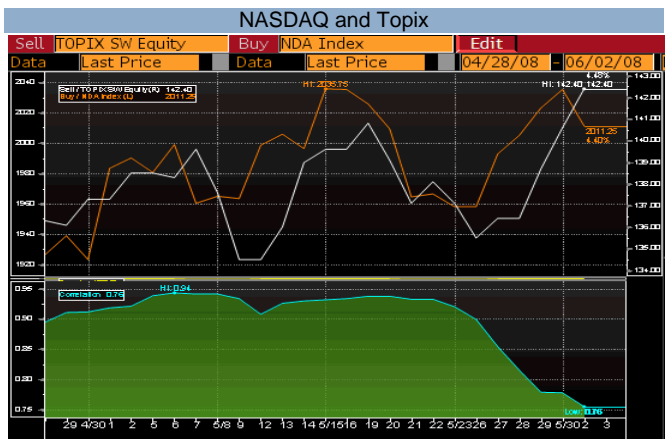
Source: Bloomberg

– MONTHLY HEDGE FUND STRATEGY COMMENTS –

– MAY 2008 –

Stock markets trends were less persistent during May, following April's strong rallies. Yet the overall long exposure was profitable especially at the end of the month.

The Canadian, Japanese, and emerging markets indices were a good source of performance, followed by Europe and then the United States indices.



Source: Bloomberg

On the FX side, long positions in emerging currencies (Polish Zloty, Turkish Lira and Mexican Peso) were profitable, but gains were offset by short positions on European currencies.

GLOBAL MACRO +1.10% MTD, +5.93% YTD

– A second start

In spite of the high dispersion observed in performance this month again, with returns ranging from -4.23% to +4.34%, the majority of the fund's were in positive territory, leading the Global Macro platform to be up more than 1% for the month.

May was marked by the rebound on global stock indices as well as new record levels reached in the energy spectrum: oil prices absolutely dominated financial markets along the month, up almost \$15 per barrel.

What's important to underline is that the funds managed to resist well to the very difficult markets conditions; thus emerging and commodities specialists had to face challenging market conditions and finished the month with very decent performance.

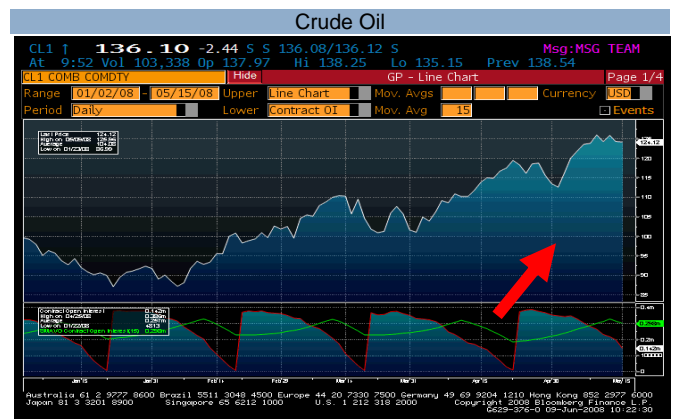
On the equities side, the strength of US and European markets continued to be supported by the optimism that the worse phase of the credit crisis has probably passed. This helped to boost most of the major stock indices for the month, in Europe in particular. Thus, global equities conditions were profitable not only for systematic funds that remain still long on the sector but also for discretionary managers.

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Inflation kept on being a central and worrying theme last month: fears of rising oil & food prices fed higher inflation expectations. Thus, in early May, European bond yields were reaching a near four-month high. Both discretionary and systematic funds, relative value ones in particular, were able to take profits on this bonds sell-off.

In commodities, energy market was the main driver of positive returns:

New highs in crude oil combined later in the month with a run-up in the natural gas market were the main drivers of returns not only for commodities specialists but also for global macro managers in general.



Source: Bloomberg

Conversely, metals were quite a significant source of loss. Thus, copper prices were damaged by declining demand and rising inventories in China. More generally this reflects the deteriorating growth-inflation condition, with emerging markets likely to continue to provide an inflationary impulse to the global economy, while the global industrial cycle weakens.

The fact that many market participants are expecting the Fed to begin its rate tightening cycle sooner helped the pressured USD to record gains against most of its major trading currencies. Thus, global macro managers, who are playing the rebound of US economy for most of them, participated quite well in the rebound of the green money. The Australian Dollar was also a good contributor to performance within the currency sector in May, with the currency rising to a 25-year high against the USD, partly attributed to the run up in the energy market.

Emerging markets remained quite choppy this month again: Except for Japanese markets that recorded solid gains, the rest of Asia remained firmly in the red. Elsewhere, concerns mounted that policymakers will have to strengthen monetary conditions excessively to slow down activity and comply with their inflation target. As a result, the Shanghai Composite Index has already dropped 21% since March, while the India's Nifty Index is down almost 7% over the same period.

– MONTHLY HEDGE FUND STRATEGY COMMENTS –

– MAY 2008 –

Macro managers resisted quite well to this difficult environment, benefiting from their sectorial diversification, mainly via financials and energy related securities.

FIXED INCOME **-1.49% MTD & -13.08% YTD**

– **Inflation concerns are back**

Following April recovery, interest rates were also up all over the world in May. Indeed, the comfort given by the Fed in Bear Stearns' rescue combined with new inflation concerns in the US since mid-month drove yield curves higher. 2-year and 10-year US swap rates were both up 37bps. At the same time, swap spreads were stable during the month (see graph below) before widening in early June.



source: Bloomberg

Volatility as measured by the Lehman Index (Bbg: LBOX Index) slightly increased early in the month before declining to 19.32% at the end of the month, far from March peak when it reached more than 25% (see graph below).



source: Bloomberg

In Europe, UK rates were impacted the most by these rising rates. The UK 2-year swap rates were up 57bps during the month – the second largest move on one calendar month since 2000. Euro rates continued to increase as well, as ECB

seems to remain more concerned by inflation than by slowing growth and a stronger Euro.

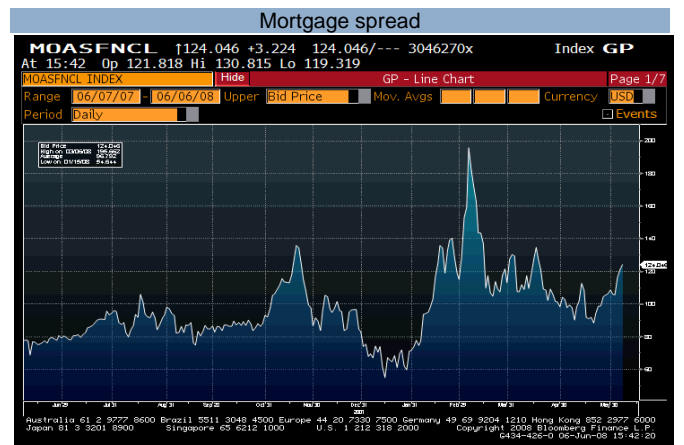
In these conditions, some funds kept on taking profit from the reversal of the former flight-to-quality whereas others were impacted by this large sell off in govies.

– **MBS markets: still convalescing**

MBS markets kept on recovering at the beginning of the month until inflation concerns reappeared in the US. Then they did not really react to the new legislative developments that concerned government sponsored agencies and foreclosure prevention. There was no new important sell-off in May; UBS confirmed it had completed the sale of \$15 billion of subprime and Alt-A US residential mortgage-backed securities to a fund managed by BlackRock.

Spreads remained historically very high and transaction volume relatively low (but higher than in March!). The spread of the MBS current coupon traded between 100 and 125 over Treasuries far from its peak at close to 200 in March (see graph 3).

In these conditions, MBS managers posted flat to negative returns.



source: Bloomberg

L/S CREDIT **+0.71% MTD & -2.09% YTD**

– **A relative quiet month but inflation fears resurged**

After the sharp rally occurring in April, May was much more peaceful for credit markets. Credit spreads remained stable during the first three weeks of the month before giving way under inflation concerns and finishing the month slightly wider.

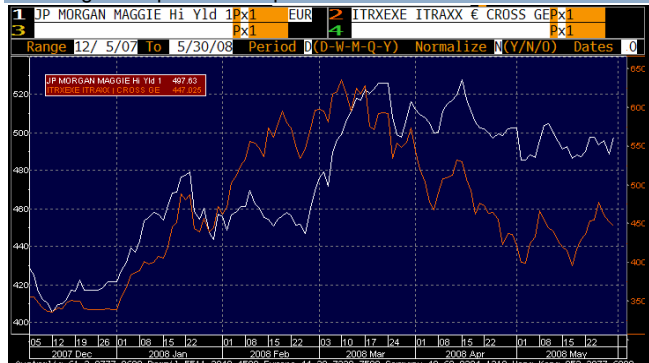
Cash spreads were still less volatile than CDS, with the JP Morgan Corporate Bond High Yield index trading in 20 bps ranging over the past month.

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– MONTHLY HEDGE FUND STRATEGY COMMENTS –

– MAY 2008 –

JP Morgan Corporate HY Spread Index vs. iTraxx Xover CDS Index



Primary markets have still been very active especially in the US where speculative grade issuers raised \$13.3 billion in May, nearly matching the prior four months' total amount (\$14.4 billion). On the Investment Grade side, \$118 billion of fixed-rate bonds were issued in May, surpassing \$102 billion in April 2008. Floating rate issuances also picked up with \$20 billion issued in May.

The high yield default rate recorded a 0.25% increase to 1.98%, approaching the 2% psychological threshold, which may confirm the credit cycle reversal toward a bearish mode.

Given those market conditions, credit managers benefited from the relative markets quietness to pursue their recovery. The decorrelation between corporate bonds which finished the month in positive territory, and CDS, which slightly widened, helped them to generate profits both on their long and short books.

EMERGING MARKETS +0.38% MTD & -5.01% YTD

– Emerging markets : EM inflation on the rise

Emerging markets performed well in an environment characterized by concerns about both inflation and further economic weakness in the US. Credit spreads tightened and EM equities continued to move higher, still buoyed by the sustained commodity rally, with commodity exporters like Brazil and Russia performing better than importing countries. Emerging currencies and local currency debt indices hit again new highs, pushed up by greater allocations from institutional investors, re-assessing G7 risks in favor of emerging markets to reduce risk.

EM inflation continued to escalate sharply, forcing Central Banks to turn hawkish. Brazil is one of the most proactive central banks in the EM space since many countries are still convinced that commodity prices will settle down and calm inflation.

At a country level, Argentinean positions were again negatively impacted by farmers strikes coupled with inflation pressures. In Brazil, the underlying economic dynamics

looked extremely solid and some managers made money on currency trades, being long BRL against the US Dollar.

CB Arbitrage +0.90% MTD & -0.24% YTD

– Fading liquidity fears and tightening credit spreads got the better on declining volatility and increasing interest rates

May was a strong month for the strategy, with an asset weighted average performance of +0.90%. This was mainly due to an appreciation of CB valuations, and to the non-materialization of concerns regarding liquidity/redemptions.

This technical threat moving away, the CB market finally priced in spreads tightening, pushing valuations up. Besides, CB managers benefited from an outstanding new issue calendar, priced at attractive terms.

While the selling pressure due to risk reduction, deleverage and liquidity chasing as experienced in March - and to a lesser extent in April - have calmed down in May, market participants were worrying about the potential redemptions that CB managers would get from disappointed investors. May 15th was the cut-off date for June-end quarterly redemption notices.

Some were expecting a worst case scenario reminiscent of what happened in 2005, when the CB market had been technically driven down to ridiculously low levels, irrespective of fundamentals, by a redemption-related selling-pressure. But it seems that investors did not pull out the trigger, recognizing the opportunity the CB market offers.

Market participants welcomed the modest redemption outflow notices with a certain relief. This news further enhanced liquidity in the CB market, as all types of CBs have traded this month within reasonable spreads.

It also enabled the CB market to finally price in the credit spread rally that occurred in April.

The relief about redemption concerns and the pricing of April's credit spread rally got the better on a declining volatility and increasing interest rates in the US.

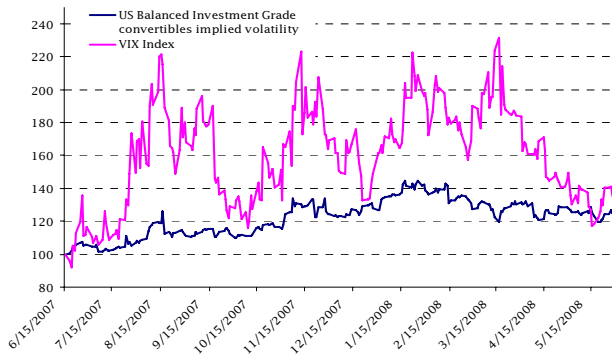
In this context, high-yield and credit sensitive names outperformed Investment Grade and volatility sensitive names.

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– MAY 2008 –

US CB implied volatility vs. VIX



The CB market as a whole is still considered cheap and attractive by market participants.

Credit spreads slightly tightened during the month of May after rallying in April. This being said, this credit spread rally was finally reflected in the CB valuations in May, especially after the relief regarding liquidity/redemption concerns, during the second half of May.

This is particularly true as the CB market got more credit sensitive as a whole with the drop of equity markets since the beginning of the year.

Volatility sold off as the equity markets were up on the first half of the month. The VIX reached a low point on May 15th at 16.30.

Then inflationary fears coupled to new concerns about financials called investors to order regarding the complacency they showed consecutively to the Bear Stearns rescue. They understood that this rescue was not the magic wand to the structural issues that are still prevailing. Consequently, equity markets sold off and volatility rallied but ended the month at 17.83 significantly below where it started it (20.79). As we entered June, a new wave of bad economic figures (employment figures) added to the turmoil and volatility returned to the 20-25 range.

The new issue calendar was very strong in May, which is a very positive note for the strategy. Globally, 34 new deals have come to the market totaling more than USD 26b. In addition to the US activity (21 deals totaling USD 15.5b), the highlight of the month was the revival of the European primary market, with 7 deals totaling USD 8.6b.

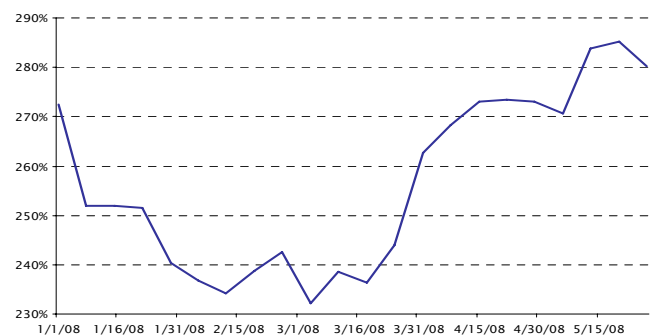
If new issuances were driven again by jumbo financial preferred issues (AIG, Fannie Mae, Legg Mason, Caixa, 3I Group), other sectors came to the CB market, with a jumbo EUR 3b (USD 4.5b) deal from Deutsche Telecom, as companies realize that their volatility can subsidize their coupon and enables them to raise capital at preferred terms.

Interestingly, these new issues are coming to the market at more and more attractive terms (decreasing premia and

increasing yields) and are getting good response from market participants.

In these market conditions, managers selectively added to the leverage as shown in the graph below, although less significantly than April as a reflection of a growing opportunity set. In doing so, they are recognizing the opportunity in the strategy.

Leverage indicator



The main risk namely selling pressure and liquidity disappeared at least momentarily, valuations are still attractive, volatility is set to stay in a high range, and yields are becoming more and more attractive, with stabilizing credit markets and maybe deteriorating equity markets.

With such an environment, managers are expecting a second half of the year favorable to traditional convertible arbitrage, remaining cautious and opportunistic with respect to credit and interest rate hedging.

EVENT DRIVEN

Merger Arbitrage	+2.50%MTD, +2.76% YTD
Special Situations	+3.15%MTD, +2.32% YTD
Distressed Securities	+0.74%MTD, -5.28% YTD

– “Injuries may be forgiven, but not forgotten (Aesop)”

May emphasized the positive trend for merger arbitrage. The total value of globally announced M&A transactions in May was \$298 billion, significantly exceeding the respective volumes for March (\$196 billion) and April (\$255 billion). Large announced transactions include NRG Energy’s bid for Calpine Corp (\$19.5 billion) and Hewlett Packard’s bid for Electronic Data Systems (\$13 billion), both in the US. According to Bloomberg, the average premium of globally announced deals in May marginally tightened: it was close to 38% compared to 40% in April. This figure is still very high compared to historical levels. In this favorable environment, risk arbitrage funds on the Lyxor platform gained around 200 basis points over the course of the month.

The partial recovery observed last month continued in May but offered this time contrasting views on a regional basis:

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– MAY 2008 –

US and Japanese equity markets again provided substantial opportunities as cheap valuations and corporate governance helped renew speculation on quality corporations. Conversely, bank deleveraging and slower growth prospects kept weighting negatively on European and Asian equity markets. Generally, whatever the performance individually achieved over the last two months, most managers believe the rebound to be at least partly technical and anticipate renewed challenges and continued volatility going forward.

The credit market continued to improve in May and pointed to a normalization of financial conditions. Spreads are sharply tighter across the board, issuance volumes have picked up somewhat from their lows in March and there are initial signs of bank balance sheet stress temporarily abating.

However, various indicators of stress are still much wider than historical averages. During the month, corporate defaults rose to 28 names on \$18.9 billion of debt (compared with 22 last year and 30 in all of 2006, according to S&P), the banking sector continued to experience write-downs of portfolio assets, consumer confidence declined, while fuel and food prices rose dramatically.

Consequently, distressed managers posted mitigated performances over the course of the month. The short positions on single names continue to be the driver of positive performance.

L/S EQUITIES

Variable Bias	+2.23% MTD, -0.40% YTD
Long Bias	+2.72% MTD, -3.50% YTD
Short Bias	-1.83% MTD, +3.77% YTD
Market Neutral	+1.15% MTD, +0.03% YTD
Statistical Arbitrage	+2.29% MTD, +5.17% YTD

– **Slidin' on That Oil**

May was a mixed month for global equities – nevertheless the majority of equity indices ended it in a positive territory. The major concern this month was rising oil prices which reached a new all-time high. On May 21st oil prices topped \$133 per barrel triggering a sell-off in equity markets. Concerns about stagflation exacerbated towards the end of the month as central banks hardened their language on inflation while revising downwards their outlook on growth. Equity markets took a plunge in the last week of May causing major indices to give away most of their gains from the beginning of the month.

Against this mixed environment Long/Short Equity managers fared well with more than 75% of them posting positive performances for the month. Performance dispersion was less significant than in previous months with returns ranging between -3% and +5.56%.

Energy and Basic Materials remained popular themes on the long side as managers sought a hedge against inflation. The two sectors contributed positively to portfolios this month as

they rallied once again boosted by record oil and commodity prices.

After April increase, managers decreased their net exposure in order to further eliminate market directionality. Such trend could be observed among all regions.

US managers fared very well although the S&P ended the month slightly lower (-40 bps). Performances ranged between -0.84% and +5.56% with only one manager ending the month in a negative territory. Many of our US managers suffered in the last week of May when equities plunged giving away some of the gains from the beginning of the month. By contrast, their European counterparts resisted better the sell-off. However, the first three weeks of the month were pretty flattish for the majority of the European specialists posting more modest end-of-the-month results. Performance for European funds ranged between -0.96% and +2.06%. European managers had a significantly lower net exposure compared to their US counterparts (8% on average vs. 37% respectively). As far as net exposure is concerned, in May as well, it remained a poor indicator of performance.

Performance dispersion was more significant among emerging markets managers posting results between -2.22% and +3.57%. Emerging markets equities suffered the most this month, the broad-based Asia ex-Japan Index posting a loss of -5.11%. Emerging markets specialists resisted the sell-off of the second and the last week of May by quickly reducing their net exposure, the aggregate ranging between 32% and 52% over the month. The average aggregate gross exposure was 113%.

Japanese managers fared better than the rest of their Asian counterparts even though Japanese equities also suffered significant losses in mid and month end. Nevertheless, major Japanese indices ended the month in a positive territory thanks to a very positive third week of May. Against this mixed environment, Japanese managers posted performances ranging between -1.63% and +3.55%, only one of them ending the month lower. Japanese managers ran an average net exposure of 14% and an average gross of 127%. For the majority of them performance came from shorts in Financials and longs in Industrials.

Global specialists turned in mixed results performances ranging between -1.14% and +2.04%. The average aggregate net and gross exposures were 28% and 140% respectively. Global managers enjoyed positive contribution from longs in Basic Materials, Energy and Industrials.

Quantitative managers posted very good if not exceptional results with only one of them posting a slight loss for the month (performances ranged between 5.50% and -0.33%). Stat Arb managers benefited from the elevated volatility whereas Multifactorial Quant Models benefited from the return to fundamentals.

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