THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

26 MAY 2021

LESS DIRECTIONAL BUT MORE RELATIVE VALUE OPPORTUNITIES IN CHINA

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Economic data portrays sustainable growth in China, but it's still unbalanced and plateauing. It remains driven by manufacturing and exports, but consumption lags, and impacts from ongoing authorities' targeted deleveraging and reforms are starting to show. They are focused on corporate debt, real estate, and corporate-dominant positions in internet and fintech, and more recently on retail access to commodity-linked investment products. While authorities are unlikely to overshoot, growth would be capped. Chinese equities seem to be bottoming after a steep correction. However, past a technical rebound, stocks might be rangy, constrained by a mixed economic news flow and fair valuations.

While stock opportunities might be less directional, alpha is improving. Market exuberance earlier this year has moderated, providing a more stable ground for stock picking. We find that the market structure has also substantially changed, with reduced and shifting sector cyclicality (see table below). Sectors' traditional allegiance to rates, CNY, and factors also abated. Moreover, the share of stock returns explained by idiosyncratic drivers soared. All these trends are consistent with increased fundamental pricing and more diversified and decorrelated set of themes, amid more affordable valuations.

Managers within the Lyxor Peer Group have been dynamic in their exposures. After the vaccine announcements, they had favored offshore exchange and export-driven stocks, before turning to stocks sensitive to domestic demand early this year, including healthcare and retail positions. While remaining long, managers are now back in stocks sensitive to external demand (concerned by domestic constraints) and are allocating to areas where stimulus are likely to remain, particularly in infrastructure. To some extent they also reweighted businesses positioned on new consumer trends as well as stocks listed overseas. Meanwhile, they have steadily sold off their tech exposures, caught in the crossfires of U.S.-China tensions and anti-monopoly offensives. Exposures to quant factors do not appear to be key allocation drivers. Overall, they have produced modest alpha year-to-date and have been resilient during the correction. High correlation and average dispersion across managers' returns suggest relatively homogeneous positioning but differentiated in sizing.

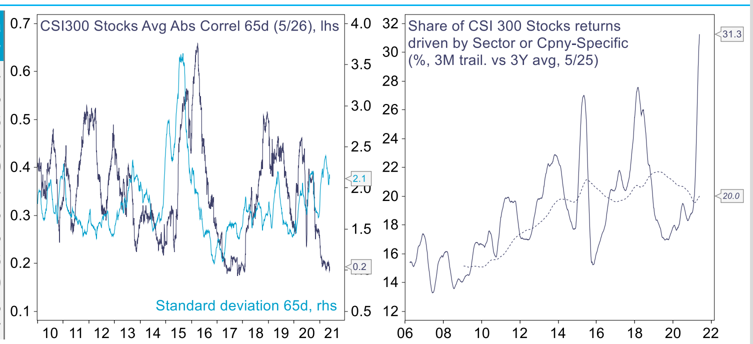
Structural patterns also support alpha in China. First, a widening market access and a heavier share of China in EM and world indices would still attract flows. Second, market depth, crucial for alpha, would further progress, driven by a broadening set of businesses, types of investors, and corporate operations. Besides, inefficiencies in onshore exchanges still provide arbitrage. Third, multiple themes generate catalysts, including the transition from an export to a consumption model, a rapid urbanization, the rise of innovation leaders in tech and beyond, an aging population, the green transition, the enhancement of corporate governance etc. In nuance, alpha remains vulnerable to geopolitics and policy-driven changes in credit, regulations, or stock short suspensions. Elevated corporate debt also requires serious risk management. [*continued p2*]

Reduced and shifting sector cyclicality

MSCI China Sectors	Cyclicality	Beta to Idx	vs. 5Y avg	Beta Volatility
Communication Svces	Ultra Cyclical	**1.3**	+0.5	24
Consumer Disc.	Ultra Cyclical	**1.2**	+0.2	18
Health Care	Cyclical	**1.2**	+0.2	26
Info Tech	Cyclical	**1.1**	-0.0	23
Index (*)	Defensive vs World	**0.9**	+0.1	39
Consumer Staples	Defensive	**0.9**	+0.1	24
Materials	Defensive	**0.8**	-0.2	33
Industrials	Ultra Defensive	**0.7**	-0.1	18
Real Estate	Ultra Defensive	**0.4**	+0.0	26
Financials	Ultra Defensive	**0.3**	-0.5	20
Utilities	Ultra Defensive	**0.3**	-0.3	18
Energy	Ultra Defensive	**0.2**	-0.5	37

(*) relationship vs. World Index

Noticeable improvement in China's alpha prospects



Sources: Bloomberg, Macrobond, Lyxor AM

Performance: CTAs Retraced Some of Their Earlier Gains

Lyxor UCITS Peer Group Performance

	Last week*	MTD	YTD
Risk Premia	-0.2%	1.4%	4.7%
CTAs	-0.4%	0.6%	4.4%
Global Lyxor UCITS Peer Group	0.1%	0.2%	2.9%
L/S Equity Directional	0.3%	0.2%	4.3%
Event-Driven: Merger Arbitrage	0.2%	0.2%	3.5%
Global Macro	0.0%	0.1%	0.5%
Event-Driven: Special Situations	0.2%	0.1%	7.2%
L/S Equity Market Neutral	0.2%	0.1%	2.9%
L/S Credit	0.0%	0.0%	0.4%
MSCI World	0.1%	0.0%	10.6%
Bloomberg Barclays Global Aggregate Bond Index	0.1%	-0.1%	-2.3%

*Last Week: May 14 to May 21. YTD and MTD until May 21. Source: Lyxor AM

Global equities remained flat this week, as Covid-19 trends in Asia, inflation concerns, and doubts about U.S. reflation tempered demand for riskier assets.

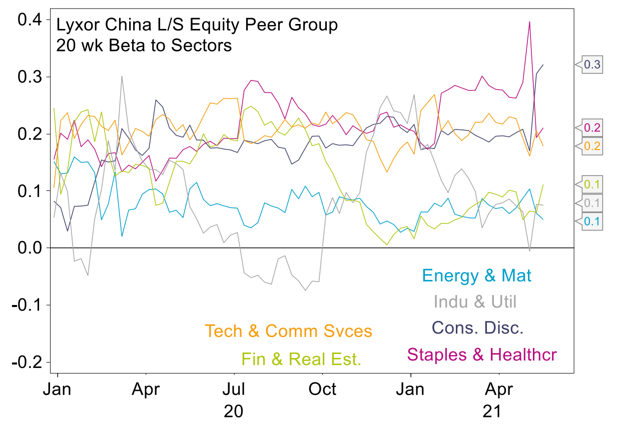
Hedge fund strategies were in line with markets.

L/S Equity Directional strategies continued to produce alpha, successfully navigating market concerns about surging inflation. In contrast, CTAs retraced some of their earlier gains hit by their bond and soft commodity exposures.

Month-to-date, hedge fund strategies outperformed mainstream markets, boosted by the strong performance of CTAs.

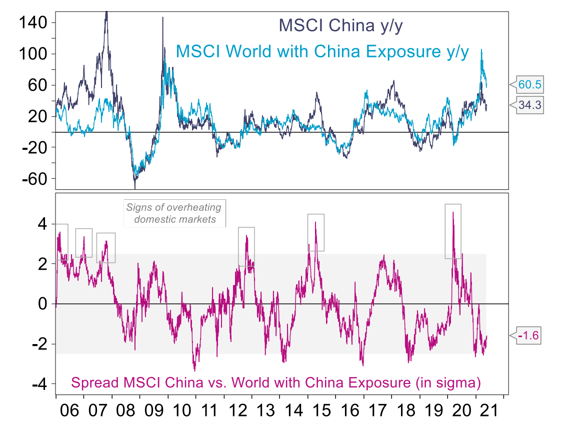
Less Directional but More Relative Opportunities in China [*continued from p1*]

Additions in Consumer Discretionary and Manufacturers at the expense of Tech



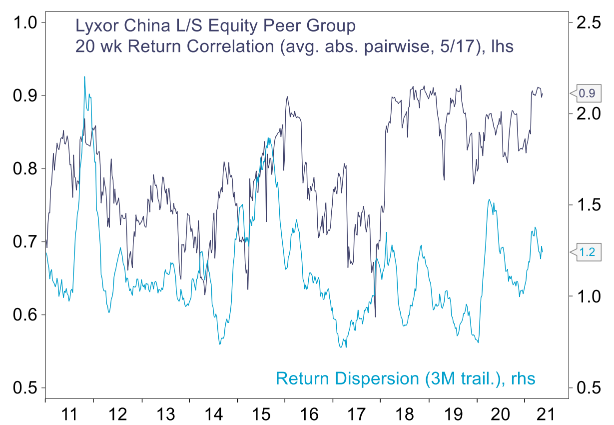
Source: Bloomberg, Macrobond, Lyxor AM

Fading signs of market exuberance among domestic investors



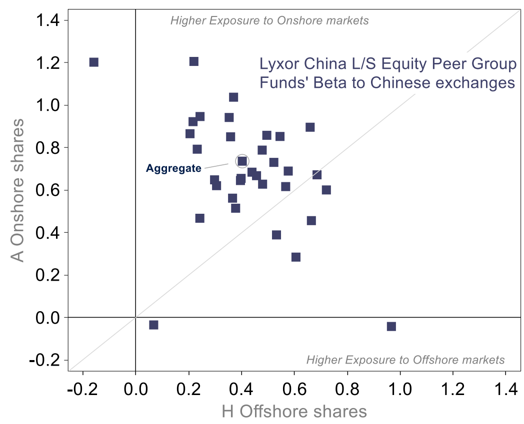
Source: Bloomberg, Macrobond, Lyxor AM

Homogeneous managers positioning, but sizing differs



Source: Bloomberg, Macrobond, Lyxor AM

Balanced offshore and onshore managers' exposures



Source: Bloomberg, Macrobond, Lyxor AM

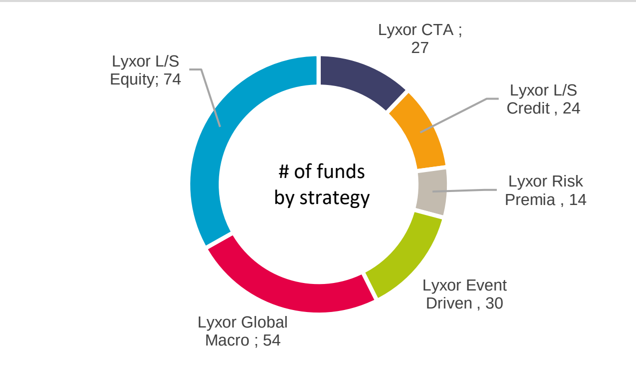
METHODOLOGICAL APPENDIX

The information contained in this report on the performance of 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



As of May, 2021

- 223 strategies across the main categories in the industry
- USD 187 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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