THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

28 JAN 2019

HEDGE FUND POSITIONING AFTER THE STORM

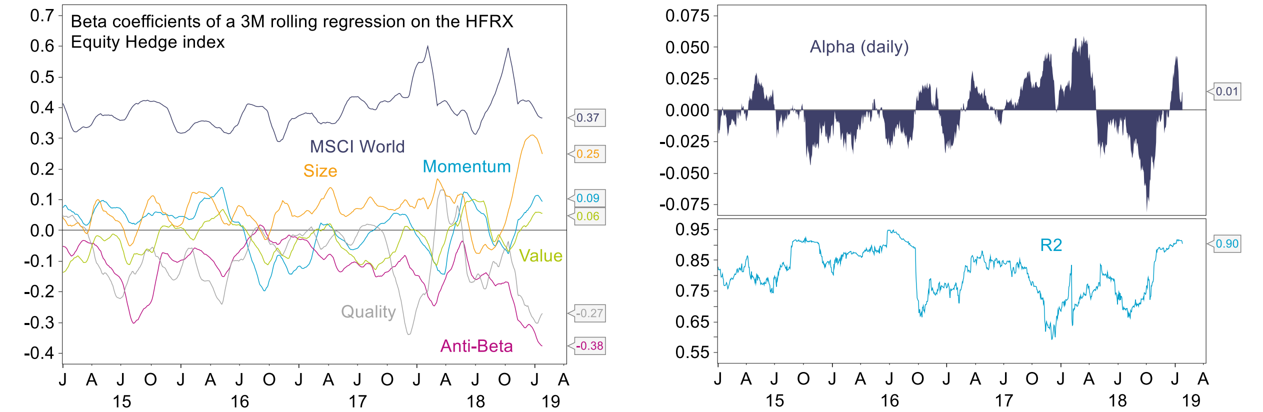
Philippe Ferreira
Senior Strategist

Jean-Baptiste Berthon
Senior Strategist

The market rebound started at end of December has taken place amid an easing of trade tensions and hopes that a no-deal Brexit will be avoided. A softer stance from major central banks has also been supportive. But preliminary manufacturing PMIs for January suggest that growth deceleration continues. At this stage, it looks like any shock to the euro area could tip the economy into a recession. In this fragile environment, we discuss hedge fund positioning and the extent to which the recent rebound in risk assets has led hedge funds to add risk in portfolios. In a nutshell, caution remains the keyword, as L/S Credit is one of the very few strategies which added risk during the sell-off.

- The positioning of CTAs and Global Macro strategies on equities remains very cautious at present. Meanwhile, long Fixed Income positions have increased over the past few weeks. The stance has thus turned more defensive, even though the outlook on EM assets has turned more constructive. We see a lot of divergence in views on FX and commodities. Long USD exposures are now less consensual.
- Merger Arbitrage strategies have been very selective in regard to allocating capital to recently announced deals. They nonetheless invested into some new deals, such as the Celgene vs. Bristol-Myers proposed merger. Merger Arbitrage strategies maintain a short duration bias in terms of deals' expected completion to contain portfolio volatility.
- L/S Equity strategies reduced their beta in late 2018 and remain broadly cautious now. In Q4-18, they reduced gross and net exposures in a context where sector rotations were against their positioning (long cyclical vs. defensives). Market Neutral strategies, which tend to have a momentum bias, have also reshuffled their portfolios, turning short high-beta names and long low-beta stocks. The January market rebound, which was led by value stocks, still had a positive impact on L/S Equity performance overall.
- Finally, L/S Credit strategies were among the very few to take advantage of deteriorated market conditions to add risk in portfolios in late December. The sharp widening in HY credit spreads was seen as an opportunity, and the strategy experienced a decent rebound in January, especially for directional strategies.

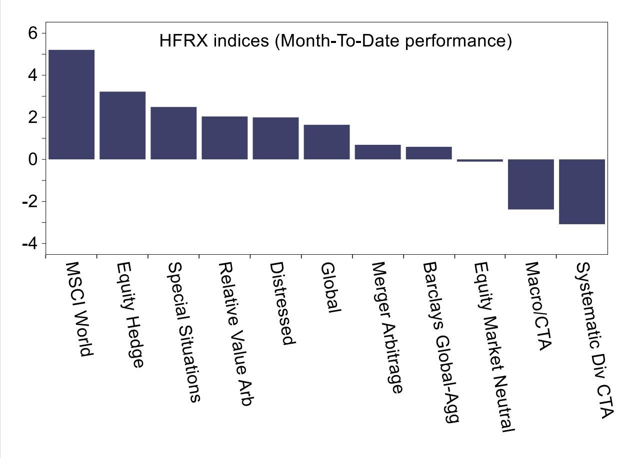
L/S Equity strategies are not buying the recent market rebound



Based on daily changes. 1-month moving averages. Dow Jones thematic U.S. market neutral indices. Sources: DJ, Macrobond, Lyxor AM

PERFORMANCE & POSITIONING

CTAs face renewed downward pressures in January



Up to January 24th. Source: HFR, Macrobond, Lyxor AM.

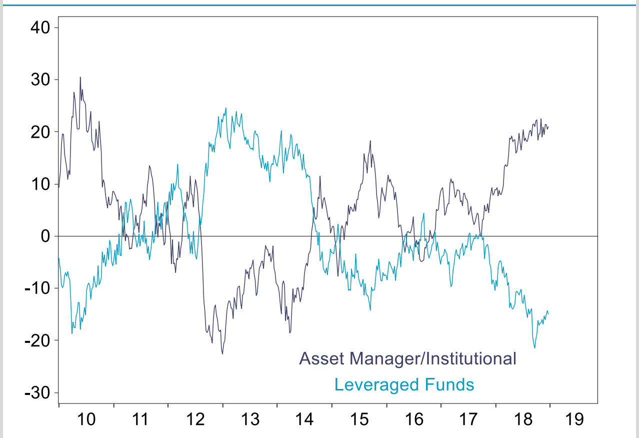
The market rebound started at the end of December fueled strategies that were most exposed to risk assets, such as L/S Equity and Special Situations. This is in sharp contrast to performance in Q4-18, which was dreadful.

Our preferred strategies are those that can navigate fast changing market conditions like those experienced recently. Merger Arbitrage and Fixed Income Arbitrage have met expectations in that respect.

CTAs did well in December but are under pressure in January, due to the rebound in equities. The strategy maintains short positions on equities.

Leveraged funds have started to re-weight fixed income

Net positions on 10Y Treasuries (% of open interest)



Futures & Options. Source: CFTC, Macrobond, Lyxor AM

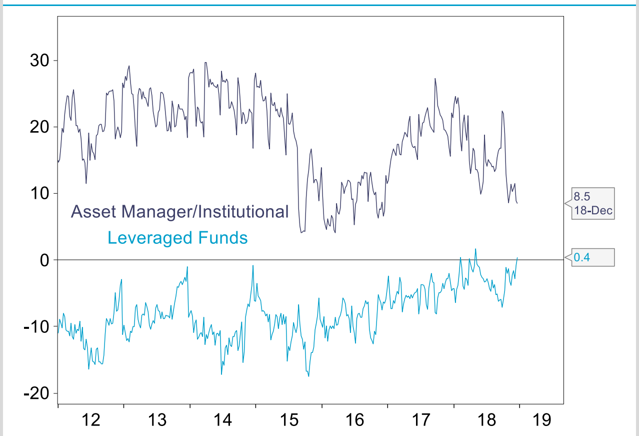
As previously discussed, CTA/ Macro strategies have remained broadly cautious in their positioning, keeping a defensive stance on equities and re-weighting fixed income.

Evidence on the re-weighting of fixed income by hedge funds is also reported in publicly available data from the CFTC (with a lag due to the shutdown of the U.S. government) – see link. Their numbers suggest nonetheless that "leveraged funds" still maintain short positions on both 2Y and 10Y U.S. Treasuries.

Based on the information available (hedge fund strategies on our platform), the overall positioning from Global Macro strategies in fixed income appears to be long at present, especially within Asia and Emerging Markets. Yet, Macro managers retain their short bias in U.S. fixed income, in line with CFTC data.

Leveraged funds remain cautious on equities, just like us

Net positions on the S&P 500 mini (% of open interest)



Futures & Options. Source: CFTC, Macrobond, Lyxor AM

The broad universe of hedge funds has remained cautious on risk assets, except L/S Credit strategies which took advantage of wider high yield credit spreads at the end of December.

None of the strategies invested in equities that we monitor have recently added to their exposures, though gross and net exposures of L/S Equity strategies have drifted upwards with the market rebound in January.

We also remain pretty much defensive in light of the large uncertainties ahead. The probability of a recession in the U.S. in twelve months' time has increased and, historically, a U.S. recession is associated with a 35% drawdown of the S&P 500. Political uncertainties also remain elevated (Brexit, trade wars, U.S. political divisions/ shutdown). Finally, the U.S. earnings season is not proving to be very supportive compared to the expectations so far.

DISCLAIMER

The circumstances in which this publication has been produced are such that it is not appropriate to characterize it as independent investment research as referred to in MiFID and that it should be treated as a marketing communication even if it contains a research recommendation. This publication is also not subject to any prohibition on dealing ahead of the dissemination of investment research. However, Lyxor is required to have policies to manage the conflicts which may arise in the production of its research, including preventing dealing ahead of investment research.

This material has been prepared solely for informational purposes only and does not constitute an offer, or a solicitation of an offer, to buy or sell any security or financial instrument, or to participate in any investment strategy. This material does not purport to summarize or contain all of the provisions that would be set forth in any offering memorandum. Any purchase or sale of any securities may be made only pursuant to a final offering memorandum. No advisory relationship is created by the receipt of this material. This material should not be construed as legal, business or tax advice. A more robust discussion of the risks and tax considerations involving in investing in a fund is available from the more complete disclosures incorporated into the offering documentation for such fund.

This material has not been prepared in regard to specific investment objectives, financial situations, or the particular needs of any specific entity or person. Investors should make their own appraisal of the risks and should seek their own financial advice regarding the appropriateness of investing in any securities or financial instrument or participating in any investment strategy. Before you decide to invest in any account or fund, you should carefully read the relevant client agreements and offering documentation. No representation is made that your investment objectives will be achieved. This material is not intended for use by retail customers.

Any descriptions involving investment process, risk management, portfolio characteristics or statistical analysis are provided for illustrative purposes only, will not apply in all situations, and may be changed without notice. Past performance is not indicative of future results, and it is impossible to predict whether the value of any fund or index will rise or fall over time.

While the information in this material has been obtained from sources deemed reliable, neither Société Générale (“SG”), Lyxor Asset Management S.A.S. (“Lyxor AM”) nor their affiliates guarantee its accuracy, timeliness or completeness. We are under no obligation to update or otherwise revise such information if and when it changes. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. SG, Lyxor AM and their affiliates assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. Lyxor AM and its affiliates may from time to time deal in, profit from the trading of, hold, have positions in, or act as market-makers, advisers, brokers or otherwise in relation to the securities and financial instruments described herein. Service marks appearing herein are the exclusive property of SG and its affiliates, as the case may be.

Hedge funds may invest in futures and other derivative instruments. Futures trading and other derivatives may permit extremely high degrees of leverage and expose the funds to, among other things, volatility, market illiquidity, market risks, legal risks and operational risks. Hedge funds may be exposed to risks relating to non-domestic markets, including, without limitation, risks relating to currency exchange, tax, lack of liquidity, market manipulation, political instability and transaction costs. An investment in a hedge fund is subject to a total loss.

This presentation contains the views of Lyxor AM analysts and/or strategies. The views espoused in this presentation may differ from opinions and recommendations produced by other departments of SG.

Note about Indices: Indices are not available for direct investment. A comparison to an index is not meant to imply that an investment in a fund is comparable to an investment in the funds or securities represented by such index. A fund is actively managed while an index is a passive index of securities. Indices are not investable themselves, and thus do not include the deduction of fees and other expenses associated with an investment in a fund. Not all the funds that comprise indices cited herein are suitable for U.S. Investors as a result of, among other things, the implementation of the Volcker Rule. Please see the offering documentation for these funds for more details.

Notice to U.S Investors: Any potential investment in any securities or financial instruments, the categories of which are described herein, may not be suitable for all investors. Any prospective investment will require you to represent that you are an “accredited investor,” as defined in Regulation D under the Securities Act of 1933, as amended, and a “qualified purchaser,” as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the “40 Act”). The securities and financial instruments described herein may not be available in all jurisdictions.

Investments in or linked to hedge funds are highly speculative and may be adversely affected by the unregulated nature of hedge funds and the use of trading strategies and techniques that are typically prohibited for funds registered under the ’40 Act. Also, hedge funds are typically less transparent in terms of information and pricing and have much higher fees than registered funds. Investors in hedge funds may not be afforded the same protections as investors in funds registered under the ’40 Act including limitations on fees, controls over investment policies and reporting requirements.

Notice to Canadian Investors: Any potential investment in any securities or financial instruments, the categories of which are described herein, may not be suitable for all investors. Any prospective investment will require you to represent that you are a “permitted client,” as defined in Canadian Regulation National Instrument 31-103, and an “accredited investor,” as defined in National Instrument 45-106. The securities and financial instruments described herein may not be available in all jurisdictions of Canada.

For more information, U.S. and Canadian investors and recipients should contact Lyxor Asset Management Inc., 1251 Sixth Avenue, New York, NY 10020 or invest@lyxor.com.

Notice to U.K. Investors: This communication is issued in the UK by Lyxor Asset Management UK LLP, which is authorised and regulated by the Financial Conduct Authority in the UK under Registration Number 435658.

Source: This document has been prepared by Lyxor Asset Management S.A.S., 17 cours Valmy, 92800 Puteaux. Lyxor AM is a French management company authorized by the Autorité des marchés financiers and placed under the regulations of the UCITS (2014/91/UE) and AIFM (2011/61/EU) Directives. Lyxor AM is also registered with the U.S. Commodity Futures Trading Commission as a registered commodity pool operator and a commodity trading advisor.