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HOW ARE ACTIVE MANAGERS NAVIGATING CHINESE MARKETS EUPHORIA?

Jean-Baptiste Berthon
Senior Strategist

Philippe Ferreira
Senior Strategist

Bernadette Busquere Arnal
Hedge Fund Analyst

CrossAssetResearch@lyxor.com

The gradual recovery of Chinese equities strongly accelerated since the end of June. Both onshore and offshore Chinese equity indices are up around +15% in July. While the rally was broad across sectors, the momentum was particularly strong for the tech and consumer discretionary sectors, while defensive and energy stocks lagged. The rally is unfolding in extreme trading volumes, supported by strong domestic and foreign inflows.

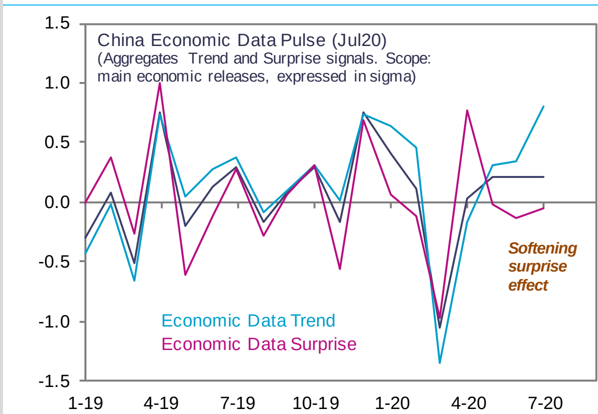
The improving macro environment set the stage for this rally. China is leading the way in restarting its economy after dismantling its lockdown. The recovery in industrial activity and economic releases have positively surprised since March, with the resurgence in infection cases being manageable so far. Equity markets are also benefitting from strong macro liquidity, a large part of which resulted from Chinese authorities' targeted but continued stimulus. Improving liquidity has become palpable in surging monetary aggregates and social financing, as well as in liquidities released from banks and in foreign demand for Chinese assets. However, these positive factors do not convincingly explain the recent surge. On balance, economic surprises in June were actually milder with signs of a more laborious recovery in household and external demand. Besides, liquidity indicators have not particularly spiked in June.

Instead, we believe three factors may have been more direct catalysts. First, the lag in Chinese equity valuation and prices relative to other foreign markets had not reflected China's relative success in managing the virus impact. Second, corporate profits announced late June were better than expected and back in the green (+3% y/y in May, boosted by tech and healthcare companies). Earnings revisions also stabilized, with 2020 FY EPS estimates slightly improving. Finally, domestic investors' flows amplified the surge in prices, while emphasizing improving domestic confidence. In particular, retail flows, trading leverage and the opening in new onshore trading accounts all accelerated in July.

As a result, early signs of euphoria are appearing. Chinese stock valuations are not cheap anymore, measured in absolute, through P/E multiples, or relative to economic and market differentials with other regions. Also, Chinese stock prices are now overshooting foreign-stocks that have high exposure to Chinese revenues, usually a sign of overheat. Meanwhile, key tactical Chinese equity indicators (technical, breadth, valuation in particular) are flashing red. Finally, with Chinese indices reaching their 2017 pre-trade-war resistance levels, risks following the passage of HK's new law from a new round of U.S. tariff escalation or renewed pressures on Chinese tech, both look shrugged off.

Yet, the rally may have further room to expand, supported by prospects of extra monetary/fiscal stimulus [*continued p2*]

On-going Chinese economic recovery



Strong liquidity environment

Sources: Bloomberg, Macrobond, Lyxor AM

PERFORMANCE

Hedge Funds Boosted by Prospects of Additional Stimulus

Lyxor UCITS Peer Group Performance

	Last Week*	MTD	YTD	# of funds
CTAs	-0.1%	-0.1%	-3.5%	26
Risk Premia	0.1%	0.1%	-9.6%	20
Event-Driven: Merger Arbitrage	0.1%	0.1%	-3.1%	21
Bloomberg Barclays Global Aggregate Bond Index	**0.1%**	**0.1%**	**4.0%**	
Global Lyxor UCITS Peer Group	**0.5%**	**0.5%**	**-3.4%**	**224**
L/S Equity Market Neutral	0.3%	0.3%	-1.2%	26
Global Macro	0.8%	0.8%	-3.4%	48
L/S Equity Directional	0.9%	0.9%	-3.1%	56
L/S Credit	0.5%	0.5%	-0.9%	28
Event-Driven: Special Situations	0.5%	0.5%	-6.6%	7
MSCI World	**1.7%**	**1.7%**	**-3.8%**	

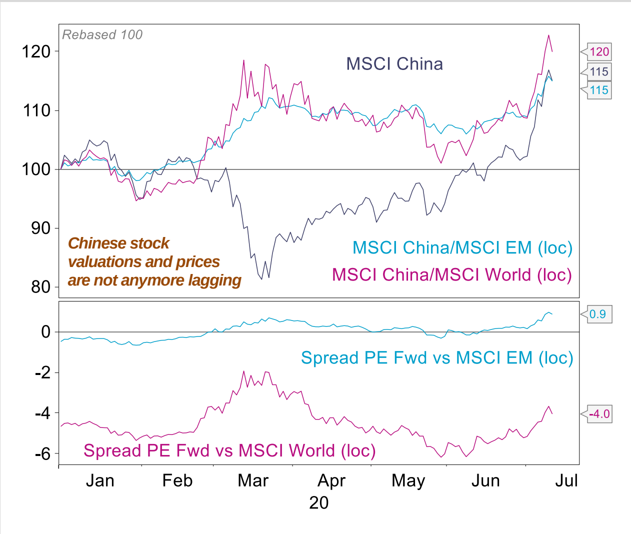
*Last Week: Jun 30th to Jul 7th. MTD and YTD as of Jul 7th. Source: Lyxor AM

Cyclical assets performed well this week. Rising U.S. infection cases remained cause for concern, but investors focused on prospects of further monetary and/or fiscal policy action to mitigate the fallout. The sparse data released this week still surprised on the upside. Chinese markets outperformed, though U.S. and EU markets also did well. Cyclical commodities were up, unlike the U.S. dollar which further corrected.

Hedge funds headed north, led by L/S Equity diversified strategies, followed by Global Macro. Fixed Income and Credit strategies also did well, boosted by further spread tightening and rising inflation breakeven.

CTAs lost ground from long dollar positions, limited exposures to equities and their short on commodities. None of these positions are particularly strong bets, but suggest CTAs tend to be positioned for a market reversal, currently providing hedge in portfolios.

How Active Managers Navigate Chinese Market Euphoria *[continued from p1]*



Sources: Macrobond, Lyxor AM

and by the inertia of momentum forces, in our view. The current rally is also much more moderate compared to those in 2015 and 2008. While Chinese markets may be getting more vulnerable to corrections, we maintain our O/W stance for the time being.

Chinese equity managers appear to have successfully captured the rally. According to Lyxor's peer group of Chinese Equity UCITS funds, they have increased their net exposure over the recent months to record levels. They only marginally took profits over recent days. They also benefitted from their tilt towards growth, quality, tech, and tertiary/services stocks, as well as those likely to benefit from infrastructure spending. We estimate that the strategy is still generating alpha and has fully recovered losses early this year.

Correlation across managers' returns has remained historically high, suggesting a lack of diversifying themes. However, surging dispersion in managers' return point to diverging views as to the next phase of

Sources: Bloomberg, Lyxor AM

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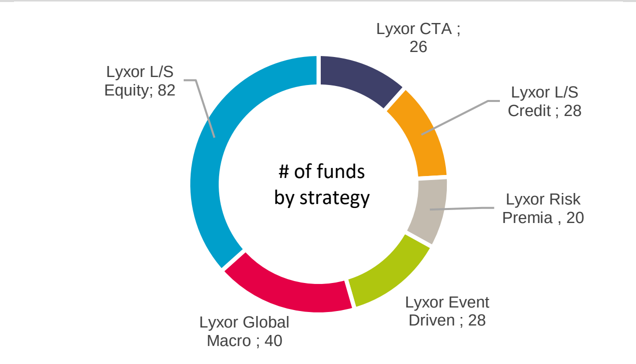
METHODOLOGICAL APPENDIX

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 July 2020

- 224 strategies across the main categories in the industry
- USD 167 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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