THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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Risk Arbitrage To Benefit From Gradual Deal flow Normalization

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Dear reader, please note there will be no Weekly Brief next week. The next Weekly Brief will be available on August 10th. We wish you a lovely holiday season.

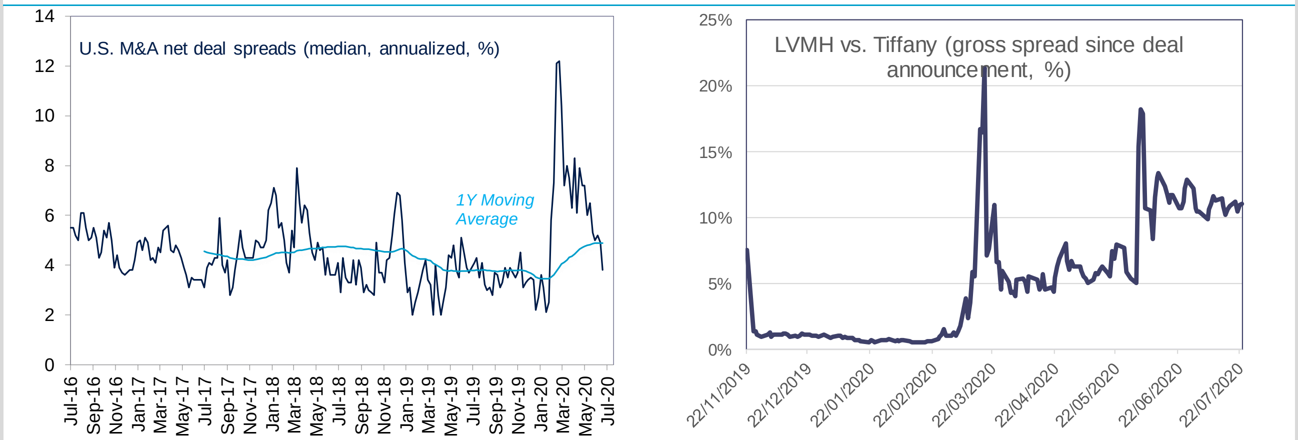
Though market concerns over the economic impact of rising COVID-19 infections in the U.S. remain, the MSCI World is on track to end July in positive territory, up +3.0% month-to-date as we go to press. In our view, the environment remains challenging, and finding assets to diversify portfolios is an issue as Treasury yields are close to record lows.

Merger Arbitrage is typically an attractive alternative strategy to diversify portfolios. Its equity market beta is low, and volatility in returns is also contained. Our stance on the strategy remains constructive (Overweight) despite the recent dry up of M&A volumes in Q2 2020. However, we note that the environment for Merger Arbitrage strategies has improved.

U.S. M&A volumes have started to take off in June and more recently, there has been a flurry of relevant deal announcements for Merger Arbitrageurs. They took place in sectors such as Energy (Chevron vs. Noble), Communication Services (Adevinta ASA vs. Classifieds Business/ eBay), Industrials (Alpha Laval vs. Neles), and Information Technology (ADI vs. Maxim Integrated Products). Some complex deals in disrupted industries also reached completion, such as the $17.3 bn buyout of Caesars Entertainment by Eldorado Resorts. In parallel, there has been renewed interest for Special Purpose Acquisition Companies (“SPACs”) in a context where liquidity is king and opportunities to deploy capital were constrained by M&A activity. A special purpose acquisition company is an entity that's set up specifically to make an acquisition of an existing business. They have grown in popularity this year, having raised more than $12 bn so far this year according to Dealogic, close to 2019′s record total of $13.5 bn.

Overall, deal spreads have tightened over the course of July towards 4% across a subset of deals, though they remain wide for few risky transactions where implied odds of completion are weak or have been going through litigation. Against this backdrop, pure Merger Arbitrage strategies tend to maintain a cautious positioning.

Deal spreads have tightened recently but they remain wide for few risky transactions



Universe includes M&A deals whose spread trades in the 0-30% range. Sources: UBS, Bloomberg, Lyxor AM

Hedge Fund Performance: Risk Assets Fueled Directional Alternative Strategies in July

Lyxor UCITS Peer Group Performance

	Last Week*	MTD	YTD
Bloomberg Barclays Global Aggregate Bond Index	**0.3%**	**0.7%**	**4.6%**
L/S Credit	0.5%	1.1%	-0.3%
MSCI World	**1.9%**	**4.8%**	**-0.8%**
L/S Equity Market Neutral	0.2%	0.4%	-1.1%
Event-Driven: Merger Arbitrage	0.4%	0.9%	-2.3%
L/S Equity Directional	0.9%	1.6%	-2.4%
Global Macro	0.7%	1.5%	-2.7%
CTAs	0.5%	0.7%	-2.8%
Global Lyxor UCITS Peer Group	**0.6%**	**1.1%**	**-2.8%**
Event-Driven: Special Situations	1.0%	0.8%	-6.4%
Risk Premia	0.2%	0.5%	-9.1%

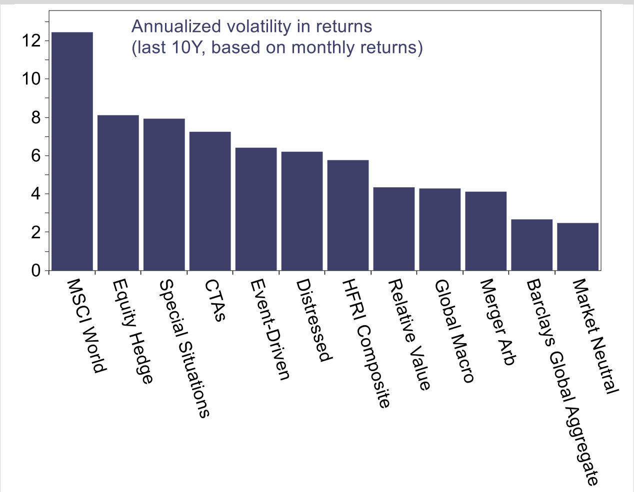
Last week: July 14th to July 21st. Source: Bloomberg, Lyxor AM

Lyxor Peer Groups suggest hedge fund performance was up +1.1% so far in July, with Market Neutral L/S underperforming (+0.4%) and Directional L/S Equity, Global Macro and L/S Credit strategies outperforming (+1.0% to +1.6%). Every hedge fund strategy was up during the weekly period under review.

In recent weeks, market concerns over renewed COVID-19 infections in the U.S. and to a lower extent in Europe have not translated into profit taking, with risk assets climbing higher on the back of additional stimulus talks by policymakers and substantial earnings surprises in the U.S. where the earnings season has started mid-July.

On a year-to-date basis, L/S Credit continues to outperform other hedge fund strategies (-0.3%).

Merger Arbitrage is One of the Least Volatile Hedge Fund Strategy



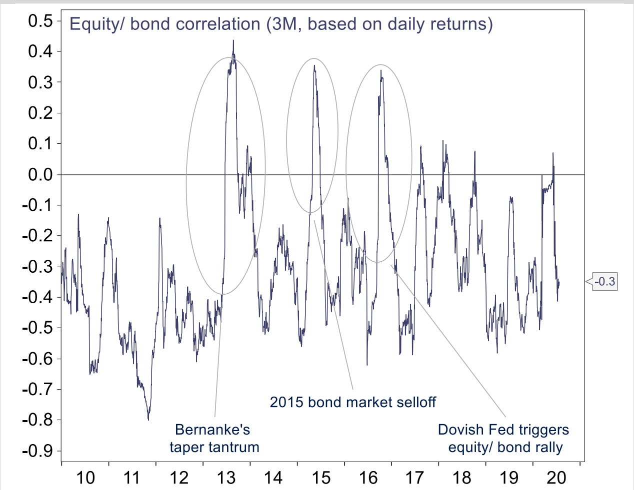
Hedge fund strategies' volatility is estimated based on HFRI indices. Source: HFR, Bloomberg, Macrobond, Lyxor AM

Over the long run, Merger Arbitrage strategies have demonstrated their diversification power. Based on broad indices such as the HFRI, we note that the track record in bad times, when risk assets suffer large selloffs, is quite outstanding. This is related to the fact that the equity market beta of the strategy is structurally low (though it jumped to unusual high levels in Q1-2020).

Additionally, the volatility of returns is among the lowest in relative terms. We estimate the annualized volatility of Merger Arbitrage returns to be 4% over the past ten years, three times less than equities (the realized volatility of the MSCI World stood at 12.5% during the same period).

For those reasons, we believe that Merger Arbitrage remains adequate in current market conditions, where the recent rebound in risk assets pushed valuations to elevated levels.

Despite Low Bond Yields, Fixed Income Still Adds Diversification in Multi Asset Portfolios



Based on MSCI World and Barclays Global Aggregate. Source: Bloomberg, Macrobond, Lyxor AM

Equity and bond returns have been positive in recent months but the correlation regime between them remains firmly in negative territory. Our estimate is based on daily returns over the past three months.

As a result, and even though sovereign bond yields remain close to record lows, especially in the U.S., fixed income assets continue to bring a valuable source of diversification in multi asset portfolios.

Yet, from a mid- to long-term perspective, there are question marks about the potential for central banks to start to signal monetary policy normalization in 2021, and its implications on bond yields.

As a result, although the asset class brings diversification at present, its mid-term outlook appears to be constrained. Our stance on 10-year Treasuries and Bunds stands at Neutral over the next three months but Underweight over the next twelve months.

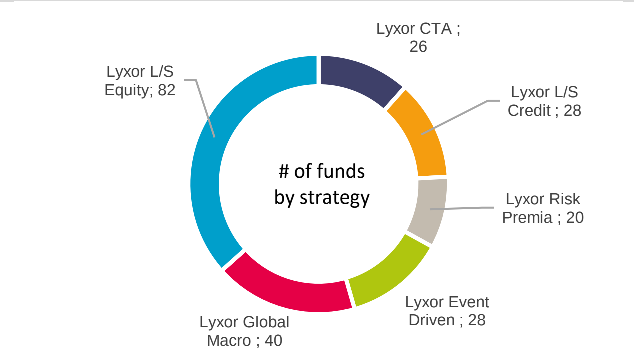
METHODOLOGICAL APPENDIX

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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