

# THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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## RISING BOND YIELDS POSE HURDLES FOR CTAs



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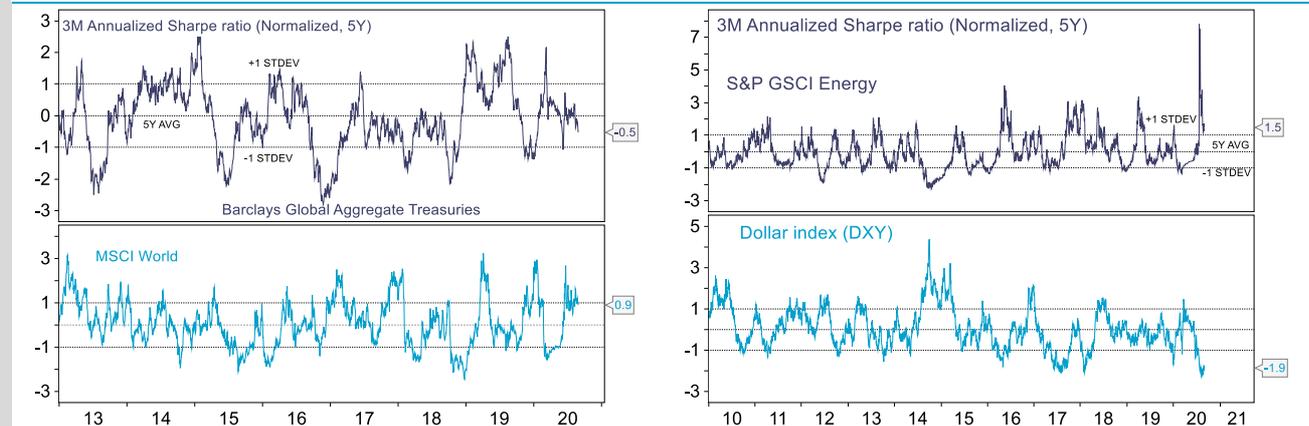
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Rising inflation expectations fueled bond yields over the course of August, in a context where recent CPI releases exceeded market expectations in the U.S. Both the headline and the core CPI rose +0.6% month-on-month in July in the U.S., compared to expectations at +0.3% according to Bloomberg. On a year-over-year basis, the core CPI rose +1.6%, vs. expectations at +1.1%. Inflation surprises particularly lifted bond yields at the long end of the curve, both in the U.S. and in Europe even though inflation in the euro area has been in line with expectations.

The recent rise in bond yields had negative implications for some alternative strategies. CTAs underperformed in August, down -1% according to our estimates as of August 25<sup>th</sup>. The trend reversal in fixed income was somewhat smooth and has contributed towards limiting the damage for trend followers, who remain heavily long on fixed income. Meanwhile, losses on fixed income were partially offset by long positions on equities and short positions on the USD which continued to experience downward pressures in August.

Going forward, bond yields may be influenced by the shift in the Fed's monetary policy strategy, from flexible inflation targeting to average inflation targeting. The shift was announced at the end of last week by Fed Chair Powell at the Jackson Hole Economic Policy Symposium. The Fed had previously signaled it was moving toward average inflation targeting, but the announcement came sooner than expected and coincided with the conclusion of its year-and-a-half-long monetary policy framework review. Whether this strategy shift will raise inflation outcomes and expectations remains to be seen, but our stance remains constructive on inflation breakevens, both in the U.S. and in Europe. As a result, the risks for CTAs are tilted to the downside, but we maintain a Neutral stance on the strategy on the back of its dynamic features. Since the beginning of the year, trend followers have further demonstrated their ability to adapt to fast changing market conditions, allowing them to navigate the Covid-19 market turmoil remarkably well. CTAs will probably manage to limit losses if the upward trend in bond yields continues, on the back of diversified positions across the curve. Yet, the evidence of the recent years suggests that long term factors (demographics, technology) prevail on accommodative monetary conditions for the inflation outlook. In the coming months, we expect moderate upward pressures on bond yields, which, in our view, can be absorbed by trend following strategies.

### Downward trend in sovereign bond prices hurt CTAs in August



All series in total return and USD hedged. Normalized series (mean is zero and the standard deviation is 1). Sources: Macrobond, Bloomberg, Lyxor AM

**Hedge Fund Performance: Directional Hedge Fund Strategies Outperformed in August**

Lyxor UCITS Peer Group Performance		
	Last Week*	MTD
<b>MSCI World</b>	<b>1.3%</b>	<b>5.3%</b>
Event-Driven: Special Situations	0.2%	1.6%
L/S Equity Directional	0.2%	1.6%
Global Macro	-0.2%	0.7%
L/S Credit	0.1%	0.6%
<b>Global Lyxor UCITS Peer Group</b>	<b>-0.1%</b>	<b>0.5%</b>
Risk Premia	0.0%	0.5%
Event-Driven: Merger Arbitrage	-0.1%	-0.1%
L/S Equity Market Neutral	-0.1%	-0.2%
<b>Bloomberg Barclays Global Aaaerate Bond Index</b>	<b>-0.1%</b>	<b>-0.6%</b>
CTAs	-0.6%	-1.0%

Last week: August 18<sup>th</sup> to August 25<sup>th</sup>. Source: Bloomberg, Lyxor AM

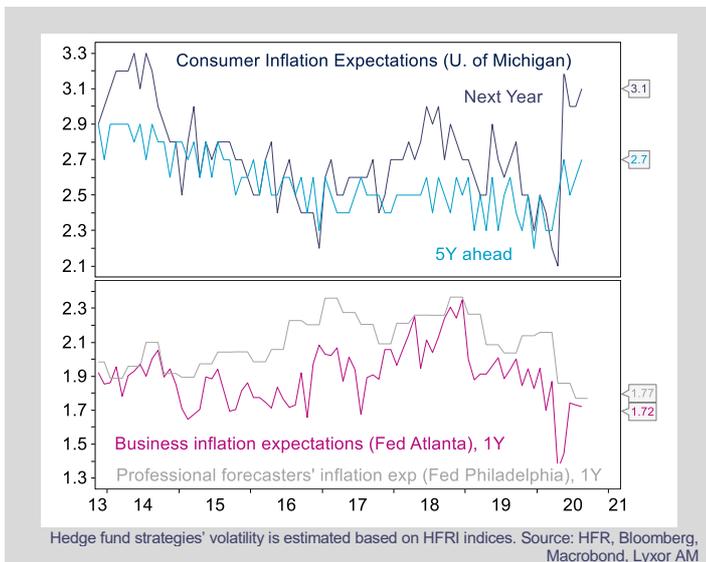
Thus far in August, Lyxor Peer Groups suggest hedge fund performance was up +0.5%, with CTAs underperforming (-1%) and Special Situations, Directional L/S Equity, Global Macro, and L/S Credit strategies outperforming (+0.6% to +1.6%).

In recent weeks, the rally in stock prices went uninterrupted, with the MSCI World up +5.3% in August (as of Aug. 25<sup>th</sup>), led by Technology and Consumer Discretionary stocks.

Directional hedge fund strategies outperformed as a result, with Special Situations and Directional L/S Equity up +1.6% during this period.

Concurrently, low beta strategies such as CTAs, Market Neutral L/S, and Merger Arbitrage underperformed.

**Consumers Expect Inflation to Rise Towards 3%; but Monetary Tightening is Not Around the Corner**

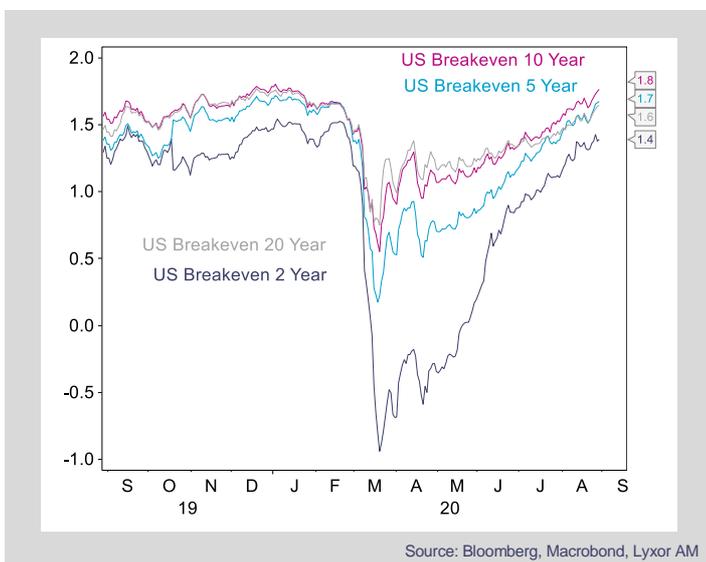


There is a broad range of surveys gauging inflation expectations in the U.S. which in recent months have markedly diverged.

Consumers surveys have signaled rising inflation expectations both in the short term (1 year) and the longer term (5 years). According to such surveys, the inflation rate would reach 3%, but the inflation outlook depicted by business or professional forecasters' surveys is significantly different. It suggests that inflation would remain close to, but below 2% next year.

Even if inflation rises towards 3% as consumers expect, it would not imply monetary tightening following the Fed's strategy shift to average inflation targeting. The FOMC "seeks to achieve inflation that averages 2% over time." Following periods of persistent sub-2% inflation, the Fed would thus aim to achieve "moderately above 2 percent for some time."

**Market-based Inflation Expectations Rebounded but Remain Low**



Inflation breakevens rebounded markedly in the U.S. since the end of the first quarter, when the Great Lockdown translated into acute fears of deflation. At that time, the 2-year U.S. inflation breakeven fell close to -1%.

Unprecedented monetary accommodation, along with rising evidence that the economic impact was less severe than feared, lifted inflation expectations to around +1.5% at present.

Yet, market-based measures of inflation expectations do not signal inflation is about to outpace the 2% target of central banks. From that perspective, inflation-linked assets are consistent with the inflation scenario of business surveys or professional forecasters discussed above.

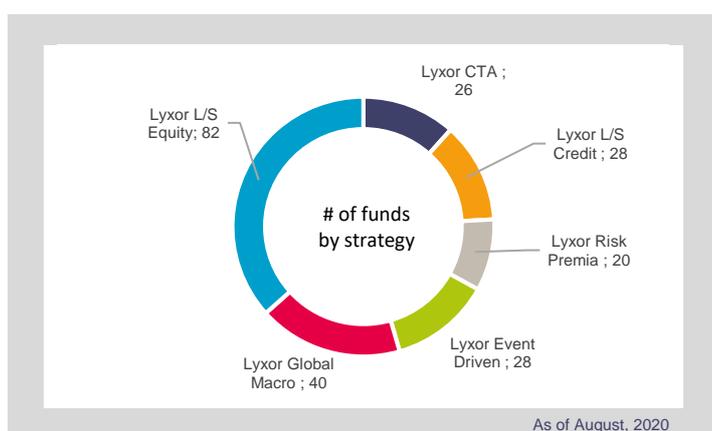
## METHODOLOGICAL APPENDIX

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



- 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:

- We only include UCITS strategies;
- Assessment by Lyxor's Hedge Fund selection team based on funds' materials or manager interaction;
- We only include strategies with assets under management of at least USD 50 million; and
- We only include strategies with at least a one-year track record.

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