THE WEEKLY BRIEF

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Merger Arbitrage Firms Up Despite Equity Plunge

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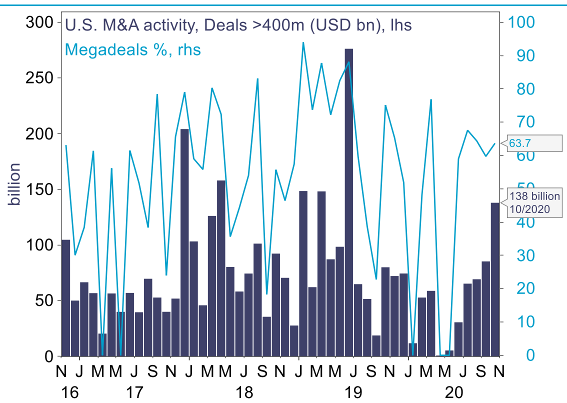
Amid the sound and fury of renewed Covid-19 lockdowns across Europe, global equities took a plunge at the end of October, bringing the MSCI World down -3% for the full month. Bonds did not provide much protection, as fiscal stimulus packages needed to avoid a major blow to economic activity would put upward pressure on yields.

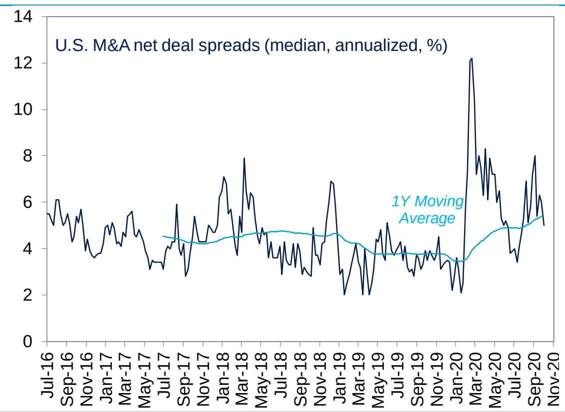
In the hedge fund space, strategies with a higher market beta such as Special Situations and Directional L/S Equity underperformed (-0.8% and -0.6% respectively in October), while CTAs and Market Neutral L/S also posted negative returns (-1.2% and -0.8%). Merger Arbitrage and L/S Credit managed to post positive returns.

Merger Arbitrage has benefitted from attractive deal spreads, renewed M&A volumes in the U.S., and from its power of diversification. We estimate its equity market beta at 3% now, below the 5-year average (8%). This implies a -10% fall in the MSCI World would lead to a -0.3% fall in returns.

Reframing Merger Arbitrage in the current context of U.S. elections, the strategy is not deploying assets based on views on the election outcome. Cash holdings are elevated at present. Agnosticism vs. the U.S. election also implies that managers are not concerned in the short term about a potential Democratic President and tougher anti-trust regulations. The key theme to watch for in Merger Arbitrage are Special Purpose Acquisition Companies ("SPACs") and how far they will boost corporate activity. A SPAC is a financing tool that allows investors to co-invest with a sponsor (the acquirer). It is a newly formed public company whose sole purpose is to acquire or merge with an operating business within a fixed time frame. SPACs have been around since the 1980s, but their popularity has increased since the early 2000s. In 2020, the SPAC market has boomed as Mega SPAC IPOs emerged. They have brought increased liquidity to the market and attracted institutional and alternative investors. SPACs are attractive for Merger Arbitrage strategies as they offer an attractive and low volatility return profile. SPACs were strong positive contributors to Merger Arbitrage returns last month. They should allow robust M&A volumes in the quarters to come, with USD 50bn of unlevered capital available to make acquisitions according to Dealogic as of end-Q3.

M&A activity firms up and new deals came with attractive spreads





As of October 2020. Megadeals are deals above USD 5bn. Sources: Eikon, UBS, Lyxor AM

Hedge Fund Performance: Merger Arbitrage and L/S Credit stay afloat in October

Lyxor UCITS Peer Group Performance

	Last Week*	October	Q3	YTD
Event-Driven: Merger Arbitrage	0.0%	0.7%	1.3%	-1.3%
L/S Credit	-0.5%	0.0%	1.8%	0.5%
Bloomberg Barclays Global Aggregate Bond Index	0.1%	0.0%	0.7%	4.7%
Global Macro	-0.8%	-0.3%	1.3%	-2.7%
Global Lyxor UCITS Peer Group	-1.0%	-0.5%	1.1%	-3.2%
L/S Equity Directional	-1.9%	-0.6%	2.2%	-2.4%
Event-Driven: Special Situations	-2.3%	-0.8%	1.5%	-6.2%
L/S Equity Market Neutral	-0.5%	-0.8%	0.5%	-1.7%
CTAs	-1.1%	-1.2%	-1.0%	-5.6%
Risk Premia	-1.1%	-1.7%	0.4%	-10.9%
MSCI World	-5.4%	-3.0%	6.8%	-1.7%

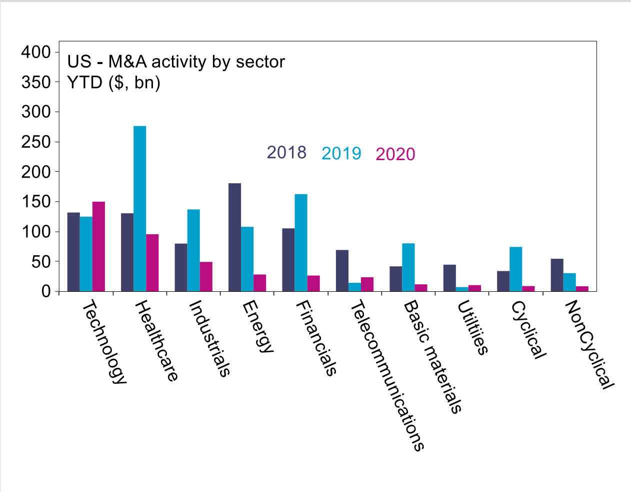
*As of October 30th. Source: Bloomberg, Lyxor AM

Hedge funds were down -1% last week as market conditions took a turn for the worse. This brought the monthly performance of our Global Lyxor Peer Group in October to -0.5% (vs. -3.0% for the MSCI World).

Merger Arbitrage outperformed with flat returns last week and a positive performance for the full month (+0.7%). Strategies with a higher market beta such as Special Situations and Directional L/S Equity underperformed (-2.3% and -1.9% resp. last week), while CTAs and Market Neutral L/S also posted negative returns (-1.1% and -0.5% resp.).

For the full month, CTAs underperformed, down -1.2%, as their long stance on equities and U.S. bonds suffered headwinds. Finally, within Global Macro, Systematic strategies underperformed Discretionary ones.

U.S. M&A activity has remained elevated in Technology and Health Care sectors



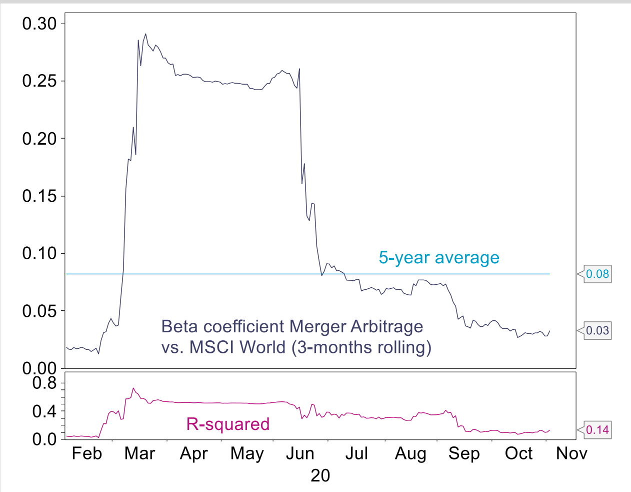
As of October 2020, for deals above USD 400m. Source: Macrobond, Lyxor AM

M&A activity firmed up significantly in recent months in the U.S. while it has been much weaker in Europe. Over the past four-month, U.S. M&A volumes were actually back to pre-Covid-19 crisis amounts.

Sectors such as Technology and to a lower extent Health Care and Industrials continue to experience robust M&A activity.

In the past two months, huge transactions in semiconductors such as the USD 40bn proposed merger of Nvidia with ARM and AMD's $35 bn plan to acquire Xilinx boosted the numbers in the Technology sector and contributed to the overall spread tightening observed in recent weeks.

Merger Arbitrage is all but directional at present



Based on daily returns. Source: Macrobond, Lyxor AM

A simple univariate regression between Merger Arbitrage returns and the MSCI World suggests the equity market beta of the strategy remains very low, at 3% at present vs. 8% on average over the past 5 years.

This contributes to explain why the strategy was highly resilient in October, despite the equity market plunge amid renewed lockdowns in Europe.

Our stance on the strategy remains supportive (Overweight). We particularly favor this strategy in a context where valuations are rich across traditional asset classes and the Covid-19 resurgence poses huge downside risks to economic activity and financial assets. Amid rising public indebtedness, sovereign bonds are not an attractive option to diversify portfolios. In turn, M&A volumes and deal spreads remain supportive for Merger strategies, which we favor compared to other low beta strategies such as Market Neutral L/S Equity and CTAs.

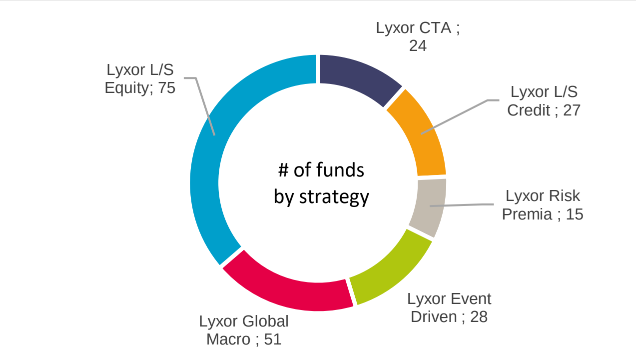
METHODOLOGICAL APPENDIX

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 November, 2020

- 220 strategies across the main categories in the industry
- USD 174 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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