THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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MOST L/S EQUITY EMERGE UNSCATHED FROM FACTOR ROTATIONS

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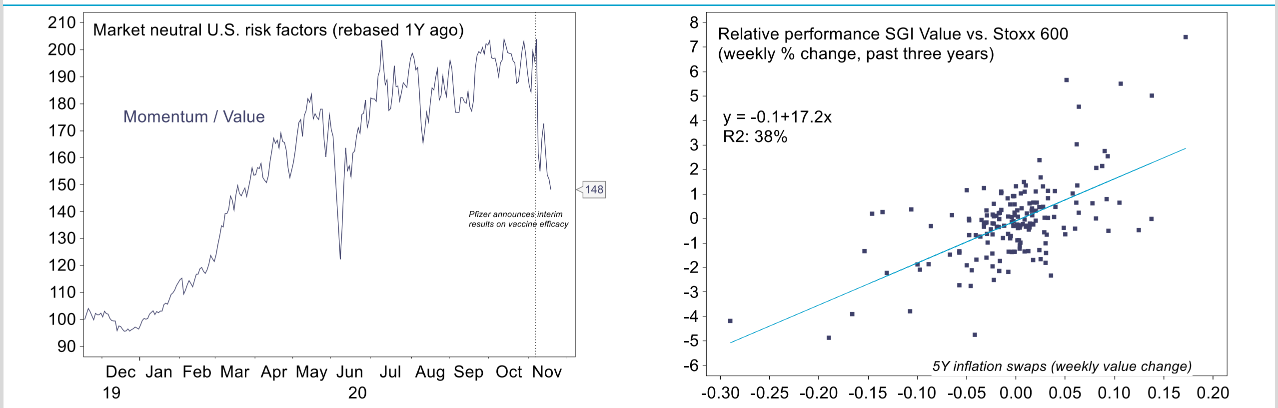
A massive momentum reversal occurred earlier in the month, when Pfizer announced interim results of its Covid-19 vaccine. On November 9th, the U.S. Dow Jones Momentum Index fell by a record -14% in a single day. In this long/ short index, value stocks were on the short side and they experienced a massive rebound. Over recent days, such rotation out of momentum/ quality/ low beta into value/ size stocks has continued.

Several hedge fund strategies have momentum biases, in particular L/S Equity, and CTAs. Considering the fact that this rotation took place in a bullish environment, most hedge fund strategies ended the week in positive territory. Directional L/S Equity (+1.2%) benefitted from their market beta, but alpha contributed negatively for all but those strategies with an explicit value bias. One strategy benefitted particularly from the changing market landscape: Special Situations (+3%). In relative terms, their higher market beta and value bias was supportive.

CTAs and Market Neutral L/S ended the week in negative territory but losses, in the range of -1% to -1.5% according to the Lyxor Peer Groups, were overall contained. Dispersion has been high within the Market Neutral L/S space, with 20% of our sample down in excess of -3%, a significant loss for strategies which are traditionally low vol. Most managers have now neutralized their factor biases to edge against further rotations into value stocks.

Going forward, a sustainable rebound in value stocks looks unlikely, particularly in Europe. A significant part of their underperformance in recent years was also related to the low inflation/ low yield environment, which looks unlikely to change. Some value sectors such as financials might benefit from the gradual normalization in economic activity, which would occur in H2-2021, and could start to normalize dividend distribution next year. In parallel, momentum crashes are usually short lived. In this context, we maintain the UW stance on Market Neutral L/S and upgrade Special Situations to N.

A historic momentum reversal. A sustainable value rebound looks unlikely in Europe



Sources: Dow Jones, SG, Bloomberg, Macrobond, Lyxor AM

Hedge Fund Performance: Special Situations rides the value wave

Lyxor UCITS Peer Group Performance

	Last Week*	MTD	YTD	# of funds
MSCI World	2.7%	10.0%	8.2%	
Event-Driven: Special Situations	3.0%	5.2%	-1.5%	7
L/S Equity Directional	1.2%	3.7%	1.2%	52
Global Macro	1.6%	2.2%	-0.8%	51
Global Lyxor UCITS Peer Group	0.3%	1.7%	-1.5%	218
L/S Credit	0.4%	1.5%	2.0%	27
Event-Driven: Merger Arbitrage	0.6%	1.1%	-0.2%	21
Bloomberg Barclays Global Aggregate Bond Index	-0.2%	0.1%	4.8%	
Risk Premia	-0.8%	0.1%	-10.8%	13
CTAs	-1.7%	-0.5%	-6.0%	24
L/S Equity Market Neutral	-1.0%	-0.6%	-2.3%	23

*As of November 13th. Source: Bloomberg, Lyxor AM

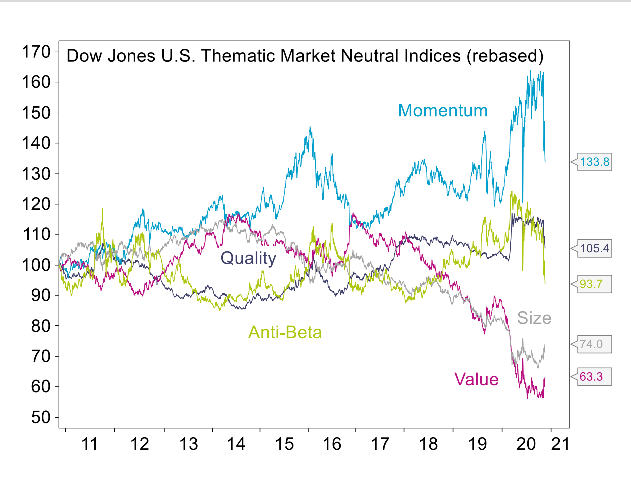
Vaccine availability would be a game changer for the global economy next year. In anticipation of such normalization, markets experienced strong moves last week. Special Situation strategies, which have a value bias, benefitted the most from the news.

In turn, Market Neutral L/S, which have a momentum bias, suffered from the factor rotation.

The remaining strategies were relatively immune to such factor rotations but benefitted from the rally in risk assets. Global Macro strategies did well overall (+1.6% last week). Every sub-Macro strategy did well, with EM Macro outperforming slightly so far this month.

L/S Credit and Merger Arbitrage benefitted less from the market rally due to their moderate/ low market beta but both ended the week in positive territory as well.

Momentum is a risky risk factor which pays off over the long run



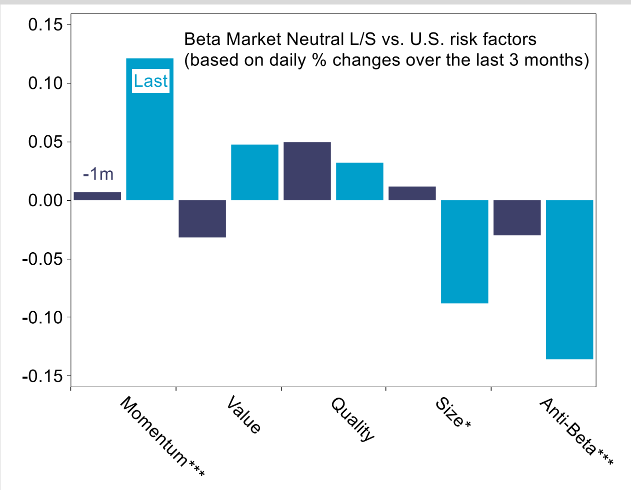
Source: Dow Jones, Lyxor AM

Momentum remains the best performing risk factor over the long run, compared to size, value, low beta, and quality. Yet, it is a risky risk factor with a maximum drawdown which reached 57% back in 2014. Meanwhile, the maximum drawdown of the value factor, at 52% was reached earlier in H2-2020.

Based on such considerations, there is room for value stocks to recover from their sharp losses registered in 2020.Yet, the upside remains capped, at least in the EMU, by low inflation prospects.

Momentum is also the most volatile risk factors, with an annualized volatility of 13.5% over the past ten years, vs. 10.4% for Value.

The Covid-19 vaccine caught Market Neutral L/S on the long momentum side



* and ***: significant at 90% and 99% confidence level. Source: Dow Jones, Macrobond, Lyxor AM

Based on our estimates, Market Neutral L/S strategies were significantly exposed to the momentum risk factor before the reversal, with a beta slightly above 12%. This suggests that at 10% fall in the momentum risk factor would imply a -1.2% loss in Market Neutral L/S strategies, all else being equal.

Since the momentum risk factor lost -13.3% last week, it would have suggested a -1.6% fall in Market Neutral L/S. Yet, their short exposure to the anti-beta risk factor, which lost -8.6% last week, helped offset losses on momentum exposures.

Our stance on the strategy remains UW. It is a defensive strategy, which is thus less attractive in a context where the next economic recovery, propelled by the vaccine availability, is likely to be around the corner. This suggests having some beta in portfolios would fuel performance, while factor rotations are likely to continue to pose hurdles for Market Neutral L/S.

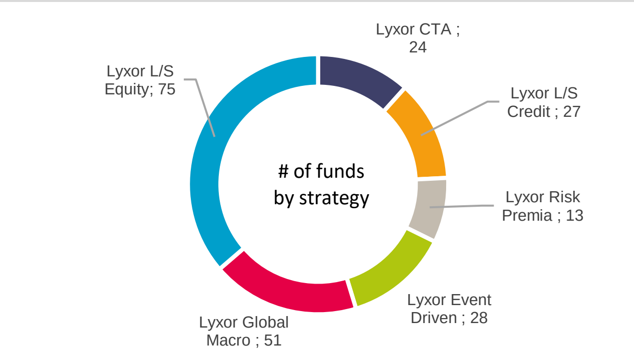
METHODOLOGICAL APPENDIX

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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