THE WEEKLY BRIEF

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VOLATILITY IN RATES LITTLE SEEN IN HY SO FAR

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Volatility in interest rates year-to-date has unevenly impacted credit markets. Investment grade credit (IG) weakened in sympathy with sovereign yields, especially in high quality and long duration paper. IG bonds were down -3.6% in the U.S. year-to-date, and -0.5% in Europe where rates volatility was lower, with backing from the ECB's purchases. In contrast, HY has been resilient, still up +1.6% in the U.S. and +2.5% in Europe, supported by about 60 bps of spread tightening, especially in riskiest HY tranches, as well as in energy in the U.S. and in materials in Europe. We review how L/S HY managers on both sides of the Atlantic manage rate volatility and where they concentrate their fire power.

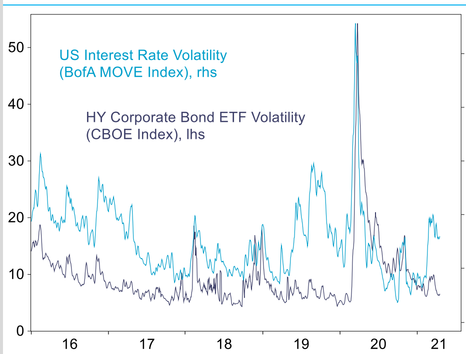
Rates volatility is closely monitored by managers, who hedge the bulk of their interest rate exposures. They tend to use futures or shorts on long-term duration corporate bonds within the higher quality segment (they may short perpetual bond for instance). For now, their hedges have negatively contributed since volatility in HY has not materially soared.

The search for carry, the recovery in oil prices and prospects of economic reopening have further compressed spreads and supported flows. There have been few credit events year-to-date while HY markets remained isolated from the trading anomalies that temporarily unsettled stocks (including short-squeezes led by retail investors or the unwinding of Archegos positions). The asset class has also been less sensitive to the multiple sector and factor rotations that have rocked equities.

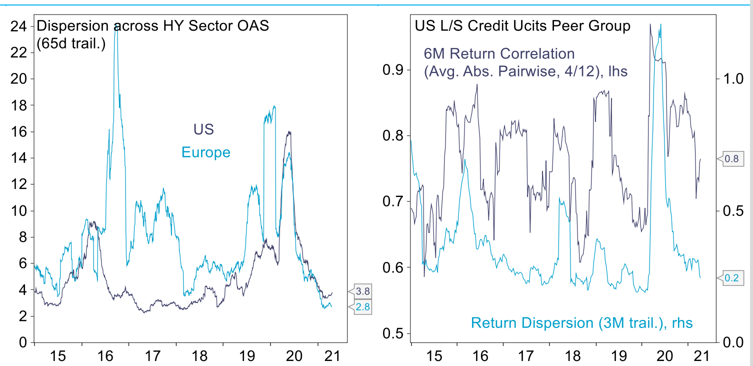
Yet, with spreads hovering nearby their 10-year lows, managers see limited tightening potential. Those that outperformed had moved to lower quality tranches. With less than 3% of carry left in HY, they expect investors will favor equities. Overall, they keep a long exposure but less than last year. On the short side, they favor expensive IG bonds while being cautious on fundamental shorts. Indeed, they do not see corporate leverage as a top preoccupation at this stage, considering the mild default wave, the positive economic and profit outlooks, and stimulus support.

On the long side, they focus on the recovery, especially on cyclical issuers that are likely to rebound the fastest. They are adding some fallen-angels that could return in IG (Carnival Corp. for example) and are starting to increase allocation to UK issuers, to leverage on the fast vaccination roll-out (including bars, supermarket, fitness). In financials, they focus on issuers that still trade in wider spreads (DB and more recently CS for example). They also allocate to legacy tier-one bonds, which will lose their eligibility in banks' tier-one capital assets (they are less liquid than Cocos but trade at premium). They still allocate to EU periphery issuers, expecting further convergence and more M&A. Finally, they do not see yet an overdose of HY issuance, while they lock in discounts in the primary market. The low correlation across managers returns emphasizes a differentiated set of themes. The strategy might offer increasingly needed diversification and hedging. [*continued p2*]

HY volatility isolated from rates' so far



Poor dispersion in HY, but low managers' return correlation



Sources: Bloomberg, Lyxor AM

Performance: Reflation Momentum Unevenly Captured

Lyxor UCITS Peer Group Performance

	Last week*	MTD	YTD
MSCI World	1.3%	4.6%	11.2%
Event-Driven: Special Situations	1.1%	2.1%	6.9%
L/S Equity Directional	0.5%	1.9%	3.8%
Event-Driven: Merger Arbitrage	0.4%	1.3%	3.0%
Global Lyxor UCITS Peer Group	0.5%	1.3%	2.6%
Risk Premia	0.6%	1.2%	3.8%
CTAs	0.7%	1.1%	3.5%
Global Macro	0.4%	0.9%	0.5%
L/S Equity Market Neutral	0.5%	0.9%	2.6%
Bloomberg Barclays Global Aggregate Bond Index	0.2%	0.4%	-2.0%
L/S Credit	0.1%	0.4%	0.3%

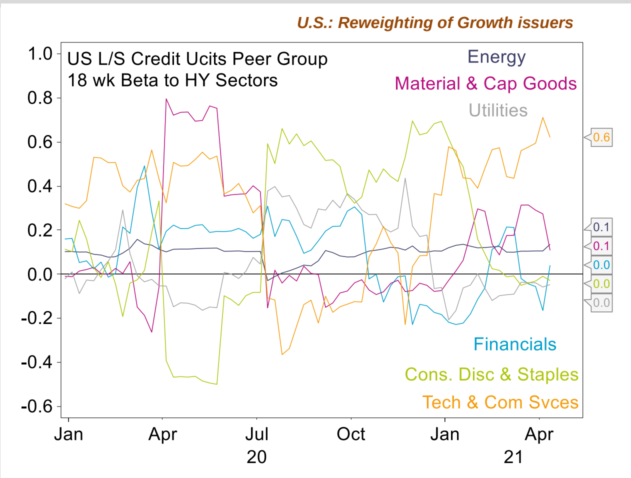
*Last Week: Apr 4 to Apr 16. YTD and MTD until Apr 16. Source: Lyxor AM

Strong data releases in the U.S., China and to a lesser extent Europe provided further support to risk assets. U.S. Treasury yields softened despite robust macro data releases. Meanwhile, sovereign yields in Europe climbed.

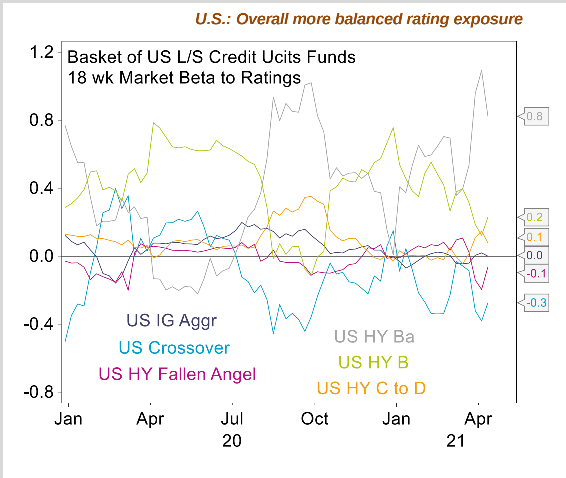
Hedge fund strategies were all in positive territories this week, supported by rising risky assets and the reflation momentum.

Special Situations once again took the lead and outperformed the L/S Equity diversified strategy, which only partially benefitted stock rotations. CTAs benefited from the reflation trend, due to their long equity exposure. They also gained from the recent gold recovery, boosted by a weaker dollar and a pullback in U.S. bond yields. Global Macro, also long on commodities, benefited from their rising prices.

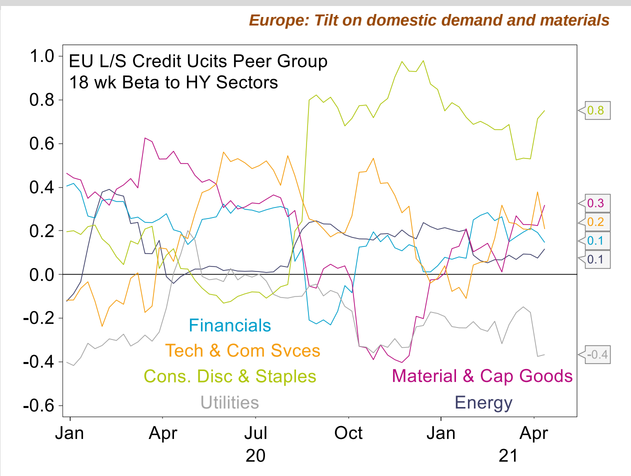
Volatility in Rates Little Seen in HY So Far [continued from p1]



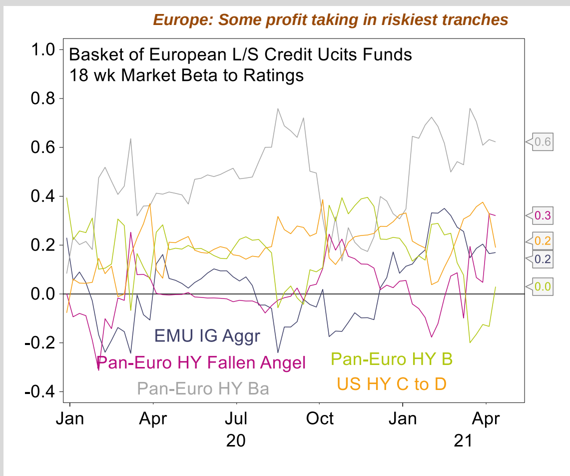
Source: Bloomberg, Macrobond, Lyxor AM



Source: Bloomberg, Macrobond, Lyxor AM



Source: Bloomberg, Macrobond, Lyxor AM



Source: Bloomberg, Macrobond, Lyxor AM

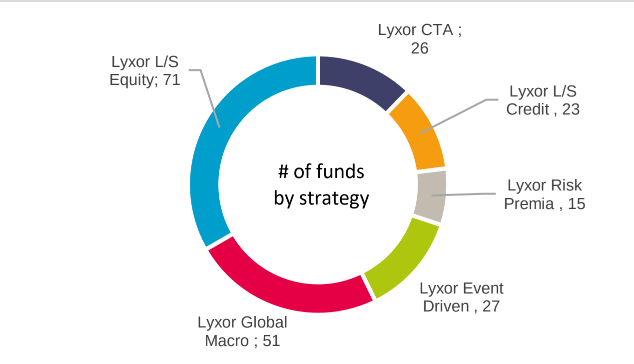
METHODOLOGICAL APPENDIX

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 April, 2021

- 213 strategies across the main categories in the industry
- USD 186 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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