THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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EM MACRO STRATEGIES REBOUND BUT FOR HOW LONG?

Philippe Ferreira
Cross Asset Strategist

Jean-Baptiste Berthon
Cross Asset Strategist

Pierre Carreyn
Hedge Fund Analyst

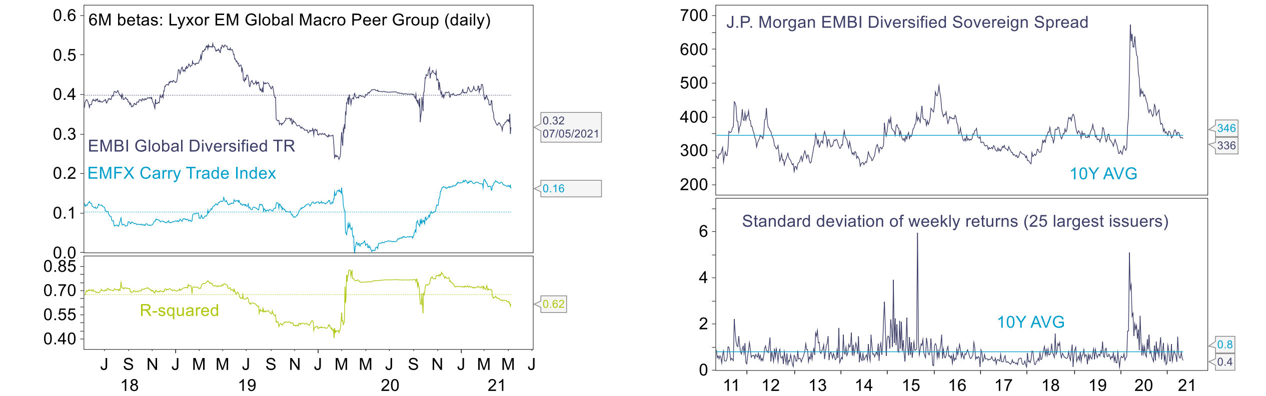
CrossAssetResearch@lyxor.com

EM sovereign credit initiated a rebound at the turn of the quarter (+3% QTD) as Treasuries bounced back after having registered the worst quarterly returns since the early 1980s (-4.3% for the Barclays U.S. Treasuries in Q1). There is indeed a strong relationship between EM sovereign credit and Treasuries. For an asset mostly denominated in USD, the former represents a higher yielding alternative to Treasuries, whose demand fluctuates according to risk preferences and relative yield dynamics. But developments in the Treasury market are not the only determinant of EM performance. Almost the entire commodity complex is also an important driver of EM sovereign credit and this tailwind partially counterbalanced the adverse Treasury effect in recent months.

In line with broader market developments, EM Global Macro strategies rebounded quarter-to-date, up +1.6% as of May 7th, but still down -1.3% year-to-date. The rebound in EM currencies was also supportive and as such, we revisit our stance on EM Macro strategies.

In our view, the market environment should remain adverse, with Treasury yields expected to head towards 2%. Also, spreads are tight at present, at 333bps over Treasuries. Our stance on the strategy was downgraded in March to Neutral and we now downgrade it to Underweight. We remain defensive as U.S. inflation prospects are putting renewed upward pressure on Treasury yields and the USD. Also, the commodity tailwind can be misleading. Despite the stellar rise in oil prices, the EMBI Saudi Arabia, UAE, Russia, and Qatar were down year-to-date in a range of -3% to -5%. But there is some room for arbitrage considering the diversity of local situations at the issuer level. For instance, Mexico has managed to cut rates in recent months and is likely to be bolstered by the U.S. recovery. It also benefits from a better Covid-19 situation than the rest of Latin America. On the contrary, Brazil hiked rates two times this year, by a cumulative 150 bps, and the Covid-19 scares could translate into a downgrade of the sovereign rating. Talented managers can take advantage of such opportunities. Several strategies are hedged against rises in Treasury yields, but we suggest selectivity and expect EM Macro to underperform.

Tight spreads, rising bond yields and low dispersion is a hurdle for EM Macro strategies



Sources: Bloomberg, Macrobond, Lyxor AM

Hedge Fund Performance: CTAs Keep Climbing Higher

Lyxor UCITS Peer Group Performance

	Last week*	April	YTD	# of funds
MSCI World	1.1%	4.1%	11.9%	
Event-Driven: Special Situations	0.4%	2.3%	7.5%	6
L/S Equity Directional	0.5%	2.2%	4.7%	51
Event-Driven: Merger Arbitrage	0.1%	1.7%	3.5%	21
Global Lyxor UCITS Peer Group	0.5%	1.3%	3.2%	213
CTAs	1.3%	1.3%	5.1%	26
L/S Equity Market Neutral	0.2%	1.1%	3.0%	20
Global Macro	0.3%	0.8%	0.7%	51
Risk Premia	1.4%	0.6%	4.7%	15
L/S Credit	0.1%	0.6%	0.5%	23
Bloomberg Barclays Global Aggregate Bond Index	0.2%	0.3%	-2.0%	

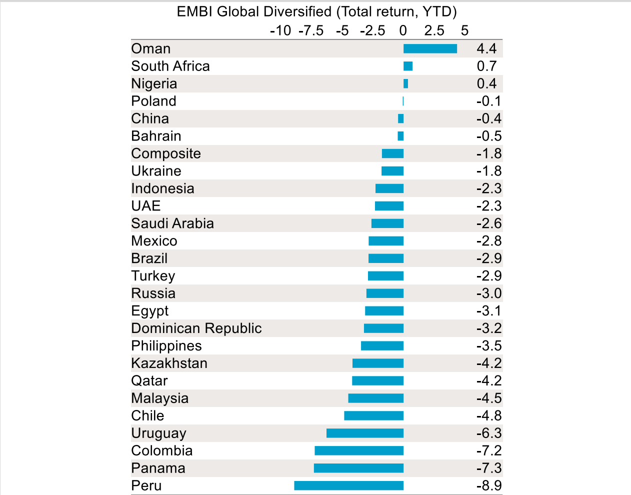
*Last Week: April 30th to May 7th. YTD as of May 7th. Source: Bloomberg, Lyxor AM

CTAs outperformed last week and over the course of April, as equities posted additional gains (their equity market beta stands close to 40% at present). High beta strategies such as L/S Equity Directional and Special Situations also outperformed. Our stance on such strategies stands at Overweight.

On a negative note, L/S Credit continues to underperform as tight High Yield credit spreads remain a hurdle, on average. We downgraded our stance on the strategy to Neutral back in March.

Going forward, our strongest convictions remain Event-Driven and CTAs, though the latter is vulnerable to a trend reversal in equities, which we deem possible in the short run after the bull run year-to-date. Our views on equities remain nonetheless supportive in the medium-term.

There is Some Dispersion Between Issuers, but it is Actually Below Average



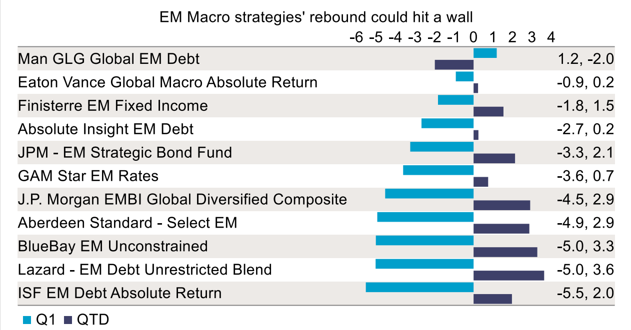
* Constant of the regression. U.S. Market Neutral risk factors. Source: Macrobond, Lyxor AM

Dispersion can be seen as a source of alpha for skilled alternative strategies. Provided that they can discriminate adequately an investment universe, they are in a position to constitute long and short books that contribute positively to performance.

There has been some dispersion amongst EMBI Global Diversified country indices. Latin America has been under intense pressure, as the Covid-19 pandemic deteriorated the credit profile of those issuers. EMEA did better, but there are question marks regarding the dispersion within GCC countries. Saudi Arabia, UAE, Qatar, Chile, and Peru are down despite the stellar rise in oil and copper prices. Political risk might contribute to explain such differences.

Overall, dispersion is nonetheless less supportive than it was some months ago (see right hand sided chart on previous page) and contributes to explain why we downgrade EM Macro strategies to Underweight.

Dispersion in EM Macro Strategies' Returns are Due to Persist



Data as of May 7th, 2021. Source: Bloomberg, Macrobond, Lyxor AM

Despite our Underweight stance on EM Macro, some strategies are still capable of delivering positive returns.

Yet, within our Lyxor Peer Group composed of ten strategies, only one of them ended Q1 in positive territory. This suggests that generating performance in an adverse market environment remains challenging, but not impossible, for EM Macro.

We nonetheless believe that investors should be highly selective, to the extent that we expect EM Macro strategies to underperform, on average.

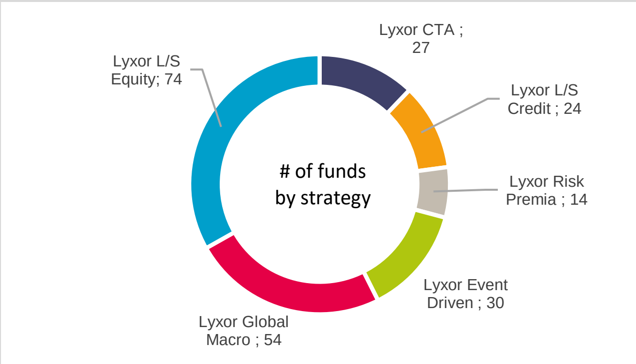
METHODOLOGICAL APPENDIX

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 May, 2021

- 223 strategies across the main categories in the industry
- USD 187 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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