

HOW HEDGE FUNDS RE-ASSESS THE REFLATION TRADE WITH COMMODITIES?



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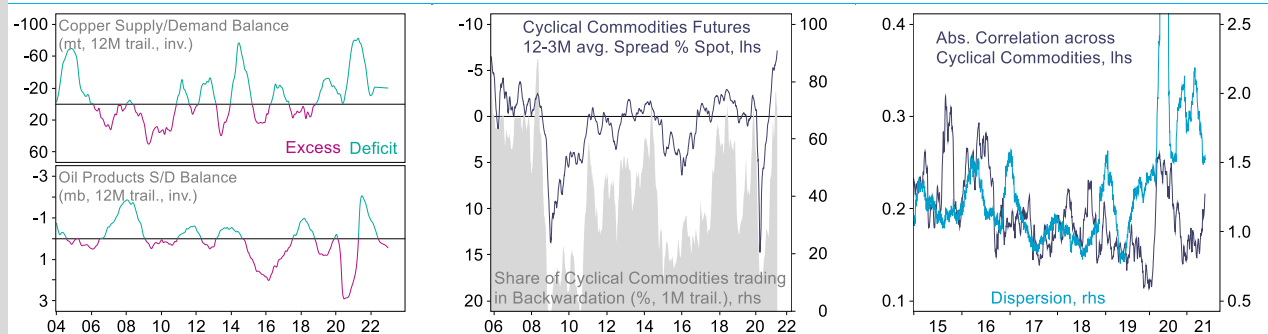
The second leg of the commodity rally, after the vaccine announcement, saw prices soar +30%, heterogeneously though. Cyclical commodities outperformed precious metals and agricultural. Furthermore, dispersion within each commodity group has been elevated, while pairwise correlations were low. There has been clear differentiation across commodities function of the pulse in their supply and their end-use drivers, as well as from market flow dynamics.

Since June, however, the asset class has been running through turbulence. In addition to profit taking, weakness in commodity prices has reflected investors' doubts about the 'reflation trade'. Doubts started with evidence of a plateauing Chinese economy. Leading on the way out of the pandemic, the largest world importer of commodities is now losing some traction. Targeted Chinese authorities tightening (seeking to ease structural imbalances) also contributed to moderate the activity. Second, unsettled supply chains and chip shortages slowed several industries, especially auto manufacturing heavily using commodities. Third, declining visibility on U.S. spending plans, scaled down over the political process, hit commodities most exposed to infrastructure. Fourth, the more hawkish June FOMC, which acknowledged strong U.S. growth and sustained inflation in the short-term, led markets to reprice an earlier tapering than planned, denting the appetite for risk assets. Meanwhile, the Fed and investors conviction that inflation would normalize in the longer run eroded demand for inflation hedges. Also, the jump in dollar after the FOMC hit dollar-denominated assets. Finally, Chinese efforts to stem commodity prices, that are eroding corporate margins and consumers' purchasing power, also weakened the asset class.

In our view these turbulences are temporary. They might moderate the commodity rally but could also prolong it. Metal strategic stocks that China plans to release would need to be rebuilt later. Also, structural commodity drivers are not China centric. They include decarbonation, the rise of electric vehicles, infrastructure spending, and a housing boom, which would particularly benefit base metals. Moreover, demand elasticity to prices would play out more favorably. Besides, the uncertain inflation path, with a big wildcard from fiscal spending in the U.S., would still require inflation hedging.

Hedge funds have unevenly reassessed the 'reflation trade'. CTAs, strongly hit by weakening commodity prices, have little changed their commodity exposures but are reweighting energy futures. Global Macro managers have neutralized their commodity exposures and favor equity indices to express their cyclical bias. U.S. and European L/S equity managers have also neutralized their commodities-sensitive stocks in June. They are now buying cheaper base material stocks on dips at the expense of industrials. These positions remain moderate though, all the more so they are cutting their overall net exposures and reweighting defensive and growth stocks. U.S. L/S HY managers broadly left their commodity exposures unchanged, with a greater focus on energy. Overall, hedge funds do not seem to be giving up on the 'reflation trade' but are cutting exposures ahead of the summer, while preparing for more delicate trading conditions in Q3. *[continued p2]*

Short supply in key commodities... .. Keep them in backwardation But return dispersion is elevated



Sources: Bloomberg, Macrobond, Lyxor AM

Performance: CTAs rebounding on Commodities

Lyxor UCITS Peer Group Performance

	Last week*	MTD	YTD
MSCI World	2.2%	2.4%	14.5%
L/S Credit	0.0%	0.2%	0.7%
L/S Equity Directional	0.9%	0.2%	5.4%
Bloomberg Barclays Global Aggregate Bond Index	-0.3%	0.2%	-1.8%
Risk Premia	0.9%	0.2%	4.7%
Global Macro	0.3%	0.0%	0.8%
Global Lyxor UCITS Peer Group	0.5%	-0.1%	3.2%
L/S Equity Market Neutral	0.3%	-0.1%	2.9%
Event-Driven: Merger Arbitrage	-0.3%	-0.3%	3.6%
Event-Driven: Special Situations	0.3%	-0.5%	7.1%
CTAs	1.5%	-1.3%	3.9%

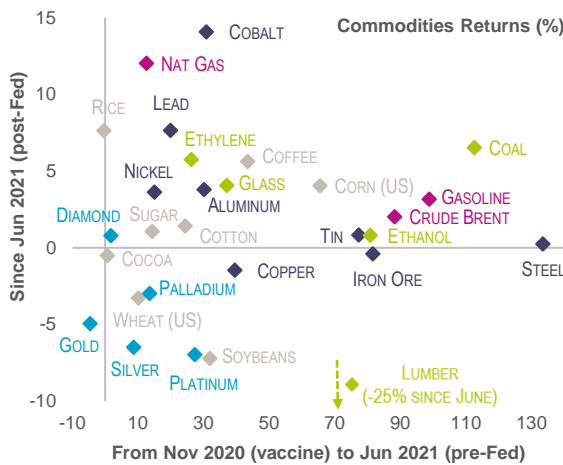
*Last Week: June 18 to Jun 25. YTD and MTD until Jun 25. Source: Lyxor AM

After digesting a more hawkish Fed on June 16, markets rebounded. Chinese and EM equities regained their lost ground, as well as commodities.

Most hedge fund strategies were all in positive territory this week. CTAs strongly rebounded thanks to their long commodity exposure, especially on their energy futures. L/S equity managers did well and produced positive alpha, thanks to their stronger cyclical exposure when compared to their value stock exposure.

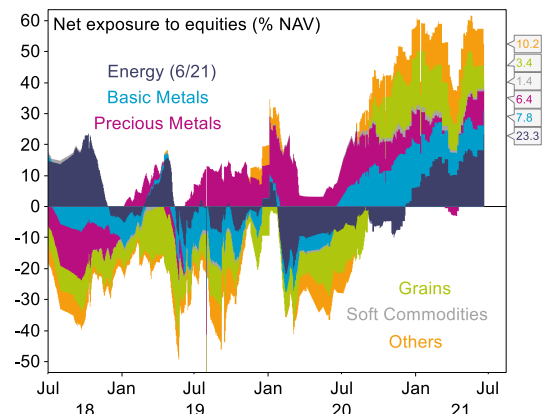
Special situations did not profit much from the equity rebound, as value stocks lagged this week.

How Hedge Funds Re-assess the Reflation Trade with Commodities? [continued from p1]



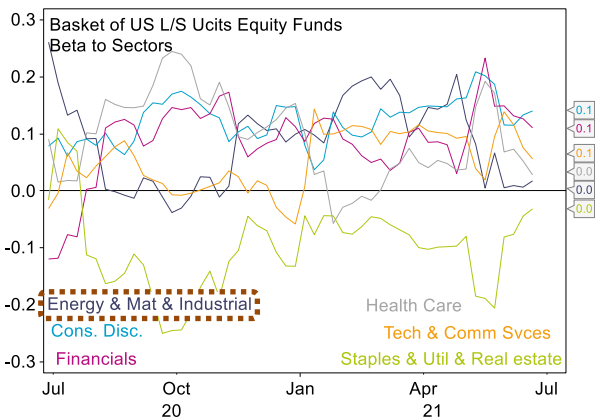
Source: Bloomberg, Lyxor AM

CTAs have fully rebuilt their elevated commodity exposures



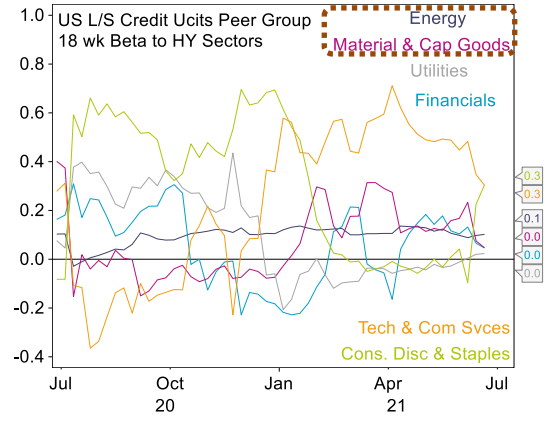
Source: Bloomberg, Lyxor AM

Reduced L/S Equity strategies' positioning on commodity-sensitive stocks



Source: Bloomberg, Lyxor AM

L/S Credit strategies little changed their allocation to commodities



Source: Bloomberg, Lyxor AM

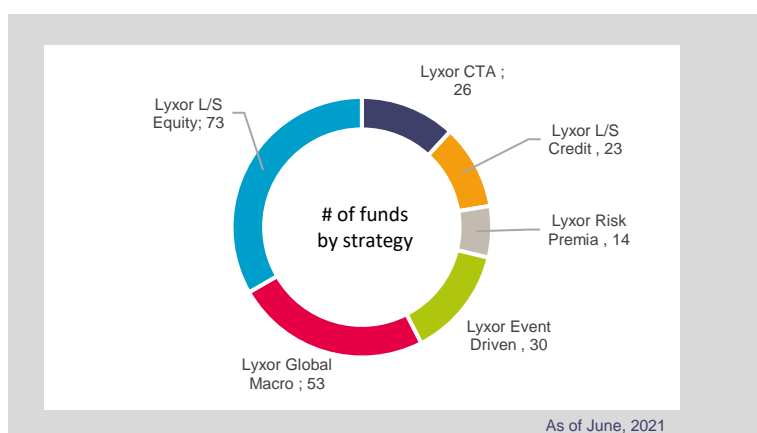
METHODOLOGICAL APPENDIX

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-of-day Friday, 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



- 219 strategies across the main categories in the industry
- USD 189 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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