# THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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# Q4 2021 HEDGE FUND OUTLOOK


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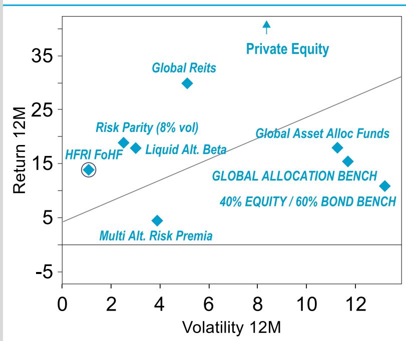
**A gradual transition toward a more 'normal' mid-cycle…** We think global growth has peaked but will remain above average, boosted by broadening consumption and surging capex. A return to more 'normal' has already started but will likely take more time than anticipated, complicated by covid variant(s), supply chains disruptions, firming inflation, more hawkish central banks and multiple political wildcards. The cycle remains modestly supportive for risk assets. In perspective, over the last 30 years, transitions to a mid-cycle usually resulted in a few months of less comfortable phase of wait-and-see, before more bullish market trends could resume.

**… has substantial implications for the alpha backdrop.** First, market sensitivity to covid trends would gradually decline, except for segments most hit by restrictions. Second, markets would be more driven by traditional macro fundamentals. Growth, inflation, productivity, leverage would be stronger market movers and asset prices would better respond to their fundamentals. Third, we expect central banks to be cautious, which would limit bond market volatility, but their uneven pace would fuel greater regional and asset discrimination. These divergences would provide a pool of relative opportunities. Fourth, as global liquidity moderate, we expect fewer trading and valuation anomalies and better capital allocations, another positive for alpha. However, the biggest wildcard would come from politics, as governments seek to withdraw stimulus, reduce inequalities, and protect strategic segments. Speculative in nature, political choices regarding fiscal spending, tax and labor regimes, regulations and allocation of public investments would be the main challenges for alpha generation.

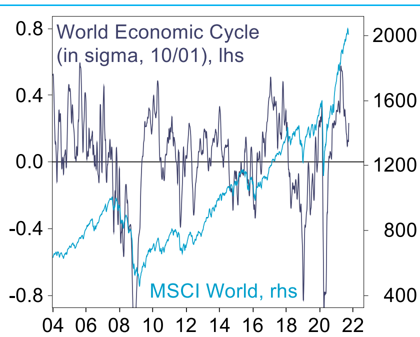
**L/S Equity: healthier alpha with potholes and less juice (→OW Diversified, ↗N Neutral).** As we return to more 'normal', stock returns would be more driven by their corporate fundamentals than by changes in valuation multiples. Less erratic quant factor rotations would set a more stable ground for alpha generation. More themes would emerge beyond covid, with corporate activity providing many price movers. Higher rates would also mean more DCF and business model differentiation. Alpha from short books would improve, less vulnerable to short-squeezes and favored by more generous valuations, primarily supporting neutral styles. However, politics would spur volatility in sectors most exposed to tax, labor and public spending changes. Richer valuations and more limited stock dispersion would also reduce the arbitrage potential.

**Event Driven: Merger Arb. and Special Situations both appealing (→OW).** The menu of merger opportunities would be plentiful both in the US and EU, with a rising share of hostile deals (riskier but juicier) and heavy private equity funding. Some deal breakups hurt merger spreads early in 2021, but they remain small in proportion. Greater regulatory scrutiny is the key risk as authorities tighten their oversight of antitrust and strategic companies. Yet, at 6% on average, deal spreads dwarf IG or dividend yields and factor higher regulatory risk, evidenced by conservative implied deal-probabilities. [*continued p2*]

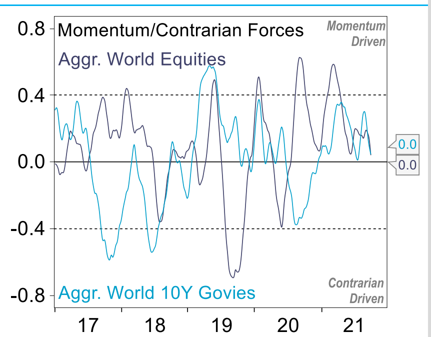
**HF in line with benchmarks**




**The economic cycle has turned**




**Markets forces will not be the same**




Sources: Bloomberg, Macrobond, Lyxor AM

LYXOR Asset Management
SOCIETE GENERALE GROUP

## Performance: Special Situations benefitted from the rebound post-Evergrande

**Lyxor UCITS Peer Group Performance**

| | Last week* | MTD | YTD |
|---|---|---|---|
| Event-Driven: Merger Arbitrage | 0.2% | 0.5% | 3.8% |
| L/S Equity Market Neutral | -0.1% | 0.2% | 3.5% |
| L/S Credit | 0.0% | 0.2% | 1.1% |
| Global Macro | -0.2% | -0.2% | 0.5% |
| Risk Premia | -0.2% | -0.4% | 6.1% |
| Global Lyxor UCITS Peer Group | 0.0% | -0.2% | 3.1% |
| Bloomberg Barclays Global Aggregate Bond Index | -0.2% | -0.6% | -0.8% |
| L/S Equity Directional | 0.0% | -0.3% | 4.7% |
| CTAs | -0.3% | -1.2% | 2.5% |
| Event-Driven: Special Situations | 0.5% | -0.4% | 9.6% |
| MSCI World | 0.3% | -0.9% | 18.6% |

*Last Week: Sep 17 to Sep 24. YTD and MTD until Sep 24. Source: Lyxor AM

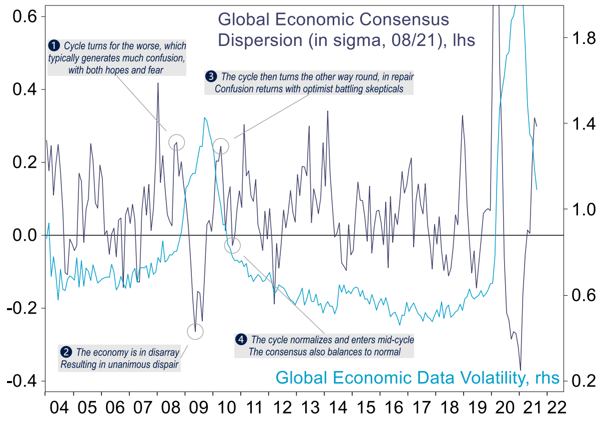
Surging risk aversion, fueled by fear that the Evergrande situation could turn systemic and by tapering concern, was brief. Markets regained their lost ground over the week, although the rebound appeared mainly technical in nature.

CTAs gave back earlier gains due to their fixed exposure and to some extent their short dollar exposures.

The rebound in value and small caps was particularly beneficial for Special Situations managers, who generated strong alpha.

## Q4 2021 Hedge Fund Outlook [*continued from p1*]

*Already on our way to a mid-cycle*




Source: Bloomberg, Lyxor AM

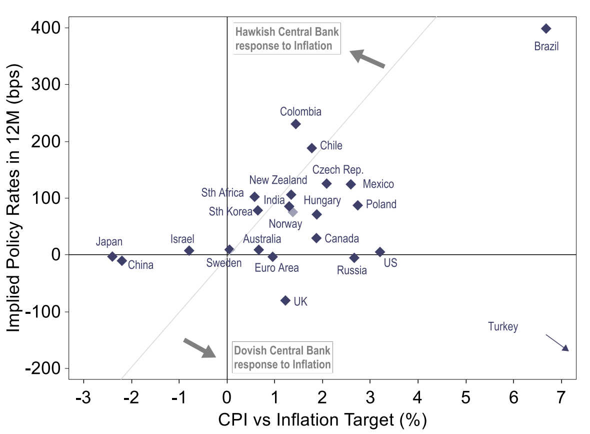
Special Situations would benefit from companies' restructuring and soaring asset sales. Multiple extraordinary shareholders meetings, where corporate changes are decided, suggest the trend is not over. Managers' exposures are modest and balanced across sectors, mitigating their market exposure. Activists, lead indicators for this segment, focus on smaller caps and are starting discussions on, or taking small stakes in, a variety of companies, suggesting they are no short of ideas. Yet, softer growth and liquidity will require more patience for trades to come to fruition.

**FI Arbitrage: EM Credit and FI Relative Value (↗OW) favored over L/S Credit (↘UW)**. Low dispersion in credit is leading managers to move to riskier issues, as well as loans and securitized credit (that are less sensitive to spreads but more sensitive to low default rate and liquidity). We see credit spreads modestly widening as we move into a mid-cycle, which would restore some alpha potential. Until then, we favor EM Credit that would benefit from diverging macro and central banks exit strategies, as well as more affordable valuations. FI relative value are also set to benefit from diverging rates and are expert in trading monetary policies.

**Global Macro: Gradual reweighting (↗OW)**. While top-down strategies usually suffer at each turn of the economic cycle, they tend to thrive afterward. As we return to more 'normal', traditional economic fundamentals would be stronger drivers, with fewer trading and valuation anomalies from excess liquidity. Declining fiscal and monetary support would accentuate regional disparities, creating relative opportunities. Diverging inflation trends and central banks, especially in EM, will be key market movers. Managers have reduced their exposures since the summer and have dry powder to benefit from these opportunities.

**CTAs: Contrasted outlook (↘N)**. We see no indication of major asset trends' pending reversals (which hurt CTAs the most). The market structure is sound, and many asset trends have recently been reset, are not overly stretched, and do not display unsustainable correlation anomalies. However, the phase of the cycle would be less supportive, with softer market directionality. A higher share of assets trading in a range could result in small but more frequent market reversals, capping CTAs' performance.

*Diverging inflation trends and central banks' exit strategies*




Source: Bloomberg, Macrobond, Lyxor AM

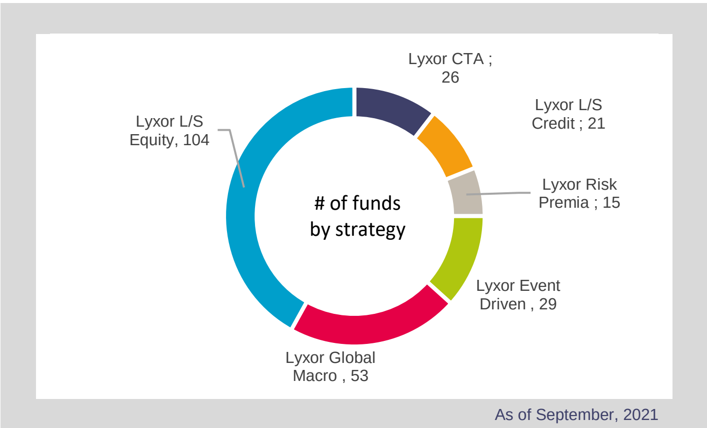
## METHODOLOGICAL APPENDIX

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-of-week, 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




- 248 strategies across the main categories in the industry
- USD 201 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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This report will be published every two weeks.

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