THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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HEDGE FUND REACTIONS TO THE CORONAVIRUS

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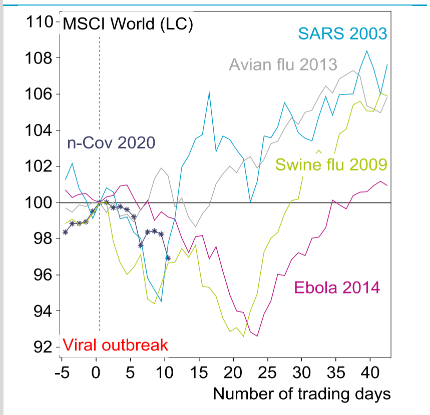
Uncertainty remains but we still expect a transitory economic impact from the Coronavirus outbreak. In a best-case scenario, authorities measures could help reverse the trend within weeks, with containment by the end of Q1. In a base-case scenario, the two-week incubation period leads to serious international contagion. Thus far the fatality rate stays low. Travel restrictions and a better understanding of the virus could lead to a resolution by the summer. An unlikely worst-case sees both world contagion and death rates soaring as authorities get overwhelmed by the number. Travel bans are increasing and manufacturing disruptions are appearing with deeper impacts on global growth.
The coronavirus could take a greater toll on Chinese consumption than during the 2003 SARS outbreak (closest proxy for now), as it is unfolding over the peak holiday season, and the hit to spending from the lockdown might be deeper. On the positive side, authorities reacted faster, and today's virus seems less deadly. The impact on global growth is likely to be transitory and policymakers still have fiscal and monetary ammunitions to counter the fallout.

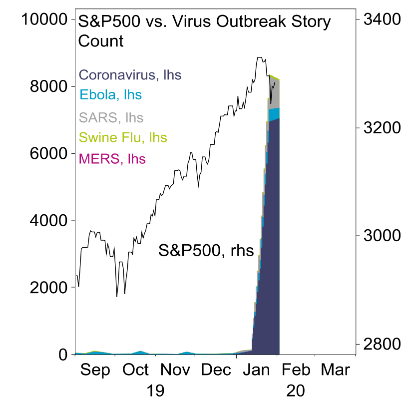
Market reaction has been measured so far, focusing on sensitive segments. DM markets receded -3%. Chinese equities were hit -8%. USD, JPY, CHF rallied at the expense of EUR and EM FX. DM 10Y govies dropped about 20 bps. Sector wise: energy, materials, consumer cyclical, value suffered the most, unlike safe haven utilities, growth, healthcare.

Hedge funds trimmed their most exposed positions but are looking for entry points. **Global Macro** managers marginally reduced their risk and added treasuries. Markets, implicitly pricing Chinese GDP below 5%, are seen as oversold by some managers. **CTAs** marginally increased their overall risk through U.S. and Asian equities, hedged with U.S. treasuries and gold exposures. They are now short energy but still neutral on base metals. A majority of **L/S Equity** managers shaved off their consumer discretionary, material, energy, airlines exposures, and Asian most virus-sensitive stocks. Else, they didn't change portfolios materially and are waiting for entry points. In particular, we find that Chinese Equity UCITS lost about -6% and were highly correlated. They marginally increased their exposures, suggesting oversold equity conditions in China. **Event Driven** managers broadly stayed put with no meaningful changes to their portfolios.

Half way?



Looking for a peak in media buzz



Chinese funds holding ground

Sources: Bloomberg, Macrobond, Lyxor AM

PERFORMANCE

Hedge Funds Resilient as the Virus Outbreak Hit Markets

Lyxor UCITS Peer Group Performance

	Last Week*	MTD	# of funds
Bloomberg Barclays Global Aggregate Bond Index	0.7%	1.4%	
MSCI World	-1.3%	1.3%	
CTAs	-0.7%	1.2%	25
L/S Credit	0.0%	0.6%	29
Risk Premia	-0.4%	0.5%	21
Event-Driven: Merger Arbitrage	0.0%	0.4%	22
Global Lyxor UCITS Peer Group	-0.4%	0.3%	239
L/S Equity Directional	-0.8%	0.1%	63
L/S Equity Market Neutral	-0.3%	0.1%	29
Global Macro	-0.3%	0.0%	43
Event-Driven: Special Situations	-0.9%	-0.7%	7

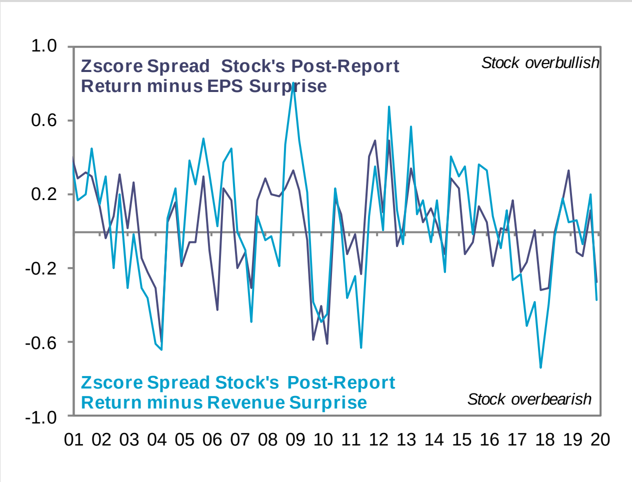
*Last Week: Jan 21st to Jan 28th. MTD and YTD as of Jan 28th Source: Lyxor AM

The coronavirus continues to put markets on alert as the growth of confirmed cases is not showing signs of abating yet. Global equities slid this week as well as govies yields.

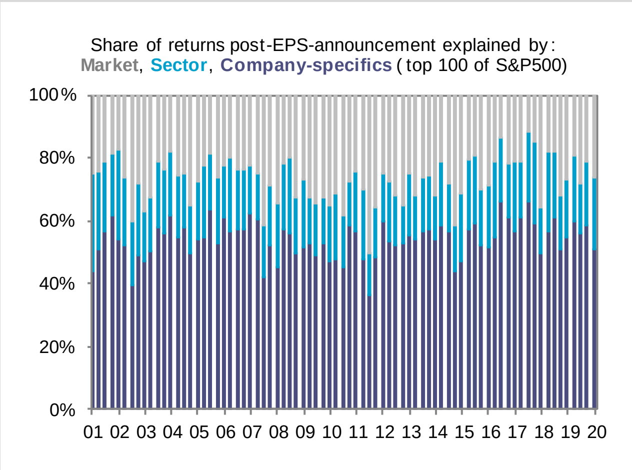
CTAs, Special Situations, and L/S Equity Directional suffered the most from their long equity exposures. CTAs maintained their equity exposures, hedged with additional long fixed income positions. They outperformed cyclical assets this week.

Since the beginning of the year, hedge fund strategies remained in positive territory, except Special Situations.

A Mixed Earnings Season for Alpha



Source: Bloomberg, Lyxor AM



Source: Bloomberg, Lyxor AM

Earnings seasons provide valuable insights on alpha. They track inflections in business dynamics, which are key catalysts for stock selection. They also provide a barometer on investors' readings on and interest for companies' fundamental changes, with limited noise from other factors. With half of the S&P 500 companies having reported their earnings, the sample is now large enough to start drawing conclusions.

The backdrop for earnings in Q4 improved vs. Q3, thanks to a modest economic inflection, improving foreign activity and resilient domestic conditions. With analysts' downward revisions slightly more aggressive than average (-4%) and companies' more cautious guidance, the aggregated estimated EPS for Q4 is seen declining -1.5% y/y. Well-managed corporate expectations and profit warnings are leading to a healthy beat ratio.

Investors look slightly disappointed, witnessed by stock returns a few days before announcement down -0.7% on average. Reports were decently welcome as stock returns after-report were flat, above the S&P 500 down -0.3% on the same periods. Limited stock volatility around announcements suggest a slight lack of interest.

Pure stock-selection alpha conditions are weak so far, with prices over-bearish relative to the dynamics of their fundamentals. The weak share of stock returns after announcement deriving from company-specific developments, aside from broader market moves is not helping either.

However, reports from L/S Equity managers suggest the alpha from market timing (low exposures early this year paid off) and from sector positioning (favoring growth, quality, tech, healthcare) was more rewarding than stock-picking.

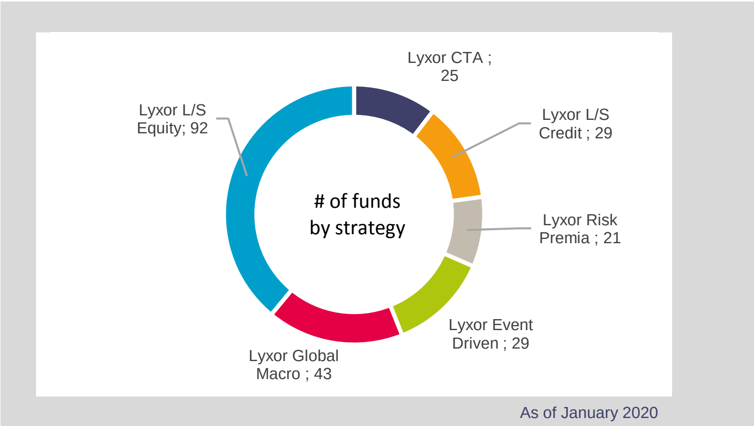
METHODOLOGICAL APPENDIX

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



- 239 strategies across the main categories in the industry
- USD 207 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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