THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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MERGER ARB UNSCATHED BY RENEWED TRADE TENSIONS

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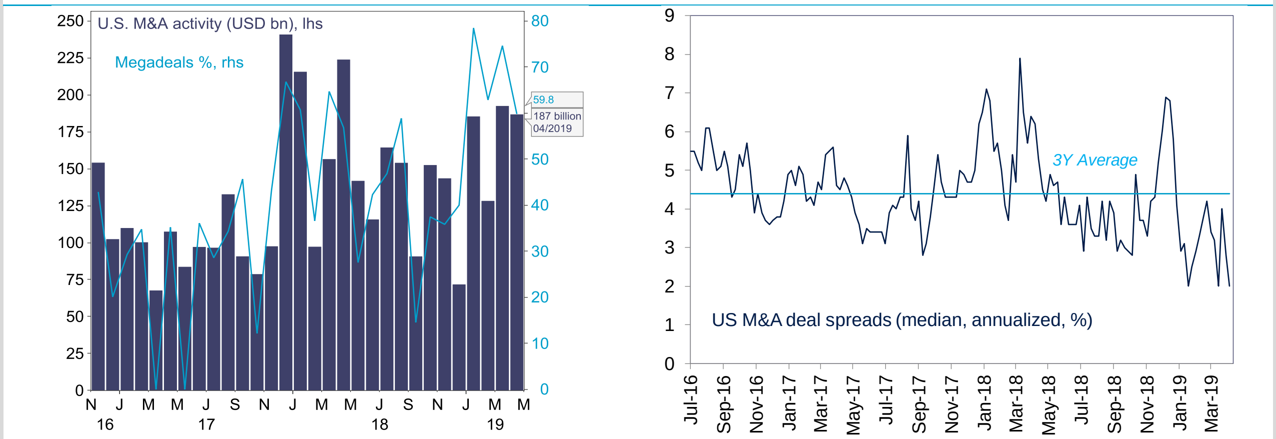
Renewed trade tensions took a toll on risk assets last week as the U.S. threatened and eventually increased trade tariffs on imports from China. The MSCI World fell by -2.4% between May 3rd and May 10th, dragged down by Japanese and European stocks which are more sensitive to global trade conditions than the U.S. market is. Meanwhile, the MSCI EM was down -4.3% as Chinese stocks plummeted. Credit markets' performance was relatively resilient despite a widening in High Yield spreads in Europe and the U.S. (approximately 30bps). EM Sovereign Credit spreads widened by a mere 15bps (EMBI Global Diversified).

In the hedge fund space, the numbers reported are up to May 7th. They capture the initial downward market movement and suggest that the industry was overall resilient. Directional L/S Equity and CTAs underperformed but the hit was largely contained (approximately -0.7%). CTAs benefitted from their long fixed income positioning which helped protect portfolios. Meanwhile, L/S Credit was flat, and Merger Arbitrage managed to deliver positive returns (+0.1%). The worst performing alternative strategy among the 240 that is monitored in this report was a Global Macro, down -3.1%.

Merger Arbitrage again demonstrated its ability to deliver positive returns in adverse conditions. This is a strategy on which we have maintained an Overweight stance over the recent quarters despite the recent underperformance. M&A volumes remained strong in the U.S. in April and rebounded in Europe. Deal spreads are tight, and this is a headwind. However, the strategy is so defensive and uncorrelated with broader market movements that we strongly reaffirm the Overweight stance.

Going forward, the financial environment is increasingly uncertain. After the year-to-date rally in risk assets, we believe that the trade war escalation between the U.S. and China is a valid reason to take profits and reduce risk in portfolios. We also believe that both countries will eventually find an agreement, but such agreement could take place after intense market pressure. Under such conditions, Merger Arbitrage is expected to do well. Finally, the associated fall in bond yields also supports our preference for carry strategies such as L/S Credit and EM-focused Global Macro strategies.

Merger Arb: U.S. M&A volumes a tailwind but deal spreads a headwind. On balance we stay O/W



Megadeals are deals whose equity value is above USD 5bn. Deal universe includes spreads in the 0-30% range. Sources: Eikin, UBS, Macrobond, Lyxor AM

PERFORMANCE

Hedge fund strategies were resilient as trade tensions flared up

Lyxor UCITS Peer Group Performance (%)

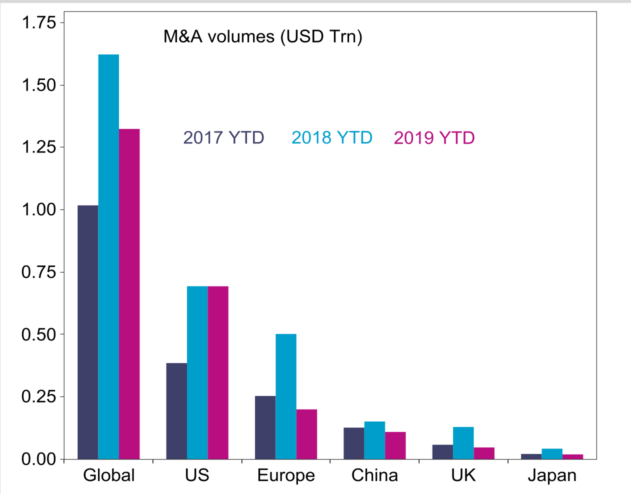
	Last Week*	April	YTD**	# of funds
Bloomberg Barclays Global Aggregate Bond Index	0.2%	0.1%	3.3%	
Event-Driven: Merger Arbitrage	0.1%	0.4%	2.0%	17
L/S Credit	0.0%	0.9%	3.2%	30
L/S Equity Market Neutral	-0.1%	-0.5%	-0.1%	37
Global Macro	-0.4%	1.1%	3.2%	40
Global Lyxor UCITS Peer Group	-0.4%	0.8%	2.9%	240
Event-Driven: Special Situations	-0.4%	1.6%	5.3%	7
Risk Premia	-0.4%	0.2%	2.2%	21
CTA	-0.7%	1.6%	4.2%	26
L/S Equity Directional	-0.7%	1.3%	4.3%	62
MSCI World	-1.9%	3.8%	14.8%	

*Last Week from 04/30/2019 to 05/07/2019. **YTD as of 05/07/2019. Source: Lyxor AM

Rising trade tensions between the U.S. and China dragged equity markets lower globally during the first week of May. Hedge funds were not spared as most strategies delivered negative returns. The worst performing strategies were the best-performing ones in April, namely CTAs and L/S Equity Directional. Such strategies still managed to outperform the MSCI World last week and losses were overall contained.

Merger Arbitrage and L/S Credit outperformed, with flat and slightly positive returns last week, respectively. Meanwhile, U.S. and Global L/S Credit strategies outperformed European ones. Finally, Merger Arbitrage demonstrated its ability to generate returns under unstable market conditions again. The best performing Merger Arbitrage strategy was up +0.7%; the worst performing one was down -0.8% last week.

Global M&A volumes down approximately -20% so far in 2019 vs. 2018, but U.S. activity stays buoyant

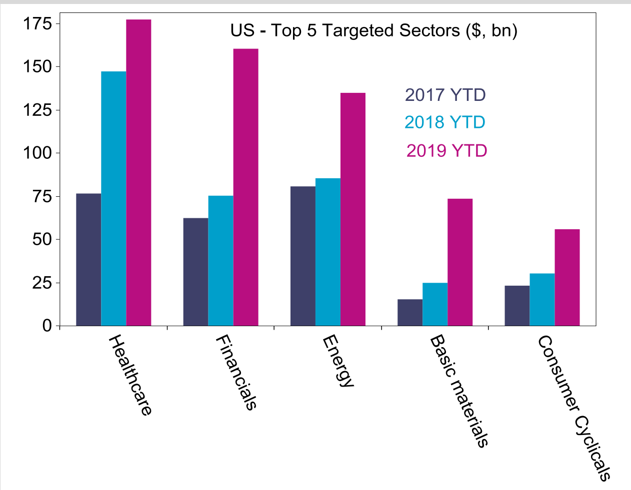


As of end-April 2019. Source: Eikon, Macrobond, Lyxor AM

M&A volumes have declined year-to-date vs. the same period last year. Yet, such decline has been mainly due to the 60% fall in volumes in Europe since mid-2018. Volumes in the UK have fallen by the same order of magnitude (63%). However, in the U.S. M&A volumes have remained strong and on par with volumes last year.

Such geographical dispersion is likely to support U.S.-focused Merger Arbitrage strategies vs. European ones. Historically, it has proved challenging to establish a statistical link between M&A volumes and Merger Arbitrage performance. However, it appears that Merger Arbitrage portfolios are more diversified, and thus less vulnerable to idiosyncratic deal breaks, when volumes are elevated.

Healthcare, financial, and energy sectors experienced a strong pace of consolidation in the U.S.



As of end-April 2019. Source: Eikon, Macrobond, Lyxor AM

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To some extent, this reflects Event-Driven portfolios, which have been heavily exposed to the healthcare sector. However, Event-Driven managers appear to avoid financials despite strong M&A volumes.

In Europe, healthcare and financials have also experienced strong volumes year-to-date, in relative terms. They are nonetheless below the levels observed in 2018 during the same period. There is a sector in Europe which is experiencing a faster pace of consolidation compared to last year, which is the Technology sector.

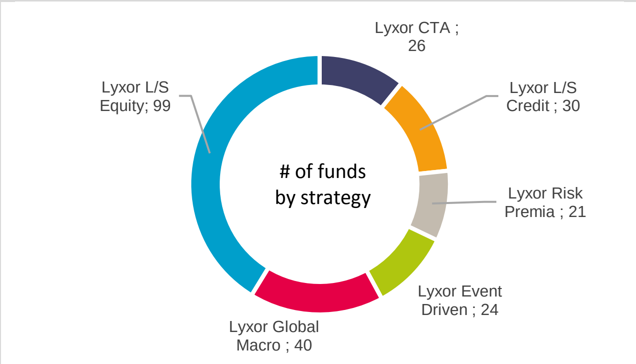
METHODOLOGICAL APPENDIX

The information contained in this report on the performance of onshore 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, 2019

- 240 strategies across the main categories in the industry
- USD 238 billion of assets under management

Criteria of inclusion

The criteria of inclusion are fourfold:

i) We only include UCITS strategies;

ii) Strategies are assessed and categorized based on fund prospectuses;

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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