THE WEEKLY BRIEF

By LYXOR CROSS ASSET RESEARCH

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WHAT'S BEHIND THE RALLY IN GLOBAL MACRO STRATEGIES

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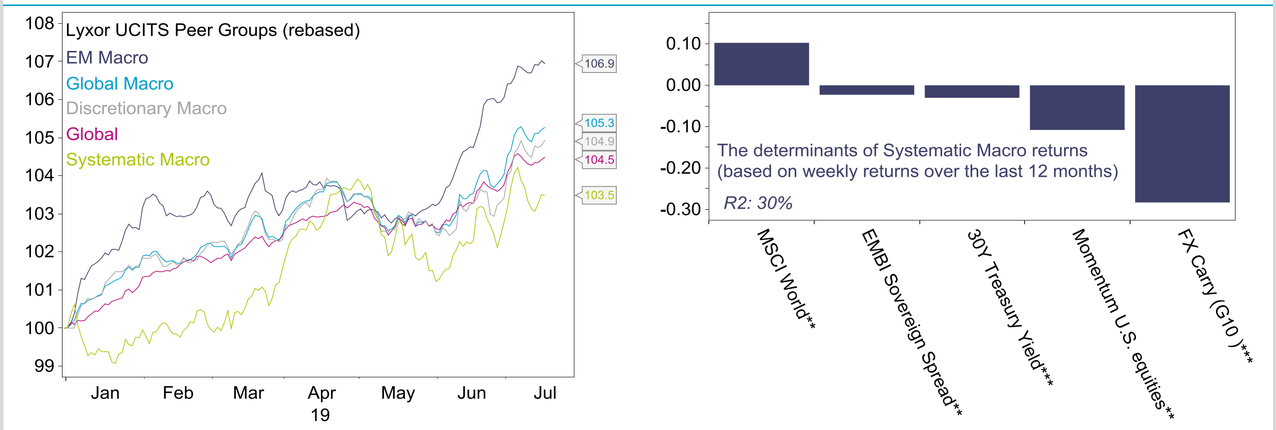
According to our estimates, CTA and Global Macro strategies have so far extended their winning streak in July. While we recently talked about the reasons for the outperformance of CTAs (+9.3% year-to-date), the performance of Global Macro strategies is a bit more ambiguous, due to the elevated dispersion between strategies.

Global Macro strategies are up +5.3% year-to-date according to the Lyxor Global Macro Peer group, which pools together 40 UCITS strategies. A significant part of such performance has been delivered by Emerging Markets ("EM") strategies (+6.9%), while Discretionary and Systematic ones lagged (+4.6% and +3.5% respectively). This was hopefully in line with our expectations. Our stance on EM-Macro has been Overweight for several months, while were more defensive on Discretionary (at Neutral) and Systematic strategies (at Underweight).

The factors behind EM-Macro returns are quite immediate. We explain the bulk of their returns over the past 12 months with two variables: an EM Currency Index and an EM Hard Currency Sovereign Bond Index. Concurrently, Discretionary managers' returns during the same period can be partly explained by: i) curve flattening trades in the 2-10y segment in the U.S., ii) buying positions on EM assets (FX, bonds, equities), and iii) selling positions on FX carry and long-dated Treasuries (30 year). However, it is trickier to explain the returns of Systematic strategies. Despite our efforts, we manage to explain only 30% of their recent returns with five variables: i) buying positions on global developed equities and long-dated Treasuries, ii) selling positions on the momentum equity risk factor and FX carry and, iii) positions which benefit from a tightening of EM sovereign spreads.

Going forward, we upgrade our stance on Global Macro strategies from Underweight to Neutral. We particularly upgrade Systematic Macro strategies to Neutral on the back of the Fed managing to lift growth expectations. We believe the Fed has both the room and the willingness to act and push forward our expectation for the first rate cut to the end-July FOMC meeting. Meanwhile our stance on EM sovereign bonds stays constructive and we upgraded U.S. equities to Overweight. Our scenario assumes that the trade truce will be extended since the U.S. administration is cornered by the presidential election next year. Trade uncertainty has caused a growth deceleration. Further escalation could dip the U.S. economy into a recession.

Upgrade Systematic Global Macro to Neutral from Underweight



*** Significant at 99% confidence level. ** Significant at 95% confidence level. Source: Macrobond, Bloomberg, Lyxor AM

PERFORMANCE

A rising tide lifts all boats

Lyxor UCITS Peer Group Performance

	Last Week*	MTD**	YTD**	# of funds
MSCI World	0.5%	1.8%	19.2%	
Global Macro	0.3%	1.2%	5.3%	40
CTAs	-0.2%	1.2%	9.3%	25
Risk Premia	-0.1%	0.9%	3.4%	21
Event-Driven: Special Situations	0.4%	0.8%	6.5%	7
Global Lyxor UCITS Peer Group	0.2%	0.7%	4.5%	243
L/S Equity Directional	0.3%	0.7%	5.5%	61
L/S Credit	0.2%	0.4%	4.8%	31
Event-Driven: Merger Arbitrage	0.1%	0.4%	2.0%	22
L/S Equity Market Neutral	0.2%	0.2%	0.6%	36
Bloomberg Barclays Global Aggregate Bond Index	-0.2%	0.0%	6.0%	

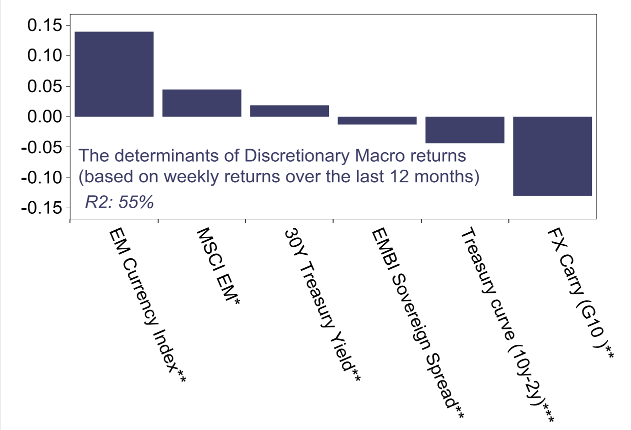
*Last Week: July 9th to July 16th. **MTD & YTD as of July 16th. Source: Lyxor AM

Halfway through the month, equity markets reached new highs (MSCI World up +1.8% MTD as of July 16th), while bond markets stayed unchanged. This has been supportive for high beta strategies such as L/S Equity Directional (+0.7%) and Special Situations (+0.8%).

The best performing strategies were CTAs and Global Macro (+1.2%). They benefitted from higher stock prices and U.S. Dollar appreciation. Macro strategies also benefitted from the slight steepening of the Treasury curve as U.S. data releases have demonstrated better than expected.

Hedge fund strategies generally delivered positive returns on a month-to-date basis. The Global Peer Group was up + 0.7%. L/S Credit underperformed. Merger Arbitrage and Market Neutral continued to lag.

EM Macro outperformance explained by their long EM markets bias



*** Significant at 99% confidence level. ** Significant at 95% confidence level. * Significant at 90% confidence level. Source: JP Morgan, Bloomberg, Macrobond, Lyxor AM

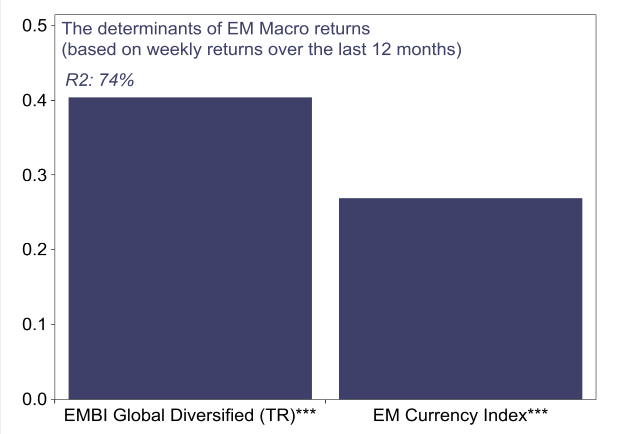
Discretionary Macro managers' returns have been reasonably good so far this year (+4.9%).

Over the past twelve months, we can partly explain their returns by: i) curve flattening trades in the 2-10y segment in the U.S., ii) buying positions on EM assets (FX, bonds, equities), and iii) selling positions on FX carry and long-dated Treasuries (30 year). All these variables are statistically significant.

The estimated coefficients suggest that a flattening of the Treasury curve by 10bps would fuel Discretionary Macro returns by +0.4% while a rise in 30Y Treasury yield would fuel returns by +0.2%.

These variables contribute to explain 55% of Discretionary Macro strategies' returns over the past 12 months.

EM Macro performance explained by their long market bias



*** Significant at 99% confidence level. Source: JP Morgan, Bloomberg, Macrobond, Lyxor AM

EM Macro strategies have delivered strong returns so far this year, in a context where the Fed monetary turnaround has fueled EM sovereign bond indices. More recently, EM currencies also appreciated vs. the USD. These two factors appear to be critical for EM Macro strategies.

We explain the bulk of their returns over the past 12 months with two variables: an EM Currency Index and an EM Hard Currency Sovereign Bond Index, both highly significant statistically. The estimated coefficients suggest that a +1% performance of EM sovereign bonds translate into a +0.4% performance for EM-Macro strategies. Concurrently, a +1% performance of EM currencies vs. USD fuels EM Macro returns by +0.27%.

Our stance on EM bonds stay constructive in a context where dovish central banks and the associated search for yield should compress EM Risk Premia.

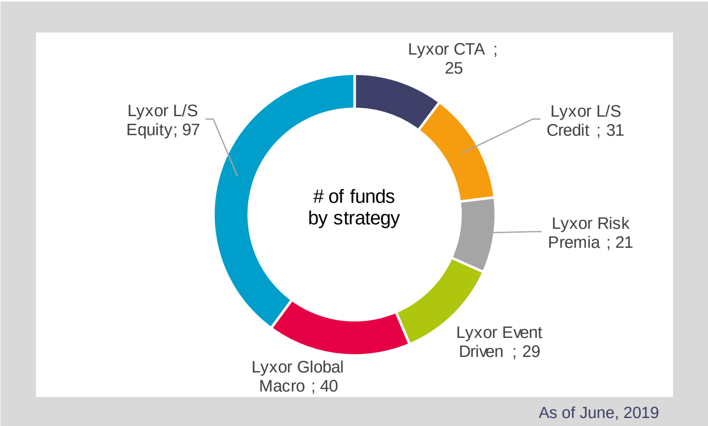
METHODOLOGICAL APPENDIX

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



- 243 strategies across the main categories in the industry
- USD 233 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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