THE WEEKLY BRIEF

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MERGER ARBITRAGE STAYS PUT DESPITE POLITICAL MEDDLING

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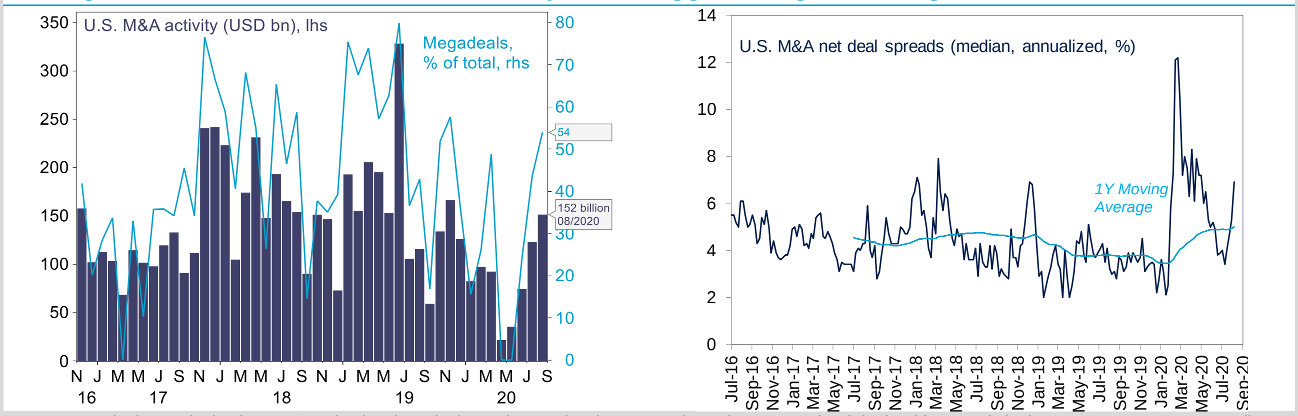
Over the recent months, the rally in risk assets pushed equity valuations to unprecedented levels since the early 2000s, leading investors to ponder whether this is a good time to reduce risk in portfolios. Yet, the likelihood that the Fed will extend asset purchases at the next FOMC meeting on September 16th suggests investors should not play too defensive. With bond yields not far from all-time lows in the U.S. and Europe, the opportunity set within defensive assets is reduced as well.

Merger Arbitrage strategies have the potential to provide alternative options vs. traditional safe assets in an effort to reduce risk in portfolios. Historically, it is a strategy with a low correlation to equities. According to our estimates, the strategy was flat in August when equities rallied but it was also immune to recent Tech-related turbulence.

In the past few days, some headwinds appeared, as the USD 16.5bn LVMH vs. Tiffany proposed merger was put in the middle of U.S./French trade negotiations. The French government directed LVMH to push the deal closing to after January 6th, 2021 (after the stated deadline in the merger agreement) due to potential U.S. imposed tariffs on French goods that would go into effect in January 2021. The potential deal break translated into a -6.4% fall in Tiffany's stock price on September 9th. However, the positioning of Merger Arbitrage strategies on the deal was limited. According to our estimates based on almost 20 strategies, their performance on the very same day was on average -15bps. Fund managers expect that the deal will happen but at a lower price tag vs. the USD $135 per share initial offer from LVMH. Overall, it is important to note that political interference in the world of Merger Arbitrage is not new. In recent years, trade wars already posed downside risks to deal completions. Yet, by construction the strategy is seasoned in evaluating policy risks and adjusting positioning adequately.

Going forward, higher U.S. M&A volumes and wider deal spreads broadened the opportunity set for the strategy on which our stance remains Overweight. Some recent notable deal announcements include Livongo Health/ Teladoc Health; Varian Medical Systems/ Siemens Healthineers; Principia Biopharma/ Sanofi; Sunrise Communications/ Liberty Global; and Momenta Pharmaceuticals/ Johnson & Johnson. They range from friendly to complex situations, with spreads that were moderately attractive when deals were announced.

Rising U.S. M&A volumes and wider deal spreads suggest Merger Arbitrage remains attractive



Megadeals are deals above USD 5bn (equity value). Deal spread estimates are based on a sample of deals with spreads in the 0-30% range Sources: Eikon, Macrobond, Lyxor AM

Hedge Fund Performance: Directional Hedge Fund Strategies Outperformed in August

Lyxor UCITS Peer Group Performance

	MTD	August	YTD
Bloomberg Barclays Global Aggregate Bond Index	0.2%	-0.7%	4.4%
L/S Credit	0.1%	0.7%	0.7%
Event-Driven: Special Situations	0.0%	2.2%	-6.1%
Global Macro	0.0%	0.8%	-1.5%
Event-Driven: Merger Arbitrage	0.0%	0.1%	-2.1%
L/S Equity Market Neutral	-0.2%	0.0%	-1.3%
Risk Premia	-0.3%	0.2%	-9.5%
Global Lyxor UCITS Peer Group	-0.3%	0.7%	-2.6%
L/S Equity Directional	-0.7%	1.9%	-2.1%
CTAs	-0.9%	-0.9%	-3.9%
MSCI World	-1.9%	6.3%	2.4%

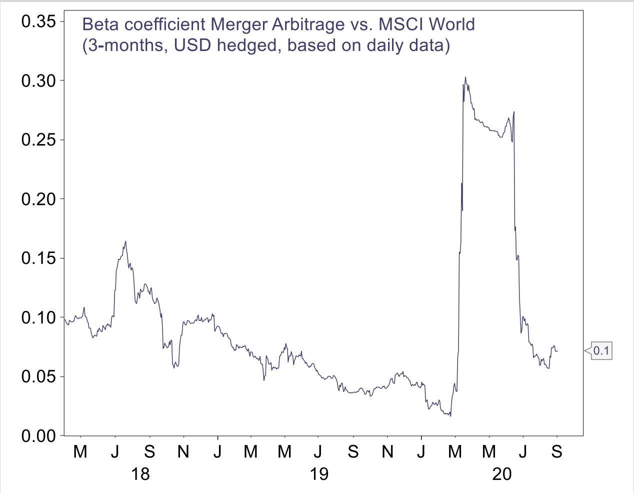
As of September 4th. Source: Bloomberg, Lyxor AM

The rise in risk aversion early September had moderate implications on hedge fund performance overall, though some strategies posted negative returns.

CTAs and Directional L/S Equity strategies underperformed, down -0.7% and -0.9% month-to-date (as of September 4th). CTAs suffered due to their long equity positioning but also from their short USD positions.

The remaining strategies were flat, with L/S Credit still outperforming on a year-to-date basis, up +0.7%.

Equity Market Beta Of Merger Arbitrage Strategies Remains Low

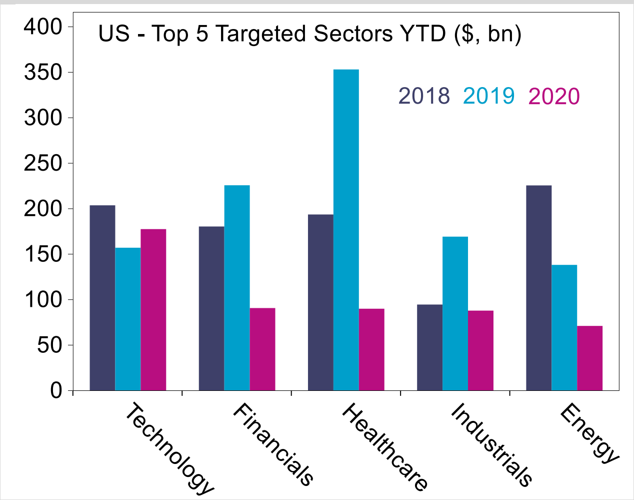


Source: Macrobond, Lyxor AM

The equity market beta of Merger Arbitrage strategies has remained at low levels over the past two months compared to those recorded over the course of Q2-2020. This contributes to explain why Merger Arbitrage strategies did not capture the market rebound in July and August and also why they were immune to the recent rise in equity volatility early September.

The current market beta came down from unusual levels in late Q1-2020 and early Q2-2020 when the selloff due to the COVID-19 lockdowns disrupted usual correlation regimes. Yet, the current level of the market beta is rather in line with those prevailing historically. This contributes towards explaining why Merger Arbitrage has, in the past, been a defensive strategy with an outstanding track record when risk assets experience wide moves. In our view, the strategy remains attractive to diversify portfolios at a time when rich valuations across traditional asset classes have investors uncomfortable.

M&A Volumes are Down but Activity Remains Concentrated in Technology, Financials, and Health Care



Source: Bloomberg, Macrobond, Lyxor AM

Global M&A volumes are down -30% year-to-date compared to the same period last year (as of end-August), with U.S. M&A volumes experiencing a contraction in excess of 50%.

Yet, U.S. M&A volumes have recovered in recent months. Deal announcements reached USD 150bn in August according to Refinitiv, which is in line with average monthly volumes in 2019.

From a sector perspective, Technology, Financials, and Health Care continue to experience the bulk of the activity in the U.S. But while volumes in the Technology sector progressed in excess of 10% in 2020 vs. 2019 YTD, volumes in sectors such as health care fell by 75%.

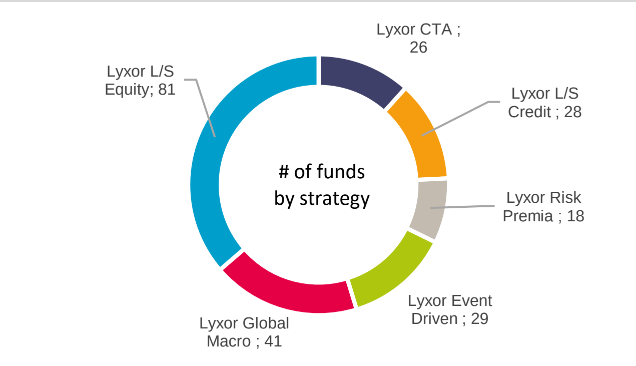
METHODOLOGICAL APPENDIX

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



As of September, 2020

- 223 strategies across the main categories in the industry
- USD 174 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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