Value Stocks Lose Steam But Active Managers Stay Afloat

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On a regular basis the weekly brief is expanded with inputs from our team of mutual fund analysts. This week we focus on the recent outperformance of value equity funds versus their benchmarks.

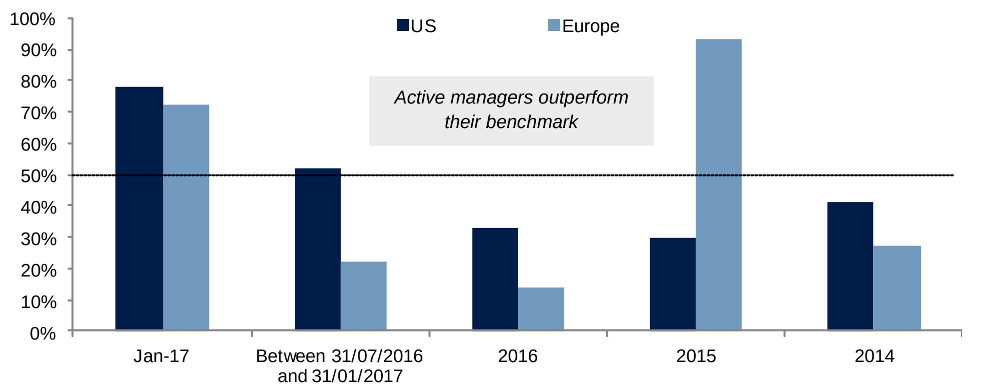
Value stocks have lost steam in early 2017 as market exuberance faded and investors reappraised the risks of trade wars. The renewed underperformance of value stocks has taken many investors by surprise as it follows a sharp rebound in the last quarter of 2016. The January reversal has been particularly abrupt in the U.S. The MSCI USA Value underperformed the market by 2% and the MSCI USA Growth by 4%.

Active investors have nonetheless been able to stay afloat (see p.5). Based on a sample of 86 value funds invested in the U.S., we find that the majority outperformed their benchmark in January. In Europe, we find a similar proportion of value biased mutual funds outperforming last month. Yet, the recent success of active investing is too short to draw robust conclusions. During recent years, funds with a value or growth bias systematically underperformed their benchmarks, in particular in the U.S. (see chart below). Such developments also highlight the fact that 2017 will, in our opinion, remain a challenging year for investors. Political risks loom large in Europe and policy uncertainty is elevated in the U.S. Although we believe that value investing has the potential to regain strength in the coming months, we also believe that the margin of error is significant and such risks need to be diversified.

With regards to hedge fund performance, we discussed in the previous edition of this report the fact that January saw mixed returns (-0.4%). In particular, trend reversals negatively impacted CTAs (-2.9% in January). During the first week of February, hedge fund performance improved markedly. The Lyxor hedge fund index was up 0.4% last week and all strategies were in positive territory. Event Driven outperformed (0.5% last week) on the back of the solid returns delivered by Special Situations funds. It is also interesting to note that market neutral L/S Equity managers are faring much better now compared to last year. Finally, the best performing hedge fund in our sample year to date is an Asian credit fund, up 6.2% and a L/S Equity manager with a value bias, up 3.7%. On the negative side, long term CTAs underperformed, but some short term and medium term CTAs are up 2% year to date.

Value funds smoothed the reversal in value stocks in January

% of value mutual funds beating their benchmark (large caps funds)



Universe of funds available for sale in Europe. Based on a sample of 86 funds for the U.S. and 113 funds for Europe. The benchmarks are respectively the MSCI USA Value and the MSCI Europe value (net total return in USD and EUR resp.). Source: Morningstar, Lyxor AM

HEDGE FUNDS AT A GLANCE

Hedge Fund Snapshot

	WTD*	Jan	YTD
Lyxor Hedge Fund Index	**0.4%**	**-0.4%**	**0.1%**
CTA Broad Index	0.4%	**-2.9%**	**-2.5%**
Event Driven Broad Index	**0.5%**	0.3%	0.8%
Fixed Income Broad Index	**0.1%**	**0.8%**	**0.9%**
L/S Equity Broad Index	0.3%	-0.3%	0.0%
Global Macro Index	0.4%	-0.8%	-0.4%
MSCI World Index	*0.6%*	*0.5%*	*1.1%*
Barclays Global Agg Bond Index	*0.2%*	*0.1%*	*0.2%*

*From 31 January to 07 February 2017

Event Driven led the pack

The Lyxor hedge fund index was up 0.4% last week and all strategies were in positive territory.

Event Driven outperformed (0.5%) on the back of the solid returns delivered by Special Situations funds.

Within the L/S Equity space, it is interesting to note that market neutral and variable bias managers are faring much better compared to last year.

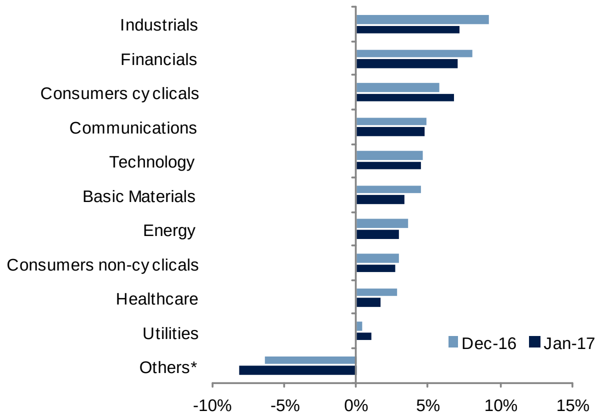
Fixed Income Arbitrage and L/S Credit underperformed last week, though our index is in positive territory. The strategies continued to outperform on a year to date basis.

L/S EQUITY

	WTD*	Jan	YTD
L/S Equity Broad Index	**0.3%**	**-0.3%**	**0.0%**
Long Bias	0.0%	-0.3%	-0.3%
Market Neutral	0.8%	0.5%	1.3%
Variable Bias	0.6%	1.2%	1.8%

*From 31 January to 07 February 2017

Managers have been cutting their exposures on most sectors
Net Exposure to Equities, % NAV



As of January 31st. Equally weighted. Source: Lyxor AM
*Others include indices, funds, diversified

Focus on growth stocks

Global equities ended the week in positive territory thanks to supportive macro data. Yet, L/S Equity funds reduced their net exposure over the last month, following the recent rise of uncertainty.

US-centric funds outperformed, buoyed by positive earnings surprises. As corporate earnings forecasts improved, investors increased their focus on growth stocks. As a result, growth-oriented managers outperformed last week. Long holdings in technology, industrials and healthcare were among the best contributors.

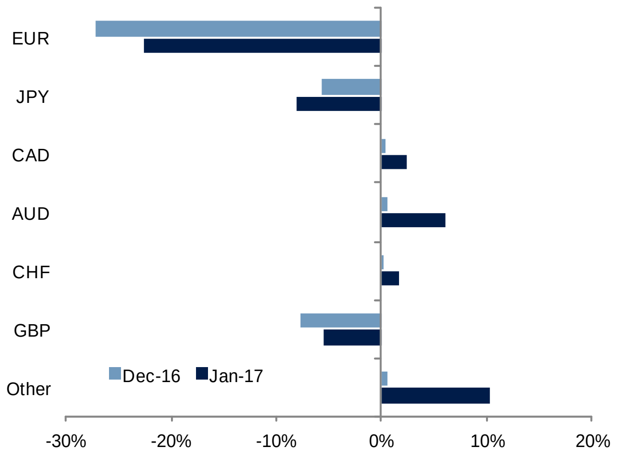
European equities proved resilient despite higher risks on the political front. European L/S Equity managers did well as their long books benefitted from positions on the technology sector, while financials detracted from performance. Overall, performance was more driven by idiosyncratic factors rather than top down themes.

CTAs

	WTD*	Jan	YTD
CTA Broad Index	**0.4%**	**-2.9%**	**-2.5%**
CTA Long Term	0.4%	-3.1%	-2.7%
CTA Short Term	-0.1%	0.0%	-0.1%

*From 31 January to 07 February 2017

Short EUR vs. USD were supportive for CTAs
Net Exposure to FX vs. USD, % NAV



As of January 24th, Equally weighted. Source: Lyxor AM

Starting February on the right foot

CTAs entered February on a positive note, partly offsetting earlier losses. The main drivers of performance were a stronger dollar versus the euro and higher stock markets on both sides of the Atlantic.

The currency bucket was profitable. Lower bond yields in Europe overall pushed the EUR lower versus USD. As such, the net short positioning of the strategy on the common currency proved quite profitable.

Returns from equities were contrasted for short and long term CTAs. While gains in U.S. and European indices dragged down the performance of short-term systems, medium and long-term funds benefited from such moves.

The fixed income area experienced disparate outcomes. The parallel downward shift of the U.S. curve impacted returns negatively. However, higher prices for long-term Gilts and Bunds were beneficial for some models.

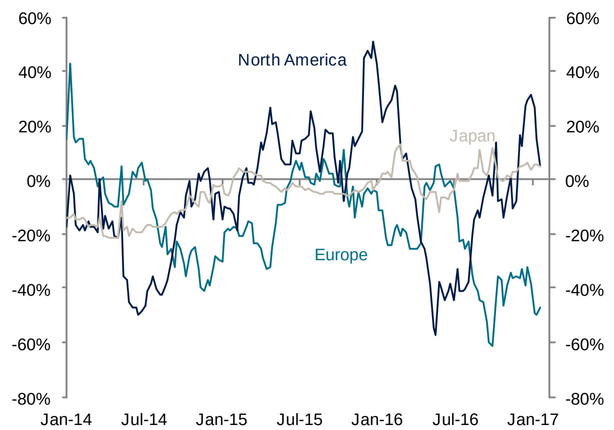
Returns from the commodity bucket were flat as gains from agriculturals were counterbalanced by losses on energy positions.

GLOBAL MACRO

	WTD*	Jan	YTD
Global Macro Index	**0.4%**	**-0.8%**	**-0.4%**

*From 31 January to 07 February 2017

Lower bond yields in the U.S. generated gains for Macro funds
Net Exposure to fixed income, % NAV



As of January 24th. Equally weighted. Source: Lyxor AM

Rates and FX proved supportive

Managers started February positively. The depreciation of the EUR vs. USD and lower bond yields in the U.S. were the main factors behind the positive returns.

The FX bucket proved supportive last week. The EUR fell vs. USD, which benefited the short exposure on the common currency of most portfolios.

Fixed income also added to performance. Lower bond yields in the UK detracted, but gains from long U.S. duration brought the average contribution of the asset class to the positive side.

The commodities bucket, and in particular energy positions, detracted from performance. Long positions on base metals also suffered on the back of lower copper prices, despite supply risks stemming from strikes in Chile.

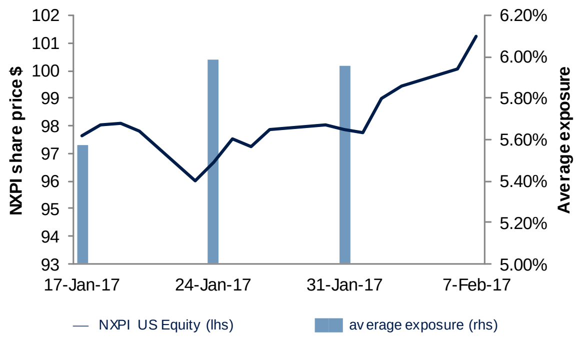
Equities also contributed negatively. Losses originated from short positions on U.S. indices, which were up for the week.

EVENT DRIVEN

	WTD*	Jan	YTD
Event Driven Broad Index	**0.5%**	**0.3%**	**0.8%**
Merger Arbitrage	0.3%	-0.1%	0.1%
Special Situations	0.7%	0.7%	1.4%

*From 31 January to 07 February 2017

US technology stocks contributed to Event Driven gains
Average Net Exposure to NXPI, % NAV



Equally weighted. Source: Bloomberg, Lyxor AM

A solid start to the month

Event driven funds were up over the week, extending their YTD gains.

Special Situations' gains were driven by managers' investments in technology, consumer non-cyclical and energy. Computer science stocks were among the best contributors on the back of positive earnings reports. Other contributors included Bristol-Myers Squibb and Energy Transfer Partners.

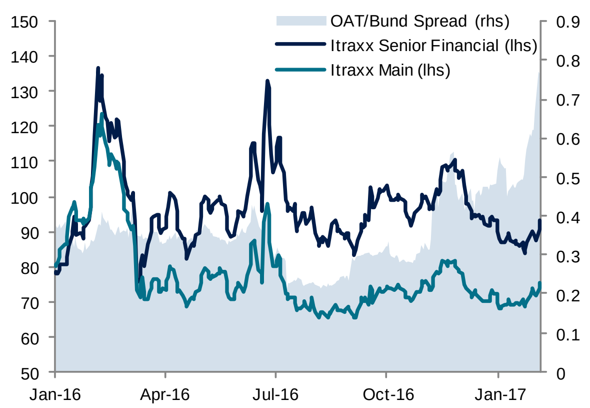
In the Merger Arbitrage space, managers benefitted from the spread tightening of the NXP Semiconductors vs. Qualcomm proposed merger. NXP Semiconductors, the target company, announced positive results and, according to broker reports, its share price could be fundamentally higher than the deal offer.

L/S CREDIT ARBITRAGE

	WTD*	Jan	YTD
Fixed Income Broad Index	**0.1%**	**0.8%**	**0.9%**
L/S Credit Arbitrage	0.2%	0.8%	1.0%

*From 31 January to 07 February 2017

10-year OAT/Bund Spread vs Itraxx indices
Spreads in bps



As of February 7th. Source: Bloomberg, Lyxor AM

OAT/Bund spread widens

Credit markets posted a lackluster performance last week. With both OAT and BTP spreads near 3 year highs vs. Bunds, the French and Italian banking sectors were a drag to the European investment grade segment. Accordingly, the Itraxx Main and the Itraxx Senior Financial widened by 2 and 3 basis points respectively.

In the U.S., market participants continued to gain exposure to risk assets following the solid non-farm payroll report. The BAML US HY index fell by 7 basis points.

Emerging markets continued to outperform last week. The Global Emerging Bond Index and the JACI non-IG index were up by 0.9% and 0.6% respectively.

On the Lyxor side, all funds posted positive results. The Asian centric fund led the pack again with significant gains in the coal sector. Some European funds also benefited from the rising coal price but posted a neutral performance on other positions. Finally, European funds managed to post gains on financials especially through CoCo positions.

MUTUAL FUNDS AT A GLANCE

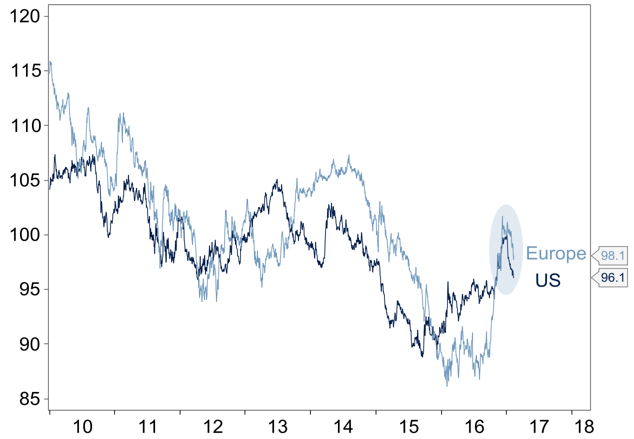
Value funds smooth the reversal in value stocks

The majority of U.S. and European value oriented mutual funds outperformed their benchmark in January

Peer Group	Number of funds in the peer group	Benchmark	Percentage of active mutual funds beating their benchmark (%)				
			Jan-17	Aug-16 to Jan-17	2016	2015	2014
US Large-Cap Value	86	MSCI USA Value NR USD	**78%**	52%	33%	30%	41%
Europe Large-Cap Value	113	MSCI EUROPE Value NR EUR	**72%**	22%	14%	93%	27%
Europe Large-Cap Growth	77	MSCI EUROPE Growth NR EUR	**54%**	49%	37%	46%	38%
US Large-Cap Growth	126	MSCI USA Growth NR USD	45%	41%	32%	42%	8%

Source: Morningstar, Lyxor AM

Value stocks have lost steam in early 2017
Relative performance of the MSCI Value vs. the MSCI Growth (rebased on 30/12/2016)



Net total return indices in USD and EUR. Source: MSCI, Macrobond, Lyxor AM

Value stocks have lost steam in early 2017 after a sharp rebound during the last quarter of 2016. Donald Trump's election turned out to be the catalyst for a significant outperformance of value vs. growth stocks in the U.S. after a quiet Q3. In Europe, value stocks rebounded as soon as July 2016. Despite the slight reversal in January, which turned out to be less pronounced than in the U.S., many European managers believe that value should outperform growth stocks in the coming months on the back of stronger economic momentum.

The underperformance of value stocks year to date has had negative implications on some equity strategies that turned more aggressive. Contrary to their European peers, U.S. Value managers made few changes to their allocation over the year. Amongst these changes was an increase of the exposure to the energy sector on the back of the rise in oil prices. In Q3 2016 they took a fairly cautious positioning before and after the U.S. presidential election. In Europe, most managers shifted their exposure towards value stocks later in the rally, according to Morningstar data.

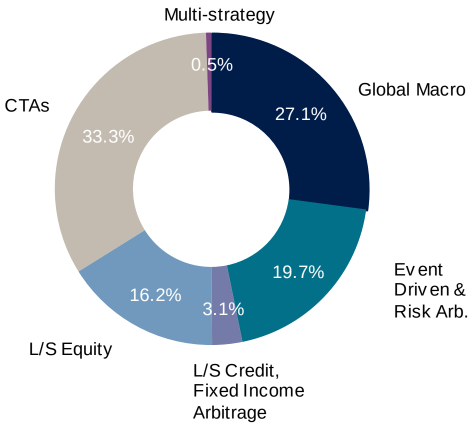
Active managers have nonetheless been able to smooth the reversal in January, both in the U.S. and in Europe. January saw a reversal in the U.S. with growth outperforming value. The move was less pronounced in Europe. 52% of the value managers outperformed the MSCI USA Value between July 31st, 2016, and January 31st, 2017, with only 33% for the whole of 2016. They were, however, 78% in January 2017. In Europe, throughout 2016, the number of value funds outperforming their benchmark was volatile: from 93% in 2015 they were only 14% in 2016 (despite a small rebound in H2). January, however, saw an increase of alpha generation.

Active management has been challenging over the past years in the U.S. Many managers believe that the increase in ETF volumes pushed correlations up and made alpha generation more difficult. Moreover, few large cap growth stocks pushed markets up while most value stocks lagged. Only 1/3 of managers were able to beat their benchmark over 2014-2016. Range-bound markets should favor dispersion and fundamental managers able to discriminate between the good and bad stocks.

METHODOLOGICAL APPENDIX

The information contained in this report on the performance and positioning of hedge funds is based on proprietary data from our Managed Account Platform. The universe of underlying funds is relatively stable, though it evolves according to fund openings and fund closures.

Lyxor Managed Account Platform: breakdown of assets under management by strategy as of December 30th, 2016



- **USD 8.3 billion** of assets under management
- Replicating approximately **USD 220 billion** of AUM

Lyxor Hedge Fund Indices

Based on the complete range of funds available on the Lyxor Managed Account Platform, a universe of funds eligible for inclusion in the indices is defined on a monthly basis taking into account the following elements:

- Investability threshold: to be included in any index, the managed account must have at least $3 million of AuM.
- Capacity constraints: all index components must possess adequate capacity to allow for smooth index replication in the context of a regular increase in investments.
- Index construction: for each index, the relative weightings of the component funds are computed on an asset-weighted basis as adjusted by the relevant capacity factors.
- Each Lyxor Hedge Fund Index is reviewed and rebalanced on a monthly basis.
- The Index construction methodology has been designed to mitigate well-known measurement biases. Inclusions and exclusions of new Hedge Funds do not impact the historical index track record.

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