# How Do Hedge Funds Position Ahead of the Atypical French Elections?

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Hedge funds generated alpha last week. Global Macro funds outperformed thanks to higher dollar and oil prices. Amid slightly negative global equities, L/S Equity funds succeeded in extracting excess returns, especially in Europe through relative trades.

Two weeks and counting before the very atypical French presidential elections, hedge funds are displaying disparate stances on this event.

Global Macro funds at Lyxor seem to be prudently positioned. After the UK referendum and the U.S. election surprises, they are more cautious. While they do not seem to be taking a particular stance on the elections, they are de-risking portfolios and favor relative value trades. Their net total exposure to equities and FX (in USD) are both below 20%.

Event Driven funds have marginally increased their European exposures since the end of 2016, however, portfolio additions are company-specific. They include merger, post-merger and recapitalization situations.

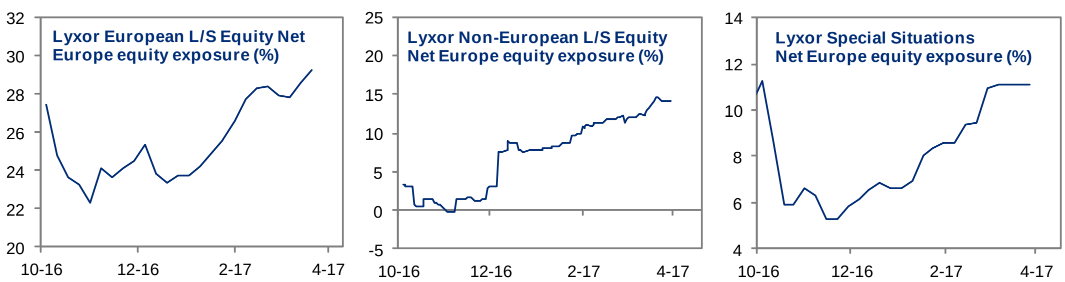
Non-European L/S Equity funds steadily increased their allocation to Europe over the last six months with little influence from trends in polls. Such funds seem to play the European recovery. Accounting for a third of their exposure, their European stakes do not seem to be abnormally hedged.

European L/S Equity managers also seem to play the recovery but with protections layers. They raised their net exposure by a third since the end of 2016, favoring cyclical sectors such as industrials, tech and materials, as well as small caps. That is not to say that they shrug this risk-off. Since the end of January, when the election stress stepped up, they reduced financials and EU-domestic stocks. Additionally, they reinforced the defensive sectors and moved toward non-EU/EMU European markets. They also maintained their short on indices futures implemented back in November 2016.

Finally, CTAs seem to be more aggressively exposed to Europe. Their long equities account for the bulk of their current directional exposure, a third of which in Europe. It is partially hedged with long Euro-bond, short EUR, short U.S. duration (all of relatively small size).

**L/S Equity and Event Driven Reinforced Their Allocation to Europe**

*Net exposure to European equities in %*




Source: Lyxor AM

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# THE WEEK IN 3 CHARTS

## Hedge Fund Snapshot: Global Macro Stands Out

| | WTD* | Mar | YTD |
|---|---|---|---|
| **Lyxor Hedge Fund Index** | **0.5%** | **0.5%** | **1.6%** |
| CTA Broad Index | **-0.2%** | **-1.0%** | **-1.0%** |
| Event Driven Broad Index | 0.3% | 0.0% | **2.5%** |
| Fixed Income Broad Index | -0.1% | **1.4%** | 1.6% |
| L/S Equity Broad Index | 0.1% | 0.6% | 1.5% |
| Global Macro Index | **1.0%** | 0.6% | 1.6% |
| *MSCI World Index* | *0.1%* | *0.8%* | *4.6%* |
| *Barclays Global Agg Bond Index* | *0.4%* | *-0.2%* | *1.2%* |

*From 28 March to 04 April 2017

The Lyxor Hedge Fund index edged higher +0.5%, with Global Macro leading the pack.

Most portfolios were rewarding for global macro managers. The bulk of gains stemmed from the appreciation of the USD vs. DM currencies. Longstanding positions on oil and European equity markets added to gains.

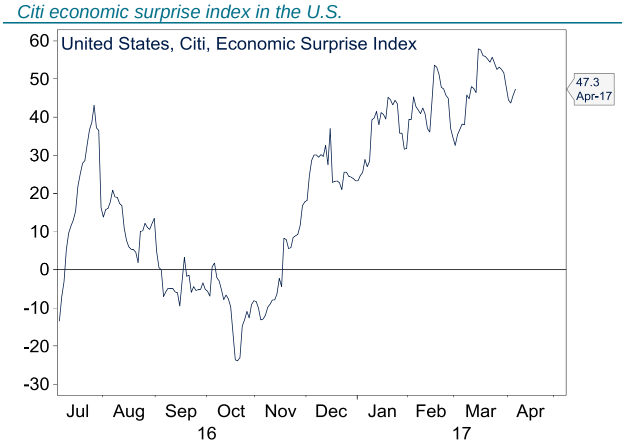
On the L/S equity side, European managers outperformed. Relative value trades within consumer and financial sectors paid off.

A number of M&A deal positions bolstered returns of Merger Arbitrage managers, including Actelion/J&J, Syngenta/ChemChina and Danone/Whitewave Foods.

## The Fed Ready to Reduce the Balance Sheet's Size

**U.S. economic data is peaking**

*Citi economic surprise index in the U.S.*




Source: Bloomberg, Lyxor AM

The Fed minutes were unbalanced, with a slightly hawkish bias.

They suggest that the reduction of the balance sheet will start closer to year-end, instead of March as previously expected. Moreover, they also emphasize stretched equities valuation. Yet, markets focus on positive but peaking U.S. economic data as well as doubts over the pulse of the reflation trades.

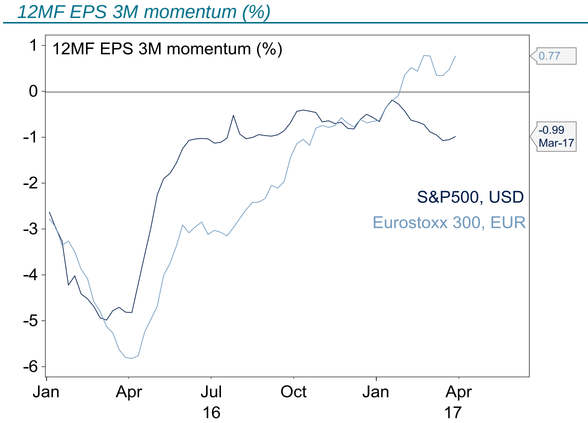
On the other side of the spectrum, the ECB dodges towards the dovish side, as European inflation conditions remain lackluster in March, and ahead of French elections.

Last week, the USD appreciated against EUR, a positive development for global macro and CTAs.

## EPS Forecasts in the Eurozone Outshine U.S. Projections

**Revisions are positive in the Eurozone, outpacing the U.S.**

*12MF EPS 3M momentum (%)*




Source: IBES Datastream. Macrobond. Lyxor AM.

Global equity markets witnessed little change last week as investors stayed on the sidelines ahead of the Q1 2017 earnings season. The momentum in earnings revisions is diverging across regions.

In the Eurozone, 12MF EPS has gathered momentum since June 2016, bringing global forecasts on the positive territory. Industrials, materials and consumer discretionary sectors lead the pack, signaling that the cyclical recovery is expected to endure.

On the flip side, economists continued to lower EPS estimates for S&P 500 companies. Only the banking sector enjoys upward revisions.

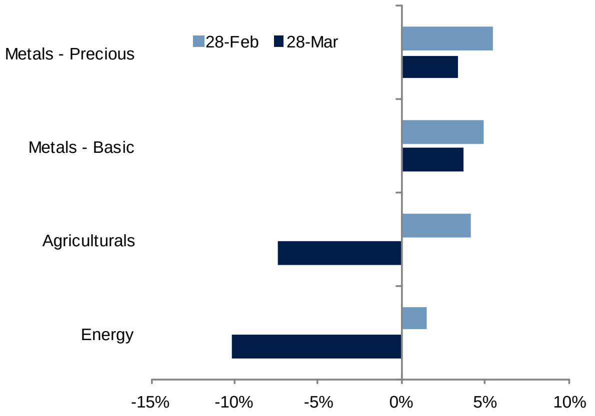
Such divergences would improve alpha in relative sector or country arbitrages. L/S stock pickers. Most hedge fund strategies are increasingly exposed to the European cyclical recovery.

## CTAs

| | WTD* | Mar | YTD |
|---|---|---|---|
| **CTA Broad Index** | **-0.2%** | **-1.0%** | **-1.0%** |
| CTA Long Term | -0.2% | -1.1% | -1.2% |
| CTA Short Term | -0.5% | 0.6% | 1.6% |

*From 28 March to 04 April 2017

**Short energy exposure detracted as oil recovered its losses**
*CTAs net exposure to commodities, % NAV*




As of March 28th, Equally weighted. Source: Lyxor AM

## Mixed Results

CTAs were slightly down last week, with both short-term and long-term models mildly down.

The short exposure to commodities was the main culprit of losses. In particular, rising oil prices dragged down the performance of models.

All other portfolios alleviated damages. In particular, longstanding exposures to European equities were the most rewarding while U.S. equities added mild profits. Few models posted losses as Japanese indices underperformed.

Within FX, CTAs benefitted from the depreciation of the EUR vs. USD. Conversely few models were hit by the appreciation of the USD vs. AUD and ZAR.

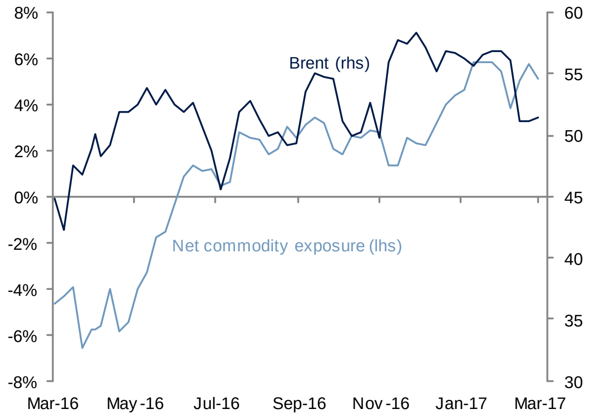
Finally, the fixed income portfolio fairly paid off thanks to lower long term rates across the developed world.

## GLOBAL MACRO

| | WTD* | Mar | YTD |
|---|---|---|---|
| **Global Macro Index** | **1.0%** | **0.6%** | **1.6%** |

*From 28 March to 04 April 2017

**Net long exposure to oil has been profitable for GM funds**
*Net exposure to commodities (% NAV) vs. Brent crude ($/barrel)*




As of March 28th. Equally weighted. Source: Lyxor AM

## Fueled by FX and Oil

FX and commodities colluded to provide a good start for the month for Global Macro funds.

The FX bucket bolstered managers returns last week, as the USD strengthened vs. most major DM currencies, in particular, the EUR. Long FX exposure to the commodity block added to gains as they benefitted from rising oil prices.

Commodities also reinforced overall performance. The rebound in oil prices was profitable while the fall of agriculturals added to gains. Short soybean stands out, as prices declined on the back of expectations of record crops in the U.S.

On the flip side, exposures to fixed income weighed in on funds returns. The net short positions on European duration and in the UK especially were marginally detrimental.

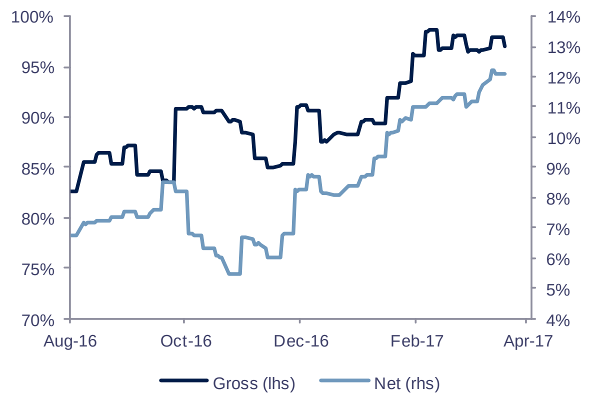
Overall, the equity portfolio brought mixed results with gains on the long Europe leg slightly offset by losses in Japan.

## L/S EQUITY

| | WTD* | Mar | YTD |
|---|---|---|---|
| **L/S Equity Broad Index** | **0.1%** | **0.6%** | **1.5%** |
| Long Bias | 0.4% | 1.5% | 1.4% |
| Market Neutral | 0.1% | 1.1% | 3.3% |
| Variable Bias | 0.0% | 0.1% | 2.3% |

*From 28 March to 04 April 2017

**L/S Equity managers enhance their exposure to European equities**
*Lyxor broad index, net Exposure to European equities, % NAV*




As of March 28th. Equally weighted. Source: Lyxor AM

## Bull on Europe

Europe outperformed U.S. equities with most sectors ending in positive territory. In that context, European equity managers outperformed their peers. The best performers benefitted from relative value stock selection in the consumer and financial sectors.

In the U.S., equity market indices ended the week flat. With this backdrop and return dispersion across individual sectors, most of gains came from growth-oriented managers, which generated profits from long and short stock selection in the consumer sector.

EM-specialized fund successfully generated alpha on both its long and short portfolios.

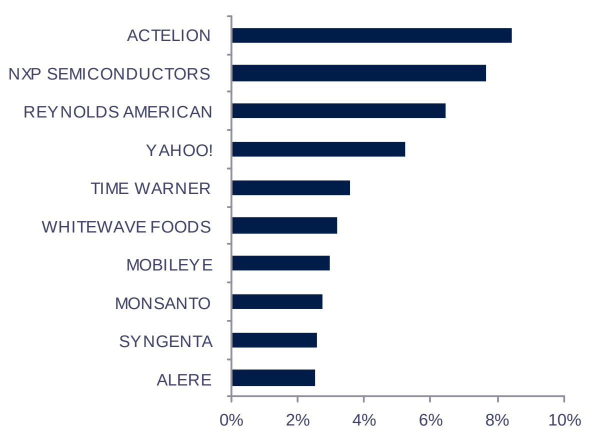
In the multi-strategy space, fundamental managers outperformed quantitative managers, hit by trend-following systems and quantitative neutral stock selection strategies.

## EVENT DRIVEN

| | WTD* | Mar | YTD |
|---|---|---|---|
| **Event Driven Broad Index** | **0.3%** | **0.0%** | **2.5%** |
| Merger Arbitrage | 0.5% | -0.5% | 0.7% |
| Special Situations | 0.2% | 0.3% | 3.9% |

*From 28 March to 04 April 2017

**Top 10 long positions of Merger Arbitrage funds**
*Average exposure, % NAV*




As of March 28th. Equally weighted. Source: Lyxor AM

## M&A Positions Rewarding

Event Driven funds continued their upward trend, with Merger Arbitrage funds outperforming their Special Situations peers.

In the M&A space, managers benefitted from the Actelion/Johnson&Johnson ("J&J") deal after J&J declared the Actelion tender offer successful. Both companies expect a deal closing in Q2. The Syngenta/ChemChina also contributed to the positive returns as the Chinese company won U.S. antitrust approval for its $43 billion takeover of the Swiss pesticide maker. The purchase of Whitewave Foods by the French food giant Danone added to the gains since the U.S. Department of Justice announced it will approve the deal. Other gainers included the NXP Semiconductors/Qualcomm deal.

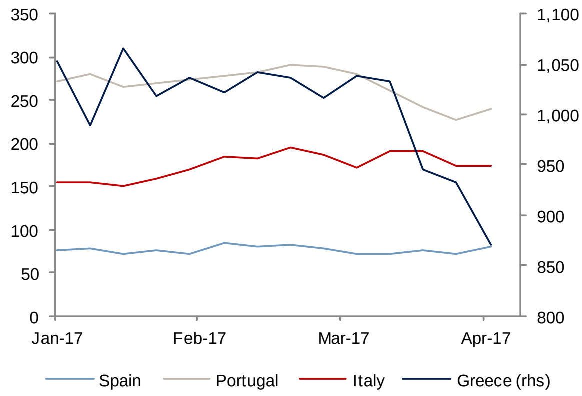
Gains in Special Situations funds were driven by positions in Communications and Technology. Positive contributors included Whole Foods and Liberty Broadband.

## L/S CREDIT ARBITRAGE

| | WTD* | Mar | YTD |
|---|---|---|---|
| **Fixed Income Broad Index** | **-0.1%** | **1.4%** | **1.6%** |
| L/S Credit Arbitrage | 0.0% | -0.6% | 1.2% |

*From 28 March to 04 April 2017

**Greek spreads have tightened on the run up to bailout talks**
*CDS spread in bps*




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

## Lackluster Credit Markets

In an environment of tight credit spreads, it seems that there is not much room left for further tightening going forward. According to a survey from the CFA Society, an industry body for UK investment professionals, 82% of UK investment professionals believed credit is now overvalued. In that context, the ML Pan-European High-Yield index widened by 12bps. Financials were no exception with the BofA Merrill Lynch CoCo Index widening by 10bps. On the positive side Greek spreads tightened by 62bps following constructive discussions over the country's next bailout.

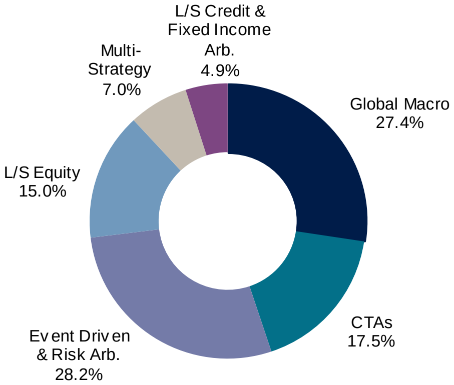
On the negative side, all funds on the platform managed to post positive performance. The best performers recorded gains on the convexity bucket and some positions on the consumer non-cyclical sector.

Asian credit markets continued their upward trend driven by strong demand and lack of supply. Our Asian credit fund's positive performance was driven by idiosyncratic positions in a Singaporean-based semiconductor company and an Indonesian auto component company.

# 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 February 28th, 2017**




- **USD 9.6 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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