# Brave New Emerging Market World?

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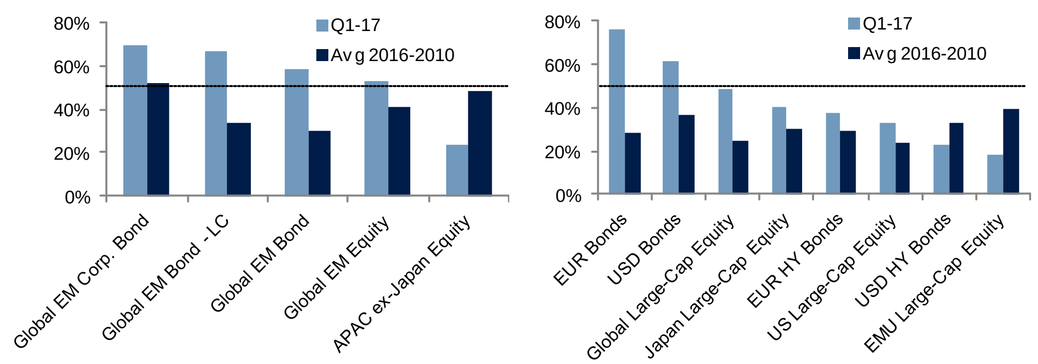
*On a regular basis, the weekly brief is expanded with inputs from our team of mutual fund analysts. This week we focus on the outperformance of EM active funds versus their benchmarks.*

Recent macro releases outpaced expectations in China while EM assets saw strong foreign inflows in Q1, according to the IIF. Overseas flows have probably been fueled by domestic factors, such as stronger economic activity, but also external factors such as elevated political uncertainty in western countries. The recent outperformance of EM vs. DM assets also probably contributed to reinforce the appeal of the asset class. From another perspective, EM active funds have a relatively good track record vs. passive funds; at the difference of other asset classes (see chart below and details on page 5).

In Q1-17, active EM managers showed positive results. Based on a large sample of global equity and fixed income funds, we find the bulk of EM managers outperformed their benchmarks (53% and 58% respectively) and posted improving results compared to 2016. Much of the outperformance of active investing in EM equities year-to-date has to do with the underperformance of value versus growth stocks. This supported EM equity funds which generally avoid value stocks. This prompts us to ask: is this a new EM investing landscape? The lower sensitivity of EM fixed income to Fed rate hikes is an interesting development. The softer stance of the U.S. government on China is also supportive. However, it is unclear whether the outperformance of EM equity funds can continue if growth stocks no longer outperform value.

With respect to hedge fund performance, the past week has been adverse for Global Macro and CTA strategies. This has taken place in the context of the announcement of general elections in the UK, which translated into trend reversals across UK assets. Higher risk aversion in Europe ahead of the French presidential election also played a role. Both strategies maintain sizeable long European equity exposures while some macro managers are also short European fixed income. Yet, the likelihood that Macron will win with a comfortable margin at the runoff on 7 May is supportive for both strategies. Meanwhile, merger arbitrage outperformed last week. The proposed merger between Abbott Laboratories and Alere is back on track at a renegotiated price, which fueled Alere's shares by more than 15% during the period under review.

**Active EM managers are having a strong run** *(% of activefunds beating their benchmark)*




Universe of funds available for sale in Europe. See last page for details. Source: Morningstar, Lyxor AM

# *HEDGE FUNDS AT A GLANCE*

## Hedge Fund Snapshot

| | WTD* | MTD | YTD |
|---|---|---|---|
| **Lyxor Hedge Fund Index** | **-1.1%** | **-0.6%** | **0.5%** |
| CTA Broad Index | -1.4% | **-2.3%** | **-3.1%** |
| Event Driven Broad Index | **0.2%** | **0.9%** | **3.0%** |
| Fixed Income Broad Index | 0.2% | 0.1% | 1.8% |
| L/S Equity Broad Index | -0.2% | 0.0% | 1.4% |
| Global Macro Index | **-2.3%** | -1.3% | -0.7% |
| *MSCI World Index* | *-0.9%* | *-0.9%* | *3.6%* |
| *Barclays Global Agg Bond Index* | *0.4%* | *1.0%* | *1.8%* |

*From 11 April to 18 April 2017

## CTAs and Global Macro Down

The Lyxor hedge fund index was down 1.1% last week on the back of the negative performance of CTA and Global Macro strategies.

The general elections announcement in the UK translated into trend reversals across UK assets. Meanwhile, higher risk aversion in Europe ahead of the French presidential election also played a role. Both strategies maintain sizeable long European equity exposures while some macro managers are also short European fixed income.

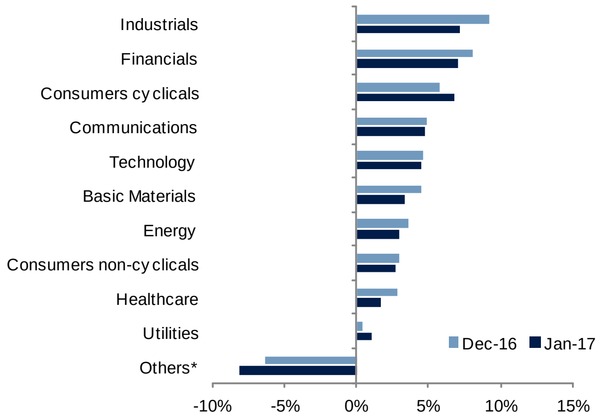
On a positive note, Event Driven outperformed. The proposed merger between Abbott Laboratories and Alere is back on track, which fueled Alere's shares by more than 15% during the period under review

## L/S EQUITY

| | WTD* | Jan | YTD |
|---|---|---|---|
| **L/S Equity Broad Index** | **-0.2%** | **0.0%** | **1.4%** |
| Long Bias | 0.4% | 0.7% | 1.7% |
| Market Neutral | -0.6% | -0.3% | 2.8% |
| Variable Bias | -0.1% | -0.1% | 2.2% |

*From 11 April to 18 April 2017

**Positioning on cyclicals had a negative impact on performance**
*Net exposure to equties by sector, % NAV*




As of April 11th. Equally weighted. Source: Lyxor AM

## Back to Safety

With climbing geopolitical unrest and weaker growth catalysts, the reflation trade continued unwinding as investors expressed a more cautious stance. Long/short equity funds returned weak performance as the rotation to safety emphasized.

This trend materialized in the U.S. as defensive sectors advanced while cyclicals collapsed. Long exposure to materials and energy was particularly detrimental due to the weakness of raw material prices. One manager outperformed due to profitable positions on the short side of the portfolio.

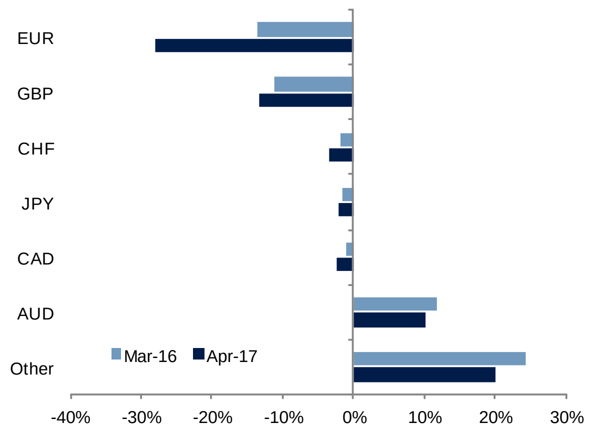
Political stress rose in Europe as uncertainty around the French election remains high and Teresa May announced a snap general election. European-focused managers suffered from the risk-off environment and posted losses on their long books. Exposure to materials, industrials and financials was a drag.

## CTAs

| | WTD* | MTD | YTD |
|---|---|---|---|
| **CTA Broad Index** | **-1.4%** | **-2.3%** | **-3.1%** |
| CTA Long Term | -1.5% | -2.4% | -3.4% |
| CTA Short Term | -1.1% | -1.3% | 0.7% |

*From 11 April to 18 April 2017

**Short EUR and GBP detracted as the USD declined**
*CTAs net exposure to FX vs. USD, % NAV*




As of April 11th, Equally weighted. Source: Lyxor AM

## French Anxiety

This week's market movements reflected apprehension regarding the upcoming French election. Investors favored bonds over equities, sent the dollar down and pushed gold a bit higher.

Equities detracted from performance again. Losses across global markets were increasingly widespread this week, which explains the asset class' negative contribution.

In the FX space, short EUR and GBP were unanimous detractors. A few EM currencies, such as the RUB, helped offset some of the losses.

Interest rates overall generated positive returns. The long bias towards Europe and sometimes the U.S. was rewarded as bond yields edged lower across the board. On average, the greatest contribution came from Europe, where the long exposures are the largest.

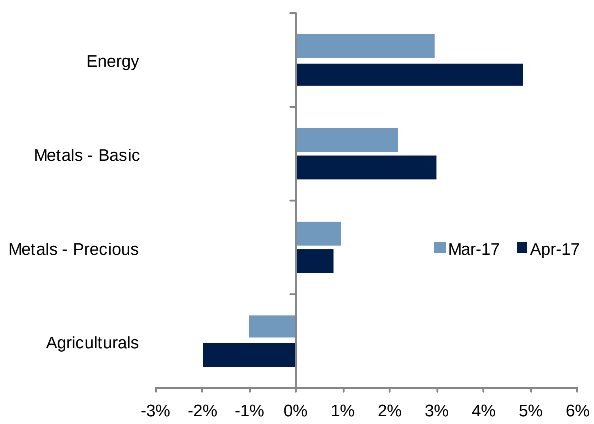
On the back of short agricultural trades, commodities offered some support. The generalized drop in base metals prices however led to losses for a few systems.

## GLOBAL MACRO

| | WTD* | MTD | YTD |
|---|---|---|---|
| **Global Macro Index** | **-2.3%** | **-1.3%** | **-0.7%** |

*From 11 April to 18 April 2017

**Oil was down in response to high inventory data**
*Global macro funds net commodity exposure, % NAV*




As of April 11th. Equally weighted. Source: Lyxor AM

## On the Down Side

Most funds posted negative results as the USD depreciated, and oil and major equity indices fell. Fixed income was a counterweight for a few portfolios.

Currencies took back last week's gains. Short EUR and JPY lost while constructive views on emerging market currencies provided some support.

Losses within the commodity bucket came from long exposures to oil and base metals, notably copper. The energy sub-bucket was down as data pointed out that global oil inventories are currently higher than they were when OPEC cuts came into force.

Stocks were equally harmful. The short U.S. leg added a few basis points, however, long Europe detracted by a greater percentage.

As for fixed income, the generalized fall in bond yields was mostly beneficial, apart for a few funds with a short exposure to European duration, which, as a consequence hurt performance. Relative value trades did well and also helped lessen losses.

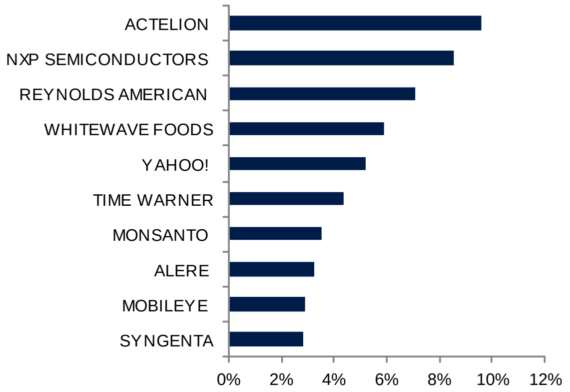
## EVENT DRIVEN

## Merger Arbitrage Outperforms

| | WTD* | MTD | YTD |
|---|---|---|---|
| **Event Driven Broad Index** | **0.2%** | **0.9%** | **3.0%** |
| Merger Arbitrage | 1.0% | 2.2% | 2.4% |
| Special Situations | -0.5% | -0.2% | 3.6% |

*From 11 April to 18 April 2017

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




As of April 11th. Equally weighted. Source: Lyxor AM

The Event-Driven platform posted a mixed performance over the week, with Merger Arbitrage funds recording strong results and Special Situations peers ending in the red.

In the M&A space, Alere was among the top contributors. After a yearlong dispute, the deal with Abbott is back on track at a renegotiated price (down to $51 from $56). Alere's shares were up more than 15%. Straight Path Communications' shares rallied on a report that Verizon is considering topping AT&T's $1.25bn bid. The stock price jumped more than 20% on the news. Syngenta also added to the gains as its transaction with ChemChina was cleared by the Chinese regulator.

As for Special Situations funds, the leading detractor over the period was the energy sector. Investments in EOG Resources were among the losers, declining along with oil prices. Investment in Universal Health Services also detracted from performance. These losses were partially offset by gains from Whole Foods Market.

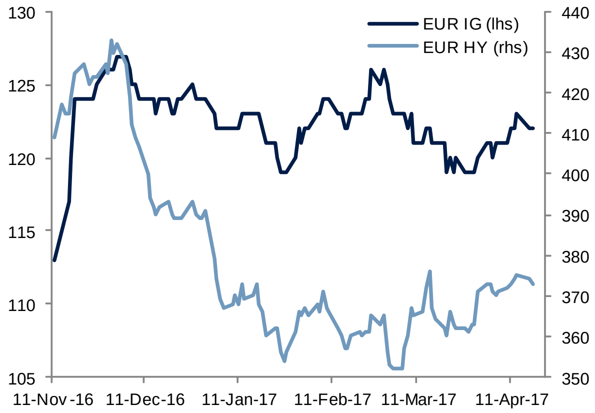
## L/S CREDIT ARBITRAGE

## Quiet Week for Credit Markets

| | WTD* | MTD | YTD |
|---|---|---|---|
| **Fixed Income Broad Index** | **0.2%** | **0.1%** | **1.8%** |
| L/S Credit Arbitrage | -0.1% | 0.2% | 1.4% |

*From 11 April to 18 April 2017

**Very quiet week for European credit spreads**
*Spread in bps*




Source: BAML, Bloomberg, Lyxor AM

Despite French political risks, credit markets remained surprisingly muted over the week and both IG and HY spreads of BAML European indices remained flat.

In the U.S., macroeconomic data was a letdown and drove credit spreads 13 bps wider for HY bonds (BAML Index). On the political front, President Trump twisted his view on long term equilibrium rates and now wishes for the Fed keeps interest rates durably low.

Funds on the platform posted mixed results. One manager was down, driven by losses on basic materials and consumers while energy and financials provided some cushion. Another fund delivered positive performance mostly thanks to its convexity bucket and European corporate mainly in consumer non cyclical and industrials.

# MUTUAL FUNDS AT A GLANCE

## EM Active Managers Rocked the House in Q1

**The track record of passive vs. active investing is impressive**

| Peer Group | # Funds in the peer group | Benchmark | % of active mutual funds beating their benchmark | |
|---|---|---|---|---|
| | | | Avg 2016-2010 | Q1-17 |
| Europe ex-UK Large-Cap Equity | 144 | MSCI Europe ex-UK EUR | 59% | 24% |
| UK large-Cap Equity | 205 | FTSE All Share | 45% | 60% |
| Europe Large-Cap Equity | 674 | MSCI Europe EUR | 40% | 40% |
| Eurozone Large-Cap Equity | 459 | MSCI EMU | 40% | 18% |
| USD Bonds | 148 | Barclays US Agg Bond Index | 37% | 61% |
| Global HY Bonds | 103 | Bofa Merrill Lynch Global HY USD | 34% | 28% |
| USD HY Bonds | 85 | Bofa Merrill Lynch US HY | 33% | 23% |
| Japan Large-Cap Equity | 262 | Topix | 30% | 40% |
| EUR HY Bonds | 127 | Bofa Merrill Lynch Euro HY | 29% | 38% |
| EUR Bonds | 645 | Barclays Euro Agg Bond Index | 29% | 76% |
| **Global Large-Cap Equity** | **1763** | **MSCI World EUR** | **24%** | **48%** |
| **US Large-Cap Equity** | **522** | **S&P 500** | **24%** | **33%** |

Universe of funds available for sale in Europe. Net total return in local currency (except otherwise indicated). Source: Morningstar, Lyxor AM

**Most EM active managers outperformed their benchmark in Q1-17**

| Peer Group | # Funds in the peer group | Benchmark | % of active mutual funds beating their benchmark | | |
|---|---|---|---|---|---|
| | | | Avg 2016-2010 | 2016 | Q1-17 |
| Global EM Equity | 599 | MSCI EM USD | 41% | 32% | **53%** |
| Asia Pacific ex-Japan Equity | 207 | MSCI AC Asia ex-Japan USD | 49% | 53% | **24%** |
| Global EM Bond | 209 | JP Morgan EMBI Global Diversified USD | 30% | 39% | **58%** |
| Global EM Bond - Local Currency | 132 | JP Morgan GBI-EM Global Diversified USD | 34% | 33% | **67%** |
| Global EM Corporate Bond | 69 | Barclays EM Intl Corporate USD | 52% | 38% | **70%** |

Universe of funds available for sale in Europe. Net total return performance. Source: Morningstar, Lyxor AM

**The underperformance of value vs. growth stocks in Q1 supported EM equity funds which tend to avoid value names**
*Relative performance of MSCI value vs. growth indices (rebased end-2016)*


Total return indices in local currency. Source: MSCI, Macrobond, Lyxor AM

**The debate on the performance of active vs. passive fund management rages on**. Actually, on average, less than 25% of U.S. or Global large-cap equity funds outperformed their respective benchmarks between 2010 and 2016. Meanwhile, the inflows recorded by the passive industry over the recent years (and outflows from active managers) point to a balance largely in favor of the ETF industry.

**There are some asset classes where the active industry fares better.** European and EM equities are segments where the track record of active strategies is superior, though the share of active funds outperforming their benchmark is still below 50% on average over the medium term.

**Active EM managers show positive results in Q1-17.** Based on a large sample of global equity and fixed income funds, we find a sizeable proportion of managers outperformed their benchmarks (53% and 58% respectively). In some sub-segments such as local currency bonds or corporate bonds, the proportion of active funds outperforming their benchmark rises to 70%. Apart from Asian ex-Japan equity managers, all posted improving results in Q1.

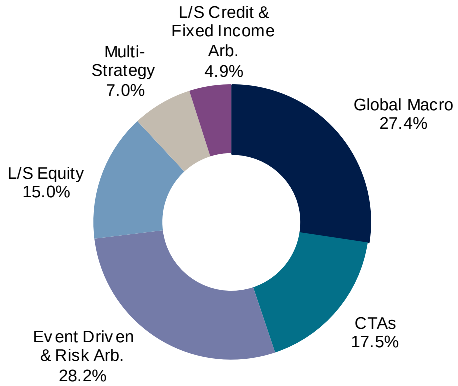
**The positive results in Q1 follow a challenging year for active EM managers.** EM equity funds performed poorly in 2016 compared to their benchmark. They actually tend to be biased towards consumer/quality stocks and avoid value names which did very well. That includes banks in Brazil and commodity exporters in South Africa and Russia. Meanwhile, the Chinese and Indian markets, which constitute a sizeable part of their allocation, performed poorly. As a result, there have been portfolio shifts after the U.S. election in favor of value sectors such as materials. This has been funded by lower holdings of consumer defensive and communication stocks. Fund managers now signal that the domestic consumer play is very richly valued. Consequently, they tend to diversify through good proxies to consumer growth, such as financials, healthcare, communication and IT.

**Regarding EM fixed income, inflows into the asset class remained strong in Q1-17** while the asset class appears to be less sensitive to U.S. policy rate hikes. The consensus among our managers is that as long as the FED rate hike cycle is gradual and well telegraphed to the market, EM assets will perform well. They also expect the healthier EM fundamentals to support the asset class.

# 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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