MACRO MANAGERS ARE SCRATCHING THEIR HEADS JUST LIKE YOU

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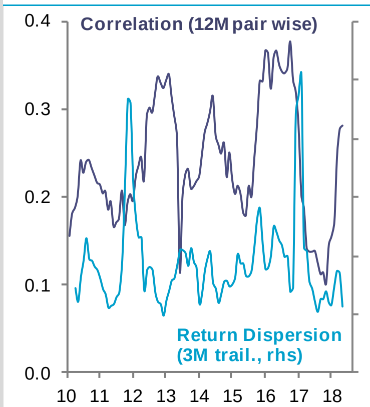
Europe took center stage this week, with further developments in the Italian political saga reminding investors that there are still powerful Eurosceptic forces at play and forcing investors to end their hopes of meaningful eurozone reforms. However, fading prospects of another election in the near term are providing a respite. Spain is also entering a phase of uncertainty after Prime Minister Rajoy was forced out of office, but this is a minor issue compared with Italy. Concerns about trade quickly revived, as a result of the US's imminent implementation of tariffs against most of its trading partners. The main risk would come from spiraling multilateral retaliation and the weakening of global trade organizations.

Hedge Funds were overall flat this week, emphasizing their appealing profile in the current environment. The Italian stress mainly hurt CTAs, hit in their long bonds. L/S Equity funds also suffered from derisking, in line with their cautious exposure. By contrast, Event-Driven, away from the epicenter, were more resilient.

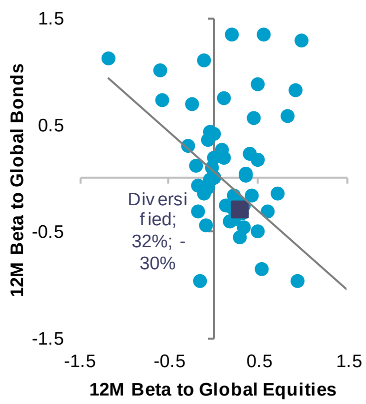
Markets will have to go on dealing with multiple uncertainties, including concerns about the continued integration of the eurozone, trade fears, a potential revival of risk linked to Iran later in the year, disappointing economic data everywhere apart from the US, a strong dollar still threatening some economies, and monetary normalization progressing in the US. Conditions are likely to remain challenging for most investment styles.

We wondered how Macro funds are dealing with this. Our bottom-up managers survey (see p2) confirms our top-down observations. The surging correlation across returns of a large basket of diversified Macro funds year-to-date tells us that they are facing the same drivers and that they struggle to find decorrelating arbitrages. Meanwhile, the low dispersion across their returns and their modest sensitivity to markets suggest that a majority of them are refraining from taking aggressive risks. Yet, we find that the alpha they individually extract has been increasingly volatile this year. This shows that they struggled to navigate the stream of uncertainties which ebbed and flew. As a result, they are flat or so year-to-date.

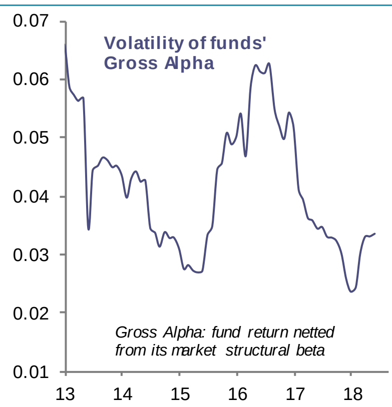
Diversified Macro funds



Sensitivity to equities & bonds



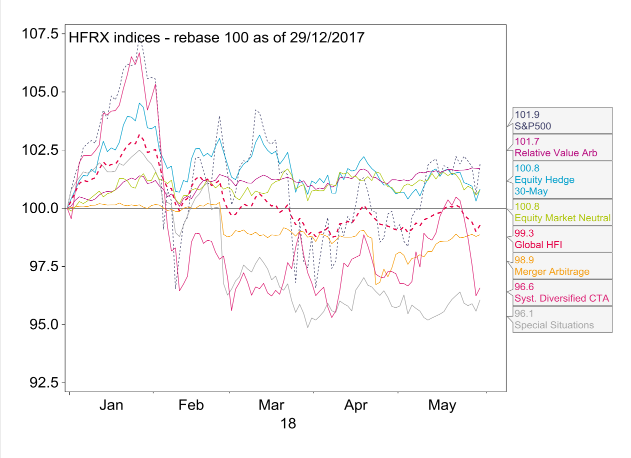
Volatility of funds' alpha



Source: Bloomberg, Lyxor AM

THE WEEK IN 3 CHARTS

Hedge Fund Snapshot: Hedge Funds are resilient depsite market turbulences



Source: Macrobond, Lyxor AM

Market turbulences only moderately impacted hedge funds last week, with CTAs underperforming.

Trend-followers suffered the most from the market reversal. Both the decorrelation between equities and bonds and plunging oil prices were the most detractor to performance.

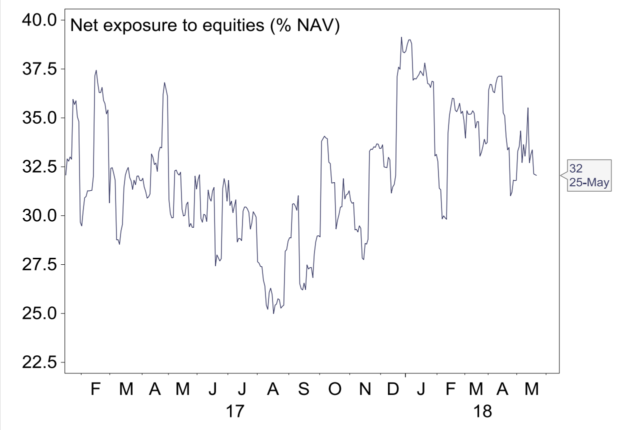
In the L/S Equity space, few positions were held on Italian stocks, which resulted in marginal losses for Lyxor funds. Managers with the longest cyclical tilts, in particular those that bet on rebounding energy stocks, underperformed. Overall, managers did not add risk in portfolios in May, which helped alleviate losses.

Relative Value Arbitrage and Event-Driven funds ended the week on the positive side.

Has market turmoil left fingerprints on hedge fund positioning?

Lyxor L/S Equity funds stay overall cautious

Net exposure to equities (% NAV)



Source: Lyxor AM

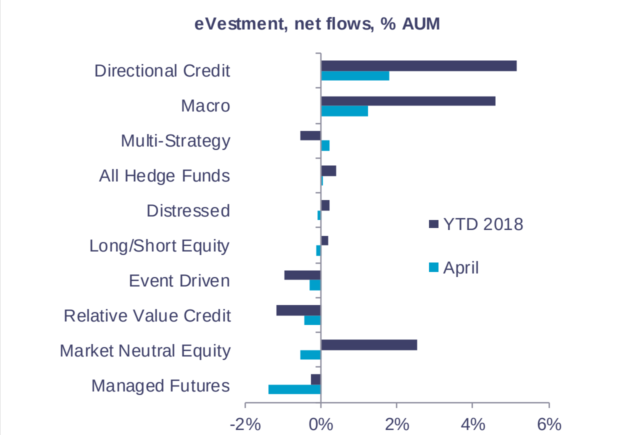
Hedge funds remained reluctant in May to add risk in portfolios amidst multiple uncertainties including political stress, trade war, asset price valuation and the dollar appreciation. Their cautious stance helped them navigate relatively well the market turmoil last week.

In the aftermath of the market correction, most Lyxor L/S Equity managers are sticking to their guns. The longest bias funds only shaved off their exposures. In contrast with the February sell-off, managers did not add risk on lows. Those with strong long-term fundamental convictions remained confident.

Global Macro views are more heterogenous, with some managers expecting the situation to normalize overtime vs. other seeing the political stress as a long-term potential systemic risk. Most funds reduced their risks, with a preference for relative value trades.

Directional Credit and Macro hedge funds continued to attract investors in April

Net flows into hedge funds



April 2018. Source: eVestment, Lyxor AM

Offshore hedge funds continued to lure investors' interest in April, with USD 1.8bn of net inflows. The year-to-date inflows as of April (USD 13.7bn) represent half of the total 2017 inflows.

The breakdown shows heterogeneous strategies appeal. Besides about 2/3 of the managers represented in the eVestment sample suffered outflows in April. Yet they were offset by new allocations. Macro and Directional Credit strategies continued to catch the eyes of investors, with a growing appetite for EM funds, in the credit space especially.

By contrast, trend-followers suffered the strongest outflows for the second consecutive month due to their February underperformance. Market Neutral Equity funds were also disregarded in April.

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 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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