INVESTMENT STRATEGY

AS LONG AS CENTRAL BANK MUSIC PLAYS

THIRD QUARTER 2020

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Completed July 6th, 2020. Data as of June 26th, 2020 unless otherwise specified.

12-MONTH MARKET VIEWS

	U/W	N	O/W
Equities	EM vs. DM Equities EMU Materials EMU Energy EMU Communication Brazil vs. EM Equities	U.S. Equities UK Equities U.S. Growth vs Value JP Equities India vs. EM Equities	U.S. Staples vs. Discretionary U.S. Quality & U.S. Banks EMU Equities (tactical) EMU Financials & EMU IT EMU Health Care JP Intl vs. Dom China vs. EM Equities Russia vs. EM Equities
Fixed Income	10Y UST 10Y Bund	10Y Gilt 10Y JGBs SPGBs BTPs EM Debt HC US IG Credit EUR HY Credit	2Y UST EUR IG Credit GBP IG Credit U.S. Credit HY U.S. Inflation Breakeven EMU Inflation Breakeven
FX		EURUSD USDJPY	
Commodities			Brent Crude Gold Copper
Hedge Funds	L/S Equity Market Neutral	L/S Equity Directional Global Macro Systematic Global Macro Discretionary CTA FI Multi-Strategy	Special Situations Merger Arbitrage L/S Credit EM Global Macro

U/W Underweight
N Neutral
O/W Overweight

EXECUTIVE SUMMARY

Macro & Market Views

Virus containment is progressing unevenly, advanced in Europe and Asia, but concerning in the U.S. and Latin America. Meanwhile, lockdown easing and economic reopening is accelerating worldwide. With a full global economic recovery priced-in for 2021 and stimulus reflected in richening asset valuations, there is little room for disappointments. Yet, record policy support is absorbing a large share of the shock and is flooding markets with liquidity, thus providing a backstop to asset prices. Furthermore, authorities would not relapse in large-scale shutdowns. Risks look balanced in mainstream assetswhich calls for a neutral stance.

We see more relative opportunities. Uneven responses to the pandemic and diverging monetary and fiscal stimulus would continue to lead to diverging economic and market performances in Q3 2020. Additionally, as we move past the pandemic peak, other risks are resurfacing with rising trade tensions, U.S. elections and Brexit, requiring tactical and pragmatic positioning.

We are neutral on developed equities. We tactically favor EMU equities, supported by ECB's purchases and by a positive optionality from the proposed Recovery Fund. U.S. stocks are floored by the unconditional Fed support, but valuations are rich considering U.S. elections and virus spread related risks. Within uncompelling Japanese equities, we see value in foreign vs. domestic exposed stocks.

Central banks' efforts to keep low real yields would crush rates directionality, keeping us neutral on major developed sovereign issues. We foresee a modest yield curve steepening in the U.S., Europe, and UK. A likely inflation spike next spring calls for an O/W stance on breakeven. In high-yield, we favor U.S. over Europe amid slightly cheaper valuation and more conservative default estimates.

EM economies are facing multiple challenges, though situations are highly heterogeneous. We U/W EM equities that may not be the usual "early cycle plays" relative to DM, favoring relative calls (O/W China and Russia, U/W Brazil). Valuations look unappealing in EM HC debt, but with default risks concentrated in smaller issuers and central bank support, we stay Neutral.

The oil and copper rallies need consolidation. However, oil destocking and surging Chinese copper demand keep us strategically O/W on both. Gold fundamentals remain supportive (O/W), but the upside looks more moderate.

Alternative Strategies

Alternative strategies helped cushion portfolios during the market stress in Q1 2020. We estimate the annualized volatility of the MSCI World at 38% in H1-2020 and the volatility of a 50/50 equity bond portfolio at 19% (MSCI World & Barclays Global Aggregate Bond index). Meanwhile, the volatility of our global liquid alternative benchmark stands at 6% during the same period.

Going forward, we expect strategies such as L/S Credit and EM Global Macro to provide attractive returns on the back of the dispersion among corporate and EM sovereign issuers which remains high. The search for yield is an investment theme which remains key as central banks keep a lid on yields, however, risk mitigation remains as important. In this framework, we continue to favor Merger Arbitrage as corporate deal spreads remain elevated (c. 6%). M&A volumes bounced back in the U.S. in June. Concurrently, we maintain L/S Market Neutral at U/W on the back of its sensitivity to factor rotations. The strategy also appears less suitable at this stage of the business cycle.

MACRO & MARKET VIEWS

MARKETS GETTING HIGH ON STIMULUS

After their dismal performances in the first quarter, **risk assets rallied, almost recouping their losses.** Year-to-date and as of June 26, developed equity markets (MSCI World) are down "only" -8%. In local currency terms and due to China's remarkable resilience (CSI 300 Index +1%), emerging markets (MSCI EM) fared even better, losing -6% over the same period.

In fixed income markets, corporate credit (JP Morgan JACI and Bloomberg-Barclays indices) followed similar patterns so far this year: Asia and U.S. investment grade credit yielded positive returns of 3% and 6%, respectively; U.S. and European high-yield limited their losses with a total return of about -5%.

Illustrating **investors ambivalent sentiment, traditional safe havens performed relatively well quarter-to-date** . Long-dated U.S. Treasuries and German Bunds (Bloomberg-Barclays 7-10-year indices) offered slightly positive returns while gold prices continued their uptrend, closing the period at $1764 per ounce. The market selloff in the first quarter mostly reflected the measures imposed by governments across the world to control the COVID-19 pandemic. Ranging from social distancing to full lockdown, such containment measures crushed world economic activity.

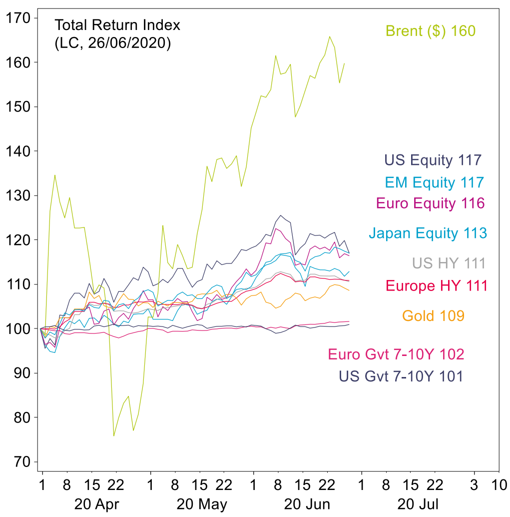
Recent revised estimates from the IMF showed real GDP contracting this year by 8% in advanced economies and recovering in 2021 at hardly 5%. Eurozone ('EMU') countries are expected to suffer the most, which explains the underperformance of EMU equities in Q1 2020.

Not surprisingly, the ensuing market recovery was fueled by the expected or realized relaxation of containment measures that would allow activity to recover. Indeed, green shoots recently appeared that comforted the risk-on mode. Business and consumer surveys upturned while Citigroup Economic Surprise Indices surged.

Yet, we believe that the **main driver of the market rally lies with the impressive array of stimulus displayed by policymakers** across the world. Governments have announced above $10tn of fiscal support (including guarantees on loans to businesses), which combined with the recession induced loss of fiscal revenues, would swell budget deficits and add 10 to 25 percentage points to debt to GDP ratios in 2020.

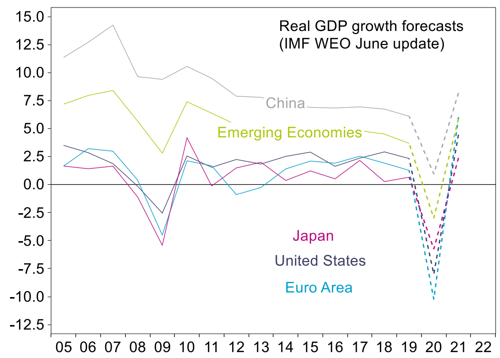
While part of the fiscal push will take time to be fully implemented, the **unprecedented monetary support** in

Quarter-to-date Asset Class Performance



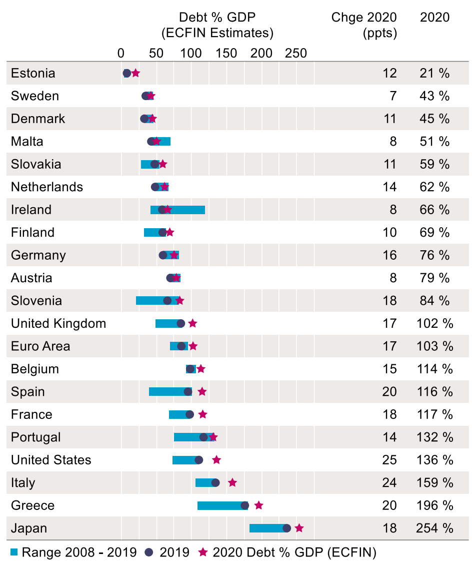
Source: Macrobond, Lyxor AM

Unprecedented shock on activity



Source: Macrobond, Lyxor AM

Unprecedented policy support



Source: Macrobond, Lyxor AM

the form of rate cuts, quantitative easing or backstops to ensure market functioning and liquidity for the business sector, was immediate and reassured investors. **Potentially, central banks' backing could exceed $10tn, which would bring policy support beyond $20tn which is 25% of world GDP**.

WHAT RECOVERY SCENARIO IS PRICED-IN?

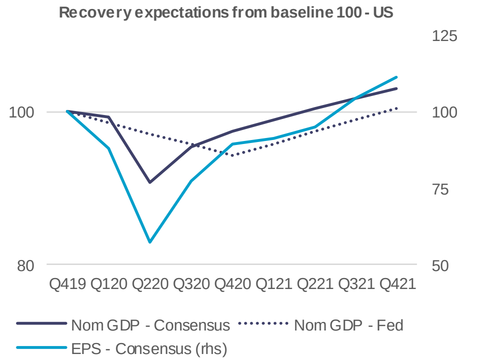
Responses to the COVID-19 outbreak have been highly uneven regarding the levels of preparation as well as the timing and magnitude of shutdowns which are deeply influencing exit strategies and the speed of economic resumption in different countries. **Monetary and fiscal responses have also diverged, both in size and in policy orientation. These responses will likely continue to lead to diverging economic and market performances.** Scenarios of economic recovery should be decisive market catalysts in Q3 2020 and key determinants for fair values of financial assets.

Considering the combined top-down consensus (Bloomberg) on real GDP and CPI inflation, we find differing expectations between regions. Markets seem more cautious about the Eurozone, UK, and Japan, where nominal GDP would not surpass last year's level before 2022. By contrast, the U.S. and especially China are expected to recover faster.

We use the deviation from pre-crisis nominal GDP expectations to estimate the structural loss of wealth inflicted by the pandemic, which includes businesses that will not recover, jobs permanently lost, and consumption alterations. A milder structural impact is seen in the U.S., Japan, and China (2% to 3% structural impact on GDP by the end of 2021) than in UK and EMU for which the lost wealth would reach 5% and 9% of GDP, respectively.The loss of wealth is expected to be considerably higher in the immediate aftermath of the pandemic (about 10% in the U.S. and China, 20% in the UK and EMU). The economic rebound and record monetary and fiscal stimulus would help mitigate the first-round effects from the COVID-19 pandemic.

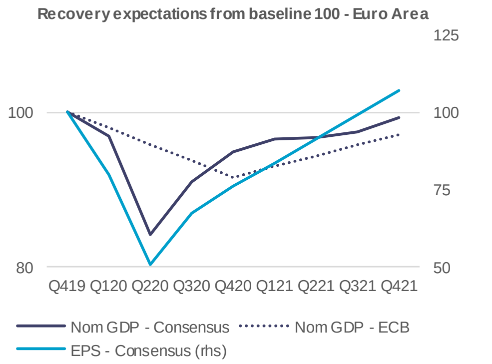
Bottom-up consensus (Bloomberg) EPS estimates for the main indices paint a similar picture. S&P 500 EPS are expected to recoup their peak level in 2021 whereas Euro Stoxx 300 EPS will likely wait until 2022. **Abundant liquidity and state subsidies are reflected in the changes in earnings multiples compared to pre-crisis levels. Compared to January, P/E multiples surged** seven points based on 2020 FY EPS in the U.S. and EMU, five points in the UK, and a little less in areas where money creation has been milder. Based on 2021 earnings and expected to have fully recovered in most regions, P/E ratios are still two to three points higher than January

U.S. recovery scenario currently priced-in



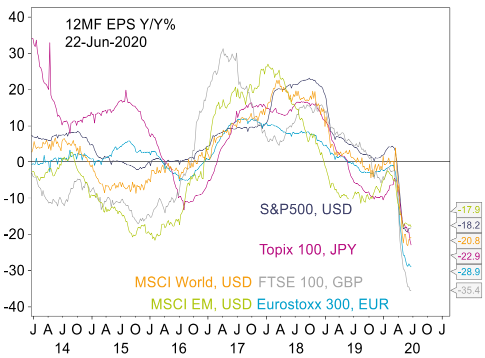
Source: Bloomberg, Lyxor AM

EMU recovery scenario currently priced-in



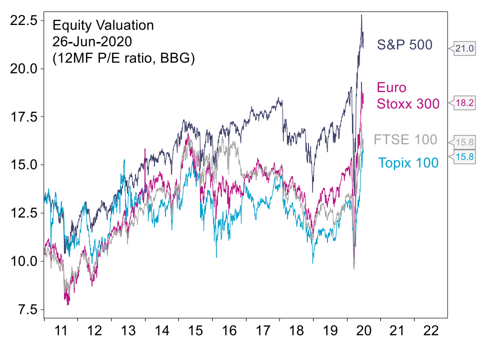
Source: Bloomberg, Lyxor AM

Larger loss of wealth in Europe



Source: Macrobond, Lyxor AM

Surging Equity multiples



Source: Macrobond, Lyxor AM

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levels in the U.S., EMU, and China. Markets reflect a scenario where stimulus and the restart of economic activity could offset about 75% of the inflicted first-round structural losses.

The surge in equity multiples seems to exceed the typical impact seen in past episodes of combined monetary and fiscal expansion. We think that, in aggregate, this leaves **little to no room for negative surprise** at a time of looming risks from trade, U.S. elections and second waves of COVID-19. **We see regional divergence though: the consensus looks conservative in Europe, optimistic in the U.S.**, and in between in Japan, UK, and China.

COVID-19, NOT SO EASY TO CONTAIN …

The outlook for economies and markets will likely depend on the capacity to contain the COVID-19 spread. When confronted with the health crisis, with hospitals at full capacity and a rising death toll, most governments imposed measures of social distancing, partial or even full lockdown. Those policies bore fruit and the amount of new infections globally have decelerated sharply over April. Thereafter, the daily growth rate of diagnosed cases stabilized in the range of +1.5-2%, circa 150.000 new COVID-19 cases per day in May and June.

This global picture hides different situations. While so far Europe seems to have successfully controlled the outbreak, the U.S. and a dozen developing countries from Latam, South Asia, and the Middle East are struggling to contain the virus spread. In the U.S., Sunbelt states experienced a surge of new infections in the first half of June. Additionally, local outbreaks in Singapore, China, and more recently in Germany raised concern.

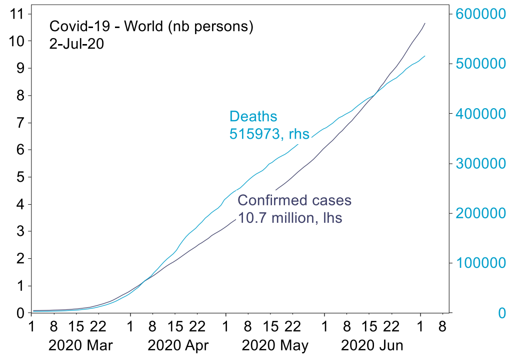
In our view, the probability of renewed massive lockdowns is low. Authorities are wary of the dire economic consequences of containment measures and prefer the new policy of **testing and contact tracing**. When extensively implemented, **it can efficiently identify and control new clusters of infections.** Yet, many areas do not have adequate infrastructure. In the northern hemisphere, the main risk would be a second wave in Q4 2020 during the flu season as the flu boosts COVID-19 transmission.

On the positive side, the unprecedented research effort on treatments and vaccines is starting to yield results.

Over 250 treatments are currently being developed, of which 25% are in clinical tests / late stage trials such as the University of Oxford's Dexamethasone or Gilead's Remdesivir. Several governments already approved their use.

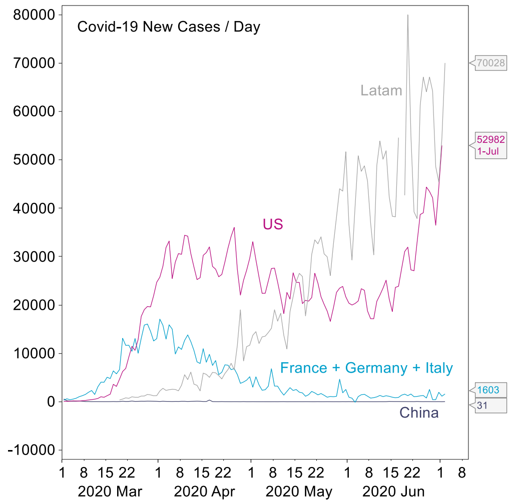
According to the general opinion of most experts, a vaccine is unlikely to be ready before mid-2021. Yet, 11

COVID-19 global spread



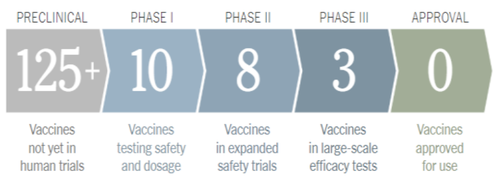
Source: Macrobond, Lyxor AM

The 1st wave is not over in America



Source: Macrobond, Lyxor AM

Unprecedented research effort on vaccines



Source: NY Times

potential vaccines are already in phase II (expanded safety trials) or phase III (large scale efficacy test). The World Health Organization ("WHO") has recently identified the candidates developed by Oxford University-AstraZeneca and Moderna Inc. as the front-runners in the race to find an effective vaccine for the viral infection. Both have been selected for the U.S. War Speed $10bn program.

STRATEGY FOR UNPRECEDENTED TIMES

What investment strategy should investors adopt in COVID-19 times, that is in times when "the path forward for the economy is **extraordinarily uncertain** …" as Fed Chair Powell asked in his remarks to U.S. lawmakers?

Let us review the pivotal factors of our central scenario:

1) **The capacity to control the pandemic.** While progress is being made in treatments that should alleviate the death toll, a vaccine is unlikely to be ready before mid-2021, at best. Several countries / states do not have yet the adequate infrastructure to implement the testing and contact tracing policy, which could efficiently control the virus spread. **We believe the pandemic will be hard to keep in check in certain geographies,** compromising the speed of their recovery.

2) **We doubt that governments will resume their massive lockdown policies**: they have proven far too damaging for the economy. However, local initiatives are probable in areas where infections are accelerating. Even if authorities remain passive, **the fear factor will likely play a role, prompting citizens to follow some form of self-containment**, reining in economic growth.

3) **Governments and monetary authorities are committed** to supporting growth and preserving financial stability. **Central banks have become buyers of last resort.** We believe policymakers are ready to do more, should the situation deteriorate unexpectedly.

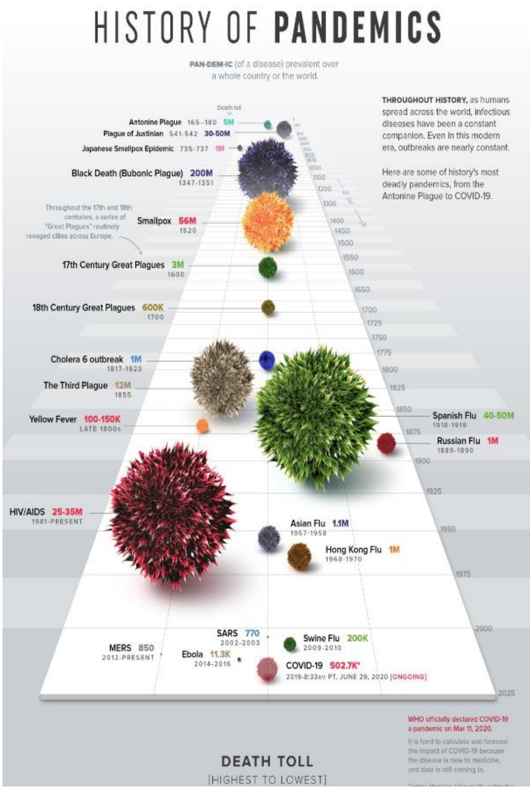
4) **A global lengthy recovery should develop. Already, green shoots have appeared.** With the lockout, consumer and business confidence surveys are rebounding. Hard data for May and June is often above expectations Citigroup Economic Surprise Indices are surging in the U.S. and recovering in Europe.

5) **Risk asset valuations appear rich,** leaving no room for disappointment notably in case of a second wave of COVID-19 in the western world.

Provided that the virus is kept in check, we believe investors should stay cautiously invested. In our view, market corrections will constitute buying opportunities. Overextended valuations prevent us from adding risk at this stage and prompt us to favor relative and tactical calls.

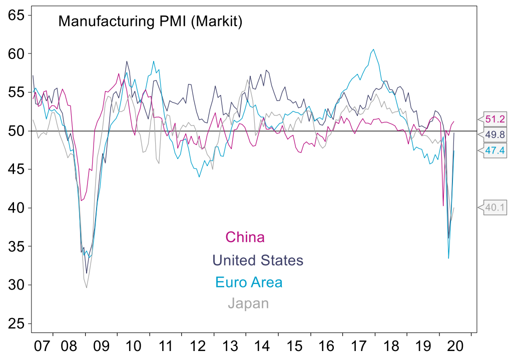
Beyond the uneven COVID-19 spreads and uneven policy responses that will likely dictate relative performances, we think that the U.S. elections and Europe potential debt mutualization will be decisive for markets in the coming quarter.

History's most deadly pandemics



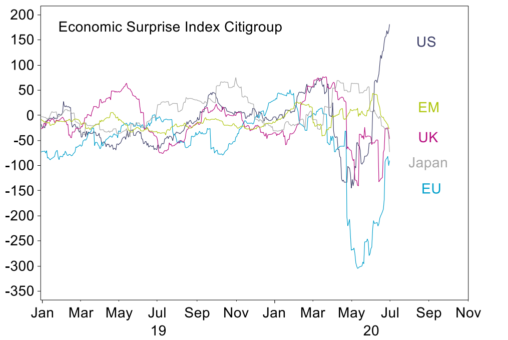
Source: Visualcapitalist.com

Business confidence is rebounding



Source: Macrobond, Lyxor AM

The recovery surprised to the upside, so far



Source: Macrobond, Lyxor AM

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THE CLOSE CALL BETWEEN U.S. AND EUROPE HIGH-YIELD

U.S. and Europe high-yield ('HY') performed well over the quarter, both yielding about 10% total return (Bloomberg-Barclays indices). Our coherence models suggest that in the U.S., the current pricing is in-line with other U.S. assets while in Europe, HY issues are slightly expensive relative to other assets. Spreads (adjusted for 5-year swaps to capture the corporate idiosyncratic risk) have compressed over the quarter but remain far above the typical levels seen in expansions, leaving room for further compression, should the recovery prove sustained.

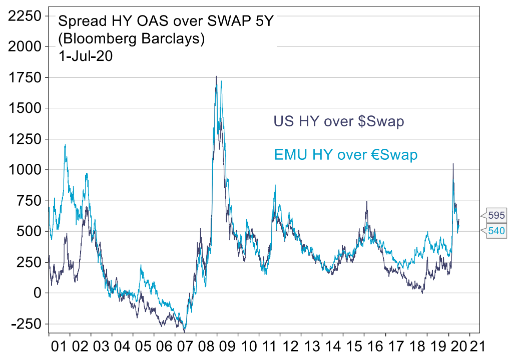
Moody's outlook is much worse for the U.S. where the default rate is estimated to peak at 12.4% next February before receding at 11.6% in May 2021. The pattern is similar for Europe, but the estimated default levels are about halved, due to the better rating composition of the European universe.

We estimate that the default probability implied in U.S. current option adjusted spreads is 6.4% for next January, about half of Moody's bottom-up forecast. We see three reasons that could explain this: the market expects a very quick wave of default; the market has become complacent; Moody's forecasts are too pessimistic. We tend to believe that there is complacency in the market but also that bottom-up forecasts could be revised down. As detailed in a later section, we keep a constructive view on oil prices, which could limit defaults in the U.S. HY energy segment.

Also, the Fed has deployed an arsenal of facilities ('F') to avoid a solvency crisis: The primary market corporate credit F provides a funding backstop for corporate debt to help eligible issuers maintain operations. The secondary market F purchases ETFs and corporate bonds in the secondary market to support market liquidity. The Main Street F fosters lending, the Paycheck Protection Program Loan F facilitates lending to small businesses and the Term ABS Loan F facilitates ABS issuance. As at June 24, the above facilities combined amount to $149bn with a total capacity exceeding $1500bn. Most facilities operate through special purpose vehicles financed by the Fed, the financing being secured by the SPVs' assets. By contrast, the ECB purchases IG corporate bonds at a pace of roughly €10bn per month, taking the credit risk onto its balance sheet, which could prove limiting.

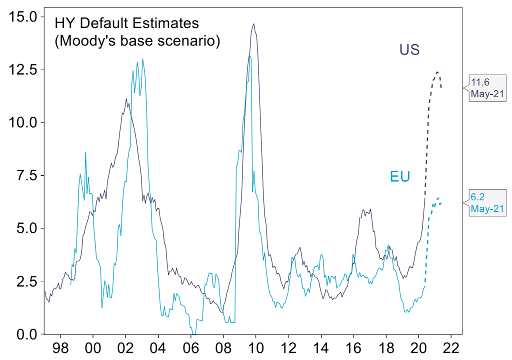
All in all, we tend to prefer U.S. to Europe HY. Yet, the close call could be reversed depending on the virus spread control and the E.U. proposed recovery plan.

HY swap spread compression is not over



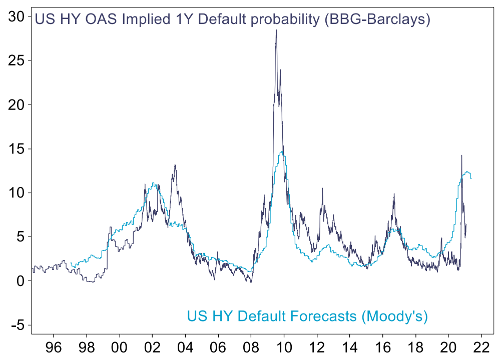
Source: Macrobond, Lyxor AM

The outlook for default is worse in the U.S.



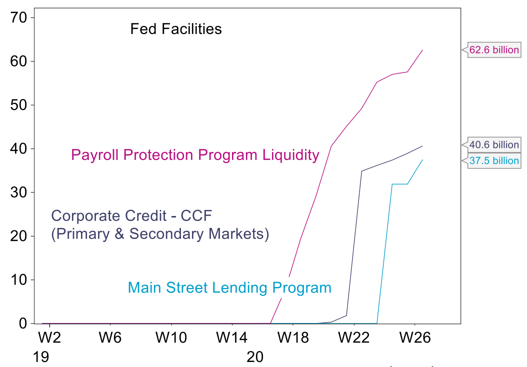
Source: Bloomberg, Lyxor AM

Complacency in the U.S. HY market?



Source: Macrobond, Lyxor AM

Fed facilities ramping up



Source: Macrobond, Lyxor AM

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SHORT-TERM NEUTRAL ON U.S. TREASURIES

The U.S. macro momentum improved sharply with the lockout.

Soft data rebounded as evidenced by most business surveys for the manufacturing sector, for services and for small companies. Meanwhile labor market indicators surprised to the upside in May with material payroll gains and a much lower unemployment rate than feared. Core retail sales jumped 11% year over year ('yoy') far above market expectations (5%). The housing recovery appeared more hesitant but there were positive signs regarding capex.

While recent macro data bodes well for the U.S. economic outlook, the COVID-19 spread that does not seem under control in several Sunbelt states could compromise growth prospects. The surge in newly infected cases appears particularly worrisome in California, Texas, Florida, and Arizona. True, the large increase in new diagnosed cases is partly due to the much bigger testing activity. Yet, the percentage of positives keep increasing, a clear sign that the pandemic is not in check.

Also, experts argue that **beyond few hundreds new cases per day, the testing and contact tracing policy is extremely difficult (or too costly) to implement.**

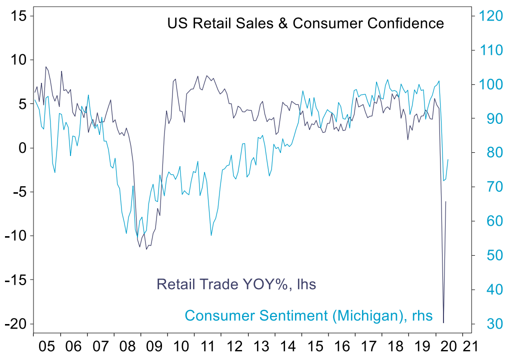
We believe it is critical to evaluate whether the current spread surge will later translate into a rising death toll that would be intolerable to voters. All we know at this stage is that progress has been made in treatments that should lessen the fatality rate.

We think that authorities will be reluctant to resume severe containment measures, but frightened citizens may self-restrain, impairing the recovery. We will monitor this pivotal risk carefully.

Fed Chair Powell recently reaffirmed that he was against pulling back on any form of stimulus too soon. Furthermore, we believe that the Fed stands ready to add accommodation by creating new facilities or altering existing ones if need be. The Fed seems unlikely to shift away from its zero interest rate policy anytime soon. Negative rates have apparently been ruled out given their mixed results when used in other countries. We believe yield curve control at the short end of the curve is likely as it reinforces the forward guidance on Fed fund rates.

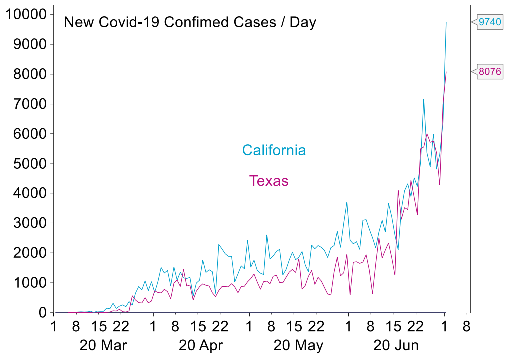
The Fed's extremely accommodative policy prompts us to take a neutral ('N') stance on U.S. Treasury yields for the coming quarter. Looking further ahead, we see upside to the 10-year yield that will likely reflect the normalization of the economic situation.

Consumption no longer under lockdown



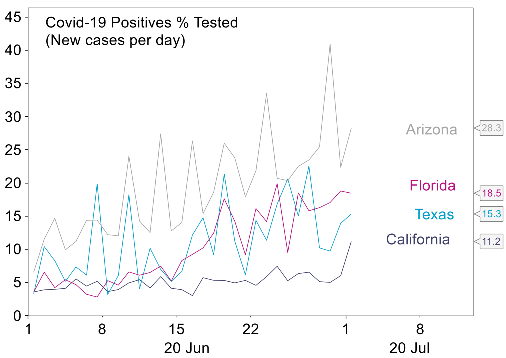
Source: Macrobond, Lyxor AM

New COVID-19 cases per day – California and Texas



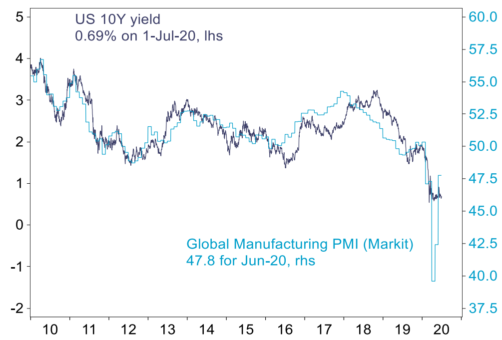
Source: Macrobond, Lyxor AM

Pandemic not in check in Sunbelt states



Source: Macrobond, Lyxor AM

Our 12M target on 10-year yield stands at 1%



Source: Macrobond, Lyxor AM

O/W BREAKEVEN INFLATION AMID A PROBABLE INFLATION SPIKE NEXT SPRING

Recent data showed a continued fall in May numbers for both headline and core inflations. Most items exhibited lower readings, pushing **the diffusion index down to a level unseen for more than three decades, which does not bode well for an upturn soon.**

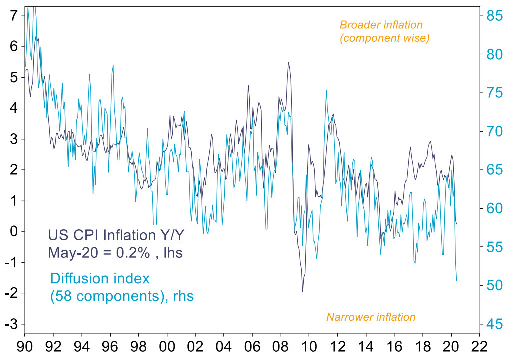
Few items saw a significant rise in yoy inflation since February (pre-COVID-19 outbreak). Inflation on food and beverage more than doubled to +3.9% while prices of medical care services accelerated to +5.9%, which probably explains the unexpected surge in consumer expectations to +3% a year from now. This is in sharp contrast with professional forecasters who anticipate below 2% inflation in June 2021.

We updated our core-inflation model to take into account the sharply lower nominal GDP currently estimated for this year and next). Assuming the dollar index and WTI prices remain unchanged, **the model suggests that core inflation will be at around 1.7% in June 2021. Factoring-in oil prices base effects and possible scenarios, we find a likely spike in headline inflation next Spring. Though transitory by nature, those oil related spikes typically result in higher breakeven levels. We take an O/W stance on U.S. Breakeven inflation**

That being said, long-term inflation trends will remain muted in our view. To be sure, several inflation hurdles have started to falter:

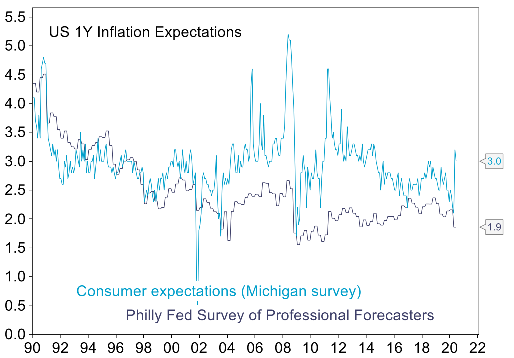
1) The **"Peace dividend"** has faded away with the rise of a multi-polar world. The peace dividend related to the end of the Cold War, which allowed countries to cut defense budgets and thus non-productive spending, a source of long-term inflation
2) The appetite for **budgetary discipline** seems to have disappeared with the 2009 financial crisis and the current COVID-19 crisis. Huge budget deficits become acceptable if it is the price to avoid deflation.
3) Volcker's **tight monetary policies** have long been forgotten… Since the global financial crisis and more so over the last few weeks, major central banks have deployed unorthodox measures to prevent a deflationary spiral and foster an inflation revival.
4) **Free trade** and its benefits including specialization, economies of scale, and increased competition (all of which favor disinflation) are taking the back seat. Brexit, increased US tariffs and ongoing reshoring illustrate the resurgence of protectionism.

No early sign of an inflation upturn



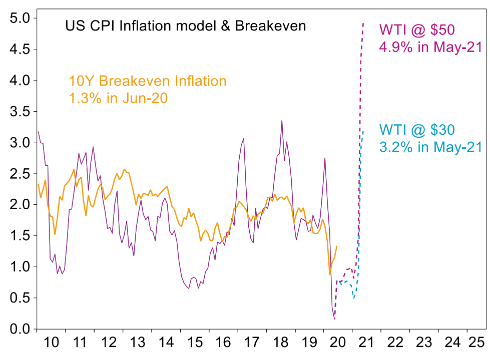
Source: Macrobond, Lyxor AM

Contrasted inflation expectations



Source: Macrobond, Lyxor AM

Headline CPI to spike next Spring



Source: Macrobond, Lyxor AM

Other headwinds are not about to weaken and could allow a lengthy bottoming process in inflation.

Technology (new communication channels and wider internet usage) and the resulting faster transmission of ideas, improved energy efficiency, developments in big data, etc. all contribute to greater productivity. Automation should also continue to curb wage inflation by providing substitutes to low value-added jobs. **Demography** is also said to play a role in inflation, but the issue and related evidence are rather controversial.

A PUZZLING EARNINGS PICTURE

Corporate revenues have probably dropped dramatically during the lockdown period, painting a bumpy quarterly profile. Bloomberg bottom-up consensus estimates show a **likely fall of 2020 sales of -8%,** quite like our top-down model. We factored-in nominal GDP forecasts from the Fed, a stable dollar and WTI prices grinding higher towards $40 per barrel for the next 18 months. The results show for **2021 sales a more muted recovery** (+5.7%) than expected by markets (+8.4%).

Using Bloomberg data for earnings, we find that **bottom-up and top-down consensus estimates for S&P 500 2020 EPS remarkably converge towards an inordinate slump of -20%.** We find it difficult to challenge those estimates given **the extraordinary uncertainty attached to the extreme economic event** the world is going through. More than half of S&P 500 companies withdrew their guidance for Q2 2020 EPS and about a third withdrew their guidance for 2020 EPS. We focus on 2021 earnings, assuming some form of normalization next year. According to Ibes consensus, **EPS will have recouped their 2019 high level in 2021. However, two major headwinds could compromise this optimistic scenario.** First, the COVID-19 pandemic that might be more difficult to curb than hoped. Second, the looming elections.

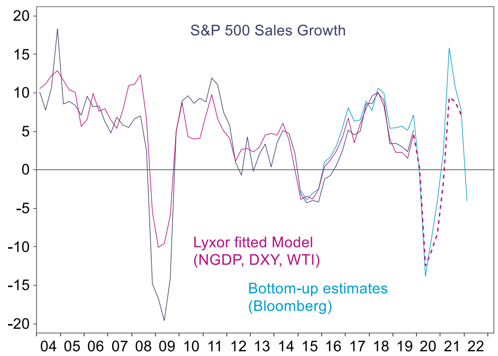
TOWARDS A DEMOCRATIC SWEEP?

Election prospects, as estimated using PredictIt bets, have turned in favor of the presumed Democratic nominee. Joe Biden is also leading in recent polls by an average margin exceeding 9%. **While we reckon that no election is a forgone conclusion, we now attach a 60% probability to a Biden win.**

More importantly for potential market impact, prospects for the balance of power in Congress changed as well. At least 35 of the 100 seats in the Senate and all 435 seats in the House will be up for elections. While Democrats are likely to retain the House majority, Republican senators in several swing states are threatened by President Trump's deteriorating standing in the polls. PredictIt bets indicate **over 60% chance of a Democratic Congress.**

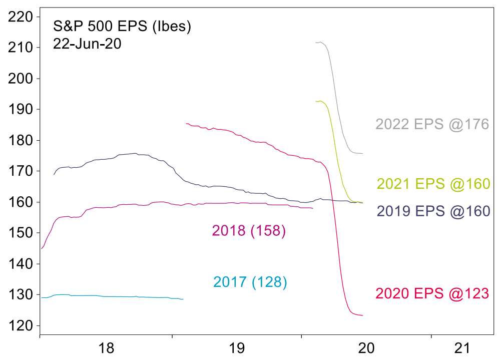
A Democratic sweep would allow Biden to push forward his pro-labor agenda including a $15/hour minimum wage, pro-unionization measures and generous unemployment benefits. Medicare for all, and personal tax increases for high-income earners look probable. Clean energy and corporate tax hikes will likely follow once businesses have recovered from the COVID-19 crisis. **Corporate profitability would be impaired by increased costs and taxes.**

S&P 500 Sales estimates



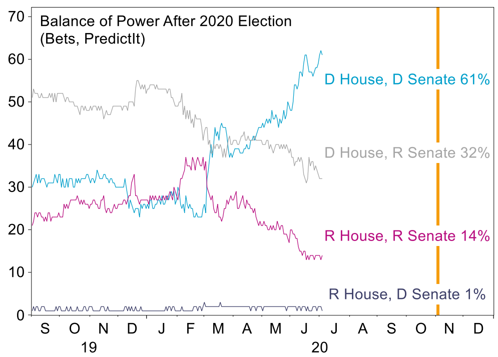
Source: Macrobond, Lyxor AM

S&P 500 2021 EPS back to 2019 high level?



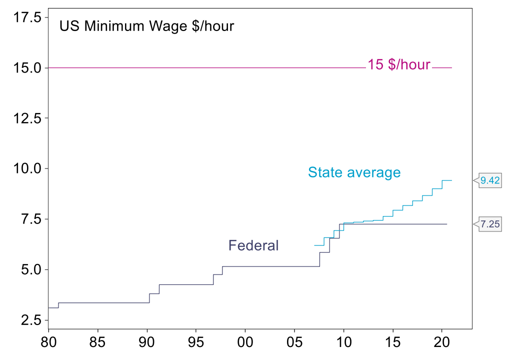
Source: Macrobond, Lyxor AM

Will Republicans lose the Senate?



Source: Macrobond, Lyxor AM

Biden's labor agenda



Source: Macrobond, Lyxor AM

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STAYING INVESTED IN EXPENSIVE U.S. EQUITIES

The earnings outlook does not look compelling. As detailed in the preceding sections, uncertainty over corporate profits for 2020 is exceptionally high and prospects for next year and thereafter are blurred by risks of a major shift, post-U.S. elections towards a less business friendly policy.

Valuation levels could justify trimming risk. Most metrics are back to record highs. End of June, the S&P 500 price to sales ratio stood at 2.2, close to levels last seen during the Tech bubble in early 2000. Similarly, the S&P 500 12-month forward PE ratio rose above two standard deviations from its 30-year mean. Equity risk premia, a measure relative to U.S. yields, mean reversed but the Treasury market is distorted by the Fed's quantitative easing.

This challenging backdrop would not be complete if we did not mention the record concentration risk: The S&P 500's nine largest capitalizations represent almost 30% of the total capitalization.

Yet, we believe that fighting the monetary wave is rarely rewarding and we stay Neutral on U.S. equities.

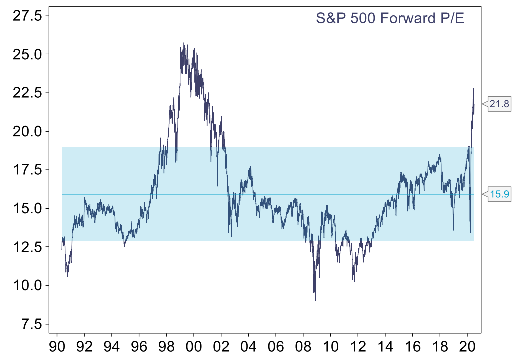
In terms of themes and sectors, at times of great uncertainty, we maintain an O/W stance on Quality stocks that overperformed so far and will likely remain among investors' safe choices. In the same vein, we keep an O/W Staples vs. Discretionary while reckoning that the latter, distorted by Amazon weight, could keep overperforming in the short-run. Banks could start regaining some lost ground as the lengthy recovery unfolds. We maintain a constructive 12-month view at O/W on inexpensive U.S. Banks for their cyclicality. The sector should also benefit from the yield curve steepening. Banks remain under the Fed's scrutiny as shown by the recent limitation on buybacks and dividends to preserve capital, which may weigh on short-term performance.

EURUSD, NOT A NO-BRAINER

Our model, designed to capture macro momentum, monetary, and yield gap influences, suggests an upside potential towards purchasing parity level over the coming months. Policy risks on both sides of the Atlantic add to the case for a firmer EUR: A Democratic sweep at next U.S. elections could affect the dollar while the EC recovery plan, if secured, could strengthen the euro.

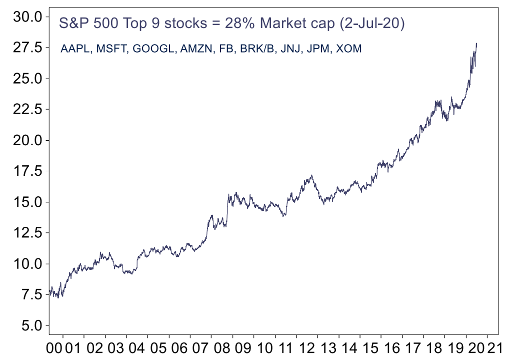
Yet, we refrain from exiting a neutral stance. We believe the control over the COVID-19 spread will affect the pair. Also, speculative positions look already overstretched, keeping us from favoring EUR.

S&P 500 Sales estimates



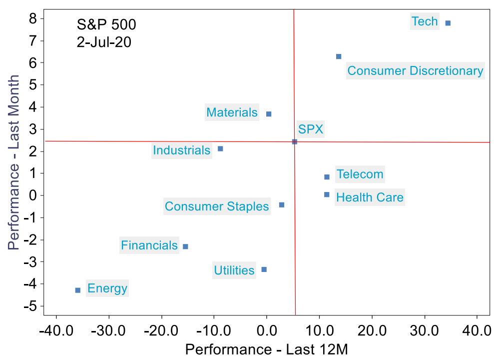
Source: Macrobond, Lyxor AM

S&P 500 Record concentration



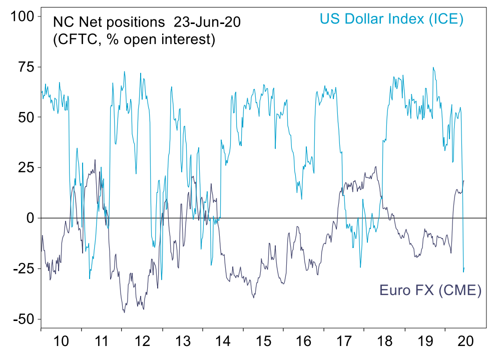
Source: Macrobond, Lyxor AM

S&P 500 Sector Rotation



Source: Macrobond, Lyxor AM

Speculative positions on USD turned short



Source: Macrobond, Lyxor AM

EMU: TOWARDS A TURNING POINT?

The ECB has been on a buying spree, expanding the size of its balance sheet by an unprecedented amount in Q2 2020 (EUR 1 trillion), easing collateral rules (it now accepts "fallen angel" bonds), and announcing new refinancing operations. Net asset purchases reached EUR 155bn in May and it allotted more than EUR 1300bn at the 3-year TLTRO tendered on June 18th, attracting bids from 740 banks. Early June, the size of the Pandemic Emergency Purchase Programme was almost doubled and its duration extended until June 2021. With some assumptions on money demand and net liquidity injections, we project total ECB assets will reach 7.4 trillion in twelve months; or more than 60% of 2019 EMU nominal GDP.

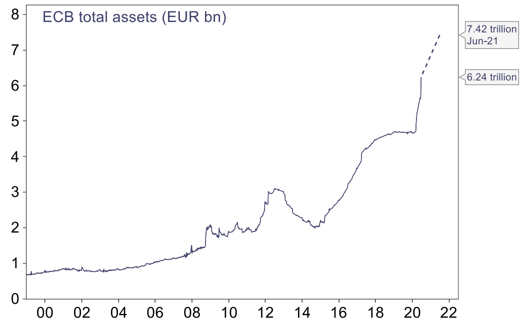
Despite additional ECB purchases, deviations from capital keys coupled with higher sovereign issuance imply that net-net issuance (net of redemptions and ECB purchases) has turned positive for countries such as Germany and The Netherlands. The total estimated increase in German net supply for 2020 will be at least EUR 220bn, exceeding the total anticipated extra ECB purchases of German debt (EUR 160bn). Meanwhile, net-net supply from peripheral countries such as Italy and Portugal has turned negative, suggesting that redemptions and ECB purchases will exceed issuance.

In this context, **we maintain our U/W stance on 10-year Bunds** and expect the yield curve to steepen slightly with the spread between 10y and 2y yields expected to stand at 40bps in 12 months from 20bps at we go to press. Concurrently, **we revised up our stance on peripherals such as Spain and Italy to N from U/W**. We refrain from upgrading peripheral bonds to O/W as the shock on public finances will be massive. Question marks on long term public debt sustainability are unlikely to be solved anytime soon, but after the recent rally we find the risk reward is just fair.

With regards to inflation expectations, we believe that the combination of record policy stimulus (both monetary and fiscal – see below), energy base effects and potentially some price pressures related to the supply shock will likely lift inflation expectations to higher levels. Considering that fact that inflation expectations remain quite low, i.e. below 1% for 10-year inflation swaps, our stance on EMU inflation expectations stands at O/W.

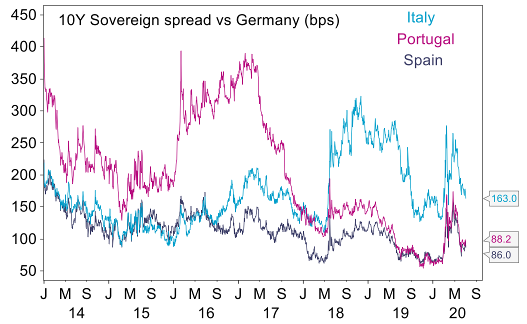
Apart from monetary stimulus measures discussed above, fiscal stimulus also looms large. According to official announcements, the combination of immediate fiscal spending, tax credits/ deferrals and guarantees amount to 45% of domestic GDP in countries such as Germany and Italy. Apart from such national stimulus measures, the European Commission proposal for a

ECB's assets to reach 60% of EMU GDP in 2021



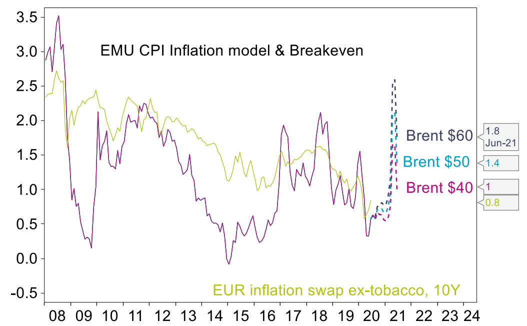
Source: Macrobond, Lyxor AM

The risk reward for peripheral bonds is fair considering ECB purchases



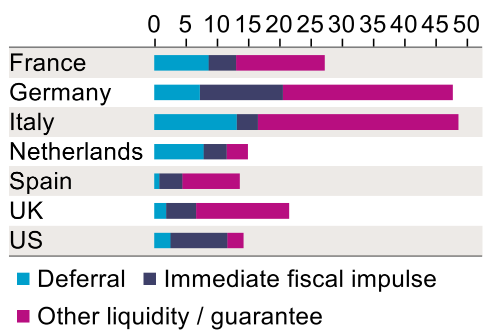
Source: Macrobond, Lyxor AM

Energy base effects will lift headline inflation



Source: Bloomberg, Macrobond, Lyxor AM

Discretionary fiscal measures adopted in response to COVID-19, % of 2019 GDP



As of 15 June 2020. Source: Bruegel, Lyxor AM recovery fund ("Next Generation EU") has the potential to lure back foreign investors.

The key elements of this EUR 750bn proposal, which comes on top of the ESM's EUR 540bn Pandemic Crisis Support Facility, are the following: a EUR 560bn European Recovery And Resilience Facility (of which EUR 310 bn grants and EUR 250 bn loans); EUR 55 bn of additional cohesion policy funding between 2020 and 2022 (grants for municipalities, hospitals, companies); and a EUR 31 bn Solvency Support Instrument (Equity support to viable companies via the European Investment Bank). The proposal has been discussed at the June 19th EU summit and is likely to be finalized in Q3 2020 under Angela Merkel's last EU Council Presidency, which started on July 1st.

The recovery fund will be funded by bond issuance from the European Commission on behalf of the EU and as such, involves debt mutualization between EU members. Bonds are expected to be repaid jointly from 2028 to 2058. The funding is likely to be complemented by taxes (digital services, carbon border adjustment mechanism) but such details are not yet finalized.

SHORT TERM O/W EUROPEAN EQUITIES

The likelihood that this proposal will be delivered soon leads us to upgrade the stance on EMU equities. The standoff with "Frugal countries" (The Netherlands, Austria, Denmark, Sweden) has been on the mixture of grants and loans, and it looks like a compromise had been reached on this at the June EU summit. In terms of timing, Merkel has urged EU member states to reach agreement on the bloc's future budget and Recovery Fund before the summer break. The next EU summit will take place in-person on July 17-18.

The short-term O/W stance on EMU equities is not a valuation call but rather a view on better than expected EPS and economic prospects. The consensus appears to err on the side of caution and potentially positive surprises, coupled with additional stimulus measures discussed above, could help reverting, at least temporarily, the sharp underperformance of EMU equities vs. U.S. equities over the past decade.

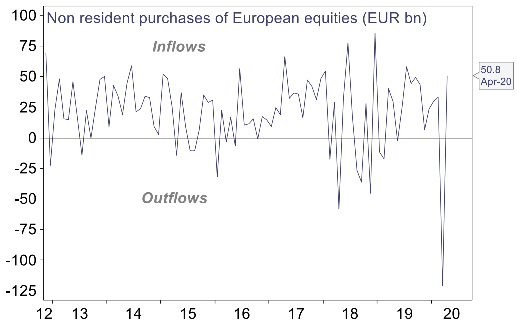
In terms of sector views in the EMU we increase the risk profile of our recommendations. We now have IT stocks at O/W, on robust EPS growth and hefty margins. We maintain EMU Financials at O/W on i) valuation, ii) credit growth which has been fueled by state guarantees, iii) the potential for lighter regulatory pressure and, iv) the expected steepening of yield curves in the EMU. We also maintain Health Care stocks at O/W on valuation and elevated margins. After the Q2 2020 market rebound and despite our overall constructive stance, we are also keen to maintain this defensive sector at O/W. Otherwise, we downgraded defensive sectors such as Communication Services (U/W), Consumer Staples (N).

"Next Generation EU" could be adopted in July

SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	€540 billion
Next Generation EU	Temporary reinforcement €750 billion
Multiannual Financial Framework	€1 100 billion

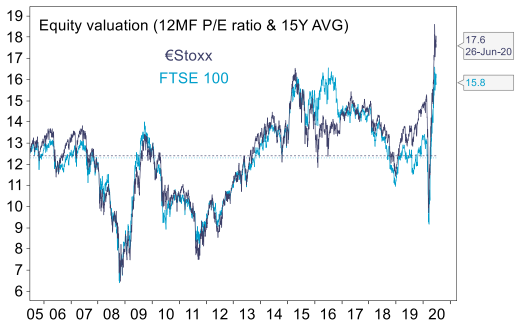
Source: European Commission, Lyxor AM

It has the potential to lure back foreign investors



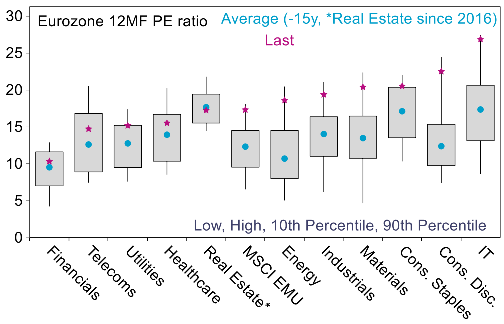
Based on the financial account of the balance of payments.
Source: Eurostat, Lyxor AM

O/W EMU equities, but not for valuation reasons



Source: I/B/E/S, Macrobond, Lyxor AM

O/W Financials & Health Care



Source: I/B/E/S, Macrobond, Lyxor AM

Then, we maintain Energy and Materials at U/W on the expectation that the transportation sector, the main source of energy demand, will remain disrupted in H2-2020. Visibility on dividend policies also remains very limited. With regards to Materials, the sector is richly valued, and capex could remain depressed in current economic conditions. This would pose a constraint on the sectors' future earnings, which the consensus expects to rebound markedly as soon as 2021.

NEUTRAL UK EQUITIES & GILTS ON BREXIT

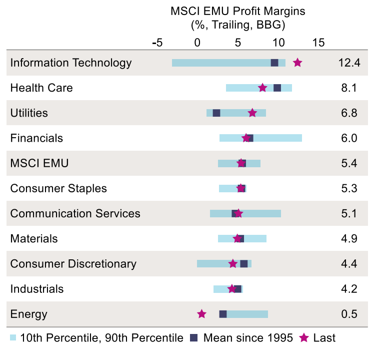
The Bank of England ('BoE') erred on the side of hawkishness recently. It has proved quite accommodative in recent months, following the footsteps of the Fed in cutting rates and boosting asset purchases. But the most recent decision in the second half of June was more hawkish than expected. The expansion in QE came in at the bare minimum of market expectations at GBP 100bn. Moreover, the decision to expand the Bank's asset purchases was not unanimous. The BoE expects the hit to Q2 output to be slightly less severe than previously anticipated and acknowledged some upside risks to the 2020 growth outlook. The BoE is also probably willing to keep some powder dry in case the hard Brexit risk increases materially.

Our stance on Gilts stays N. Short dated yields would stay anchored by the BoE, which made it clear it would refrain from going negative. Meanwhile, we expect the 2y-10y segment to steepen slightly on strong supply.

The hard Brexit risk remains. The timing to find a trade deal with the EU is tight in a context where the UK rejected an extension of the transition period beyond end-2020. The fourth round of negotiations proved inconclusive early June and Boris Johnson unveiled a new plan to unblock negotiations and make substantial progress in July. The Brexit cabinet committee discussed areas for possible compromise, including the right to diverge from EU standards but sanctioned by tariffs. The key aspects of a trade deal include: regulatory alignment, fisheries, a trade dispute mechanism, financial services, and security and law enforcement. A potential strategy to unblock negotiations would involve a partial trade agreement in 2020 with some sectors such as financial services dealt with later in 2021. Yet, ahead of a formal round of negotiations in the week of July 20, there has been limited progress in the talks.

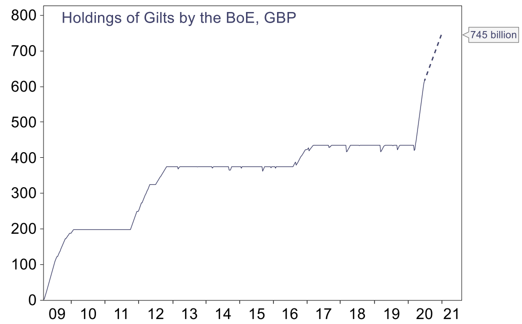
Although we believe the Brexit issue will eventually be dealt with, uncertainty could rise become finding an arrangement. This might accentuate the headwinds for the UK economy. While the FTSE 100 is a defensive index, with a lower beta and a higher dividend yield than other benchmarks, we find it unappealing at present and would wait to have more clarity to rather take positions on the FTSE 250.

Hefty profit margins also a support for IT



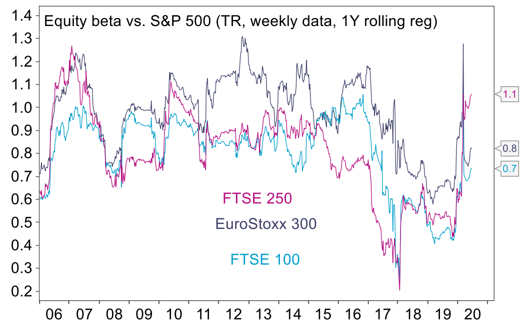
Source: Bloomberg, Lyxor AM

Gilt purchases by the BoE to keep a lid on yields



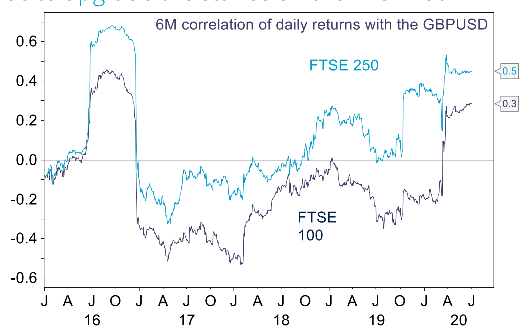
Source: BoE, Macrobond, Lyxor AM

We stay N on the FTSE 100, a defensive market



Source: Bloomberg, Macrobond, Lyxor AM

Some progress on Brexit would probably lead us to upgrade the stance on the FTSE 250



Source: Macrobond, Lyxor AM

JAPANESE ECONOMY: HIGHER RESILIENCE TO COVID-19

Relative insulation from COVID-19. Japan started the year slowed by the series of shocks it endured over 2019. Yet, Japan is likely to outperform most developed countries in Q2 2020, thanks to its relative insulation from the pandemic. Infection cases stayed manageable after the quarantining of the Princess Diamond cruise-ship early February. The larger spreading by end-of-March led authorities to declare a nationwide state of emergency in April and tighten lockdown rules. Finding clusters of infections and tackling their underlying causes (crowded spots such as gyms and clubs) has been the pillar of its response to the virus. With high voluntary compliance but relatively soft social distancing constraints and without large-scale testing, Japan managed to contain the outbreak in a month.

A milder shutdown led to a milder economic toll. So far there has been no major virus reacceleration, allowing authorities to lift the state of emergency by mid-May ahead of schedule.

Two main fiscal packages, representing 15 to 20% of GDP, were designed to mitigate the impact from the plunge in consumption and external demand. However, their economic passthrough might prove more modest than headline numbers. Of the ¥26tn April package and ¥32tn announced in May, about ¥17tn and ¥7tn, respectively, might be spent in 2020. This would represent 5% GDP, which would then be partially saved. The BoJ has not sit idle but its policies focused on backing the government's fiscal expansion.

All in all, Japanese Q2 2020 GDP could settle around -20% qoq SAAR while real-time indicators and economic releases point to a plunge of -30 to -40% in the US and the EMU. While Japan is not expected to fully recover before 2022, the structural cost inflicted by the COVID-19 would be manageable (about 2% of GDP based on the Bloomberg consensus)

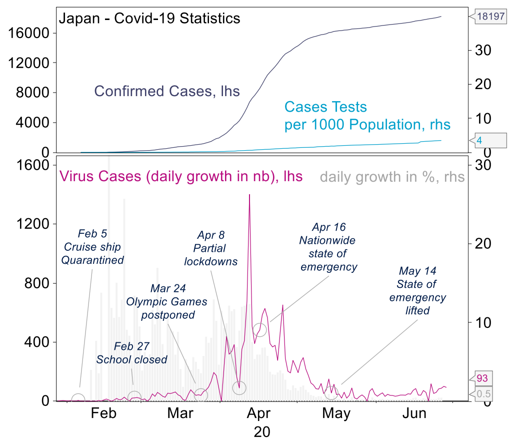
A milder recovery in store. A milder Japanese economic toll than most developed peers would give way to a milder rebound from lows. Japan would also lag due to its elevated relative exposure to external demand. The JPY trade-weighted would be mildly supportive in the short-term, in our view.

Moreover, its economic ties with Asia and China would make its economy more sensitive to any U.S.-China trade escalation.

The boon from lower oil prices is gradually fading while the economic pulse in major oil producing countries would constrain Japan's export outlet.

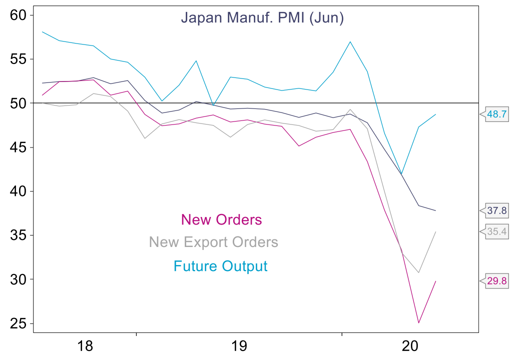
Finally, Japan is likely to carry an adverse inertia from its past shocks (consumption tax, typhoon, delayed Olympic games). In particular the digestion of the higher

Better Japanese insulation from COVID-19



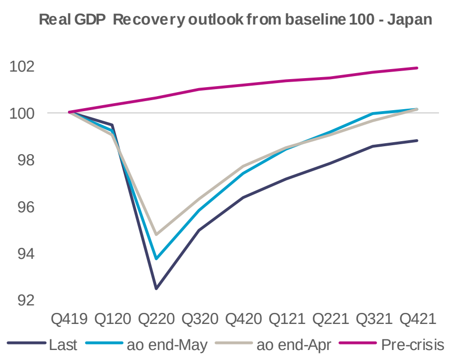
Source: Macrobond, Lyxor AM

Milder activity plunge means milder rebound



Source: Macrobond, Lyxor AM

Japan recovery prospects revised down



Source: Bloomberg consensus, last as of Jul 2, Lyxor AM

consumption tax would be further complicated by the impact of COVID-19 on consumption patterns.

JAPAN EQUITIES: NOT CHEAP ANYMORE

A mixed economic backdrop could also translate in a mixed backdrop for equities.

On the positive side, Japanese equities would benefit from recovering traction in the global economic cycle. More than 70% of the market cap

back to the top

of the Topix 500 is from companies with more than 40% of their revenues from abroad.

The rise in P/E multiple expansion since the virus crisis has also been modest relative to other regions. The Topix P/E forward on full-year 2021 earnings has expanded 1.8 point compared to January. Monetary policies are implicitly expected to have more limited impact on market liquidity than elsewhere. In particular, the P/E forward on FY 2021 EPS expanded 4 points for the S&P 500. This leaves some room for P/E multiple's expansion in Japan.

Japanese equities would also be floored by the positive macro and earnings inflection. Meanwhile, positioning and sentiment indicators still suggest a cautious stance on Japanese equities, which is bullish.

On the negative side, we think the rally since March is getting stretched. Japanese economic out-performance in Q2 2020 is priced. The lower multiple expansion vs. the rest of the world since pre-crisis level reflects lower monetary stimulation than elsewhere. Additionally, companies' guidance is deteriorating – albeit on a smaller sample than usual.

Importantly, we find that absolute and relative valuations are not anymore cheap, with most measures hitting their higher deviation range.

Finally, Japanese equities are capped by increasingly adverse technical and breadth patterns.

Overall, we think that Japanese equities are not cheap anymore and that the rally needs digestion. We stay Neutral for now.

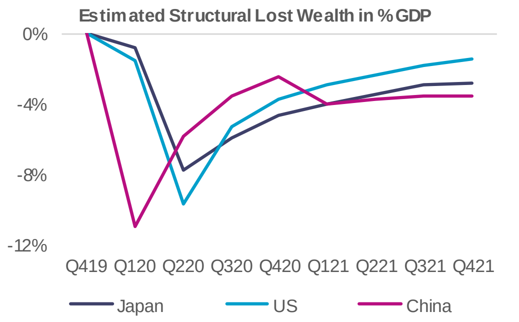
Favor Foreign vs. Domestic exposure. At positive macro junctures, Japanese international-exposed stocks, which have a pro-cyclical bias, tend to outperform domestic oriented stocks. Also, trade-weighted JPY could be marginally supportive.

USDJPY: BATTLE OF SAFE HAVENS

The trade-weighted JPY looks vulnerable in the short-term to a more cyclical stance. Regarding USDJPY, the medium-term outlook is modestly bearish in our view.

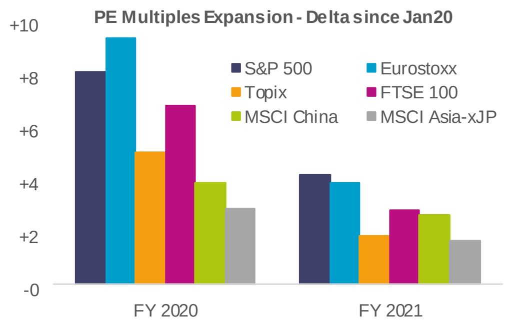
First the convergence in world monetary policies and sovereign yields are supportive for JPY vs. USD. Second, Japanese relative success in containing the virus compared to the U.S. and a milder economic toll are also bullish JPY in the short-term. Third, smaller monetary and fiscal stimulus in Japan than in the U.S. are favoring the yen. Fourth, JPY's safe-haven status may have a more solid ground than the dollar's ahead of U.S. elections. Fifth, weaker cross-border transactions and Japanese investors' carry search

A milder expected structural cost from COVID-19



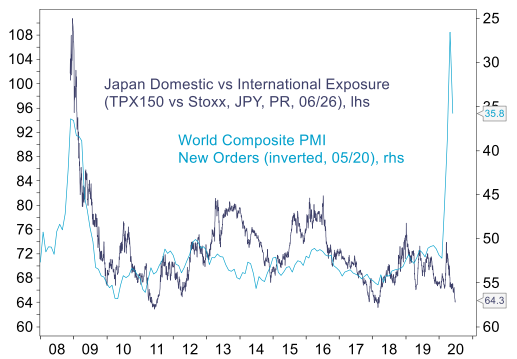
Source: Bloomberg, Lyxor AM

Modest Japan relative P/E multiples expansion



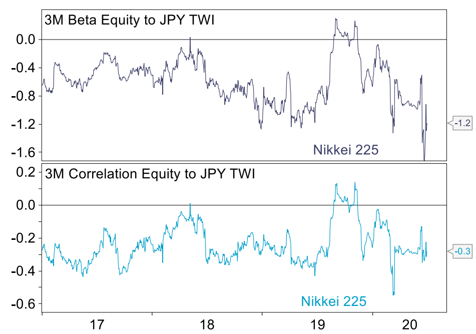
Source: Bloomberg consensus, as of Jul 2, Lyxor AM

Foreign-exposed stocks boosted by global cycle



Source: Macrobond, Lyxor AM

Negative Japanese equity-JPY correlation remains



Source: Macrobond, Lyxor AM

may for once be more supportive for JPY. Finally, technicals are mildly favoring JPY.

We expect these trends to normalize by year-end, after the U.S. elections. We are neutral on USDJPY, with a 3M and 12M target at 106 and 108, respectively.

EM ECONOMIES: BLEAK OUTLOOK IN AGGREGATE, HIGHLY DISPERSED IN REALITY

Multiple macro challenges dampen Emerging market countries' recovery outlook, in aggregate… EM economies are facing multiple shocks at a time, which are darkening their recovery prospects.

The pandemic forced many EM countries to impose social distanciation restrictions among the tightest in the world. While heavily impacting their activity, weaker health infrastructures and weaker people's compliance with lockdown rules resulted in mixed success in combatting the progression of the virus.

In a majority of EM countries, the virus is not contained yet. Latin America has become the new epicenter after the U.S. This would delay their deconfinement or impair domestic demand as economies re-open in countries that are easing restrictions too early.

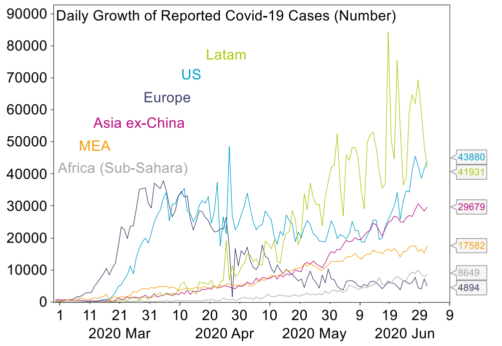
EM countries are also facing a plunge in external demand, with varying sensitivity function of their regional exposures. Latam tends to be more sensitive to trends in the U.S., Eastern Europe relies on the pulse in Western Europe. Asia is more sensitive to Chinese demand (which is improving) and global trade (which is still under pressure). Lead global trade indicators remain depressed and show no pending rebound for now.

While most EM countries are hit both on domestic and external demand, they have weaker leeway to stimulate their economies than in developed country. This would cap their recovery.

Nonetheless, several countries are opting for quantitative easing (QE) or a proxy of it. We think they are facing increased risk of capital flight. These countries include Poland which designed a QE equivalent accounting for 4% of its GDP, targeting 9%, Chile (2.5% and 4%), Colombia (1% and unknown), Indonesia (1% and 1.5%), Hungary (0.5% and 3%), the Philippines (0.5% and 0.6%), South Africa (0.5% and 2%), Romania (1.5%?), Brazil and Turkey (size both unknown).

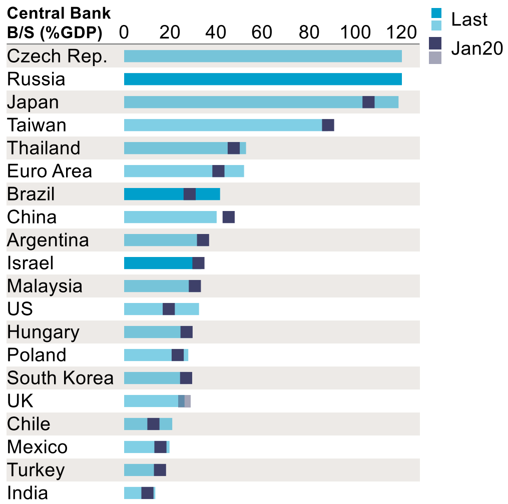
In the medium- to long-term, EM countries are facing deglobalization, a trend that gained steam before the pandemic but that is just likely to accelerate. Globalization and intertwined supply chains would remain in the coming decade, but multilateral trade

Latam has become COVID-19's new epicenter



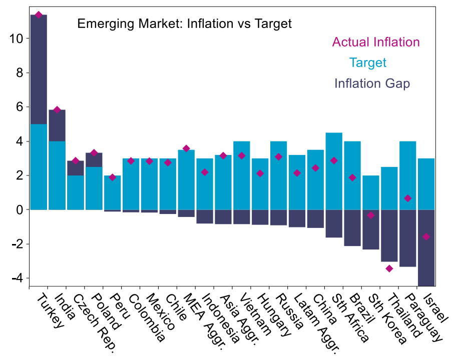
Source: Bloomberg, Lyxor AM

EM countries' uneven monetary leeway



Source: Bloomberg, Lyxor AM

Uneven EM inflation backdrops



Source: Macrobond, Lyxor AM

agreements appear to have reached their limits (in terms of complexity and their lack of flexibility). They might increasingly get replaced by bilateral or partial trade arrangements. We expect more regional and intra-regional trade and supply chains. As a result, the growth in global trade could stand in a [0-5%] range going forward

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vs. a [10-15%] range observed in the last two decades. This would be a major challenge for EM countries, requiring heavy and painful shifts in their economic models

Some countries display acute vulnerability to capital outflows and are burdened by debt, a situation that is likely to worsen due to more fiscal leniency to mitigate the impact from COVID-19.

For these reasons, EM countries economic recovery could lag that in developed countries. The consensus (based on Bloomberg) implicitly expects that Asian countries will recover only once developed countries have. We agree.

Unusual macro dispersion favors relative approaches. The aggregate picture hides highly heterogeneous situations. Divergences that we spotted last quarter only increased since then.

Virus containment as well as the sanitary and economic responses are uneven across EM countries. Single country leverage to regional business cycles (Latam vs. the U.S., CEE vs. EU, Asia vs. China and global trade) diverge. Their sensitivity to fiscal and monetary stimulus implemented in developed countries and in China also vary. Their ability to stimulate their economies (function of their vulnerability to capital outflows and to their external debts) and their sensitivity to commodity prices are uneven. These divergences would all lead to heterogenous recovery prospects.

This is an environment more favorable for relative value than outright trades. Arbitrages seem most appealing in EM FX, equities and Latam credit.

EM EQUITIES MIGHT NOT BE “EARLY-CYCLE”

Not an early-cycle play. EM countries’ fundamentals and an unfinished business with the virus suggest EM equities could lag in the recovery.

We think the risk/reward for EM equities is not compelling enough to venture in an early stance.

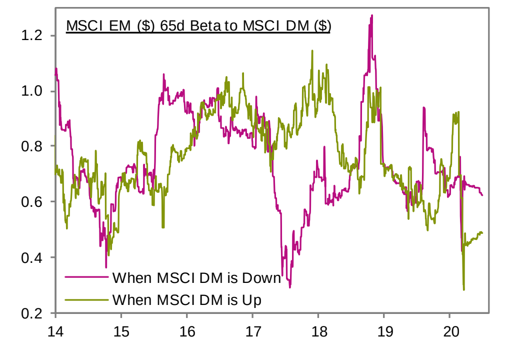
First, market and macro trends look richly prices, both in absolute and relative to developed markets. Second, the sensitivity of EM equities to changes in global trade suggest that their P/E 12M forward already factor a full global trade recovery. Various lead indicators for trade do not suggest a meaningful recovery yet. Third, EM stocks are hurt by a deterioration in their operational and gross margins. Fourth, our tactical indicators suggest the rally since March is getting stretched, with adverse technical, breadth and valuation factors.

EM equities’ recovery might be dependent on global liquidity. Signs of a weakening U.S. dollar could be a critical catalyst. In the meantime, **we are U/W EM vs. DM equities and favor relative value trade within the asset class**.

Better Chinese momentum (O/W vs. EM)

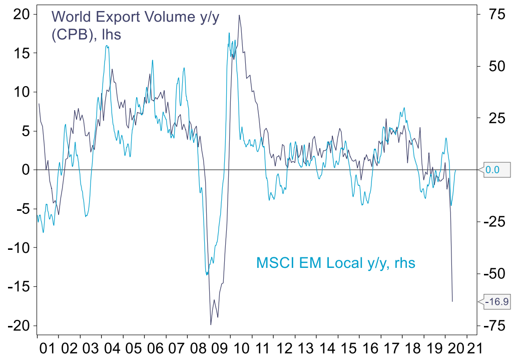
We expect Chinese equities to remain supported by the manufacturing restart and a gradual normalization in domestic demand. Authorities’ tailored fiscal and monetary stimulus, which aims at tackling unemployment and avoid deflation risk, provide a firm floor.

Asymmetrical EM beta to DM equities



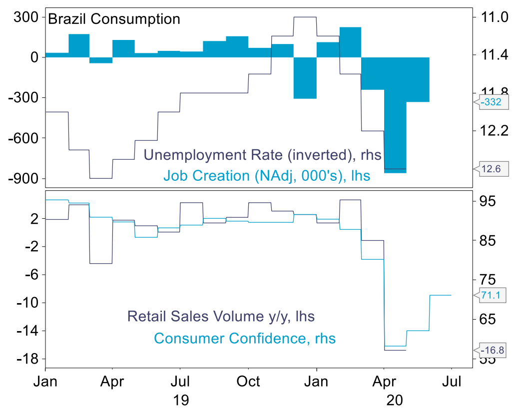
Source: Bloomberg, Lyxor AM

EM equities priced for full global trade recovery



Source: Macrobond, Lyxor AM

Impaired Brazilian consumption



Source: Macrobond, Lyxor AM

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Trade and diplomatic tensions are key risks. They are set to intensify in the medium-term with multiple front lines (tougher integration pressures towards HK and soon Taiwan, rivalry in the South China sea, tech subsidies and cross sales, trade practices and tariffs). Yet, we expect them to remain rhetoric in 2020 or concentrated on the ones having milder economic and market impacts.

The correlation between Chinese and DM equities might increase, given Chinese external demand reliance on DM countries' economic recovery.

Finally, the rally of Chinese equities has not overheated. Absolute and relative valuations are close to fair in our view. Meanwhile, improving margins are positive catalyst.

Brazil's many macro issues (U/W vs. EM)

Brazil economic restart without virus containment is likely to weigh on the recovery. We expect consumption patterns to be impaired and activity to remain sluggish due to the fear factor (real-time indicators suggest activity is still about 25% off cruise levels).

Brazil is facing a severe deterioration in its economic pulse and we expect the recovery to lag the other EM countries.

Political stress has been intensifying for months. Tensions between the President and both the house and the judicial system are likely to worsen. We do not expect an impeachment, but popular support would further wane, limiting the room fro structural reforms. Mr. Bolsonaro's unpopularity could lead to fiscal leniency. Plans to launch a QE could sap BRL ground.

All in all, we think Brazilian risks are insufficiently factored. We are U/W vs. EM equities.

India's worsening outlook broadly priced (N vs. EM)

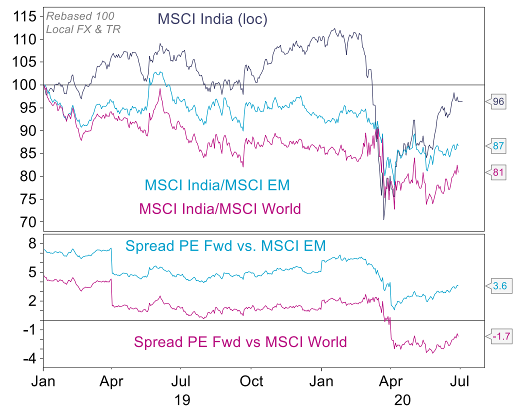
India's economic pulse is deteriorating fast, resulting from a very severe implemented lockdown.

The uneven compliance with lockdown rules (social distanciation is vitally hitting the poorest) seem to have prevented so far, a decisive virus containment. Real-time indicators suggest India's activity is still off about 30% from cruise level.

We fear that the restart of activity will be disappointing. This would force authorities to offer more generous stimulus and other rounds of rate cuts (probably 50bps), leading to weaker financial stability.

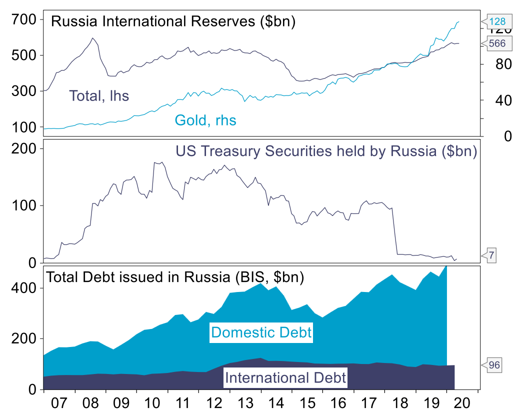
Clash at Indian's border with China is raising the risk premium. Competition between these two powers is

Indian risks are broadly factored in



Source: Bloomberg, Lyxor AM

Russian reserves to mitigate COVID-19 impact



Source: Macrobond, Lyxor AM

set to intensify. Recent events emphasize a less consensual approach from India. Yet, we expect that tension at borders will be deescalated.

On the positive side, Indian equities are better pricing the multiple risks, making us reluctant to turn U/W. We are neutral.

Russia's lighter diplomatic and oil stress (O/W vs. EM)

Russia's economic outlook is worsening, hit by mobility restrictions to tackle COVID-19 and by falling oil revenues. The leeway to make progress on Russia's structural weakness will erode, amid growing popular discontent and shrinking resources for social benefit spending. Its stronger financial stability would help manage the shock. Further stimulus will be needed, with about 100bps of rate cuts in store.

However, new infection cases are steadily declining paving the way for an economic restart. With budget built on a $40/b oil price assumption, the recovery in oil prices is easing pressure. We also expect the standoff with the West to stay

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broadly in check in Q3 2020. Attempt to move forward on implementing the Minsk agreement will probably fail and could ultimately result in new rounds of sanctions. For now, though, the status quo is reducing the risk premium on Russian equities.

Finally, Russian equities lagged in the global and EM market recovery. Relative discount in P/E ratio stand at highs, and tactical patterns are attractive. We are O/W vs. EM equities.

EM HC DEBT – NEUTRAL OVERALL UNTIL VALUATION IMPROVES

Following a sharp tightening in spreads since March, the multiple EM risks do not look well rewarded anymore in EM Hard-Currency debt, in our view.

Absolute and relative spreads are close to their fair value according to models based on economic and market differentials. We also see limited single country outright buying opportunities.

With an overall 5% yield-to-worst, the relative appeal of EM HC Debt to U.S. HY (7%), global HY (6.5%) or CoCos (6%) seems poor.

Strong primary issuance and a stretched momentum since March are also calling for a pause.

However, we keep a neutral stance. Further support from EM central banks and ample global liquidity provide a floor to the asset class.

Besides, none of the index' heavyweights are facing a imminent acute credit issue. With the exception of Argentina, countries that are facing greater default risk are smaller weights. They include Suriname, Zambia, Sri Lanka, Belize, Angola, Tajikistan, Bahamas, and Mozambique.

The global asset re-correlation since March also caught up EM HC debt, which is displaying limited diversification benefit within credit allocations. However, we think that the normalization in trading conditions would reverse this trend, with investors increasingly focusing on the multiple country divergences. EM HC debt is still relevant in credit allocation.

BRENT: DESTOCKING HAS STARTED

Tactically cautious: too fast too strong. Following the sharp rebound in oil prices from record lows, a weaker sense of urgency could cap the near-term upside.

The strategic Saudi-Russian dissent regarding the long-term equilibrium price could return to the fore. Constrained by their budget and their reforms, Saudi Arabia tends to target long-term prices above $70 for

Favoring relative value opportunities in EM

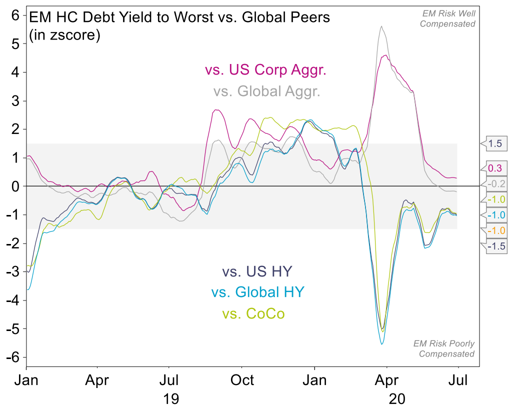
	EM HC Debt			EM FX TWI			EM Equity (local)		
	OAS Spread	Absolute Zsc	Relative to Aggr. Zsc	YTD%	Absolute Zsc	Relative to DXY Zsc	YTD%	Absolute Zsc	Relative to Aggr. Zsc
Latam									
Argentina	2992	-0.1	-0.1	-1.4	0.6	0.5	50.2	-0.4	-0.5
Brazil	438	0.9	1.9	-6.9	-1.7	-1.6	30.5	-0.2	-0.6
Chile	271	0.4	0.2	3.0	-0.6	-0.7	22.9	-1.0	-1.4
Colombia	327	0.8	2.2	8.4	-0.6	-0.6	-2.0	-1.5	-2.0
Mexico	438	0.8	1.8	-0.1	-1.5	-1.4	11.6	-0.9	-1.9
Peru	270	0.7	1.1	-2.2	0.1	-0.7	21.7	-1.3	-1.7
Venezuela	0	-1.4	-1.4	13.2	1.8	1.9			
Asia									
China	317	0.8	0.3	-2.0	-0.1	-0.6	16.1	1.7	1.5
India	424	0.6	0.8	-1.3	-1.7	-1.3	21.2	-0.5	-1.2
Indonesia	260	0.6	0.4	13.9	1.0	0.4	7.7	-1.1	-1.6
Malaysia	215	0.6	0.0	-5.6	-2.3	-1.8	12.9	-0.3	-0.8
Philippines	201	0.9	0.6	2.3	1.9	1.9	16.9	-1.1	-1.5
South Korea	114	0.5	-0.3	0.5	-0.2	-0.5	19.1	0.7	0.9
Thailand	221	0.9	0.4	0.5	-1.1	-1.0	18.1	-1.1	-1.4
MEA									
Hungary	154	0.9	0.2	-0.3	-1.6	-1.2	15.7	-0.7	-1.4
Israel	263	-0.7	-0.8	3.0	1.4	0.5	21.7	0.2	-0.2
Poland	75	0.3	-0.4	1.9	0.5	-0.2	18.8	-1.0	-1.4
Russia	231	0.4	-0.2	14.7	-0.4	-0.5	16.0	-0.3	-1.3
Saudi Arabia	174	0.4	-0.3	-0.2	0.9	-0.1	14.2	-0.9	-1.3
South Africa	499	0.6	0.9	3.3	-1.0	-1.0	27.6	-0.1	-0.6
Turkey	591	0.5	0.5	-4.6	-1.4	-1.3	24.4	0.7	0.8
UAE	237	0.6	0.4				12.6	-1.0	-1.5
Qatar	169	0.4	-0.3	-1.6	-1.8	-1.5	4.2	-1.0	-1.8
Aggregates									
EM Aggregate	394	0.4		0.0	-1.4	-1.0	17.8	0.4	
Asia	310	0.8	0.7				17.1	0.9	1.4
EMEA	387	0.5	0.7	3.4	-0.8	-0.7	16.4	-0.6	-1.8
Latam	573	-0.1	-0.5	-0.9	-1.6	-1.4	24.3	-0.5	-1.1

Very Oversold | Oversold | Neutral | Rich

Note: the table presents absolute and relative 12M Zscore for headline EM countries' debt, FX and equity

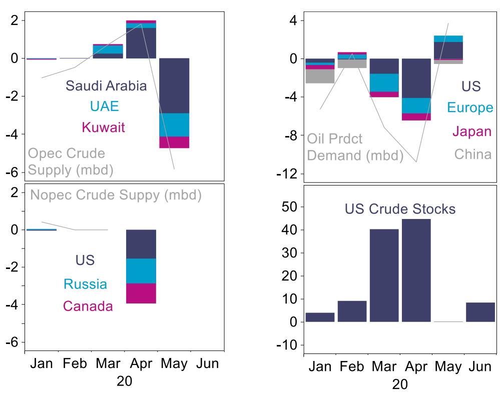
Source: Bloomberg, Lyxor AM

EM HC Debt yield not compelling vs. DM peers



Source: Bloomberg, Lyxor AM

Crude output and demand early normalization



Source: Macrobond, Lyxor AM

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Brent, while Russia might favor a $40/b-$50/b range to maintain its market share. Higher oil prices could result in a weaker OPEC quota compliance. U.S. producers could be tempted to loosen their efforts as prices return closer to their production breakeven. The supply from Libya could also increase by up to 0.5mbd, if the export blockade is lifted.

Demand was arguably better than feared, which rebounded as mobility restrictions eased. We suspect the trend would moderate in the coming months, in line with a gradual and partial economic recovery.

Tactical conditions also look stretched. The rapid repositioning in futures and options suggest institutional investors are back to market-weight. Additionally, buying pressure from banks' gamma hedging might be well advanced.

A slower recovery going forward. Strategically O/W. While the rally in oil prices since March likely needs digestion, we remain strategically O/W. Crude and oil products destocking has started. In particular stocks in Cushing, which epitomized the glut in crude supply, have now peaked. While demand will only gradually recover, China which is leading the way on economic reopening and reports a surge in oil imports that is yet to be reflected in end-demand. Dollar could also be mildly supportive.

We keep our Brent 3M and 12M target at $40/b and $55/b, respectively.

COPPER: FURTHER PROGRESS AFTER A PAUSE

The rally needs digestion. Copper steadily rallied nearly +30% from its lows back in March and is down only -5% from its highs in January when China implemented lockdowns in Wuhan. Stretched technicals and rich valuations compared to other metals, Chinese assets and macro-economic trends are all calling for a pause.

We find that the rally was rather driven by short-covering than by investors' outright repositioning. This would floor prices and give room at a later stage for further upside. Our models suggest that around $5700/t - $5800/t, copper would be appealing again.

In the medium-term, we remain bullish. Chinese imports are surging, pointing to more traction in copper end-demand, with support from infrastructure stimulus. The normalization in excess copper stocks – especially in Chinese warehouses, also bodes well.

The supply side remains constrained, with outage in key producing countries. In particular, the pandemic is impacting production in Chile and Peru. The decline in large miners' capex and exploration spending also point to moderating global output. Meanwhile structural trends in electronics, battery and electric vehicle remain intact in our view.

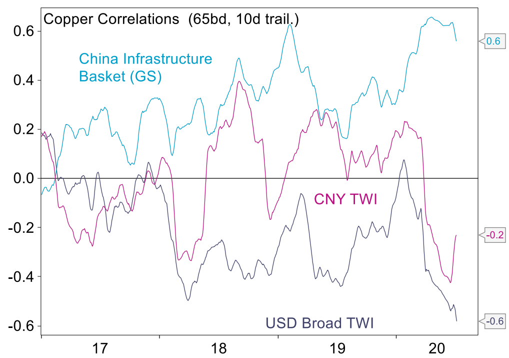
We see copper trading around $6200/t 12M from now. The key risks to our view are a disappointing global economic recovery. A new round of escalation in the U.S.-China trade war would also adversely impact copper.

Will OPEC discipline wane after the rebound?

Key OPEC Members	Ouput % Quota	Output % Spare Capa.	Spare Capacity in mbd
Saudia Arabia	100%	74%	3.0
Iraq	115%	86%	0.7
Iran	-	51%	1.9
UAE	100%	72%	1.0
Kuwait	100%	71%	0.9
Nigeria	105%	74%	0.5
Venezuela	-	76%	0.2
Angola	114%	92%	0.1
Libya	-	7%	1.2
Algeria	100%	75%	0.3
Opec u/ quota	**104%**	**71%**	**9.7**

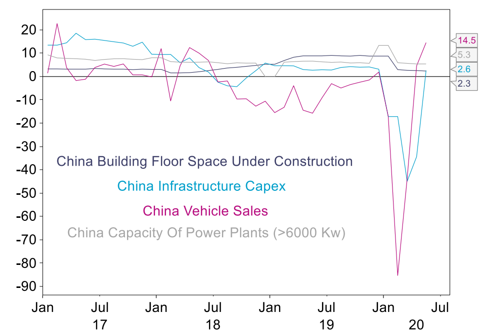
Source: Bloomberg, Lyxor AM

Copper strong correlation to China and USD



Source: Bloomberg, Lyxor AM

Chinese copper end-demand is trending higher



Source: Macrobond, Lyxor AM

GOLD: REMAINING ON HEDGE

Fundamentals remain supportive albeit less than a quarter ago. Massive monetary and fiscal stimulus are likely keep real rates at record lows long after the virus crisis is dealt with. Gold would also remain an appealing alternative to cash, especially for Japanese and European investors. The share of negative yielding debt is exceeding 20% of global aggregate again.

Investors will likely maintain their allocation to gold given the significant execution risks linked to the global recovery, with intensifying threat from local resurgence of cases, a potential second wave by fall, trade escalation risks. In particular, the deterioration of U.S. infection cases, which would eventually be reflected in economic data, are providing a solid ground to gold.

Geopolitics also remains supportive as key mining countries keep struggling with containing the virus.

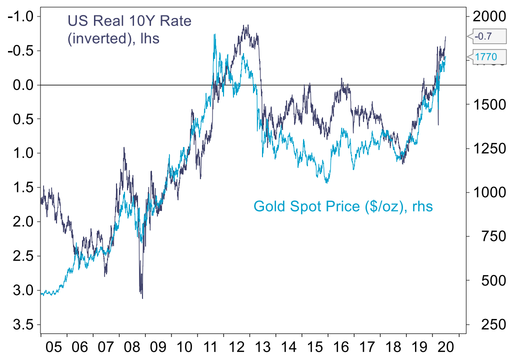
While US dollar could be mildly supportive, we think the richness and the vulnerability of most headline cyclical assets will keep sustained demand for gold.

Tactical conditions are mixed. Trading gold volumes are declining, suggesting a waning interest as prices keep on surging. Positioning remains mixed: gold is a consensual hedge in the retail sector, which is the primary contributor to flows, whereas institutionals stand at market-weight. Relative valuations and measures of the term structures suggest gold prices are close to their fair values.

We expect gold prices to creep higher, but the upside seems more limited going forward. We remain O/W for hedging purposes with a 12M target at $1850/oz, consistent with range trading in the higher bands.

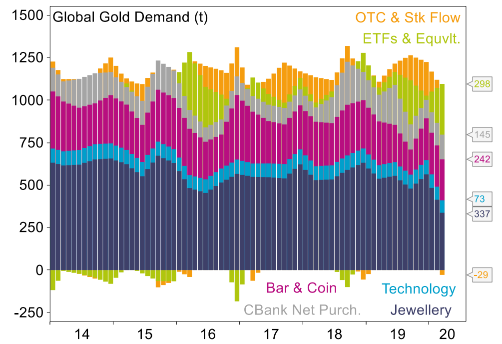
Upside risk would come from a rebound in physical demand for electronics and jewelry. The downside would come from fading tail risks or a firmer economic recovery than expected.

Gold supported by record low yields



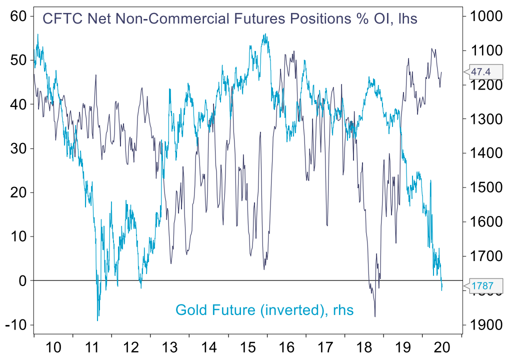
Source: Bloomberg, Lyxor AM

Softening gold physical demand



Source: Bloomberg, Lyxor AM

Gold futures positions close to their highs



Source: Macrobond, Lyxor AM

ALTERNATIVE STRATEGIES

KEY VIEWS

Alternative strategies brought diversification during the turmoil in Q1 2020 and partially captured the rebound in Q2 2020. We estimate the annualized volatility of the MSCI World at 38% in H1 2020 and the volatility of a 50/50 equity bond portfolio at 19% (MSCI World and Barclays Global Aggregate). Meanwhile, the volatility of our Global liquid alternative benchmark stands at 6% during the same period (up to June 23rd). From the perspective of returns, our Peer Groups suggest EM Global Macro, L/S Credit, Market Neutral L/S, and Merger Arbitrage outperformed in H1 2020 (from -1% to -3.5%). On a negative note, Global Macro (Discretionary and Systematic) as well as Special Situations, a subset of Even-Driven, underperformed (from -4.5% to -6.5%).

Going forward, we revise up the risk profile of our recommendations, restoring the O/W stance on L/S Credit and EM Global Macro strategies. Overall, we maintain our preference for Event-Driven and Relative Value strategies (O/W), vs. L/S Equity (U/W) and CTA/ Global Macro (N).

- We increase exposure to strategies such as Global Macro in EM and L/S Credit (both upgraded to O/W). They should benefit from the dispersion among corporate and EM sovereign issuers, which remains high. The search for yield is an investment theme which remains key as central banks keep a lid on yields. But risk mitigation is as important.
- We continue to favor Merger Arbitrage as corporate deal spreads remain elevated (c. 6%). M&A volumes bounced back in the U.S. in June, but not in Europe.
- We maintain L/S Market Neutral at U/W on the back of its sensitivity to factor rotations. The strategy also appears less suitable at this stage of the business cycle.

Finally, our stance on L/S Equity (U/W), Global Macro (N) and CTA (N) remains unchanged. Historically, CTAs faced difficulties when central banks were on a bond-buying spree, causing rangebound markets. However, it seems premature to downgrade CTAs for now and we keep the N stance as the strategy continues to protect portfolios. After the market rebound in Q2 2020 and in a context where COVID-19 infections in the U.S. have raised renewed market concerns, we believe it is adequate to maintain exposure to such strategies.

KEY VIEWS

L/S Equity (Underweight)

U/W L/S Market Neutral

N Directional L/S

Event Driven (Overweight)

O/W Merger Arbitrage

O/W Special Situations

L/S Credit/ Fixed Income Arbitrage (Overweight)

O/W L/S Credit (upgraded)

N Multi-Credit FI Arbitrage (downgraded)

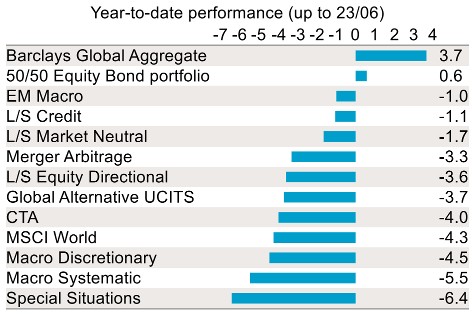
Global Macro (Neutral)

O/W EM Macro (upgraded)

N Systematic and Discretionary Macro

CTAs (Neutral)

Performance of liquid hedge fund strategies



See methodology of Lyxor Peer Groups in the appendix. Indices in total return in USD. Source: Bloomberg, Lyxor AM

Investment views on hedge-fund strategies

	U/W	N	O/W
Hedge Funds	L/S Equity Market Neutral	L/S Equity Directional Global Macro Systematic Global Macro Discretionary CTA FI Multi-Strategy	Special Situations Merger Arbitrage L/S Credit EM Global Macro

(-) is a downgrade; (+) is an upgrade
Source: Lyxor AM

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CTA & MACRO (UNCHANGED AT N)

CTAs have navigated the market selloff remarkably well. Yet, they gave back some of their returns in Q2 2020 on the back of long positions in fixed income and defensive trades in commodity and FX markets. Long precious vs. base metals and short energy trades detracted from the performance of strategies invested in commodities. Short EUR positions vs. USD were also challenged by the appreciation of the common currency as the EU considers some form of debt mutualization.

CTAs protect against downside risks thanks to low exposures across asset classes. The strategy cut long equity positions in February and stays long on fixed income and the USD but at much lower levels than earlier in the year. Yet, CTAs faced difficulties when central banks were on a bond-buying spree during the last decade, causing rangebound markets. After the Q2 2020 market rally, CTAs remain somewhat attractive (N).

With regards to Global Macro, we observed an elevated dispersion in returns in Q2 2020. EM Macro outperformed (+8.4%) while Systematic strategies underperformed (-1.5%). Then, Discretionary strategies stood in between (+6.8%) as they also benefitted from the rally in EM assets (equities and bonds). The spectacular rebound in oil prices was a critical support for EM issuers.

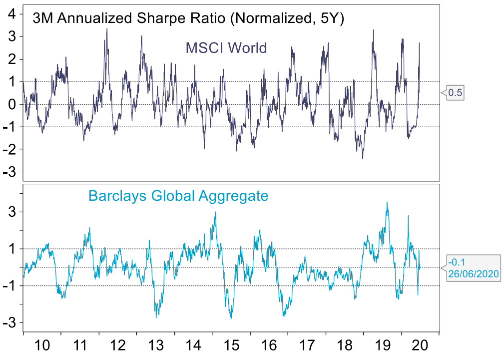
Going forward, we restore the O/W stance on EM Global Macro. They could benefit from the elevated dispersion among corporate and EM sovereign issuers. The search for yield remains a critical investment theme as central banks keep a lid on yields. But risk mitigation is as important and alternative managers have a good track record, with a volatility in daily returns divided by a factor of 2 in H1 2020 compared to the EMBI Global Diversified, a hard currency bond benchmark.

UPGRADE L/S CREDIT TO O/W

We restore the O/W stance on L/S Credit strategies for similar reasons that above: the search for yield with risk control and higher dispersion between corporate issuers as corporate restructurings and default rates jump. The latter is a source of alpha opportunities for L/S Credit managers.

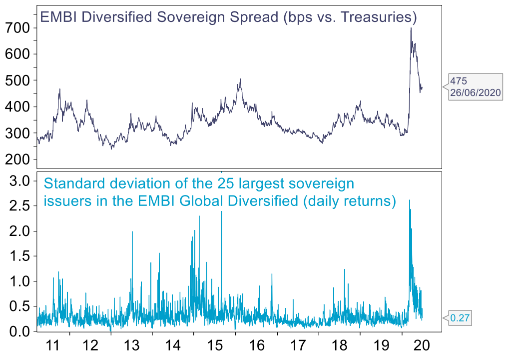
Historically, such strategies have proved sensitive to a deterioration of liquidity conditions, causing wide moves in credit spreads and related derivative instruments. Although we are aware of downside risks, we believe liquidity issues are being addressed by central banks, which have provided unprecedented funding to the financial system on both sides of the Atlantic. The deterioration of credit quality is also an issue as the contraction of economic activity caused damage on corporate balance sheets. Yet, L/S Credit strategies have proved cautious in their positioning.

CTA bring protection at present



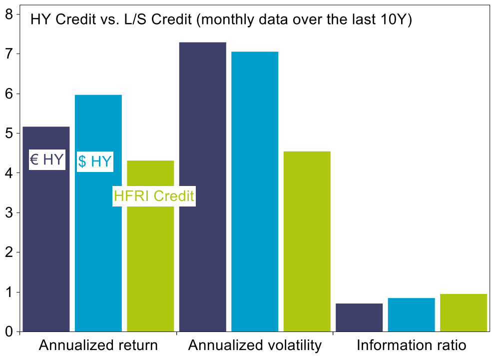
In total return and FX hedged. Normalized series (mean zero and standard deviation 1). Source: Macrobond, Lyxor AM

O/W EM Macro; issuer dispersion stays high



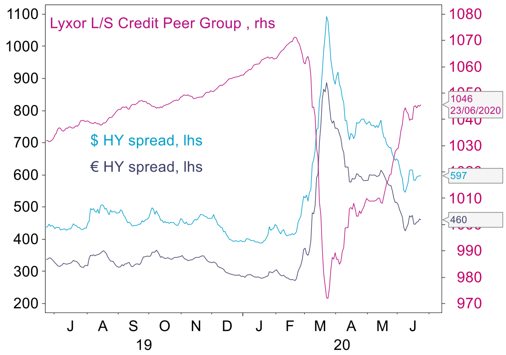
Source: JP Morgan, Bloomberg, Macrobond, Lyxor AM

L/S Credit for yield with risk control



Source: HFRI, Markit, Macrobond, Lyxor AM

L/S Credit strategies almost closed the Q1 2020 gap



Source: Bloomberg, Macrobond, Lyxor AM

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EVENT-DRIVEN (UNCHANGED AT O/W)

Event-Driven strategies rebounded in Q2 2020 after having registered sharp losses in Q1 2020. For H1 2020, Merger Arbitrage still managed to outperform, down -3.3%. But volatility in returns was higher than usual. Special Situation strategies were down -6.4% in H1 2020; They managed to keep volatility in returns at reasonable levels, far below equities.

Our stance on the strategy stays at O/W. The likelihood of higher corporate action in the world post-COVID-19 (spinoffs, tender offers, mergers & acquisitions, bankruptcy, litigation, capital structure dislocations, shareholder activism) should be a structural support. M&A volumes appeared to be rising from the ashes in June and the consolidation in the health care sector is far from over. Merger Arbitrage remains a defensive strategy while Special Situations is more sensitive to market gyrations. Special Situation and distressed strategies offer a leverage on global economic activity, which has started to rebound in June.

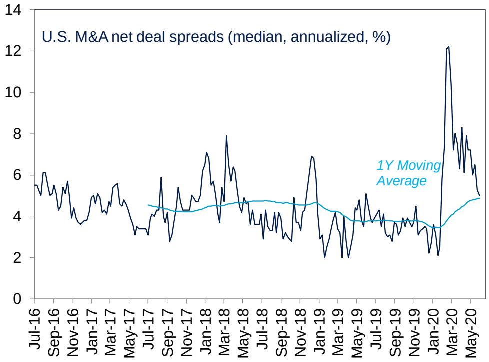
With deal spreads close in the range of 5-6%, the Merger Arbitrage strategy is a source of carry in a low bond yield environment. Deal spreads have nonetheless been volatile, as transactions such as Tiffany vs. LVMH and Delphi Technologies vs. BorgWarner entered a period of uncertainty. The strategy will nonetheless smooth out market gyrations to the extent that its equity market beta has normalized at lower levels. At this early stage of the economic recovery, Merger Arbitrage is the only defensive strategy that we have at O/W.

L/S EQUITY: PREFER DIRECTIONAL (N) TO MARKET NEUTRAL L/S (U/W)

L/S Equity strategies were somewhat disappointing in H1 2020, with Directional strategies down -3.6% and Market Neutral ones -1.6%. Yet, the negative beta contribution for the most directional managers was offset by alpha generation driven by favorable sector and factor exposure. Our estimates suggest that Directional managers have reduced their beta below 20% at present and do not have strong style biases apart from a slightly short momentum exposure. Alpha generation has been elevated in the second half of Q2 2020. We stand N on the strategy and advise selectivity. We prefer flexible strategies that can adapt their market beta dynamically.

With regards to Market Neutral strategies (U/W), they somewhat protected portfolios during the selloff but did not capture the beta-driven market rally. They appear to be less suitable at this stage of the business cycle, with their sensitivity to factor rotations being a structural hurdle.

Wide deal spreads as a source of opportunity

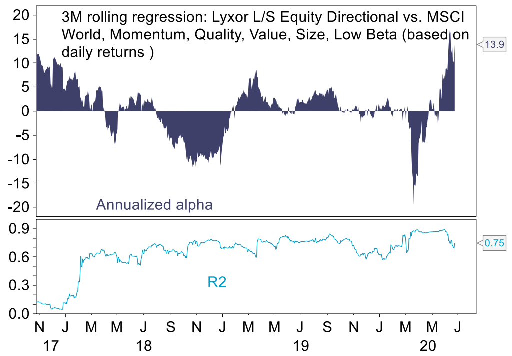


Deal universe includes spreads in the 0-30% range. Source: UBS, Lyxor AM

Merger Arbitrage beta normalized at lower levels

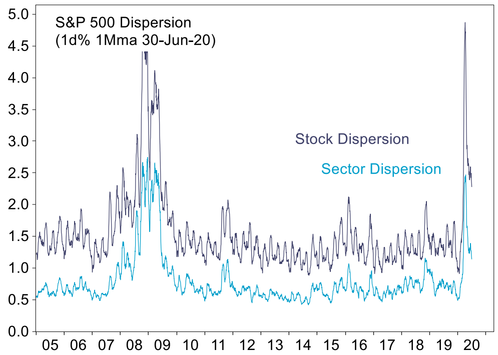
Source: Macrobond, Lyxor AM

Alpha generation has been supportive lately



U.S. market Neutral risk factors. Source: Dow Jones, Macrobond, Lyxor AM

Dispersion: an opportunity for some L/S



Source: Macrobond, Lyxor AM

METHODOLOGICAL APPENDIX ON LYXOR ALTERNATIVE UCITS PEER GROUPS

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 team of hedge fund analysts.

Performance is calculated on a daily basis, using an arithmetic average (equally weighted average).

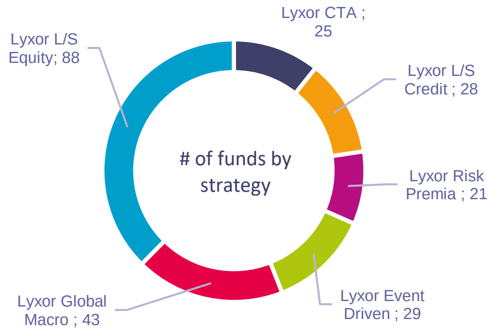
Regarding share classes used in these peer groups, we selected the primary share class as referenced in Bloomberg. Non-USD share classes are hedged in USD based on hedging costs available on Bloomberg.

As of March 2020, there are 234 strategies across the main categories in the industry, representing USD 196 billion of assets under management.

The criteria of inclusion are fourfold:

- We only include UCITS strategies;
- Assessment by Lyxor's Hedge Fund selection team based on funds' materials or manager interaction;
- We only include strategies with assets under management of at least USD 50 million; and
- We only include strategies with at least a one-year track record.

Lyxor Alternative UCITs Peer Groups: number of funds by strategy



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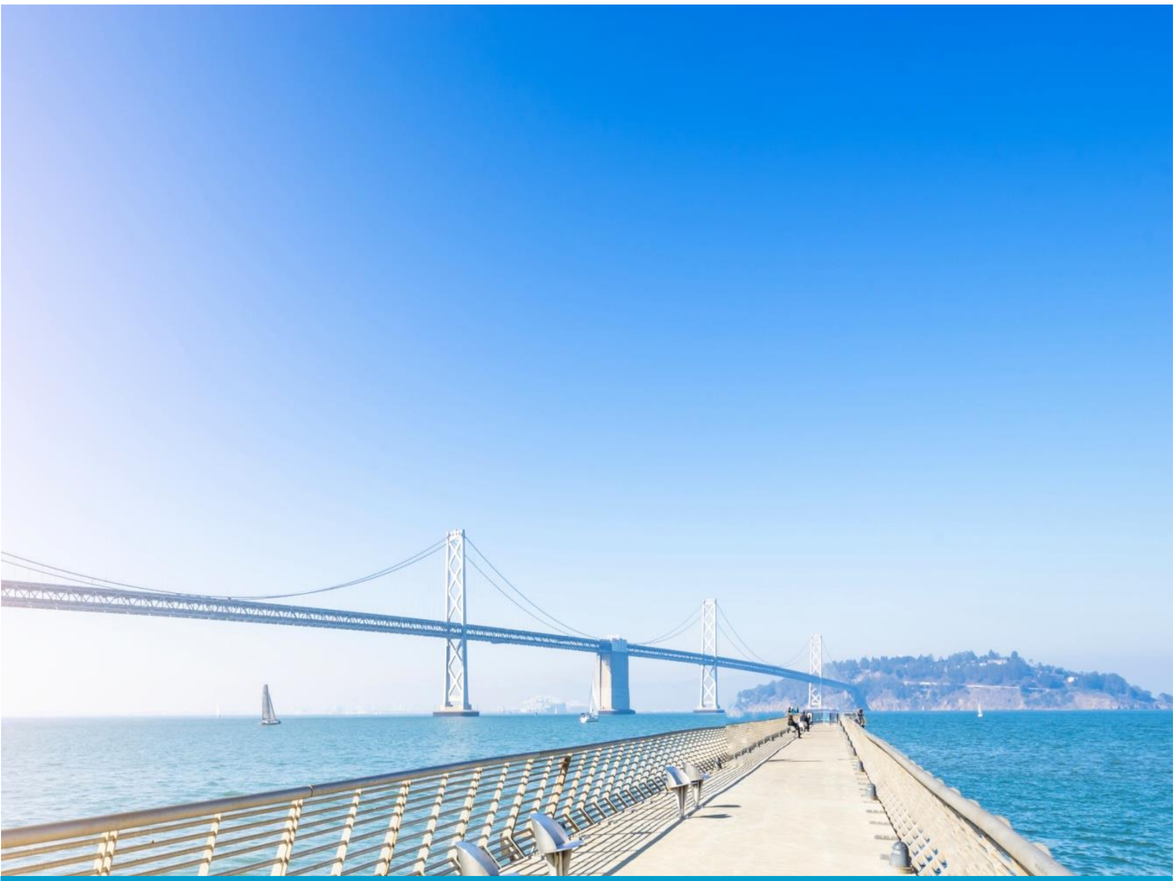

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