Hedge Funds Putting Their Best Foot Forward Q2

Following a strong Q1, hedge funds have kept performing as we move to the next quarter. The Lyxor Hedge Fund Index is up 0.4% over the week with all but one strategy closing the week positive. A disappointing job report for the month of March in the US was the main event of a rather quiet start to April. This is leading to a reassessment of US monetary policy and driving risk assets and commodities higher. Markets have actually experienced significant moves in the commodity space. In particular oil prices rebounded sharply with the WTI up 13%. The drop of energy prices has been one of the major themes of recent months, and continues to impact the performance of Hedge Funds.

On the CTA side, the strategy was down 0.4% over the week. The sharp rebound of oil prices and the commodity complex as a whole detracted as managers have been increasing their short positions on the asset class since the start of the year. Long USD positions also contributed to losses as the greenback lost some ground last week, especially against EM currencies. Losses have been mitigated by gains on equity and fixed income positions, which are still benefiting from the dovish tone of global central banks.

The Lyxor Global Macro Index is up 0.7% over the week. Commodities globally added to the gains, long exposure to agriculturals and to the energy sectors proved particularly discriminating among macro managers as oil and grain prices soared. Fixed Income and Equity buckets also contributed positively to performance.

L/S Equity strategy has been positive for the start of April, posting a 0.6% return. Managers benefited from a global risk-on sentiment driving up equity markets across regions. Emerging managers and especially Asian ones outperformed. Chinese equity markets continued to rally, fuelled by a number of recently announced, accommodative policies.

Lastly, Event driven funds kicked off Q2 on a positive note (up 0.4%), with gains coming from various sectors. Royal Dutch Shell, with its takeover of BG Group for $70bn, has opened the way for a round of consolidation in the energy sector, which is testimony of how falling energy prices have put pressure on the industry. While remaining cautious, increasing opportunities in this sector should help managers to generate performances.

Hedge Funds on the right track to deliver a good Q2

(Lyxor HF indexes performance)

Source: Lyxor AM, asset weighted.
Shell buys BG: towards a further consolidation across the energy industry?

Royal Dutch Shell announced on Wednesday a £47bn takeover, excluding debt, on its rival BG Group. By acquiring BG, Shell would increase its oil and gas reserves and production and take a strong position in the liquefied natural gas business. This move takes place in response to the slide of the oil price, one of the key factors behind the deal. Lower oil prices drag down the valuations of energy groups, creating opportunities across the industry. This could usher a new wave of mergers and acquisitions. Since the announcement, Shell B Shares have slid 9% while BG Shares have jumped +27%.

Rebound of Emerging Markets support L/S and Macro managers

Emerging markets have strongly performed last week, on the back of a lower USD, higher commodity prices and local, idiosyncratic factors. The MSCI EM was up 3.25% over the period, while the JP EM FX index was up 1.72%. This was a strong driver of gains for hedge funds, which benefited from their beta exposure on EM equity indices, especially in Asia. Macro managers gained from their long exposures on fixed income and FX markets.

Since 2014, as demonstrated here, EM indices are significantly down but we have seen an improvement in equity performance year-to-date. Fixed income and FX market conditions have been quite difficult, to say the least, as top-down factors (Fed expected tightening, oil prices, geopolitical risks) have been the main drivers of EM performance, while countries’ fundamentals have taken the back seat.

THE WEEK IN 3 CHARTS

Hedge Fund Snapshot: Global Macro benefited from Oil trend reversal

Global macro was the top performer last week, +0.7% supported by almost all asset classes. Managers were well positioned to reap the benefits from the jump in both oil prices (WTI up +13.4% last week) and higher commodity prices. In contrast, CTAs (-0.4%) suffered partly from these trend reversals as well as a lower US Dollar.

L/S equity delivered healthy returns (up 0.6%) as they benefited from the rally in the China A share market. In particular, one Asia-Pacific region manager returned an impressive return of 5.44% last week.

Event Driven continued to perform well, up 0.4%, fuelled by deals played in the communications and energy sectors among others.

Source: Bloomberg, Lyxor AM
CTAs

CTA Broad Index  | WTD* | MTD | YTD
---|---|---|---
CTA Long Term | -0.5% | -0.5% | 9.2%
CTA Short Term | 0.0% | 0.0% | 3.7%

CTAs gained on their long positioning on US rates

(Net Exposure on Fixed income, % NAV)

Loss of Energy

CTA funds had a mixed performance last week, with most losses generated on trend reversals on both commodities and the U.S. Dollar. However, negative returns were partly offset by gains on equity and fixed income positions, which are still benefiting from the dovish tone of global central banks. Short-Term CTAs provided protection in this unfavourable environment, on average ending the week marginally positive.

On the negative side, the sharp rebound of oil prices (WTI contracts gaining more than 13% over the period), and the commodity complex as a whole were quite detrimental. Managers have been increasing their short positions on the asset class since the start of the year, on the back of lower prices across all sectors. The year-to-date moves were partly caused by a stronger U.S. Dollar, which is also one of the main current bets in the book: the greenback lost some ground last week, especially against EM currencies.

On the positive side, bonds and equities kept moving higher during the week, especially U.S. rates and European equities. Small losses were generated on European rates, as managers are on the long side and the long part of the Euro curve went marginally higher.

GAINS ON OIL TREND REVERSAL

Macro managers produced positive returns last week. The weakening of the dollar, while limited compared to its year-to-date gains, impacted all asset classes. Emerging markets were a notable driver of performance as a consequence of such depreciation.

Commodities globally added to the gains as prices rallied on the back of a lower greenback. Long exposure to agriculturals and to the energy sector proved particularly discriminating among macro managers as oil and grain prices soared.

Fixed income contributed positively to the strategy’s performance. Long U.S. duration and short Europe duration added to gains last week. The biggest gains, however, were made in Brazil and in Mexico as respective rates declined strongly.

The long European equity positions contributed as stock prices resumed their upward trend on the back of the global dovish environment.

Currencies were the only negative book this month, impacted by the large short euro allocation. The strong appreciation of the Russian rouble, Brazilian real and Colombian peso also impacted performance.
The first week of April saw a continuation of the strong trends of late, with all major indices in positive territory. In this context, 2/3 of our equity managers generated positive returns, led by our EM focused managers, which on averaged posted a return for the week of +1.2%.

The best performer was a long-biased manager focusing on the Asia-Pacific region, returning an impressive +5.4% for the week, driven by longs in consumer-cyclicals, industrials and technology stocks. This manager has been able to benefit from the strong rally in the China A share market (see graph) despite running a beta-adjusted net exposure of only +45%, pointing to strong alpha generation on both the long and short side.

Variable biased and market neutral quant managers in Europe also fared well. The picture in the US was less rosy as several of our managers suffered losses. The worst performer last week suffered from negative alpha on both the long and short side, in particular in the energy and communications sectors, but remains the best performing US fund on a YTD basis.

Event driven funds kicked off Q2 on a positive note, with gains generated from various sectors and idiosyncratic events.

The positive developments of the Vivendi situation contributed to the funds’ performance. The company’s agreement to lift shareholder payouts and the chairman’s increase in the stake were viewed as encouraging to the future of the business.

Energy-related names like SunEdison, Cobalt International Energy and Whiting Petroleum were also among the prominent gainers. On April 8th Royal Dutch Shell announced a $70 billion cash-and-stock acquisition of BG Group which included a hefty premium of around 52% to the 90-day trading average of BG. This is the first major energy industry merger in more than a decade and yet the biggest deal year to date. While the market granted a 32% price surge to BG, event driven managers are taking a cautious approach rather than rushing into holding a directional position, due to the volatility in the oil space.
CB & VOL ARBITRAGE

Convertible bonds performed well last week on the back of Equity and Bond improvements. Despite a strong outperformance on Equity in Europe, convertibles posted similar performance on both sides of the Atlantic. If credit spreads behave likewise, moves in interest rates and implied volatilities may offset the divergent impact of the equity portion.

From an arbitrager perspective, the U.S. proved very well as implied volatility kept on rallying sharply last week increasing valuations in the asset class and reducing the gap with their European peers. The primary market was disappointing though, with only one new issue coming from Europe and accounting for approximately $550m.

The convertible managers on the Lyxor platform posted an attractive return, taking advantage of the positive development of the asset class in the U.S. This is especially true for the High Yield space which found some relief in the pickup in Oil prices.

Vol Catches Up in the U.S.

Credit markets returned a positive performance last week. On both sides of the Atlantic High Yield bonds recovered after a difficult end to the month. Merrill Lynch H.Y. spreads, helped by the rebound in oil prices, tightened by 10 bps in the U.S. and 8 bps in Europe. The Greek situation improved as the Finance minister announced that last week’s obligations will be met, thus removing some market anxiety. As a result, Greek bonds index was up by 1.2%, a rebound after an extremely disappointing March.

EM also posted a positive performance. Venezuela and Russia outperformed, taking profit from oil prices. On the Chinese markets the real estate sector was particularly rewarding as supportive measures have been announced to boost demand.

Lyxor credit arbitragers ended the week in positive territory taking advantage of a slight rebound of Greek bonds and European financials. The Asian focused fund outperformed the markets thanks to its exposure to the Chinese real estate sector and financials. Missed coupon payment on one name from U.S. H.Y. sector detracted performance of one of our funds.

L/S CREDIT ARBITRAGE

Credit markets returned a positive performance last week. On both sides of the Atlantic High Yield bonds recovered after a difficult end to the month. Merrill Lynch H.Y. spreads, helped by the rebound in oil prices, tightened by 10 bps in the U.S. and 8 bps in Europe. The Greek situation improved as the Finance minister announced that last week’s obligations will be met, thus removing some market anxiety. As a result, Greek bonds index was up by 1.2%, a rebound after an extremely disappointing March.

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METHODOLOGY

Breakdown of AUM by strategy

- Approximately 80 funds in the platform
- USD 7.7 billion of assets under management (as of December 30, 2014)
- Replicating USD 200 billion of AUM

Lyxor Hedge Fund Indices

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

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

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