HEDGE FUND SURVEY: CONTINUED APPETITE FOR EQUITIES; RISING CAUTION ON US CREDIT

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We would like to thank Christopher Teixeira for his valuable contribution to this report.

In this report, we discuss the results of a survey conducted at the end of June of hedge fund managers on the Lyxor platform. Managers were asked to give their views on monetary policy, equities, fixed income and credit, FX, China and energy prices.

- Overall, the results of the survey indicate positive sentiment concerning risk assets. Equities are largely expected to continue to rally, both in the US and Europe, on the back of accommodative monetary conditions recently reiterated by Janet Yellen. However, on the negative side, our managers express caution regarding US credit and China (see diagram on page 2).

- The majority of the respondents to our survey currently expect the central banks to remain extremely accommodative. According to our managers, the ECB and the BoJ should implement (or expand) quantitative easing programmes in the second half of 2014. At the same time, only 47% of respondents think that the Fed will lift rates in the first half of 2015. As a result, 10-year Treasuries are not expected to reach 3% over the next six months.

- An important finding of our survey is that hedge fund managers are increasingly cautious regarding US credit. This is being seen in the context of rising fears concerning financial stability following the extended period of near-zero interest rate policies implemented by the major central banks (see link). According to our survey, 65% of the respondents do not expect the credit rally to continue.

- Finally, the bullish stance on equities, both in Europe and in the US, was largely shared by the respondents to our survey. The level of agreement that US equities are not overvalued and European equities remain undervalued is very high (see chart on page 2).

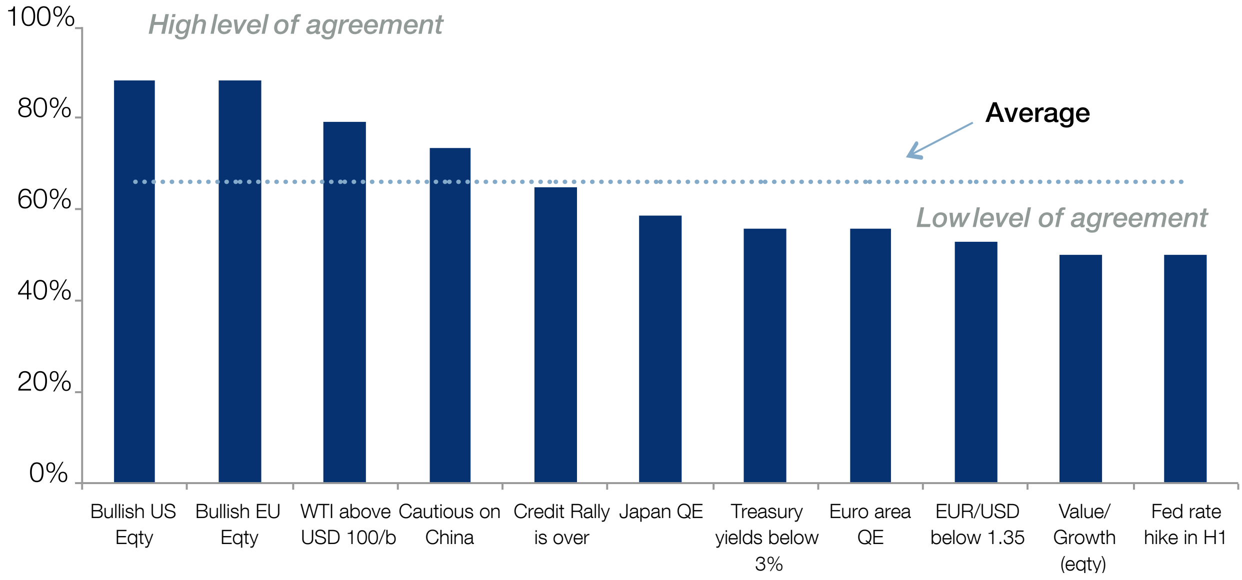
- In this report, we provide investment recommendations associated with the results of the survey. These recommendations range from L/S credit in Europe, L/S equity in Japan, Global Macro (to invest in the QE themes) to CTAs (to hedge against geopolitical risks). All investment ideas can be implemented on the Lyxor platform. Please contact your local sales representative for further information.

Our survey indicates positive sentiment concerning risk assets

Monetary Policy			Fixed Income & Forex		Equities	
US	**Euro area**	**Japan**	**Rates & Credit**	**Forex**	**Bullish or Bearish?**	**Invest with style**
50% of respondents do not expect a rate hike in H1-15	56% of respondents expect the ECB to implement QE in H2-14	59% of respondents believe the BoJ will expand its asset purchase programme in H2-14	56% believe 10Y yields in the US to remain below 3% in H2-14 65% expect the credit rally to come to a halt	53% of respondents expect the EURUSD to end the year 2014 below 1.35	88% are bullish on US equities; 71% consider they are not overvalued. 88% are bullish on eurozone equities and consider they remain undervalued.	50% of respondents do NOT expect value stocks to outperform growth stocks in H2-14

Source: Lyxor AM

There is a broad level of agreement on the bullish equity stance



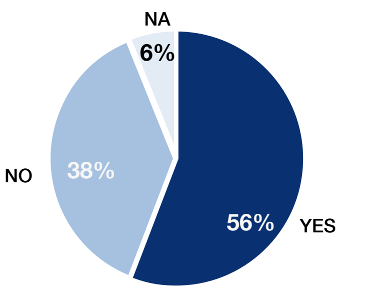
Source : Lyxor AM

ACCOMMODATIVE MONETARY CONDITIONS TO CONTINUE: SUPPORT FOR EUROPEAN CREDIT AND JAPANESE EQUITIES

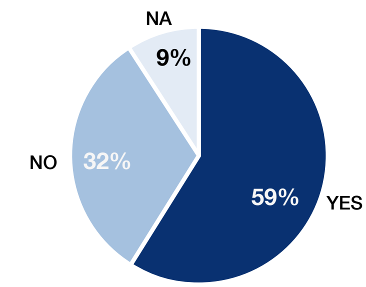
The global economy has seen unprecedented accommodative monetary conditions over the past six years. The hedge funds managers who participated in our survey do not expect the central banks to reverse their dovish stance anytime soon.

The majority of our respondents expect the ECB and the BoJ to implement (or expand in the case of the BoJ) quantitative easing programmes in the second half of 2014, with a high degree of conviction. At the same time, only 47% of the managers surveyed expect the Federal Reserve to lift rates in the first half of 2015.

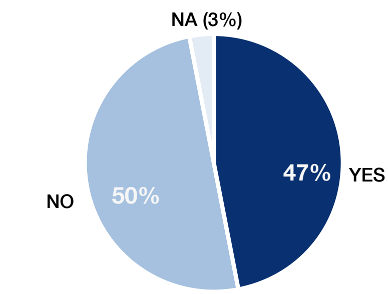
Do you expect the ECB to implement quantitative easing in the second half of 2014?



Do you expect the BoJ to expand its asset purchase programme in the second half of 2014 ?



Do you expect the first rate hike from the Federal reserve will take place in the first half of 2015 ?

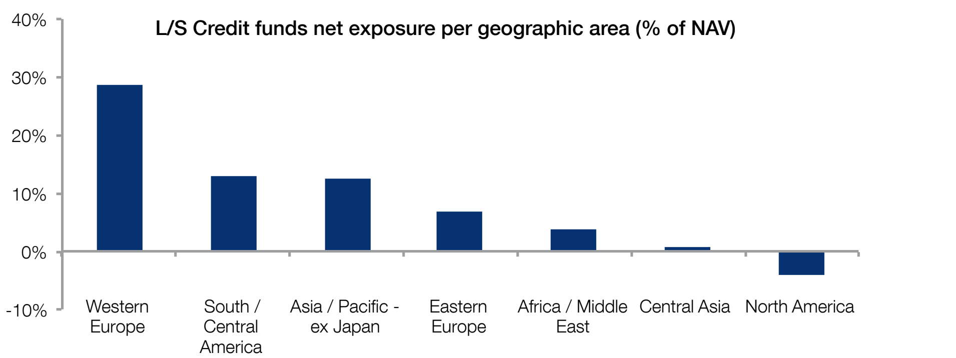


Source: Lyxor AM

Market implications: If materialised, these expectations imply that global risk assets will continue to be supported by the dovish stance of the Fed, which was reiterated Janet Yellen on several occasions recently (see link). European fixed income and high yield credit would receive an additional boost if the ECB moves forward with QE. Equity volatility would remain low as long as the "Yellen put" remains intact. In Japan, QE expansion would support the Nikkei.

Alternatives strategy: L/S Credit funds focused on Europe and L/S equity funds focused on Japan should do well if these expectations effectively materialise.

Lyxor L/S Credit should do well if the ECB launches a formal QE programme as expected



Asset weighted. As of 24 June 2014. Source: Lyxor AM

FIXED INCOME AND CURRENCIES: US CREDIT RALLY APPROACHING THE PEAK, EUR TO FALL VS. USD

The accommodative stance of central banks described above suggests that long dated yields are unlikely to normalise anytime soon. As a result, 56% of the managers surveyed in this report do not expect 10-year Treasuries to reach 3% over the next six months.

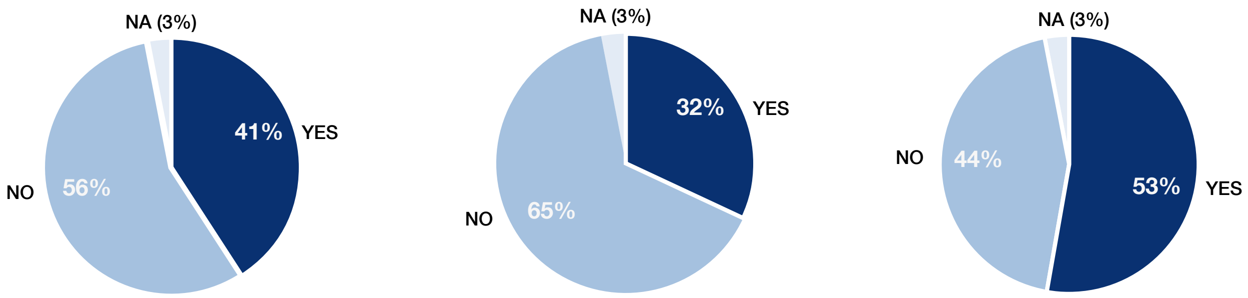
However, a growing number of hedge fund managers are increasingly cautious on US credit. According to our survey, 65% of the respondents do not expect the credit rally to continue over the next quarters.

Finally, the increasingly dovish stance of the ECB suggests that the EUR will fall versus the USD to below 1.35 according to 53% of the managers surveyed.

Do you expect the yield on 10y Treasuries to reach 3% in the next 6 months?

Do you expect the rally in US credit to continue?

Do you expect the EUR/USD to end the year below 1.35?

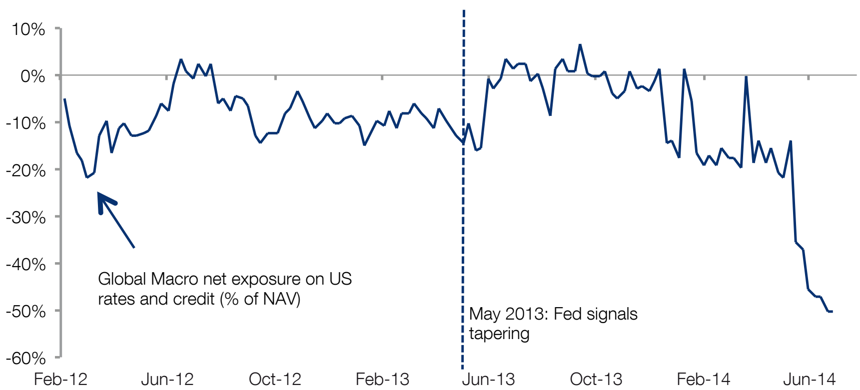


Source: Lyxor AM

Market implications: US fixed income and credit appear increasingly expensive as an asset class. Although long dated Treasury yields are not expected to move significantly higher, a long-only strategy on credit does not fit with current market conditions.

Alternatives strategy: Unconstrained bond funds are much more adapted to current market conditions. At the same time, Global Macro funds should do well as a result of established short EURUSD positions.

Hedge Funds are increasingly cautious on US fixed income and credit (% of NAV)

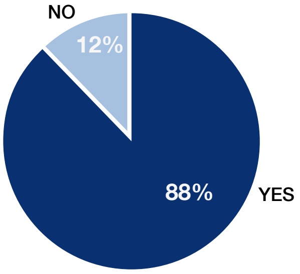


Equally weighted. As of 24 June. Source: Lyxor AM

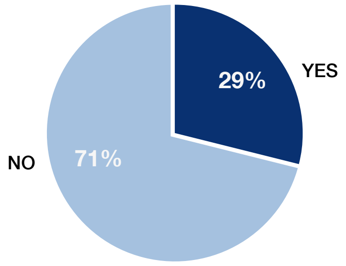
HEDGE FUNDS REMAIN BULLISH ON EQUITIES

The bullish stance on equities, both in Europe and in the US, was largely shared by the respondents to our survey. 88% of the managers surveyed expect the S&P 500 to deliver returns above 5% for the full year 2014. This implies that the second half should at least be flat, thereby preserving the gains posted in the first half (the S&P was up 6% YTD as of 30 June). At the same time, 71% of the respondents do not consider the US equity market to be overvalued.

Do you expect the S&P 500 price index to deliver a performance above 5% for the full year 2014 ?



Do you think the US equity market is overvalued ?

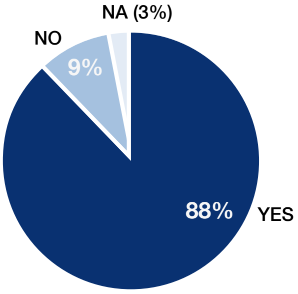


Source: Lyxor AM

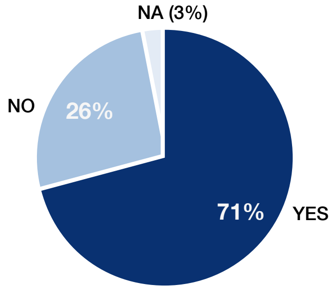
In Europe, 88% of the respondents expect the Eurostoxx 50 to deliver returns above 5% for the full year 2014 (+3.8% YTD as of 30 June). This implies a rather positive stance for the second half of 2014. Along the same lines, 71% of the respondents believe that the European equity market remains undervalued.

Finally, the respondents to our survey were more divided with regards to equity investment styles. 50% do not expect value stocks to continue to outperform growth stocks. Value stocks have underperformed growth stocks for several years, especially in the US. However, the underperformance of value stocks unexpectedly and abruptly reversed in March and April 2014.

Do you expect the Eurostoxx 50 price index to deliver a performance above 5% for the full year 2014 ?

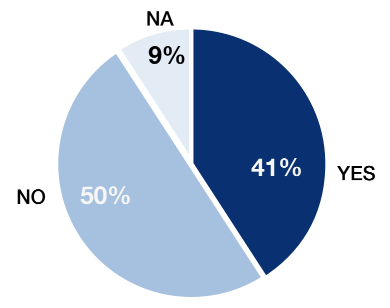


Do you think the equity market in the euro area remains undervalued ?



Source: Lyxor AM

Do you expect value stocks to continue outperforming growth stocks in the next 6 months ?

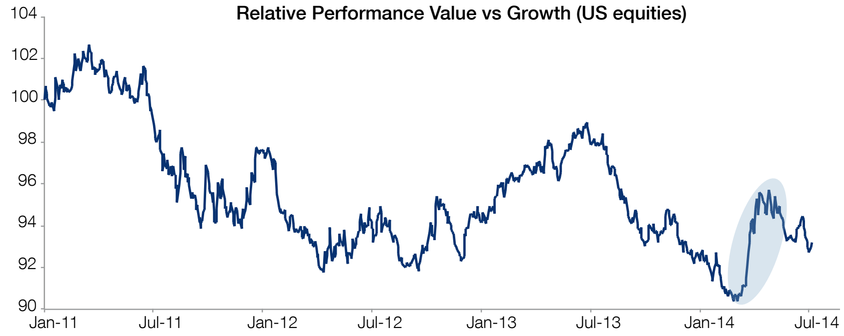


Source: Lyxor AM

Market implications: According to a recent press report, this is the least-believed bull market in years. Most asset allocators remain bullish on equities because of the lack of opportunities in other asset classes. Equity investors believe that valuations are not overstretched globally. The bullish case generally assumes that earnings will take the lead after the expansion of multiples over recent years.

Alternatives strategy: L/S equity funds continue to attract significant investor interest. However, style gyrations caused some damage earlier in Q2. As a result, investors must be aware of the biases implied by the investment style of a fund. We recommend a balance between growth and value oriented funds in a L/S equity portfolio.

Styles gyrations caused some damage earlier in Q2 to L/S equity funds



MSCI United States Growth Index vs MSCI United States Value Index. Past performance is not indicative of future results. Source: Bloomberg, MSCI, Lyxor AM

GROWTH TO DECELERATE IN CHINA; OIL REMAINS SUPPORTED BY GEOPOLITICAL FACTORS

Emerging Markets remain a key investment theme given attractive equity valuations and carry positions in fixed income. However, downside risks for EM have increased as the Fed prepares its exit strategy. The EM asset price gyrations in May 2013 (when Bernanke first signalled tapering) were a good reminder of the emerging markets' sensitivity to US monetary policy.

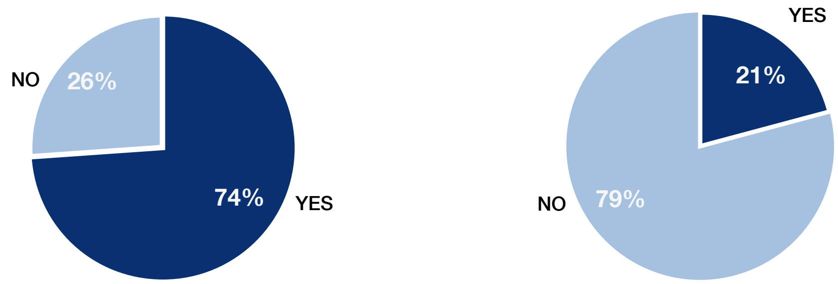
Among EM, China is obviously the most watched country. The implications for commodity markets are substantial given China's huge market share in metals and energy.
China absorbs around 20% of global energy resources and 45% of base metal production[1]. As a result, commodity exporting emerging markets are exposed to downside risks linked to deceleration in growth in China. Such a slowdown is taking place on the back of an adjustment on the real estate market and a slowdown in investment.

As a result, we surveyed our managers regarding their expectations for growth in China. The vast majority of them (74%) expect real GDP growth to fall below 7% over the next two years.

In parallel, we asked Hedge Fund managers about their views on energy markets in light of the scenario for China. Over the next six months, the WTI is not expected to fall below USD100/ bbl (USD105/ bbl as of 30 June). However, it is important to note that the survey was conducted at a time when geopolitical tensions were rising and the risk premium attached to oil prices had probably increased significantly.

Do you expect China's real GDP growth to fall below 7w% in the next two years?

Do you expect the WTI to end the year below USD100/ bbl?



Source: Lyxor AM

(1)See IMF (2013), "Impact of Chinese Demand Slowdown on Commodity Exporters", in Commodity Market Review, October.

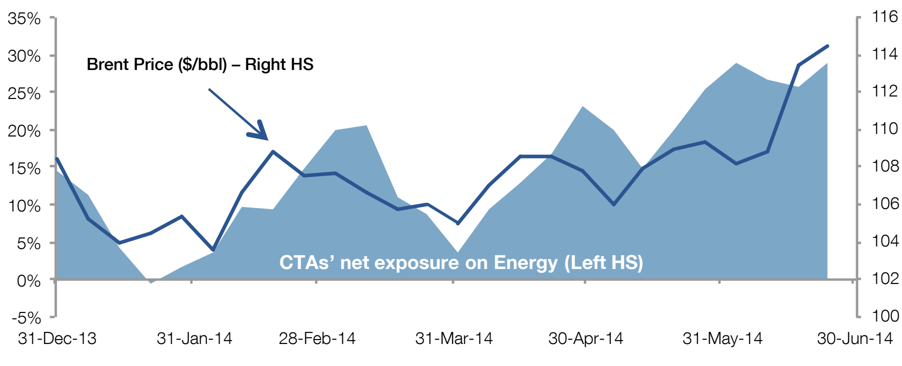
Market implications: Deceleration in growth in China would have a significant impact on emerging markets, particularly Latin America (huge producer of base metals consumed by China) and Asia (supply manufacturing chains). Latin America is more exposed here given that the deceleration would tend to come from an adjustment of the real estate market, a commodity intensive market.

Alternatives strategy: L/S equity funds with a Chinese focus playing domestic consumption themes should be resilient due to the rebalancing of the economy. At the same time, the Chinese equity market is attractive from a valuation standpoint (at 1.4x, the price to book of the A-shares market is more than 50% below the 20-year average of 2.8x). Additionally, the deceleration in growth should already be priced in to a certain extent, as this forecast is quite consensual. Finally, CTAs provide a very good hedge against geopolitical factors due to their established long energy positions.

Chinese equities are attractive from a valuation standpoint

Source: Datastream, Lyxor AM

CTAs provide a very good hedge against geopolitical factors due to their established long energy positions (% NAV)

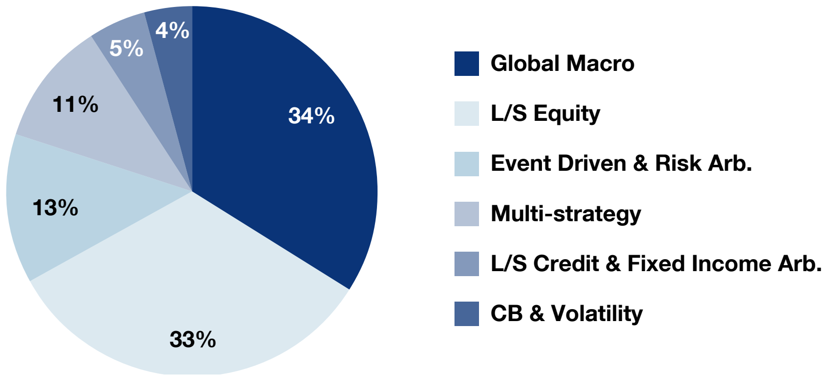


Equally weighted. As of 24 June 2014. Source: Lyxor AM

ABOUT THE SURVEY

This survey reflects voluntary responses from 40 firms (out of 55 surveyed). The assets under management of the firms surveyed represent USD 920bn. We excluded CTAs/systematic trading funds from the sample of funds surveyed. The survey was conducted during the second half of June.

Breakdown by strategy of the funds surveyed



Calculations are based on the AuM at the firm level. CTAs/systematic trading funds have been excluded. Source: Lyxor AM

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