

## Hedge Funds Down in Q3 Amidst Volatile Markets



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Market conditions remain challenging, particularly in the US where the S&P 500 fell 3% during the period under review. Part of this movement was related to adverse developments in the health care sector which suffered a severe drawdown after Hillary Clinton hinted that she would reform the sector and introduce price curbs if elected next year. This follows the controversial decision by a pharma company to significantly raise the price of decade-old drugs.

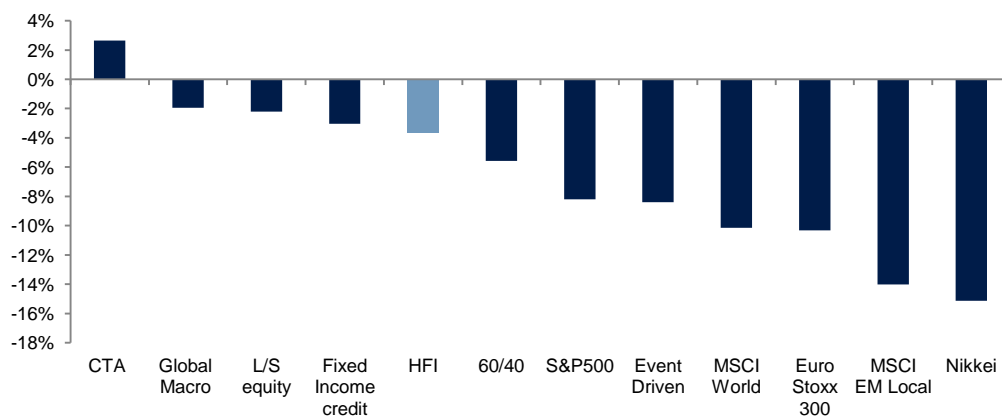
In this environment, hedge fund performance was negative, with significant differences existing across strategies. CTAs and Macro managers continued to outperform as a result of their long positions on Fixed Income. L/S Equity managers were quite resilient, though US managers suffered in comparison to their European and EM counterparts. Finally, Event-Driven funds were down as a result of their exposure to the health care sector.

Overall, the September performance of the Lyxor Hedge Fund Index (HFI) is -1.0%, while the MSCI World was down 2.1% and HY cash spreads in Europe and the US widened 70bps approximately. For the full Q3, the HFI is down 3.6%, while the S&P suffered its most severe drawdown (-8.2%) since the third quarter of 2011.

Going forward, we continue to recommend CTA and Macro strategies. The September establishment survey data signaled an easing in the pace of nonfarm payrolls (+142k in September vs August, below expectations) which continued to support Fixed Income. As a result, the rally in CTAs is ongoing. We are also overweight variable biased and market neutral L/S Equity funds which have delivered positive returns lately. Finally, we do not recommend a decrease in the exposure to Event-Driven after the drawdown. Health care names have partly recovered since the hit a few days ago and the sector is among the few ones that have not experienced a downward revision in near term earnings expectations. The sector is immune to China's growth deceleration and to the recent slump in commodity prices.

### Hedge funds outperformed a diversified portfolio and equity indices in Q3

(Q3 Performances of the Lyxor indices vs global equity indices)



Source: Lyxor AM  
 Balanced portfolio: 60% MSCI World TR / 40% Barclays Capital Agg. Bond Index. Q3 performances from 30/06/2015 to 29/09/2015.

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THE WEEK IN 3 CHARTS

Hedge Fund Snapshot: CTA, a good diversifier in a turbulent environment

	WTD*	MTD	YTD
<b>Lyxor Hedge Fund Index</b>	<b>-1.5%</b>	<b>-1.0%</b>	<b>-1.8%</b>
CTA Broad Index	0.5%	1.8%	-1.0%
Event Driven Broad Index	-4.0%	-3.8%	-6.3%
Fixed Income Broad Index	-0.7%	-0.7%	-2.2%
L/S Equity Broad Index	-0.8%	-0.1%	1.8%
Global Macro	-0.3%	0.1%	0.1%
S&P 500	-3.0%	0.9%	-9.4%
10 Y US Treasury ( in Bps)	-8.0	-2.0	-14.0

\*From 22 September to September 29, 2015

Source: Bloomberg, Lyxor AM

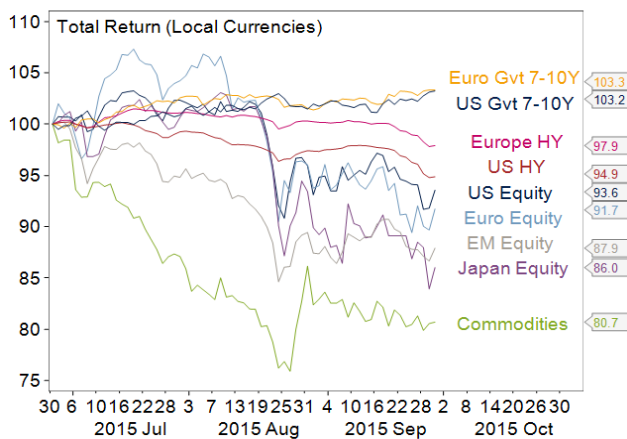
Hedge funds navigated quite well during the global equity meltdown. The Lyxor Hedge Fund Index was down 1.5% last week, while the S&P 500 nosedived 3%.

CTA (+0.5%) and Global Macro (-0.3%) funds continued to stand out, fueled by the bond rally, particularly in the US. Gains were partly offset by losses posted on some equity (long) and commodities (short).

L/S Equity managers were resilient amidst the global equity turmoil (-0.8%) while dispersion in returns among managers was elevated (performances ranged from -8% to almost +3%). In this context Market Neutral funds (+1%) outperformed.

Event Driven managers suffered a setback from the health care sector, the largest bet among managers.

Hedge funds outperformed global equity markets in Q3



Source: Bloomberg, Lyxor AM

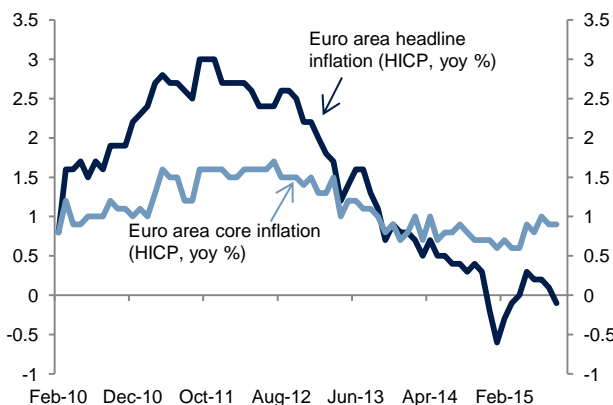
As the quarter came to an end, investors were counting their losses. The S&P 500 suffered its worst quarter since Q3 2011. Risk assets and commodities were hit particularly badly whilst fixed income and credit were somewhat spared (apart from EM in local currency).

Equity market conditions improved slightly recently, but sentiment remains fragile. Last week, the US health care sector was under pressure after having outperformed over the last twelve months.

On the alternative side, hedge funds were quite resilient in Q3. Falling energy prices and the bond rally continued to be supportive for CTAs, up 2.7% in Q3. Meanwhile, L/S Equity funds (-2.2%) outperformed global equity markets (Eurostoxx 300 -10 %; Nikkei -15%).

Falling energy prices reignited deflation fears in the Euro area in September

Deflation fears reignited in September in the Euro area



Source: Bloomberg, Lyxor AM

Deflation fears in the Euro area returned in September. This was highlighted by the Euro area annual inflation print which fell back into negative territory in September: the CPI was down 0.1% yoy.

September data was disappointing, particularly in Germany and Spain (at -0.2% and -1.2% yoy respectively). Euro area inflation remains far below the ECB target, leading some market participants to anticipate an expansion of the QE programme at the October 22 meeting.

However, falling energy prices explain the bulk of the lower inflation data. The core inflation, excluding energy and food prices, remained stable.

RESEARCH FROM LYXOR MANAGED ACCOUNT PLATFORM

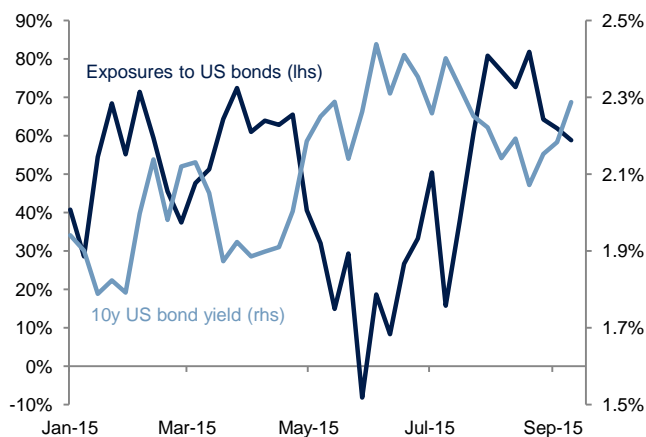
CTAs

	WTD*	MTD	YTD
CTA Broad Index	0.5%	1.8%	-1.0%
CTA Long Term	0.8%	1.6%	-0.4%
CTA Short Term	-0.7%	2.2%	-4.8%

\*From 22 September to September 29, 2015

CTAs maintained their positive exposure to US bonds

(Net Exposure to US bonds, % NAV)



As of September 15, 2015  
Equally weighted. Source: Lyxor AM

Bond rally fueled CTAs

CTAs were up last week as they benefited from some trends.

The Fixed Income bucket was the main contributor to performance. The downward trend of rates on both sides of the Atlantic enabled long positioned systems to generate gains. Most of which came from US positions in September.

In the Equity bucket, we witnessed dispersion amongst the systems. As the bulk of global equity indices fell in a highly volatile environment, short exposure proved rewarding for systems that turned short. By contrast, those that remained long continued to suffer.

The currency portfolio posted mixed results. Short Euro vs. USD exposure suffered with erratic movements over the last month. However some short positions to G10 and commodity related ones (AUD, CAD and GBP) generated gains.

Commodities proved to be detrimental as the recovery of agricultural brought most of the losses. Small gains were made on short energy. However, systems made the most of sliding commodity prices over the last month.

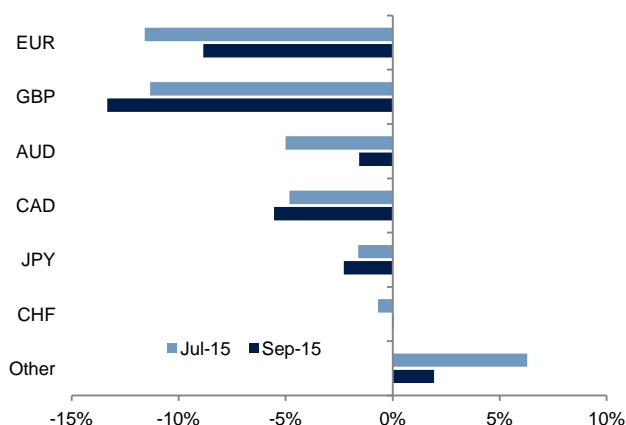
GLOBAL MACRO

	WTD*	MTD	YTD
Global Macro	-0.3%	0.1%	0.1%

\*From 22 September to September 29, 2015

Macro managers are long USD positioned

(Net Exposure to FX vs USD, % NAV)



As of September 8, 2015  
Equally weighted. Source: Lyxor AM

FX positions paid off

Global Macro managers posted a negative performance last week.

Within FX, short exposure to the British Sterling and Australian dollar paid off as the USD appreciated against both. Shorts in emerging currencies proved to be once again rewarding as they kept on following the downward trend triggered weeks ago by the devaluation of the Renminbi. Short Euro vs. USD bets were profitable over the month, but not last week.

In the Fixed Income portfolios, long exposed managers successfully extracted alpha on US and European rates positions. Yield curves have continued to flatten as investors remain cautious in the volatile environment created by the Chinese turmoil in August and by the uncertainties around the FED's action. Investors have been favouring safe haven investments.

Long equity exposure generated losses as global indices fell once again. Losses were posted over the last month, and not the last week. Positions have been decreased but the risk-on bias remains there.

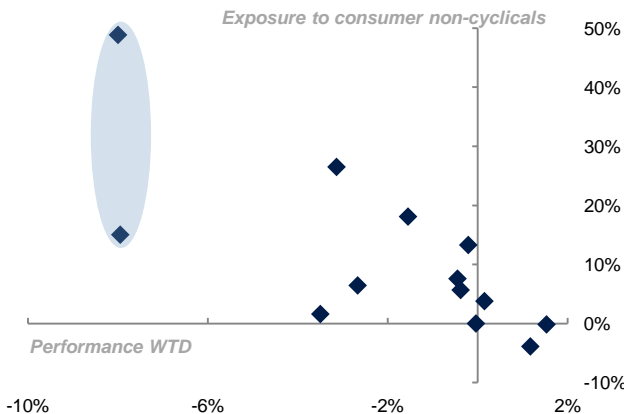
The exposure to commodities has remained limited for weeks. The asset class ended the week flat.

L/S EQUITY

	WTD*	MTD	YTD
L/S Equity Broad Index	-0.8%	-0.1%	1.8%
Long Bias	-2.7%	-1.0%	1.2%
Market Neutral	1.0%	0.1%	-1.2%
Variable Bias	-0.6%	0.3%	4.5%

\*From 22 September to September 29, 2015

**Long health care positions were the worst detractors**  
 (US and European Equity Funds Net Exposure to Consumer Non-Cyclicals (% NAV) vs WTD performances)



Exposures as of September 22, 2015  
 Source: Lyxor AM

Hit by the health care sector

It was a challenging week for L/S Equity funds as all global equity markets nosedived.

Almost all sectors posted losses. Energy and material sectors continued to be plagued by falling oil prices. The health care sector suffered from a few bad actors which caused the entire industry valuation to fall sharply. Among them, Democratic President hopeful, Hillary Clinton attacked pharmaceutical pricing as part of her campaign.

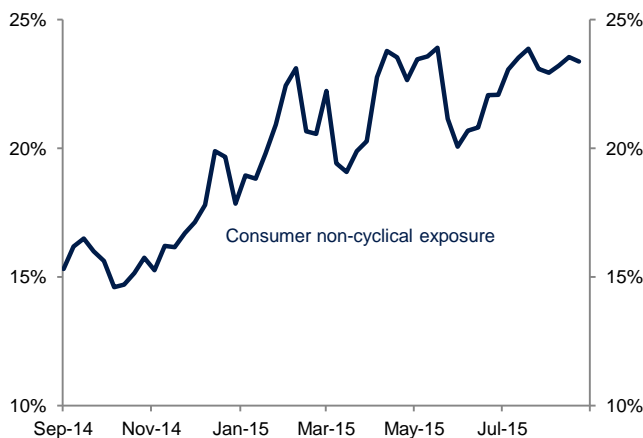
On the alternative side, the strongest performance came from Quantitative funds, with performance up to almost 3%. Our emerging market fund was another stand out performer as it benefitted from long and short positions on rewarding sectors (software and precious metal, amongst others). On the negative side, our dedicated health care manager posted severe losses from its long exposure to pharmaceutical companies. In the same vein, exposure to the health care and energy sectors significantly detracted the performance of one of our long biased funds.

EVENT DRIVEN

	WTD*	MTD	YTD
Event Driven Broad Index	-4.0%	-3.8%	-6.3%
Merger Arbitrage	-3.7%	-3.4%	-3.4%
Special Situations	-4.5%	-4.4%	-10.6%

\*From 22 September to September 29, 2015

**Consumer non-cyclicals largely dragged down**  
 (Net Exposures to consumer non-cyclicals, % NAV)



From September 30, 2014 to September 22, 2015  
 Equally weighted. Source: Lyxor AM

Major setback on Pharma rout

Event Driven funds posted the worst monthly performance this year.

Despite a positive start to the month, almost all funds were bruised by the biotech meltdown in the last few days. The health care sector was battered by a stock rout triggered last Monday by a tweet from Hilary Clinton which suggested a "price gouging" in the prescription drugs market. Valeant Pharmaceuticals plummeted over the observed period after Democrats in Congress urged a subpoena on the firm's CEO about the inflated prices of heart drugs. Growing concerns over the regulatory scrutiny led to a broad sell-off in consumer, energy, industrial and basic materials sectors. Idiosyncratic investments in the consumer non-cyclicals generated a large majority of the losses. Among the main detractors were Valeant Pharmaceuticals, Baxter International, Depomed, Allergan and Perrigo.

On the M&A front, Energy Transfer agreed to buy Williams Cos. in a \$37.7bn deal after a months long pursuit. Spreads continue to face temporary non-deal specific widening and technical dislocations. As a result, the embedded profitability of the merger arbitrage books remains high.

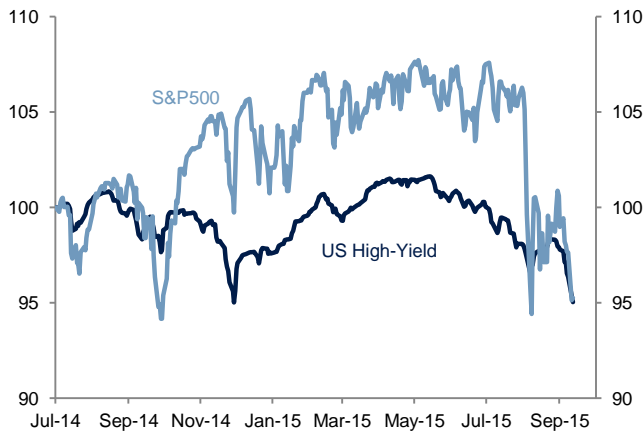
L/S CREDIT ARBITRAGE

Wider spreads on HY

	WTD*	MTD	YTD
Fixed Income Broad Index	-0.7%	-0.7%	-2.2%
L/S Credit Arb	-0.4%	-0.1%	-2.1%

\*From 22 September to September 29, 2015

Global growth concerns weighed on risk assets  
(S&P 500 and US High-Yield indexes)



Source: Bloomberg, Lyxor AM

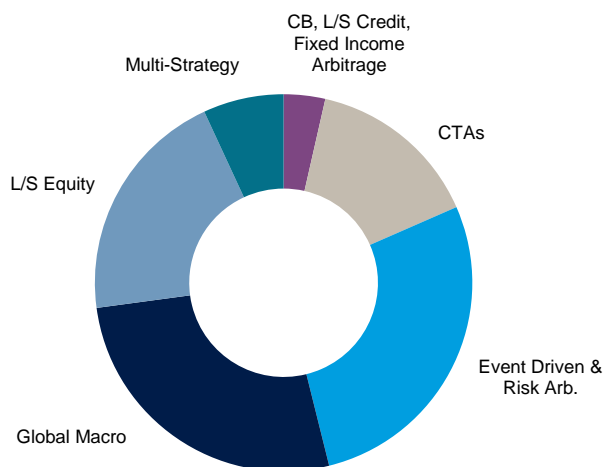
L/S credit funds went down last week in dire market conditions as concerns about global economic growth remain high.

This week reflected the trend experienced over the course of September. As Investors currently tend to favour higher quality names, IG bonds outperformed HY on both sides of the Atlantic. As a result, spreads on HY bonds widened by 45 bps and 62 bps respectively in Europe and the US.

On the Lyxor platform all credit arbitrageurs ended the week in the red. The worst performer was our Asian focused fund, which was penalised by its positions in the industrial sector and its exposure to the drop in commodity prices. Our US HY fund suffered from the sharp spread widening in basic materials and energy related names. One of our European focused funds was hurt by its positions on credit indices. Another European fund recorded losses on positions in the energy and telecom sectors but thanks to a particularly nimble positioning it has managed to stay positive for the month.

## METHODOLOGY

### Breakdown of AUM by strategy



- **66 funds** in the platform

- Over **USD 7 billion** of assets under management (as of September 1, 2015)

- Replicating approximately **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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