HEDGE FUNDS INCREASE SHORT BETS ON US BONDS

Philippe Ferreira
Head of Research
Managed Account Platform
Lyxor Asset Management
(33) 1 42 14 69 28
philippe.ferreira@lyxor.com

Hedge funds are increasing their short bets on US rates as the flow of economic data improved and inflation figures edged higher. Moderate price pressures materialised recently (PCE deflator at 1.6% yoy in April), though the inflation rate remains below the 2% target of the Fed. This triggered a rise in 10y Treasury yields last week which caused some losses on CTAs.

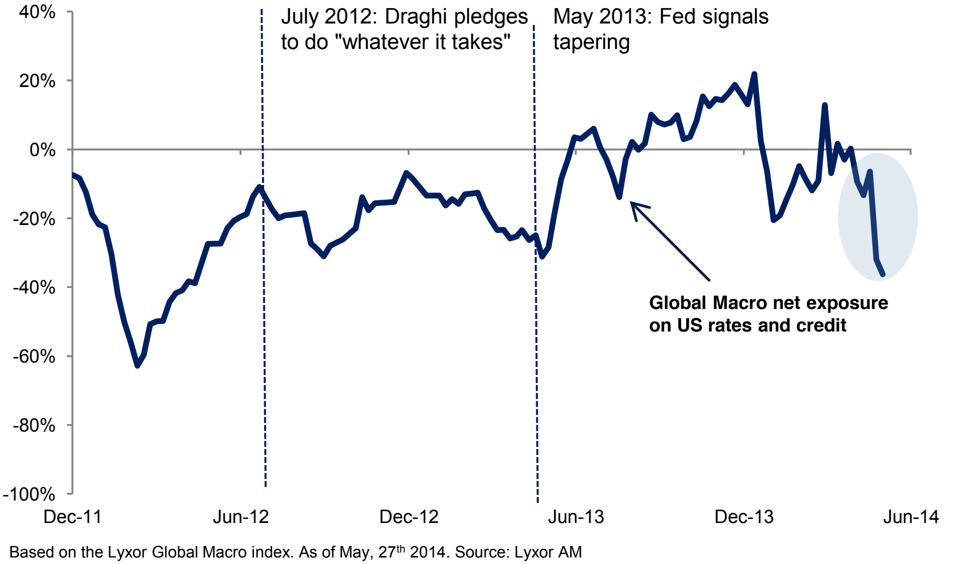
In this environment, Global Macro funds have cut quite aggressively their net short positioning on US rates and Credit, from -9% of net assets at the end of April to -36% currently.

With regards to recent performance, equity-oriented strategies (Event Driven, L/S Equity) continue to rebound while L/S Credit and Fixed Income Arbitrage remain resilient in spite of higher bond yields. The strongest performance last week was registered by Merger Arbitrage funds. The pipeline of corporate events, including mergers and acquisitions, continues to increase with high volumes of transactions announced recently.

We note finally that positioning on commodities has evolved. Some Global Macro and CTAs have increased their long positioning on energy, associated probably to the « mini-stimulus » package announced by Chinese authorities. The overall positioning of Global Macro funds on energy is moderate, but increasing from 1.8% of net assets in early May to 3.5% to date. Meanwhile, CTAs have considerably sizeable positions that increased from 20% of NAV to 25% during the same period.

> “Hedge funds are increasing their short bets on US rates as the flow of economic data improved and inflation figures edged higher.”

Global Macro: Shorting US rates more aggressively (% NAV)



Based on the Lyxor Global Macro index. As of May, 27th 2014. Source: Lyxor AM

THE WEEK IN 3 CHARTS

Hedge Fund Market Snapshot: Merger Arbitrage outperformed last week

	HFI index	Best strategy	Worst strategy	S&P 500	10Y UST
WTD (Estimated perf. between May 27th to June 3rd)	+0.3%	ED Merger Arbitrage +0.9%	CTA LT -0.7%	+0.6%	+8.4 bp
MTD (Estimated perf. between May 27th to June 3rd)	+0.3%	ED Merger Arbitrage +0.9%	CTA LT -0.7%	+0.6%	+8.4 bp
YTD	+0.9%	L/S Credit Arb. +4.2%	CTA ST -2.7%	+4.1%	-43 bp

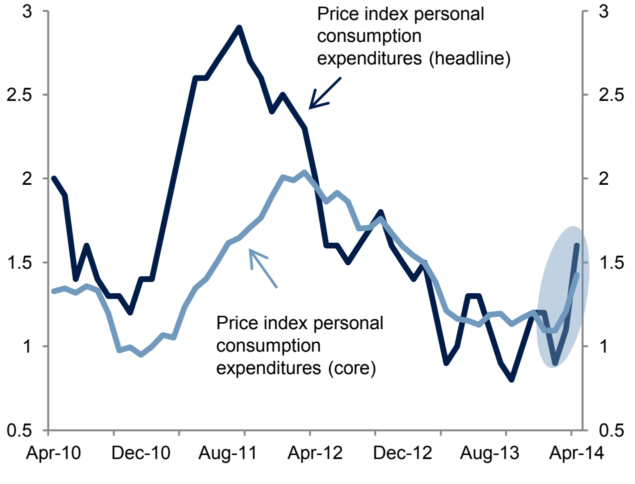
Source : Bloomberg, Lyxor AM

The strongest performance last week was registered by Merger Arbitrage funds. The pipeline of corporate events, including mergers and acquisitions, continues to increase with high volumes of transactions announced recently.

The Lyxor Hedge Fund Index is up 0.3% , supported by equity-oriented strategies (L/S Equity, Event Driven).

Year to date, L/S credit is still leading the pack, while short term CTAs are lagging.

Price pressures in the US caused a steep rise in bond yields , a negative for CTAs



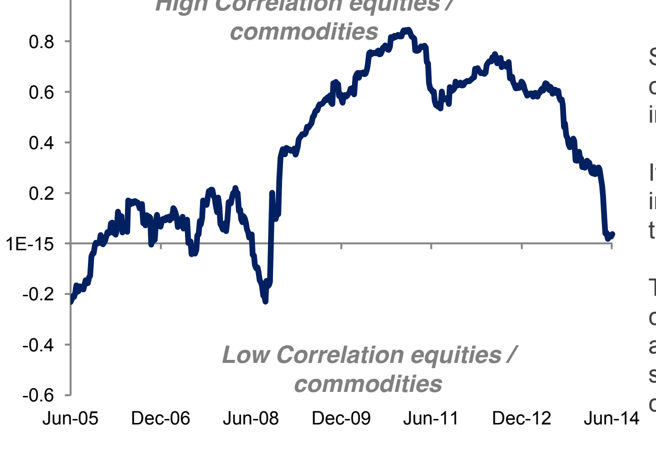
Personal Consumption Expenditures (PCE) is a measure of price changes in consumer goods and services, including households, durables/non durables and services. Source: Bloomberg, Lyxor AM.

The price index for personal consumption expenditures rose by 1.6 percent in April, compared to the same period last year. The so-called PCE deflator is the Federal Reserve's preferred measure of inflation. Excluding food and energy, the core index is up 1.4% on a year ago.

While this is still below the Fed's 2% target, it is the fastest rise in the PCE deflator since the second half of 2012.

In the days following the release, 10y Treasury yields rose significantly, from a low of 2.44% on May 28 to 2.6% on June 4, hurting the long rates positioning of several hedge funds.

Decorrelation of commodities with equities is a positive for Global Macro and CTAs



1 year correlation rolling between the S&P500 and the S&P GSCI Commodity index, based on weekly returns. Source: Bloomberg, Lyxor AM

Since the beginning of 2014, the decorrelation of commodities, as measured here by the S&P GSCI index, and equities, is impressive.

It has been interpreted as the result of several investment banks getting out of the commodities trading game.

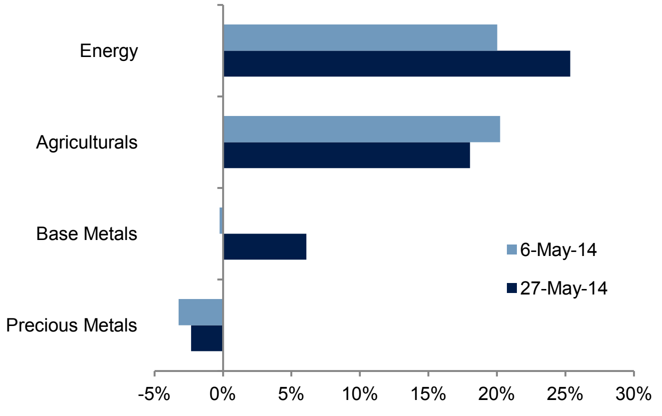
The positive aspect of this decorrelation is that commodities are becoming appealing again as an asset class providing diversification. In the hedge fund space, Global Macro and CTA funds manage active commodity positions.

CTAs

Curve steepening causes losses

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
CTA Long-Term	-0.7%	-0.7%	-2.3%
CTA Short-Term	0.1%	0.1%	-2.7%

CTAs increased positions on energy
(net exposure, % of NAV)



As of May 27th. Equally weighted. Source: Lyxor AM

It was a difficult week for CTAs with most of the funds ending the week in negative territory.

» The rates bucket was the main detractor. Long positioning on long term rates were affected as most developed countries' yield curve steepened.

» On the commodity sector, the long positioning held on the platform since the beginning of the year suffered. The energy segment was hurt as oil futures ended the week lower after a data report showed that U.S. consumer spending was weak in April.

» Equities provided gains in a context of a jittery market ahead of the ECB's policy meeting on June 5th.

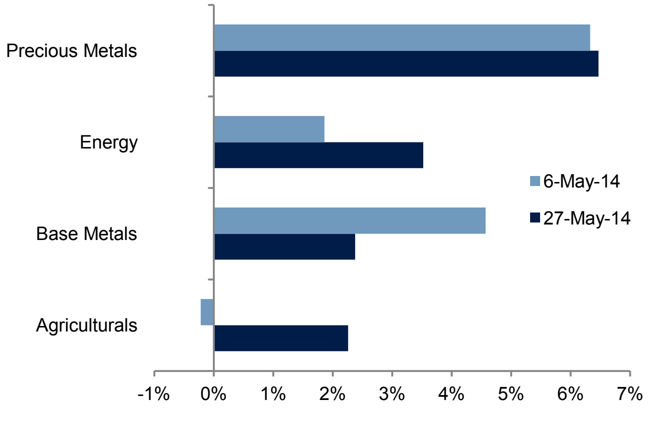
» Forex was mixed. Short GBP gains offset the losses on long euro.

GLOBAL MACRO

Mixed on commodity market jitters

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
Global Macro	-0.1%	-0.1%	2.6%

Global Macro also increased positions on energy
(net exposure, % of NAV)



As of May 27th. Equally weighted. Source: Lyxor AM

The GM performance was mixed; half the funds provided a positive return for the week.

» Losses were incurred on the commodity complex. Agricultural and soft futures were notably affected as forecasts of improved US weather and ample global supplies weighed on the grains market, while coffee continued to decrease amid indications that global supply might be on the rise.

» In Fixed income, most developed countries' yield curve steepened this week. In this context, some funds showing risk allocation in short term rates managed to provide gains with relative value trades.

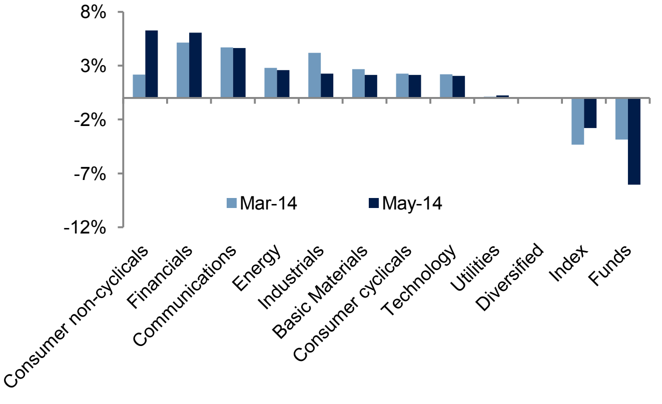
» Forex was mixed. Short Euro and short GBP proved rewarding as expectations for monetary easing put downward pressure on the single currency, while sterling weakened after reports indicated downbeat data on the U.K. housing market, prompting investors to review expectations for a upcoming rate hike.

L/S EQUITY

Up on consumer exposures

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
Long Bias	0.6%	0.6%	-0.7%
Market Neutral	0.5%	0.5%	-1.2%
Variable Bias	0.4%	0.4%	-1.7%

Positions on US consumer non-cyclicals on the rise
(net exposure on US market, % of NAV)



As of May 27th. Source: Lyxor AM

L/S Equity funds reported positive performance, with consumer stocks driving recent performance both in the US and in Europe.

» In the US, performance was driven by the recovery of momentum stocks (telecoms and consumer stocks), which are significant exposures for our managers. Long books contributed strongly to alpha generation whereas short books did not hurt so much.

» In Europe, stock markets were under pressure ahead of the ECB policy meeting. Alpha generation came from long positions in defensive stocks like consumer non cyclicals and shorts in financials and industrials.

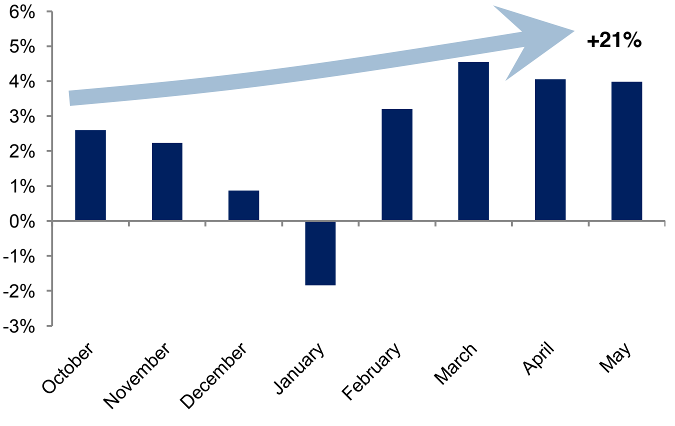
» Asian managers' performed well, in particular Japanese funds, as longs positions in telecommunications and high beta names were rewarding. The likelihood of a corporate tax cut in Japan was supportive for risk assets in the region.

EVENT DRIVEN

Confirming the upside potential

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
Merger Arbitrage	0.9%	0.9%	2.9%
Special Situations	0.6%	0.6%	2.8%

Event Driven: AuM up 21% since October 2013
(% growth of AuM on the Lyxor platform, month on month)



As of May 30th. Source: Lyxor AM

Performance of event driven funds was robust and all sub-strategies were up last week. This confirms our positive expectations on the strategy, which has received significant inflows over the recent quarters.

» The pipe of corporate events, including mergers and acquisitions continued to increase with high volumes of transactions announced recently. Two deals of particular note :

» (i) Softbank reached an agreement with Deutsche Telecom to purchase T-Mobile (USA). The deal, once completed, will be added to Softbank's purchase of Sprint last year; and

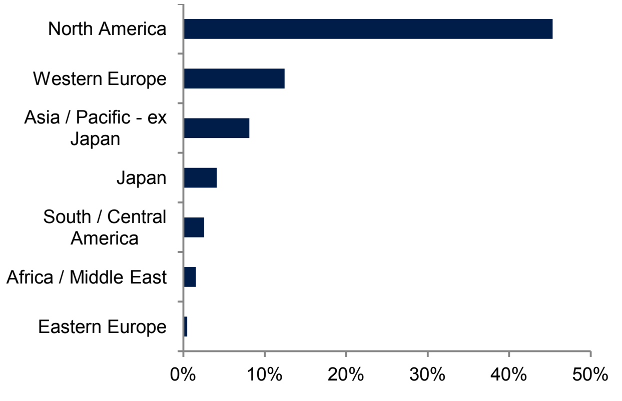
» (ii) the offer bid from Valent Pharmaceuticals International to acquire Allergan was increased from $49.4 billion to $53.3 billion.

CB & VOL ARBITRAGE

CBs supported by the credit rally

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
Convertible Arb	0.2%	0.2%	2.9%

CB net exposure per areas
(% of NAV)



As of May 27th. Source: Lyxor AM

Market settings were mixed this week, with equities detracting while credit contributing to CBs performance.

» Most equity indices detracted and the Russell 2000 underperformed other U.S. equity indices. As a result, convertible valuations were weighed down by the poor performance of the underlyings.

» The Credit component was very supportive, as the ML US HY Index spread tightened 17bps over the week.

» Good news came from the European primary market. As Alcatel-Lucent is shifting its corporate strategy, it issued a two tranche USD 1.5bn. Total global emission over the week totaled USD 3bn.

» The best performing fund generated performance on its diversified book of special situation. The underperformer was bled by its European converts book.

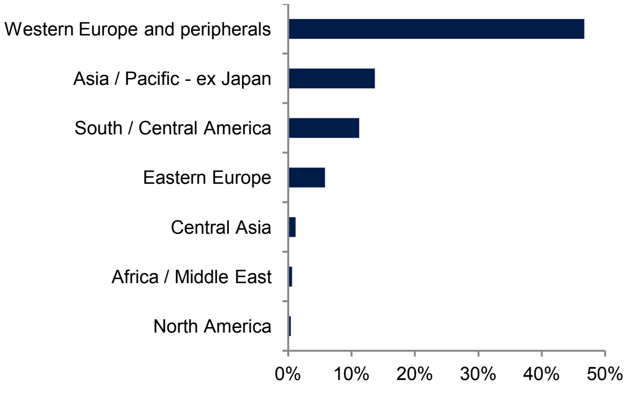
L/S CREDIT ARBITRAGE

Consolidating its position

(Estimated performance between May 27th to June 3rd)	WTD	MTD	YTD
L/S Credit Arb	0.2%	0.2%	4.2%

The strategy is up on the back of the good performance of our Asian credit manager, and despite losses on peripheral Europe. The strategy is consolidating its position as the best strategy year to date.

L/S Credit : a strong preference for peripherals
(net exposure, % of NAV)



As of May 27th. Source: Lyxor AM

» Our Asian Credit manager outperformed as Asian financials rebounded on the back of the stimulus package announced y Chinese authorities.

» Meanwhile, exposure to Greek bonds was the main source of downside in Lyxor managers’ book last week. Greek bonds lost value as investors appear to have taken some profits. In addition, political risks, related the strong performance of local extremist parties in the EU elections, may also have influenced negatively sovereign bond valuations.

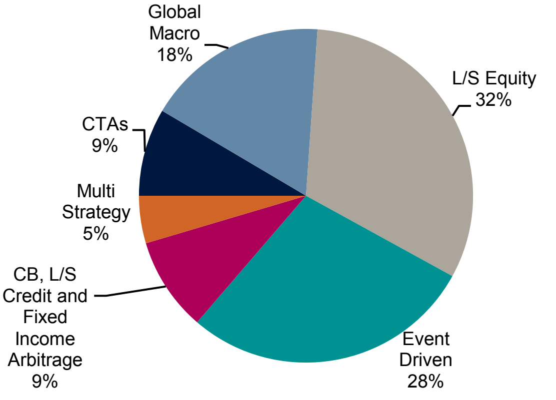
METHODOLOGY

» Approximately **100 funds** in the platform

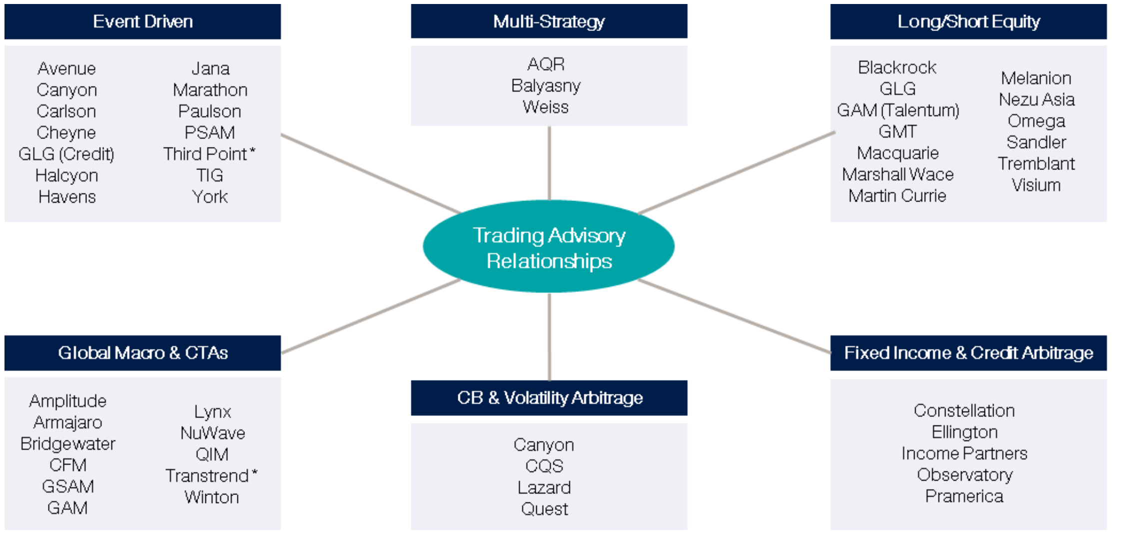
» **USD 12.1 billion** of assets under management (as of March 25, 2014)

» Replicating **USD 200 billion** of AUM

Breakdown of AuM by strategy



Lyxor has established relationships with some of the most respected, established managers. Including some of the largest Hedge Funds manager by AUM (Bridgewater, AQR, Winton, GAM,…)



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.

Important Disclaimer

Source: Lyxor Asset Management ("Lyxor AM") database except as noted

THIS DOCUMENT IS FOR THE EXCLUSIVE USE OF INVESTORS ACTING ON THEIR OWN ACCOUNT AND CATEGORISED EITHER AS "ELIGIBLE COUNTERPARTIES" OR "PROFESSIONAL CLIENTS" WITHIN THE MEANING OF MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE 2004/39/CE

Prior to investing in the product, investors should seek independent financial, tax, accounting and legal advice. It is each investor's responsibility to ascertain that it is authorised to subscribe, or invest into this product. This document does not constitute an offer for sale of securities in the United States of America. The product herein described will not be registered under the U.S. Securities Act of 1933, as amended (the "U.S. Securities Act") and may not be offered or sold in the United States of America without being registered or being exempted from registration under the U.S. Securities Act. This document does not constitute an offer, or an invitation to make an offer, from Société Générale ("SG") or Lyxor Asset Managament (collectively with its affiliates "Lyxor AM") or any of their respective subsidiaries to purchase or sell the product referred to herein.

Société Générale and Lyxor AM recommend that investors read carefully the "risk factors" section of the product's documentation (offering memorandum and supplemental memorandum). The product's documentation can be obtained free of charge upon request to client-services@lyxor.com or invest@lyxor.com for U.S. Investors.
This product includes a risk of capital loss. The redemption value of this product may be less than the amount initially invested. In a worst case scenario, investors could sustain the loss of their entire investment. This document is confidential and may be neither communicated to any third party (with the exception of external advisors on the condition that they themselves respect this confidentiality undertaking) nor copied in whole or in part, without the prior written consent of Lyxor AM or Société Générale.

All information about a Benchmark Fund and Trading Advisor contained in this document (including historical or hypothetical returns) was provided by the Trading Advisor. Such Trading Advisor is not affiliated with SG or Lyxor AM, and none of SG, Lyxor AM or any of their affiliates guarantees the accuracy, timeliness or completeness of such information. None of SG, Lyxor AM or any of their affiliates has checked the accuracy of any data herein provided by such Trading Advisor or the sources thereof nor the methods or underlying data used to prepare this information.
Under normal market conditions, Lyxor intends to offer weekly or monthly liquidity for its managed accounts. However, weekly or monthly liquidity is not guaranteed and there are circumstances under which such liquidity may not be possible, including, but not limited to: 1. Periods during which there are a large number of redemption requests, or where there are one or more large redemption requests; 2. Where Lyxor's risk management guidelines would prohibit additional liquidity (for example, in the case of managed accounts that are heavily leveraged); 3. Where the underlying investments of a managed account impose additional restrictions on liquidity (for example, the use of "gates").

The attention of the investor is drawn to the fact that the NAV stated in this document cannot be used as a basis for subscriptions and/or redemptions.

The obtaining of the tax advantages or treatments defined in this document depends on each investor's particular tax status, the jurisdiction from which it invests as well as applicable laws. This tax treatment can be modified at any time. We recommend to investors who wish to obtain further information on their tax status that they seek assistance from their tax advisor.

The accuracy, completeness or relevance of the information which has been drawn from external sources is not guaranteed although it is drawn from sources reasonably believed to be reliable. Subject to any applicable law, Société Générale and Lyxor AM and their respective subsidiaries shall not assume any liability in this respect.

The market information displayed in this document is based on data at a given moment and may change from time to time.

The Assets Under Management presented herein reflect total assets in all investment vehicles and accounts ("Lyxor Funds") for which Lyxor provides continuous and regular supervisory or management services for a fee (i.e. administrative, management and/or performance fees as well as other fee sharing arrangements, as applicable), including amounts from certain Lyxor Funds that invest into other Lyxor Funds.

AUTHORISATIONS
Société Générale is a French credit institution (bank) authorised by the Autorité de contrôle prudentiel (the French Prudential Control Authority).
Lyxor Asset Management (Lyxor AM) is a French investment management company authorized by the Autorité des marchés financiers and placed under the regulations of the UCITS Directive (2009/65/CE). Lyxor AM is a registered Commodity Pool Operator and a Commodity Trading Advisor under the U.S. Commodity Futures and Trade Commission. Lyxor AM is also a member of the National Futures Association. Lyxor Asset Management Inc. is a U.S. registered investment adviser within the U.S. Securities and Exchange Commission and a registered Commodity pool operator within the CFTC and a member of the NFA.
The fund is the holder of a certificate under the Collective Investment Funds (Jersey) Law, 1988 (as amended). SG Hambros Fund Managers (Jersey) Limited and the SG Hambros Trust Company (Channel Islands) Limited are registered to conduct "fund services business" under the Financial Services (Jersey) Law 1998 (as amended). The Jersey Financial Services Commission is protected by these Laws against liability arising from the discharge of its functions under them. The Commission does not take any responsibility for the financial soundness of the fund or for the correctness of any statements made or expressed herein or in the Offering Memorandum or the Supplemental Memorandum of the Fund.

NOTICE TO INVESTORS IN THE EUROPEAN UNION AND SWITZERLAND: This document is of a commercial and not of a regulatory nature. No prospectus has been approved by, or notified to; a local regulator (except in Jersey) and the product may not be distributed by way of an offer, or an invitation to make an offer, of securities to the public.

NOTICE TO UK INVESTORS: The products described within this document are suitable for professional investors only and are not directed at retail clients. The document is issued by Lyxor AM. Lyxor AM is represented in the UK by Lyxor Asset Management UK LLP, which is authorized and regulated by the Financial Conduct Authority in the UK.

NOTICE TO SWISS INVESTORS: The product presented herein has not been and will not be registered with, or approved by, the Swiss Financial Market Supervisory Authority FINMA (FINMA) under the Swiss Federal Act on Collective Investment Schemes (CISA). Therefore, the information presented herein or in the fund's legal documentation does not necessarily comply with the information standards required by FINMA in the case of distribution of collective investment schemes to non-qualified investors, and investors do not benefit from protection under the CISA or supervision by FINMA. The product must not be distributed to non-qualified investors in or from Switzerland, and may be distributed exclusively on a private placement basis to Qualified Investors as defined in article 10 of the CISA and related provisions in the Swiss Federal Ordinance on Collective Investment Schemes (CISO) in strict compliance with applicable Swiss law and regulations. This document is personal and does not constitute an offer to any person. This document must be distributed or otherwise made available in Switzerland on a private placement basis only and exclusively to Qualified Investors, without distribution or marketing to non-qualified investors in or from Switzerland. This document may be used only by those Qualified Investors to whom it has been handed out in connection with the offering described therein, and it may neither be distributed nor made available to other persons without the express consent of Lyxor AM or Société Générale. It may not be used in connection with any other distribution and shall in particular not be copied and/or distributed to non-qualified investors in Switzerland or in any other country. This document, or the information contained therein, does not constitute a prospectus as such term is understood pursuant to article 652a or article 1156 of the Swiss Code of Obligations or a listing prospectus pursuant to the listing rules of the SIX Swiss Exchange or any other exchange or regulated trading facility in Switzerland or a simplified prospectus, a key information for investors document, or a prospectus, as such terms are defined in the CISA.

NOTICE TO U.S. INVESTORS: Any potential investment in any securities or financial instruments described herein may not be suitable for all investors. Any prospective investment will require you to represent that you are an "accredited investor," as defined in Regulation D under the Securities Act of 1933, as amended, and a "qualified purchaser," as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the "'40 Act") The securities and financial instruments described herein may not Act) be available in all jurisdictions. Investments in or linked to hedge funds are highly speculative and may be adversely affected by the unregulated nature of hedge funds and the use of trading strategies and techniques that are typically prohibited for funds registered under the '40 Act. Also, hedge funds are typically less transparent in terms of information and pricing and have much higher fees than registered funds. Investors in hedge funds may not be afforded the same protections as investors in funds registered under the '40 Act including limitations on fees, controls over investment policies and reporting requirements.

NOTICE TO CANADIAN INVESTORS: Any potential investment in any securities or financial instruments described herein may not be suitable for all investors. Any prospective investment will require you to represent that you are a "permitted client", as defined in National Instrument 31-103 and an "accredited investor," as defined in National Instrument 45-106. The securities and financial instruments described herein may not be available in all jurisdictions of Canada. Investment vehicles described herein will not be offered by prospectus in Canada and will not be subject to National Instrument 81-102 and National Instrument 81-106. In addition, investments in or linked to hedge funds are highly speculative and may be adversely affected by the unregulated nature of hedge funds and the use of trading strategies and techniques that are typically prohibited for prospectus offered funds. Also, hedge funds are typically less transparent in terms of information and pricing and have much higher fees than prospectus offered funds. Investors in hedge funds may not be afforded the same protections as investors in offered funds, including limitations on fees, controls over investment policies and reporting requirements.

NOTICE TO HONG KONG INVESTORS: This document is distributed in Hong Kong by SG Securities (HK) Limited and Société Générale Hong Kong Branch, which is regulated by the Securities and Futures Commission and Hong Kong Monetary Authority respectively. The information contained in this document is only directed to recipients who are professional investors as defined under the Securities and Futures Ordinance, Part III.

NOTICE TO JAPANESE INVESTORS: This document is distributed in Japan by Société Générale Securities (North Pacific) Ltd., Tokyo Branch, which is regulated by the Financial Services Agency of Japan. This document is intended only for the Professional Investors as defined by the Financial Instruments and Exchange Law in Japan and only for those people to whom it is sent directly by Société Générale Securities (North Pacific) Ltd., Tokyo Branch, and under no circumstances should it be forwarded to any third party.

NOTICE TO SINGAPORE INVESTORS: This document is distributed in Singapore by Société Générale Singapore Branch, which is regulated by the Monetary Authority of Singapore. This document may only be distributed to institutional, accredited and expert investors.

NOTICE TO TAIWAN INVESTORS: This document is to present you with our all capital markets activities across Asia-Pacific region and may only be distributed to the institutional investors. The product mentioned in this document may not be eligible or available for sale in Taiwan and may not be suitable for all types of investors.