MANAGEMENT MEETINGS - NEW YORK

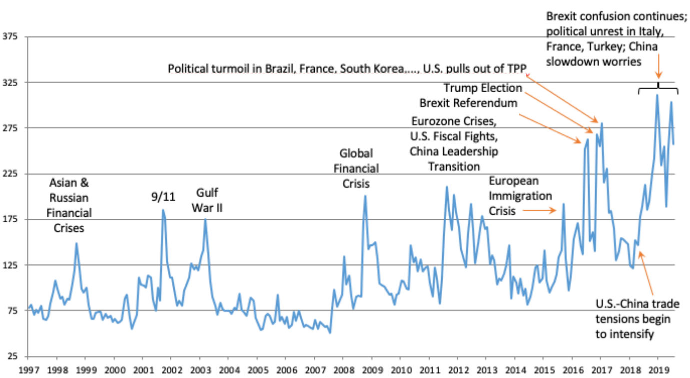
16-20 September 2019

FINANCIAL MARKET OBSERVATIONS

Over a week, we met with approximately 30 companies covering different sectors and industries such as hedge fund managers, real estate developers, financier to small and medium enterprises, litigation funders, music publishers and consumer related lenders.

In terms of market sentiment and outlook, there were clearly two camps that stood out after these meetings. On one side, hedge funds that are directly exposed to financial markets were more balanced/cautious as global economies are growing at a slower pace and are generally contracting worldwide. They indicated that threats coming from the ongoing trade dispute between US/China and the global geopolitical uncertainties (Brexit, Hong Kong and Iran to name a few) made it more difficult to invest, and that current markets are more driven and distorted by Mr Trump's tweets. To support this view, one mentioned the global economic policy uncertainty index (graph 1) that has been trending higher lately, and which implies more important market volatility and concerns over the global outlook going forward.

Graph 1 : Global economic policy uncertainty index, January 1997 to July 2019

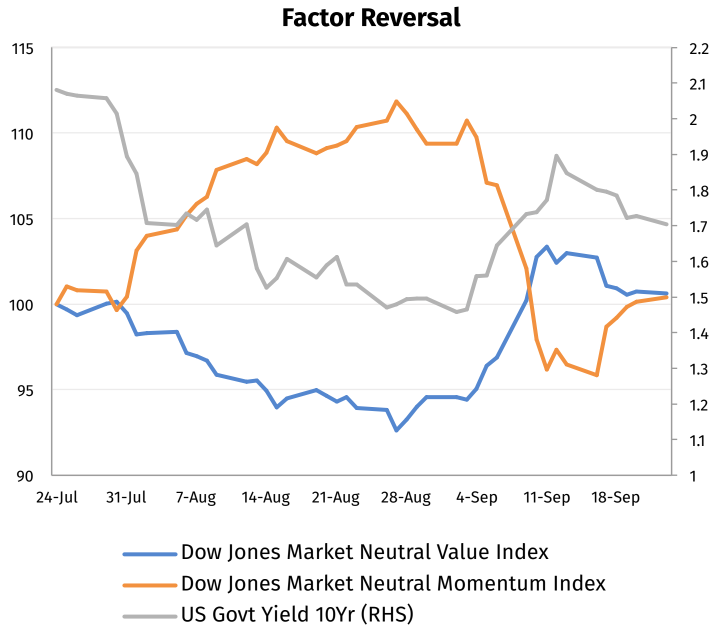


Source: Voxeu.org/CEPR, Scott Baker, Nicholas Bloom, Steven Davis

Central banks around the world have lowered interest rates this year to shore up their economies and stimulate growth, but their actions had limited success as no reflation was actually achieved. However, they seemed to be reassured by the fact that markets are starting to trade more on fundamentals, which should involve more dispersion between securities going forward and interesting investment opportunities arising from both the long and short side.

On the other side, companies that are directly exposed to real assets were more positive as they tend to have exposures to securities backed by operating assets that have low economic sensitivity and which are uncorrelated to the broader financial markets (more notably in times of stress). These companies often operate in more niche and nascent industries and are generally less overlooked by big players. They provide differentiated streams of return as they are less conventional and can normally generate better risk-adjusted returns due to its difficult to access nature. Furthermore, these companies generally hold shorter maturity amortizing paper instead of bullet payment that should also be less risky before a recession occurs. They also believe that the next downturn will come from corporates, like in 2001, as companies will not be able to service their debt and that this paper is hold by hot daily liquid portfolios that will need cash at any price/cost. Finally, they feel to be in a better position as the less liquid nature of private markets means that they will not need to sell in distressed situations and at an inopportune time.

The month of September has so far proven to be an eventful period that has directly and indirectly affected financial markets. On the surface it was not so obvious to see what happened by only looking at index returns. Performance from major indices has been positive overall, however, if analysed through a lens, sub-sectors and factors have gone through a major ride. Many investors have been caught by surprise when bond yields surged swiftly in just a couple of days leading to a big sector and factor rotation. This has caused the value factor to rally, as it was generally under-owned by market participants versus momentum positioning (buying securities that increased in price in recent months and selling securities that fell) that got crushed. Crowded positions were also hardly hit during the first days of the month and are gently bouncing back.



Source: Bloomberg

On the commodities front, crude oil prices experienced a sharp one-day move-up (+14.7%) following the drone attack in Saudi Arabia mid-September which led to some losses in certain sectors that have a higher oil factor (i.e.: energy, chemicals). Another remarkable event was the spike in the overnight repo market rate, which is mainly used by companies like hedge funds and broker-dealers to fund themselves. As they own lots of securities, they can borrow cheaply by posting the securities (usually liquid treasuries notes that do not vary much in value) as collateral to the lender in order to fund their day trading. When there is a cash shortage in the system, the repo rate tends to increase but rarely at levels seen as in the month of September since the overnight rate tends to follow the federal funds rate. The main cause of this surge was primarily technical (government auction, tax payment for big companies and holidays in Japan) but is also a consequence of the Fed's reduction in the supply of money in the system. That week, the Federal Reserve Bank of New York had to intervene and offered for four consecutive days a $75B facility to swap lower-risk Treasury holdings for cash at lower rates. There was no major impact on hedge funds due to this spike. On the contrary, some benefited as they had reverse repos on and were able to collect higher rates.

NOT ALL HEDGE FUNDS ARE EQUAL

During the month of September certain alternative strategies were more impacted by the sector/factor rotation that was triggered by the rise in bond yields. L/S equity, market neutral and CTA/Macro managers were negatively impacted that week, however, their month to date performance remains positive for most of them. CTA managers with a trend following bias have been caught by the sharp reversal in fixed income prices as their medium-term models were principally positioned on the long side (US bonds and Bunds) and are still negative for the month. Some Macro managers had losses in their fixed income book but were able to mitigate the loss with long FX positions in USD vs GBP and JPY. Long/short equity and market neutral managers were directly impacted by the sector/factor rotation as they were positioned long growth, momentum and in defensives names, which underperformed while their shorts in value, and cyclical names rebounded strongly. After a first hit we are noticing a benign recovery. Alternative fixed income and credit managers continued to perform well despite credit spreads and interest rate widening.

HFRX Index	**1-20 Sep. 2019**
Global Hedge Fund Index	+0.4%
Equity Hedge	+1.1%
Equity Market Neutral	+1.3%
Event Driven	+1.1%
Macro/CTA	-1.6%
RV Multi-Strategy	+0.3%
Fixed Income Credit	+0.7%
Other Indices	
S&P 500	+2.2%
MSCI Europe	+3.6%
Barclays Global Agg. Treasuries	-1.3%
Gold	-0.2%

Source : HFR and Bloomberg.