THE ALTERNATIVE WEEKLY BRIEF

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HEDGE FUNDS MAKE DO WITH CHALLENGING MARKET CONDITIONS

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Highly challenging market conditions for beta as well as for alpha. Central bankers are caught between bad inflation (driven by supply-shocks and by the massive monetary and fiscal stimulus deployed during the pandemic) and recession prospects. They still struggle to sort out the lesser of these two evils. High uncertainty regarding central banks' decisions, the magnitude of the world economic slowdown, the severity of the EU energy crisis, and the turn in Chinese real estate issues are all limiting managers' risk budgets and/or making them vulnerable to positioning mistakes. Unsurprisingly, a majority of market segments display contrarian behaviors, making buy-and-hold and momentum strategies vulnerable to frequent asset rotations.

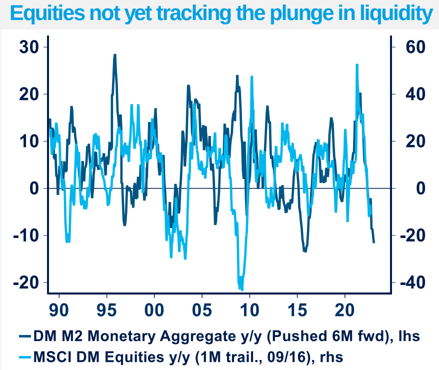
Sentiment indicators are bearish, suggesting investors are well aware of these risks. Yet, positioning indicators, which are rather neutral, tell a different story, emphasizing there is still hope (and therefore risk). In particular, bond investors are still fighting the Fed and do not believe its policy will turn as restrictive as planned. Inflation markets are already pricing a normalization. Equity analysts may still have unfinished business with downward EPS revisions. While asset valuations overall improved, the majority do not offer any more spectacular discounts since the summer rally.

This absence of capitulation is preventing managers from building portfolios on a solid ground, keeping them focused on risk management, which is an increasingly challenging task. The equity/bond correlation is firming but the relationship remains unstable, while the re-correlation across assets adds another hurdle. Also, hedging costs for a majority of assets are not yet particularly cheap and/or reliable.

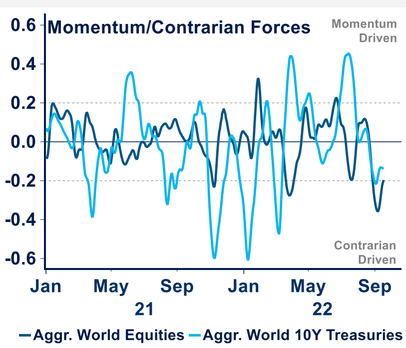
The dominance of transversal macro factors is narrowing the leeway to express thematic views, illustrated by the elevated correlations across our proprietary thematic baskets. As a result, position crowdedness remains a concern (albeit easing). Furthermore, asset prices do not optimally reflect yet their underlying fundamentals changes, a challenge for fundamental and value investors. Finally, the pause in corporate activity and reduced flows in equity, bond and structured primary markets are adding to the current lack of market catalysts.

Nonetheless, hedge funds continue to outperform traditional assets and generate modest alpha. In response to these trying times, a majority of hedge funds have greatly reduced their exposures and leverage. This move began early in 2022, accelerated in March, and was completed over the summer (L/S Credit, and to some extent Merger Arb., were the two exceptions in this broad de-risking). Thus, market timing has been a key source of excess return. ***[continued p2]***

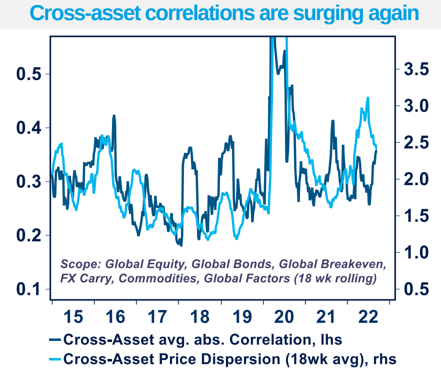
Equities not yet tracking the plunge in liquidity



Most markets have become contrarian



Cross-asset correlations are surging again



Sources: Bloomberg, Macrobond, Amundi Institute

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Performance: Hopeful U.S. driven rally

Amundi UCITS Peer Group Performance

	Last week*	MTD	YTD
Global Amundi UCITS Peer Group	0.1%	0.4%	-1.8%
L/S Equity Directional	0.0%	0.6%	-6.7%
L/S Equity Market Neutral	0.0%	0.4%	1.5%
Event-Driven: Merger Arbitrage	0.8%	0.9%	0.2%
Event-Driven: Special Situations	0.3%	0.3%	-8.3%
L/S Credit	-0.2%	0.3%	-4.1%
Global Macro	-0.1%	0.1%	-2.9%
CTAs	0.7%	0.4%	12.2%
Risk Premia	0.3%	0.2%	1.6%
MSCI World	3.0%	2.1%	-17.0%
Bloomberg Barclays Global Aggr. Bond	-0.6%	-0.7%	-9.8%

*Last Week: Sep 2 to Sep 9. YTD and MTD until Sep 9. Source: Amundi Institute

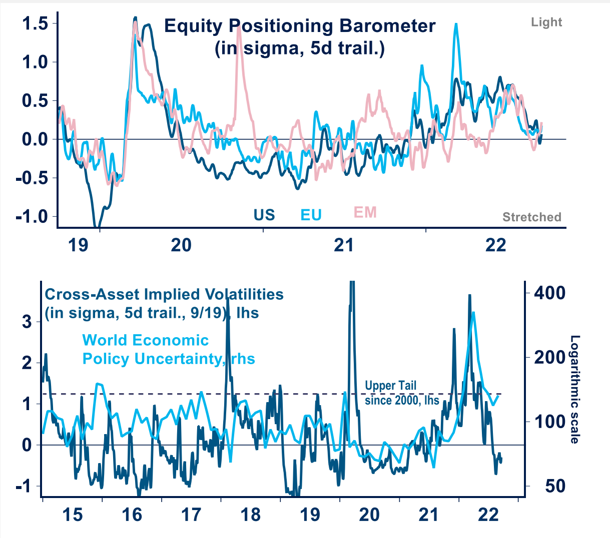
The market rally was mainly driven by U.S. equities, on growing optimism that the inflation outlook could continue to improve. The safe-haven dollar weakened. Cyclical and growth stocks outperformed defensive and value stocks. Credit spreads also ease, especially in the U.S.

Hedge fund performance were little changed. Tightening M&A spreads helped the Merger Arbitrage strategy outperform.

CTAs remained in positive territories thanks to the rise of bond yields, which offset losses in long dollar positions.

Hedge Funds Make Do With Challenging Market Conditions *[continued from p1]*

Positioning not particularly depressed and hedges are costly



Source: Bloomberg, Macrobond, Amundi Institute

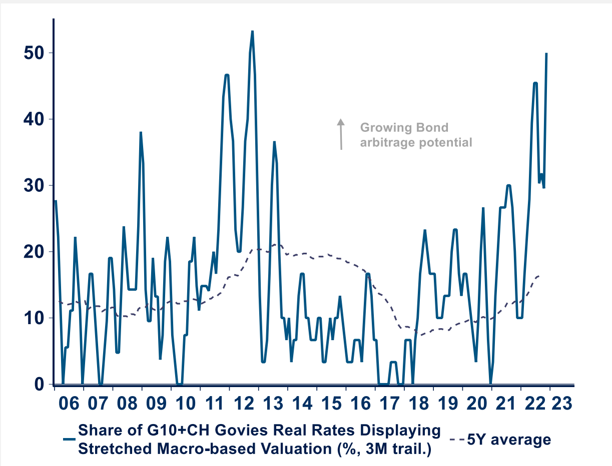
Moreover, managers increasingly diversified their portfolios, avoiding to express binary scenarios, with positions on both elevated inflation and low growth for instance. Bottom-up managers balanced their factor and sector exposures.

They also focused on relative arbitrage, in particular, those driven by regional divergences. The emergence of relative valuation anomalies (in govies, and selectively in FX and EM credit) and elevated asset dispersion were both supportive. Dispersion is not only reflecting high volatility, but is also fundamentally resulting from the rising asset discrimination as global liquidity shrinks.

As a side benefit, higher short-term yields improved the P&L from cash, a non-negligible contributor for L/S equity as well as futures investors, such as CTAs. Most managers would also have lots of dry powder to deploy when conditions align for a rally – though they would probably miss the initial phase.

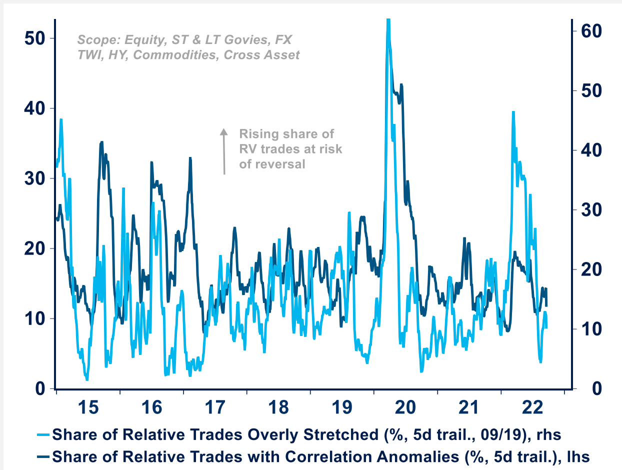
All in all, market timing, diversification, and relative-value have been hedge funds' main tools to navigate these lean times. Successfully so, so far.

Valuation opportunities appearing in G20 sovereign bonds



Source: Bloomberg, Macrobond, Amundi Institute

Relative asset relationships not overly stretched or unsettled



Source: Bloomberg, Macrobond, Amundi Institute

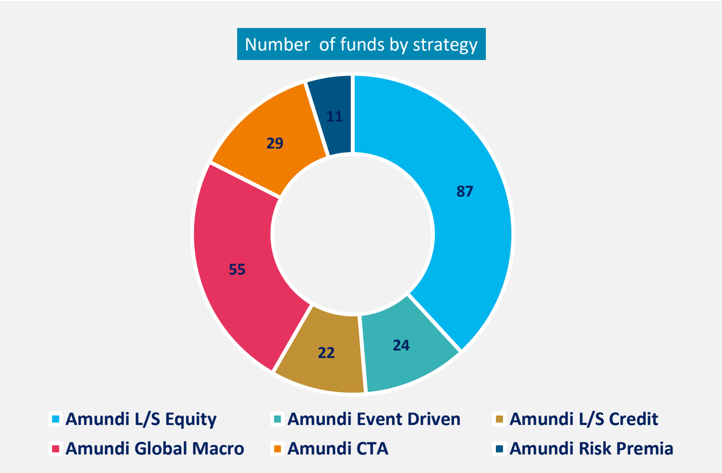
METHODOLOGICAL APPENDIX

The information contained in this report on the performance of hedge funds is based on publicly available information. The universe of underlying funds is relatively stable but varies depending on the criteria of inclusion presented below. It is based on an unbiased selection from our hedge fund analyst team.

Performance is calculated on a weekly basis, as of end-of-week, using an arithmetic average (equally weighted average).

Regarding share classes used in these peer groups, we selected the primary share class as referenced in Bloomberg. Non-USD share classes are hedged in USD based on hedging costs available on Bloomberg.

Amundi Hedge Fund Peer Groups: number of funds by strategy



- 228 strategies across the main categories in the industry
- USD 154 billion of assets under management
- As of September 2022

Criteria of inclusion

The criteria of inclusion are fourfold:

- Only UCITS strategies are included
- Assessment by Amundi’s Hedge Fund selection team based on funds’ materials or manager interaction
- Strategies included must have assets under management of at least USD 50 million
- Strategies included must display at least a one-year track record

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This report will be published every two weeks.

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