LYXOR / CHENAVARI CREDIT FUND – 2020 ANNUAL LETTER

AS OF DECEMBER 31, 2020

IN BRIEF

With vaccines being rolled out, the US election sorted, and a Brexit deal finally struck, the early days of 2021 carry hope that the start of the decade will leave the pain of 2020 behind.

However, prospects that the ringing in of the new year would bury 2020’s torments were upset by the highly contagious virus strain spreading across the UK, leading to drastic new measures. Furthermore, after the dramatic certification of Joe Biden’s presidency and the democrat win over the Senate, the early directions taken on fiscal expansion and tax will surely drive the markets’ take on the new presidency.

Much is yet to unravel to give a firm direction to 2021.

More generally, any twist to the “light at the end of the tunnel” narrative comes as a reminder that current valuation levels (with the Markit iTraxx Crossover starting the year below 250 bps) are somewhat disconnected to “on the ground” realities.

Central Banks actions seem to be beyond market forces and have spurred an almighty bull market based on super low rates and the abundance of liquidity worldwide. This powerful backdrop should not blind us from demanding valuations, with some asset classes seemingly “priced for perfection”.

As a result, keeping a decent allocation to selected Long / Short strategies remains a very valid consideration.

In this context, we are proud to present the key features of the **Lyxor / Chenavari Credit Fund (the “Fund”)**, which will **celebrate in February its 5-year anniversary since its “Relaunch”[1]:**

- Decorrelated performance, relying predominantly on alpha generation
- 6.35% annualised net return since Relaunch, with 24 months of performance above 0.65%, versus 2 months of performance below -0.65%[2]
- Improved liquidity and reduced complexity over the years, epitomised by the gradual extinction of the “Convexity” strategy (consisting of Index Tranches); although the Fund continues to foster an emphasis of retaining a convex profile (largely through vanilla options)
- Enhanced robustness and governance thanks to Clark, Chenavari’s proprietary Risk and Portfolio Management system (see our Webcast held in December on Clark, available on demand)
- The adoption of ESG new practice, with the exclusion of issuers linked to controversial activities and the integration of ESG factors into our investment process to identify material non-financial risks and opportunities
- Clear alignment of interest, with over USD10m invested in the Fund by the Chenavari team.

Looking at 2021, the Lyxor / Chenavari Credit Fund looks well positioned to navigate tight credit markets and situations with ample dispersion.

[1] The Relaunch in February 2016 consisted of a change of governance with the UCITS fund taking its independence instead of replicating an offshore fund. A low vol mantra was introduced with a strong focus on controlled drawdown, and a team of two co-PMs was empowered to directly manage the two core strategies of the fund (long / short Corporate, and long / short Financials).

[2] Source: Bloomberg and Chenavari, as of 30 December 2020. Figures provided by Chenavari are estimated and unaudited and should not be relied upon. Returns and performance are representative of Class SI USD.

1. A SIMPLIFIED, ESG FRIENDLY FUND

In 2021 we aim to capitalise on the lessons learned over the past few years to make our fund better aligned with the current environment.

We have a specific focus on simplicity, robustness, and governance.

1.1. SIMPLIFICATION: TWO CORE STRATEGIES

Historically, we have managed the Fund with an allocation to three strategies**: Corporate L/S, Financials L/S, and Convexity.**[3]

Whilst Corporate L/S and Financials L/S have been described as “Core” strategies, the Convexity strategy consisted of an allocation to a team specialised in trading tranches of indices. The Convexity strategy was therefore a portion of the fund which was not managed directly by the co-PMs.

Initially, when the Fund was launched in June 2015 as a replica of an offshore fund, this strategy was an important part of the Fund. Since the Relaunch at the end of February 2016, the strategy has been gradually managed down. The allocation of 35% at inception has come down to 15% by end 2016, then 10% end 2018, and 5% from June 2020. Over the second half of 2020, the remaining positions were exited and today the Fund has no capital allocated to the Convexity strategy.

Removing the allocation to the Convexity strategy is therefore a natural step. It simplifies the Fund considerably and foster direct accountability. In our opinion it should also enhance the liquidity profile of the portfolio as the index tranches tend to be the least liquid part of the strategy.

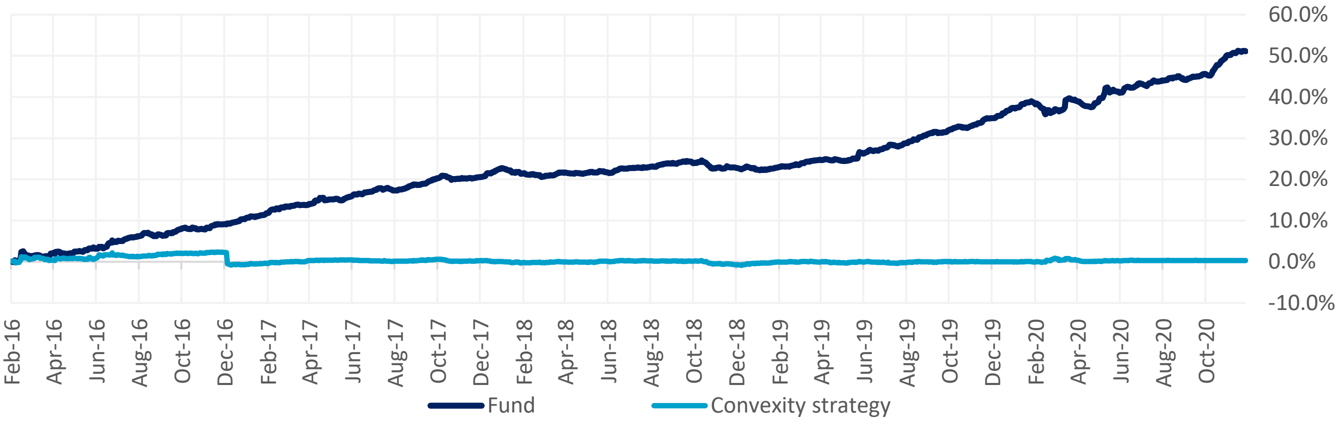
It should be noted that the Convexity strategy’s contribution to the Fund's gross performance has been marginally negative since inception (-1.6%) whilst the Corporate and Financials strategies have contributed c. +17 to +18% each (see Figure 1). The contribution of the Convexity strategy to performance never exceeded 80 bps on a given year.

Importantly, the Fund’s convex profile did not stem just from the Convexity strategy. The Financials and Corporate strategies have also brought their share, mostly via options on indices. As a result, the Fund will continue to operate with a convex profile, which is a key feature of its positioning.

In continuity with the past, the embedded convex profile will therefore continue to be built by the co-PMs at the Corporate and Financial strategies’ level, using various instruments, depending on market opportunities (mostly options on indices at present).

[3] Please note that the mentioned strategies are sub-strategies which are not detailed in the constitutive documents of the fund and conform to the overall strategy of the fund mentioned in the documents

Figure 1: PnL contribution of the Convexity bucket since the Relaunch end February 2016



Source: Chenavari estimates

1.2. THE ADOPTION OF ESG PRACTICES

As portfolio Managers we are convinced that the focus on sustainability is not only critical to improve agents' behaviour, but could also constitute a key engine for medium term performance.

We are taking steps to incorporate sustainability more prominently into our Firm's operations, as well as into the core of our investment activities.

In H2 2020, Chenavari adopted its Responsible Investment Policy, a testament to the firm's strategic vision and ESG ambition. The Policy introduces a series of formal exclusion principles for controversial activities (for example thermal coal and tobacco manufacturing) as well as for the violation of global norms and standards[4]. Furthermore, Chenavari has committed to integrating ESG considerations across all of the Firm's investment strategies, including the **Lyxor / Chenavari Credit Fund**.

In practice, the **Lyxor / Chenavari Credit Fund** now applies a formalised negative screening policy which excludes from the Fund's investment universe securities directly or indirectly linked to issuers whose activity entails controversial practices.

In addition, Chenavari portfolio managers are now able to apply their investment discretion in analysing issuers on both financial as well as non-financial characteristics, including ESG factors or criteria, to identify material risks or opportunities which may impair or enhance an issuer's ability to service its debt obligations. We have contracted the services of world leading ESG data provider, Sustainalytics, to empower our portfolio managers with objective independent ESG research.

Chenavari have also onboarded an ESG Project Manager who will support the portfolio managers with day-to-day investment activities and will lead training programmes to accelerate the implementation of responsible investment practices in the Fund.

[4] Companies which are known to be involved in the trade of products, services or activities involving pornography or prostitution, human trafficking, sexual violence against women, forced labour or child labour as defined by the International Labour Organisation (ILO) conventions, severe environmental damage, gross corruption, including extortion and briber.

2. WAS 2020 A PROPER TEST FOR MARKETS?

2020 is a year for Finance textbooks. We draw a few key conclusions:

- Central banks have taken their commitment to implement “whatever it takes to save the world” to the next level, both in terms of speed of action and magnitude.
- According to us the flipside is that they seem set on a quasi-unstoppable course to push market participants into more risk, creating moral hazard and disconnection with the realities on the ground.
- The long-term imbalances of growing debt and stretched valuations can prevail in a world where rates remain ultra-low and liquidity is super abundant.
- As such, liquidity cracks were only marginal and short-lived through the 2020 dislocation. Despite the brutality of events, passive funds and funds with liquidity mismatches were only partially tested - so long as their managers could wait and stomach March margin calls

That said, the first quarter of the year was an exceptional period for markets and many lessons can be drawn from how Funds navigated this specific period, indicating whether they were truly decorrelated long/short, or just expensive “beta riders”.

Against this backdrop, we are delighted to report that over the course of 2020 the **Lyxor / Chenavari Credit Fund** met its targets of drawdown control, low volatility and decorrelation to the markets:

- the Fund **was up 8.25% in USD and 7.3% in EUR**;
- the Fund was up every month of the year except in March, where it lost 1.03% thanks to a very active management of the Fund’s overall positioning;
- **volatility remained muted at 3.3%.**

Figure 2: UCITS Monthly performance since Fund inception, SI USD share class

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	FY post relaunch
2020	1.36%	0.52%	-1.03%	1.01%	0.60%	0.69%	0.75%	0.62%	0.00%	0.27%	2.84%	0.28%	8.25%
2019	-0.08%	0.20%	0.49%	0.36%	-0.17%	1.21%	0.61%	0.86%	1.26%	0.44%	0.44%	0.87%	6.67%
2018	1.05%	-1.29%	0.25%	0.30%	-0.14%	-0.10%	0.93%	0.10%	0.64%	-0.19%	-0.63%	-0.24%	0.65%
2017	1.34%	0.96%	0.95%	0.28%	0.64%	0.71%	0.67%	-0.12%	0.76%	1.19%	-0.32%	0.13%	7.41%
2016	-3.06%	-2.56%	1.40%	0.73%	0.14%	0.43%	1.60%	1.34%	-0.07%	1.48%	-0.15%	0.88%	7.95%
2015						-0.19%	-0.11%	-1.58%	-1.68%	0.15%	0.27%	-0.52%	NA

Note: cells in grey denote performance before “Relaunch”

Source: Bloomberg and Chenavari, as of 30 December 2020. Returns and performance are representative of Class SI USD.

THE FIGURES RELATING TO PAST PERFORMANCES REFER OR RELATE TO PAST PERIODS AND ARE NOT A RELIABLE INDICATOR OF FUTURE RESULTS. THIS ALSO APPLIES TO HISTORICAL MARKET DATA.

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3. Q1 2020 CASE STUDY

We started 2020 with a constructive stance on the market.

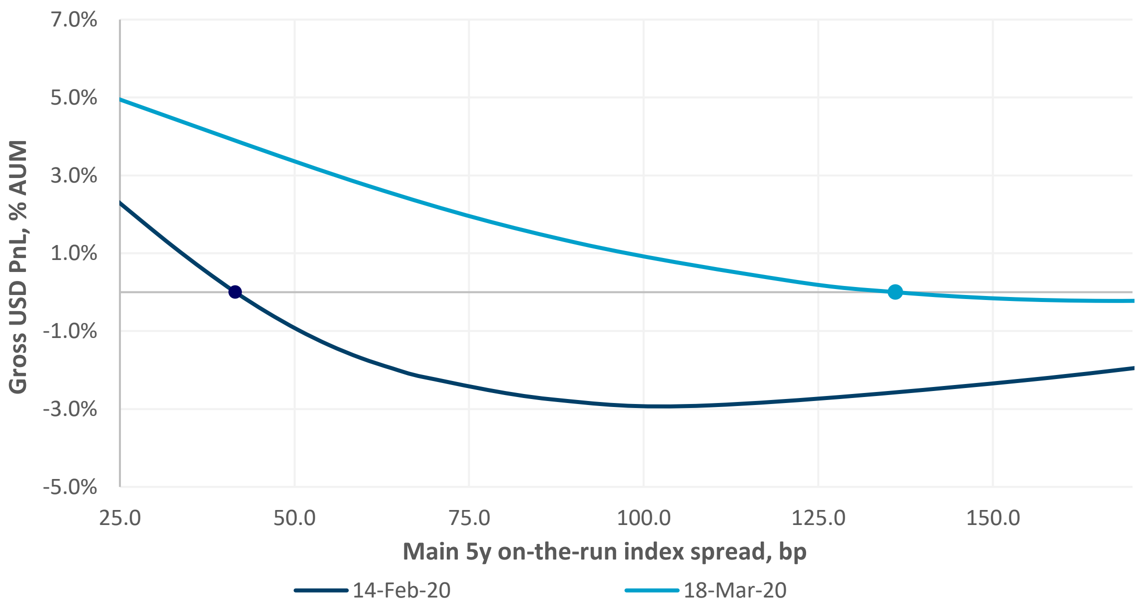
Our view was that a positive resolution of the trade negotiations between the US and China would lead to higher PMIs and a pickup in GDP growth across Europe, the US, and Asia – helping cyclical names to outperform staples.
Towards the end of 2019 we therefore positioned the fund with a more cyclical bias, even though we remained flat on credit spreads.

2020 opened on a very bullish note indeed, and our positioning worked well during the first few weeks of the year. By the beginning of February 2020 however, we felt that the market was getting a little bit too expensive in terms of spreads.

We therefore started to decrease risk, with a particular focus on B and BB cyclical names.

Figure 3 illustrates the change of positioning at Fund level.

Figure 3: Fund level systemic stress as a function of the iTraxxMain (S33) 5Y spread



Source: Chenavari estimates, as of 30 September 2020, based on assumptions defined by the Chenavari Risk team
Estimates are based on the market conditions at the time of modelling and are therefore, subject to change. Chenavari has made assumptions that it deems reasonable and uses the best information available to calculate the stress test estimates. If a different set of assumptions were used in this calculation, there could be a material difference in the calculated estimates.

The two dots on the figure show where the iTraxx Main was at the two dates of observation of the fund positioning. From there, one can see in theory how the fund should react if the market were to tighten (on the left from the “dot”) or widen (on the right from the “dot”) in a homogeneous way.

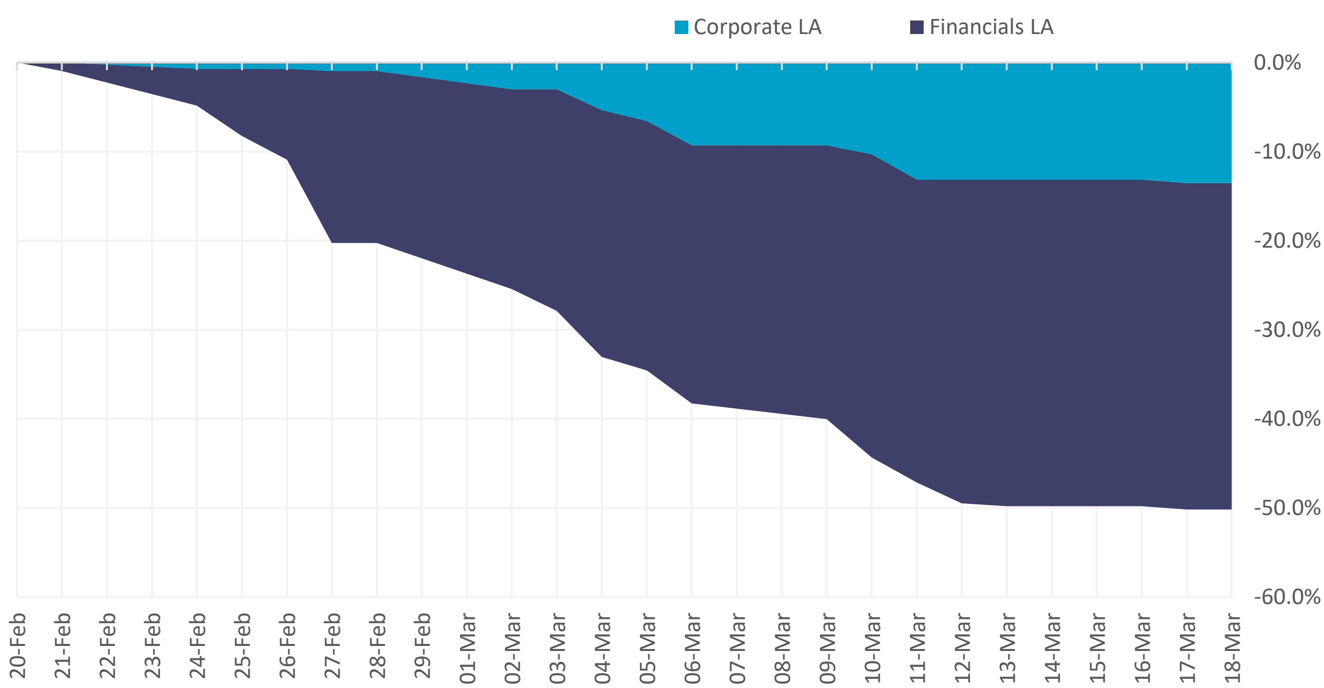
The Fund’s risk profile on 14 February is featured in **dark blue** on the chart, at a time when the iTraxx Main was trading at c. 48 basis points. The Fund’s positioning meant that in case of a market widening, it would have quite a linear drawdown until Main reached c. 60 bp; then would decrease at a slower pace until a bottom drawdown of -3%, and then move back up to -2.5% drawdown for Main reaching 125 bp, thanks to the Fund’s embedded convexity.

As we reached 18 March, the Fund's risk profile had considerably flattened, with almost no drawdown in case of a further market widening.

In essence, we started taking profits before the Covid-19 crisis crystallised in Europe. As it became apparent that Italy was in an emergency health situation, we simply accelerated the process of risk reduction.

Within a few weeks, we decreased our long positions by c. 50% of the fund exposure on a cash basis. Figure 4 shows how long positions across Corporate and Financials were reduced between 20 February and 18 March.

Figure 4: The significant reduction of existing long positions in the Corporate and Financials Books between 20 February and 18 March 2020

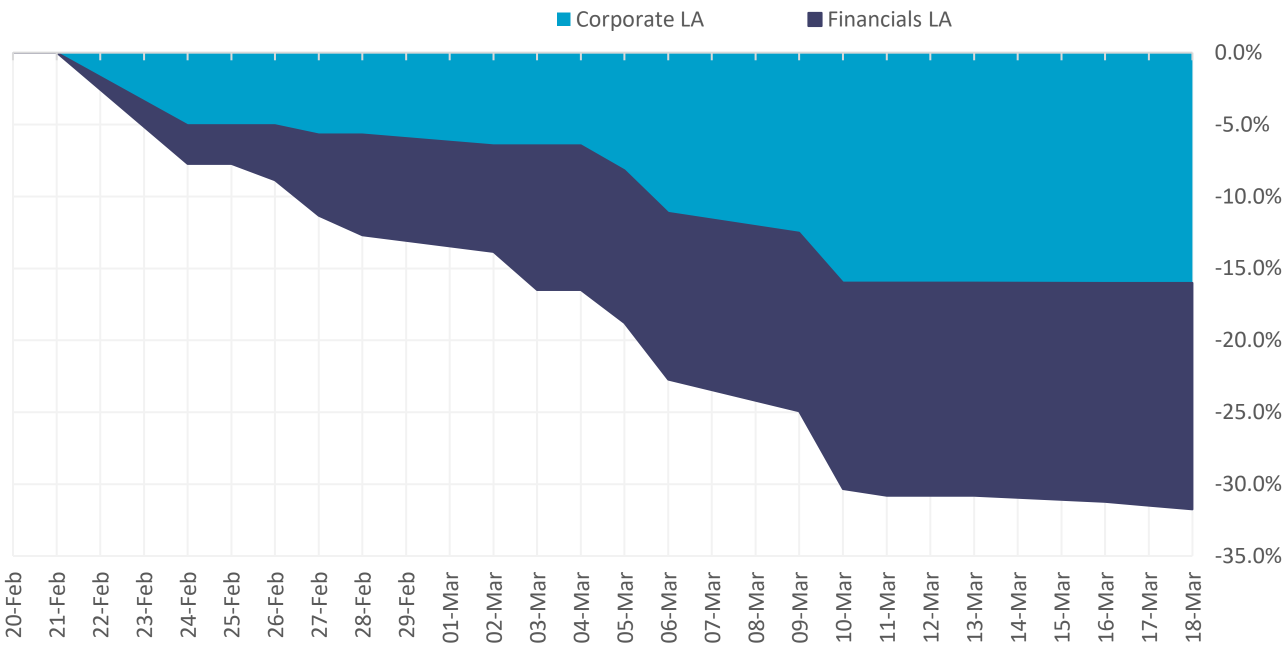


Source: Chenavari estimates as of 18 March 2020

The reduction of risk was particularly acute in the Financials strategy.
Around 40% of the reduction of the Financials book came from a decrease of Italian risk. The Fund's large exposure to Italian financial bonds was based on the conviction that a wave of domestic consolidation was about to kick in. Our expectations were put to rest by the health situation, and we therefore aggressively decreased our exposure to Italy, going from a net long position to a net short position.

On the short side, we increased shorts by over 30%, both on the corporate book and the financial book, as Figure 5 highlights.

Figure 5: A significant increase of short positions between 20 February and 18 March 2020



Source: Chenavari estimates as of 18 March 2020

This increase in short positions was implemented via synthetic instruments (CDS), but also by shorting cash bonds (through TRS), to manage the basis risk of the Fund (making sure that the amount of cash bonds on the long and short side were commensurate). In the dislocation, we felt that fund outflows could lead to an aggressive reduction of cash levels for many funds in the market. Forced sellers could appear, triggering movements in cash bonds that could be much more aggressive than the moves in the CDS.

In essence, we managed a vigorous reduction of risk over a short period of time, as we viewed the upcoming Covid crisis as a trigger for a repricing of risk.

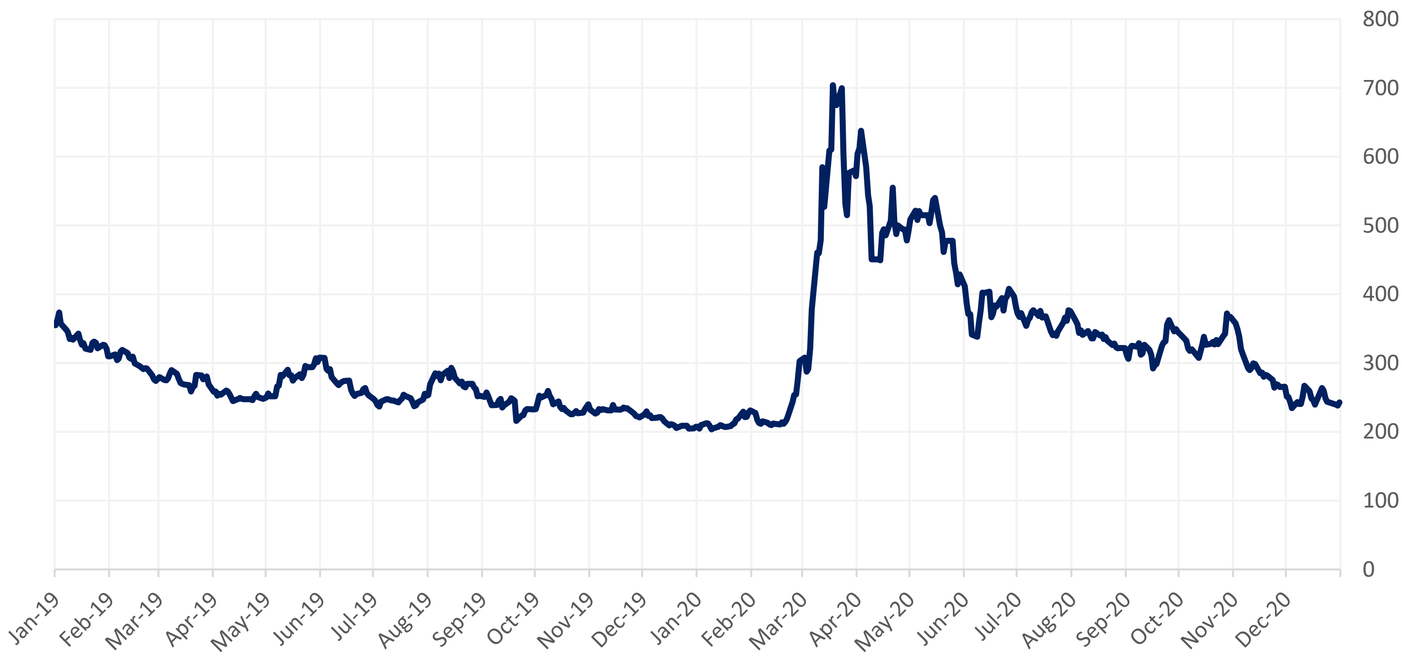
The aggressive change of risk profile of the Fund, illustrated on the three figures above, translated into a satisfactory performance versus our long / short credit peers. At the end of March, the Fund was up 0.30% YTD, after a 1% drawdown during the Month.

When we started to increase risk at the Fund level back in March - April, on the back of the massive intervention from Central Banks and Governments, we mostly implemented trades on Investment Grade ("IG") names. At the time, there was significant concern as to the amount of default that could arise. IG bonds were obviously safer and benefitted from an enhanced purchase programme from the ECB. As such we could implement very attractive trades, buying IG bonds issued by Phillips, Enel, Heathrow, Aeroport de Paris… All those issuers that had previously traded well below 100 basis points and suddenly needed to issue bonds in the range of 170 to 300 basis points.

4. EYES ON 2021: FOCUS ON ALPHA

As we enter 2021, Credit indices are back to very tight levels, with the Crossover trading below 250 bp and the Main at c.50 bp (see Figure 6).

Figure 6: Crossover trading range since 1 January 2019



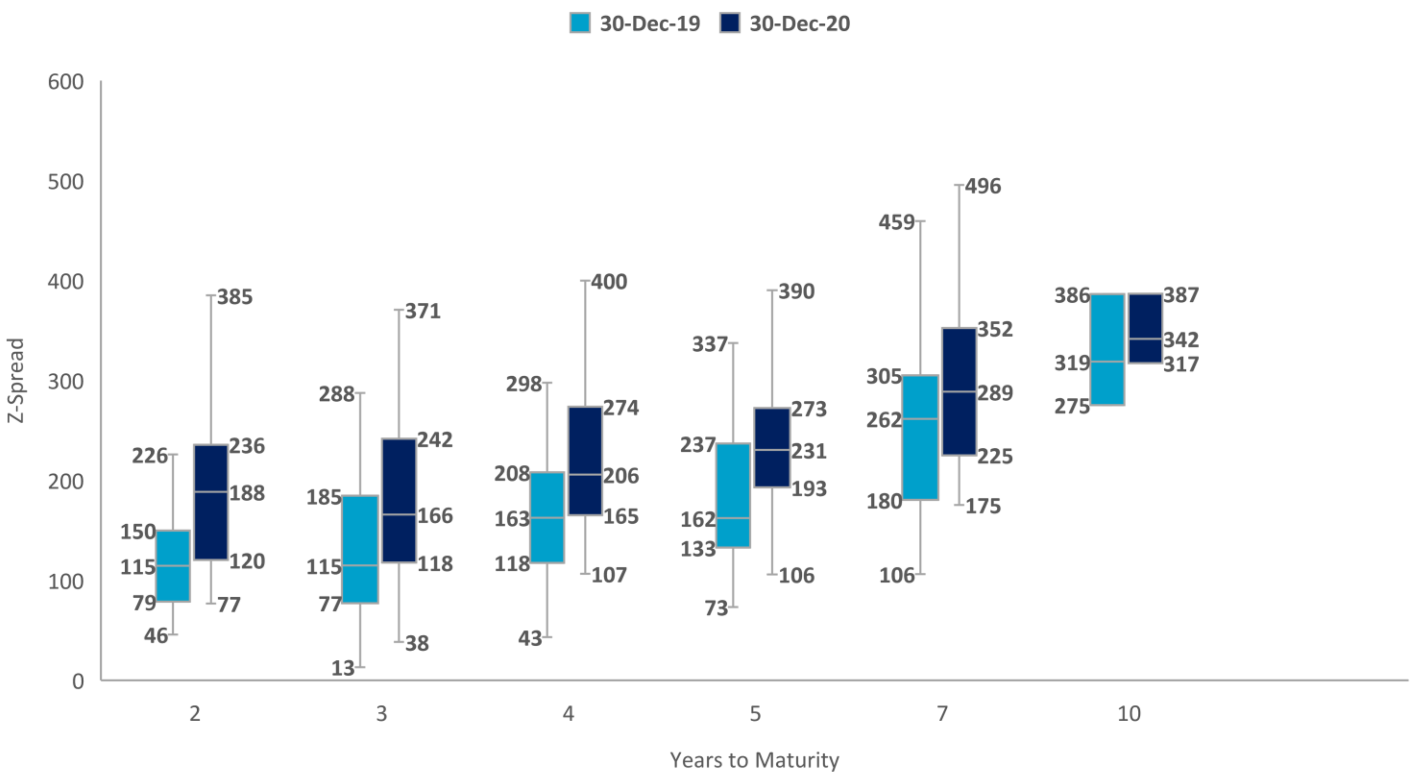
Source: Bloomberg and MarkIT, as of 22 December 2020

Despite Covid-19's brutal impact on the economy, this bullishness is justified by the massive intervention of Central Banks throughout the year, the efforts from governments to protect jobs and companies, and obviously the rollout of a vaccine. At current levels it is hard to rely on significant further tightening in credit as a reliable performance driver in the months to come.

The reopening of all sectors in the economy is expected to be gradual, and prone to stops and starts, as the current situation illustrates. This could underpin potential significant volatility during this process.

In such a context we consider that the way to play Credit markets is via **long / short strategies.**
In our opinion, the current levels of indices in Europe make it particularly relevant now to play the dispersion among names of similar ratings, thereby identifying long / short trades with a potential for significant alpha generation. This is best illustrated by figure 7.

Figure 7: Dispersion of BB bonds by years to maturity



Source: Bloomberg and Chenavari, as of 30 December 2020

Our job as stock-pickers and alpha-generators is to navigate this wide range of spreads, to identify which of the names are trading too tight against their fundamentals, and which are trading too wide.

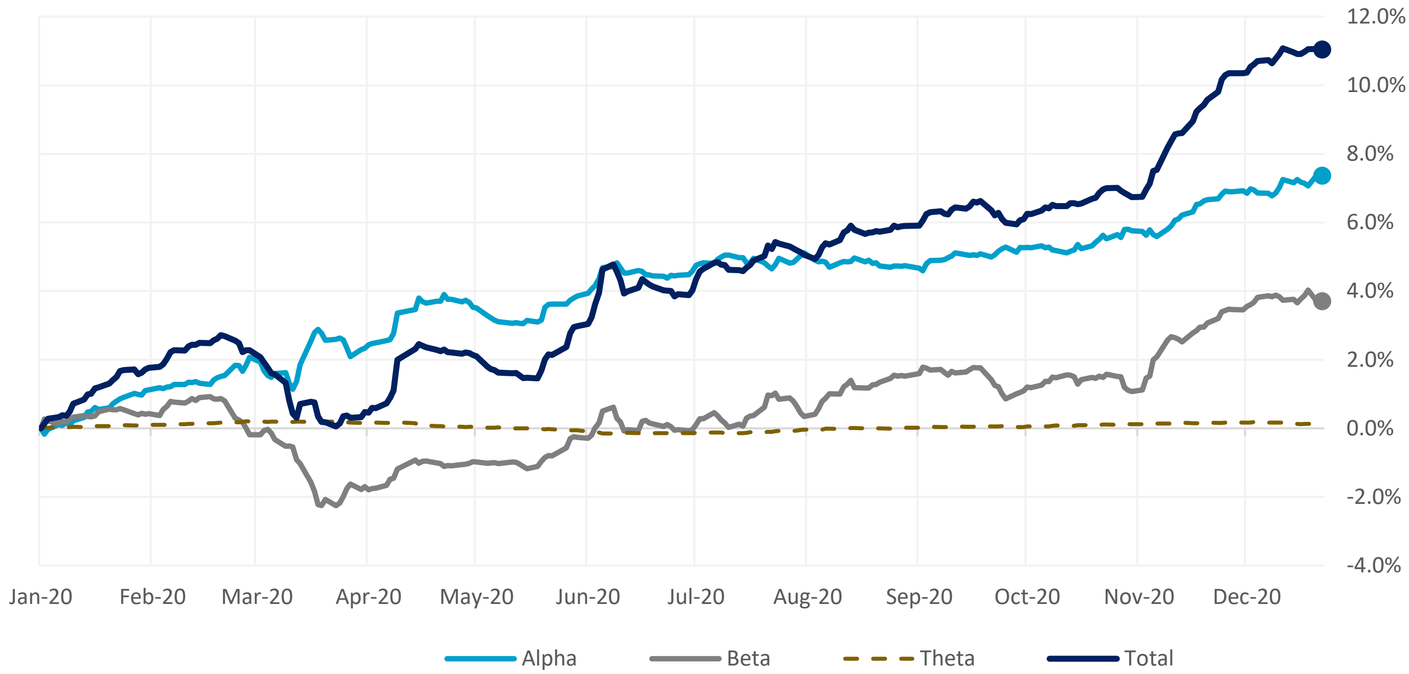
ALPHA GENERATION IS OUR KEY PERFORMANCE ENGINE

The work accomplished to alter the positioning of the Fund in Q1 2020 does not imply that we were running the Fund with an outright long bias in the first place. Indeed, our performance relies primarily on alpha generation.

As apparent in figure [1], the Fund's performance is primarily the result of many trades which all together translate into attractive returns. This focus on alpha generation is an essential point which underpins the decorrelation between the Fund and the Markets.

Figure 8 clearly highlights this point for 2020, showing that the alpha component prevailed over beta through 2020 both for the Financials and Corporate strategies.

Figure 8: Alpha was the major component of performance in 2020



Source: Chenavari estimates, as of 22 December 2020

More fundamentally, the decorrelation between the Fund and the market is well illustrated by figures 9, illustrating the Fund's low correlation to European indices, and in turn its low beta exposure.

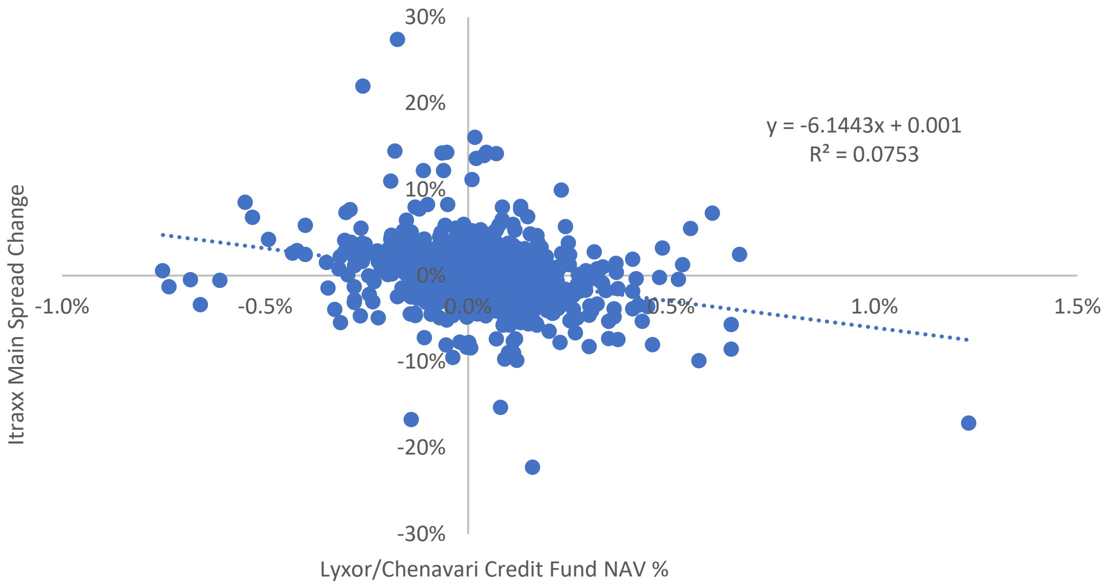
Figure 9: Correlation of the Lyxor / Chenavari Credit Fund versus key European indices

	EuroStoxx 50	EuroStoxx Banks	iBoxx EUR Corp.	Euro Bund Futures	iBoxx EUR Liq. HY
Lyxor / Chenavari Credit Fund- SI USD	0.30	0.31	0.13	-0.11	0.27

Source: Bloomberg, based on daily data observed on a rolling 2-year basis – as of 30 December 2020, indicative only.

Similarly, figure 10 shows the relationship of the daily NAV of the Fund versus the iTraxx main spread on a daily basis. The R2 of this relationship is close to zero. There are dots all over the place, and there is no obvious pattern between the market behaviour on a set day and the Fund's performance.
It is pretty much an alpha driven approach that we implement.

Figure 10: Correlation of the Lyxor / Chenavari Credit Fund daily perf vs iTraxx Europe daily performance



Source: Bloomberg and Chenavari, as of 30 December 2020, since inception of Fund Index roll dates have been removed from the sample data.

Our bottom-up research process underpins our name selection, and ultimately our alpha generation. Models produced by our research analysts are essential to build accurate forecasts of cash-flow generation for 2021 and 2022, assess the forward leverage of the issuers and then pick the best risk adjusted trades to include in the book.

In many sectors, the route to EBITDA and Cash Flow recovery from the lows of 2020 is not easy to predict; we therefore work with ranges of outcomes and probabilities, rather than a single view of what our forecast "should be". Importantly, we do not work with entrenched "deep convictions". At the top of our check list is the degree of emotional involvement of the PM or analyst in a decision. We are not looking for homeruns, for being right with a vision, or glorious trades. Instead, we want to make money trade by trade, repeatedly, and allow ourselves to revisit any case and change our mind easily without the irrational baggage that can come with it in certain environments.

Figure 11: Our "behavioural checklist" to assess the quality of a decision

1/ Degree of robustness of the conviction

How was the conviction formed? Was a 360-analysis conducted? Were there scenarios constructed with probabilities allocated to each?

2/ Degree of expertise

Is it a situation we know well and have traded a lot in the past?

3/ Degree of emotional involvement

Is the agent "in love" with their idea or keeping an open eye on the situation?

Source: Chenavari

This approach creates the opportunity to implement numerous trades, creating gains both on the short and long side – independently of any beta exposure. The ideal market scenario for us is a functional market with high volatility, but not necessarily a strong direction.

Bottom line, we manage our overall positioning and individual situations in a very dynamic way. In some cases, our trades are driven by decisions made at country levels, such as the trading of risk on Italian financials in 2020, or the management of our UK exposure in the context of Brexit. In other cases, our trades are driven by our sector views. Trades can also be driven simply by the decision to reduce or increase the Fund's net exposure. This active trading approach allows us to manage any bias in a very dynamic way. Whenever we see a shift in market sentiment turning, we are ready to raise cash levels (as we have in the past, up to 50% in extraordinary times) and swiftly flatten any potential long bias.

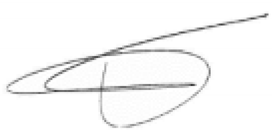
Our fund has very low carry. Historically, when we look at the breakdown of our returns, only 20% of the return comes from carry. Everything else comes from mark-to-market gains. 80% of our returns over the last four years come from trading.

At the end of the day, we accumulate the returns over time making profits on the longs, taking profits on the shorts and doing this day in and day out, hence our low correlation to indices epitomised on chart 10, with an R2 close to zero.

* * *

We hope the above helps explain the Fund's approach and are at your disposal to take the discussion forward. We thank you for your continued trust and hope to pursue a fruitful partnership with you in the years to come.

With our best wishes for 2021,



Vincent Laurencin

Deputy CEO and Chair of the UCITS portfolio review, Chenavari

DISCLAIMER

- Risk of losses
- Volatility
- Leverage & value-at-risk
- Achievement of investment objective
- Market risk
- Third party risk

For any additional details about the risks associated with the Fund, please refer to the legal documentation which is available upon request at Lyxor Asset Management – Tours Société Générale 17 Cours Valmy – 92987 Paris La Défense Cedex – France

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