The return of the Long / Short

Lyxor Chenavari UCITS fund up +4.9% (SI USD) and +4.0% (SI EUR) year-to-date as of 3 September 2020

Dear Investors,

As this letter is the first one I write from my office this year, a sense of normality and relief should finally permeate – were it not for the empty offices all around the area, and no one raising an eyebrow over my worn-out trainers.

In this new phase, Covid-19 looks like yesterday's theme for the markets. Clearly, the fallout of the pandemic is still in front of us, as corporate defaults and unemployment materialise whilst governments have less ability to ease the pain – but we do not see this as a pressing market concern.

In the short term, markets have other areas of immediate attention to focus on, most notably the US election and its subsequent ripples on the US v China relationship. Brexit will also be a key topic in Europe over the coming weeks. The extraordinary rally since the lows in March (S&P up 60% from 23 March to 2 September) should give way to more choppy waters between now and the end of the year. In European Credit, the rally has also been strong, even though indices remain much wider that the tights of February (see Figure 1).

Figure 1: Crossover level over the past 12 months

Source: Bloomberg

Positioning

After a satisfactory 12 months (the Fund is up +7.8% in USD and + 6.2% in EUR, see YTD data on figure 2), the Fund's positioning remains as nimble and agnostic as ever.

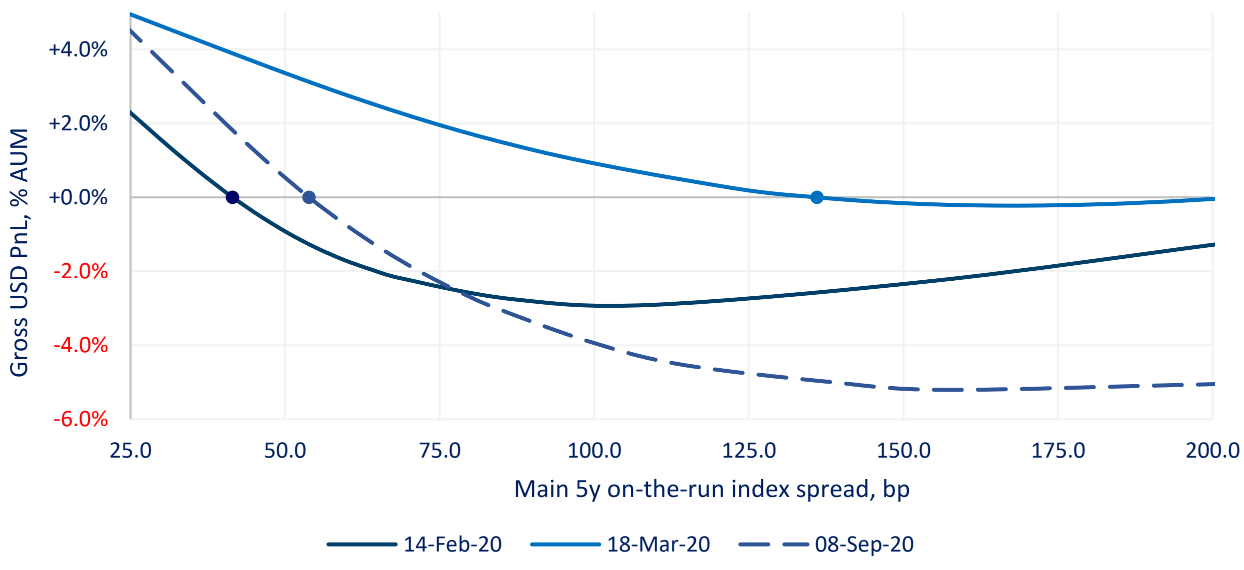
Figure 2: Lyxor Chenavari UCITS L/S Credit - gross P&L attribution overall and by Strategy (USD)

	YTD 2020	*Jan*	*Feb*	*March*	*April*	*May*	*June*	*July*	*August*	*07 Sep*
Total	**+7.05%**	+1.80%	+0.74%	-1.41%	+1.58%	+0.74%	+1.16%	+1.13%	+0.82%	+0.32%
o.w. Corporate	**+2.16%**	+1.01%	+0.35%	-1.59%	+0.85%	+0.40%	+0.34%	+0.42%	+0.33%	+0.05%
o.w. Financials	**+4.01%**	+0.74%	+0.15%	-0.17%	+0.81%	+0.42%	+0.67%	+0.57%	+0.46%	+0.28%
o.w. Structured Credit	**+0.31%**	-0.06%	+0.13%	+0.23%	-0.11%	-0.08%	+0.16%	+0.06%	-0.01%	-0.01%
o.w. Other	**+0.57%**	+0.11%	+0.10%	+0.11%	+0.04%	+0.00%	-0.01%	+0.08%	+0.03%	+0.00%
Net Perf SI EUR*	**+4.04%**	+1.21%	+0.38%	-1.21%	+0.94%	+0.55%	+0.57%	+0.68%	+0.86%	+0.01%
Net Perf SI USD*	**+4.90%**	+1.36%	+0.52%	-1.03%	+1.01%	+0.60%	+0.69%	+0.75%	+0.90%	+0.02%

** Net performance from Bloomberg as at 3 September 2020 (latest available data)*
Source: Chenavari unaudited estimates, 7 September 2020

It is interesting to compare the Fund's positioning with that of mid-February, when on-the-run iTraxx Europe (5Y) index was trading in the 45-55bps range. Figure 3 outlines the change of risk profile over at different points in time in 2020.

Figure 3: Lyxor/Chenavari Credit Fund's risk profile as a function of on-the-run iTraxx Europe (5Y) spread (the dot representing the position of the index at the time of the Curve)



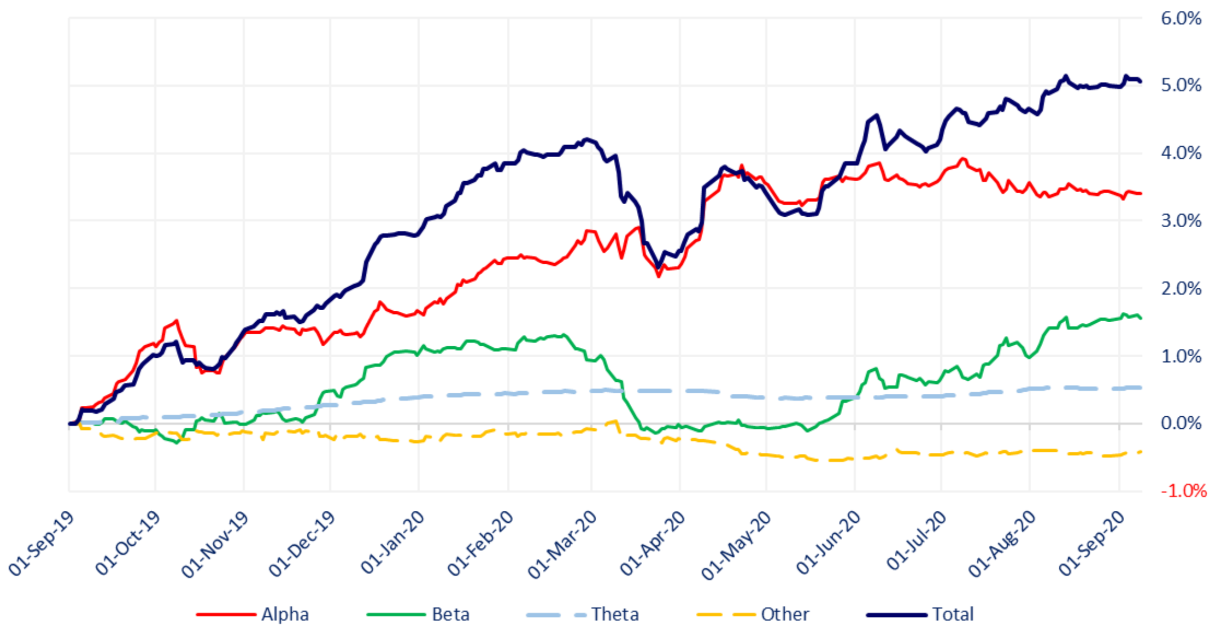
Source: Chenavari unaudited estimates, 8 September 2020

Today, the Fund is built with less convexity in case of a major market collapse (no positive PnL kicking in at extreme levels), whilst the upside / downside profile is slightly steeper locally than it was in mid-February.

For reference, the positioning as at mid-March is a good reminder of the capacity of the team to rapidly modify the Fund's profile thanks to hedges, options and convexity.

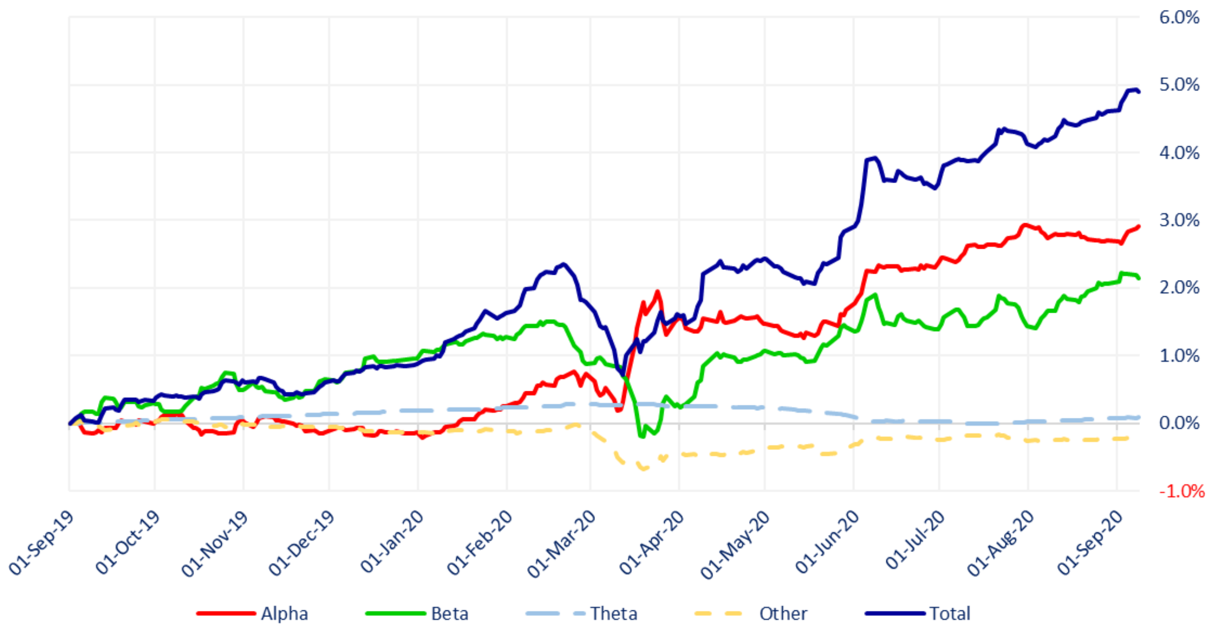
Clearly, the slight long bias expressed here has helped capture some of the market beta in the rally. This (limited) long bias has been reduced in the past few weeks. The Fund's "PV 10" (i.e. drawdown in case of a 10% widening of indices) is now -70bps, down from -100bps end of July. Indeed, we believe that the current markets lend themselves more to alpha generation. This is our main focus and contributor to performance historically, both on the Corporate and Financial strategies (see Figure 4 and 5), thanks to the in-depth work done by our Research team in conjunction with the co-PMs.

Figure 4: Corporate Strategy, 12 months Gross P&L attribution as a percentage of AuM



Source: Chenavari unaudited estimates as of 7 September 2020

Figure 5: Financials Strategy, 12 months Gross P&L attribution as a percentage of AuM



Source: Chenavari unaudited estimates as of 7 September 2020

We believe that the upcoming market environment lends itself well to our strengths, with "beta only" funds being affected by more volatile markets, whilst Long / Short funds can implement their name selection process without the fear of missing out on an exuberant bull market. In particular, after a whirlwind of sector rotation and a "K-shaped" recovery, significant gaps in pricing have emerged amid names, creating good risk/reward opportunities for research-driven name selection.

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The small decrease of risk in the Fund is explained mostly by the **Corporate strategy**.

That said, the team remains cautious of activating significant short positions, still perceived too dangerous to implement whilst the market remains very forgiving with most names overall. The reduction of risk was activated via the implementation of index hedges, as well as the reduction of selected long positions such as Fiat Chrysler, Carnival, or IAG.

Looking to seize alpha opportunities, the Corporate strategy currently positions its risk for idiosyncratic moves, with a focus on attractive recovery stories that can still deliver good returns as their business normalises. The Fund is currently long AMS, the German sensor manufacturer that acquired Osram recently. We also favour the Italian gaming company Gamenet and UK pub operator Stonegate. On the short side, we like Teva pharmaceuticals as lawsuits against the company keep emerging and the Chemical group Ineos, as current leverage combined with tight valuations and weak fundamentals leave little room for disappointment.

Also the Crossover index will be affected in September by the roll to the S34 series, with names leaving the index (e.g. Matalan, Selecta, Hema, Sunrise) and some fallen angels joining (such as Accor, Lufthansa, ITV, Peugeot), triggering a mechanical tightening of the index toward c. 285-290 bps, versus c. 320 currently. In time, this could make the new index a good instrument for further hedging of the book.

Conversely, the **Financials strategy's** credit sensitivity has slightly moved up during the summer particularly due to increased exposure to Spanish subordinated debt (via Sabadell in particular with new investments at the Tier 2 and Non-Preferred Senior levels) which has been a strong contributor to performance of late. The long is balanced by some shorts on UK banks which we believe could bear the brunt of the hard Brexit noise (e.g. Lloyds, Natwest). Worth mentioning, the team has been progressively switching risk exposure out of AT1s into the more senior part of the capital structure i.e. non pref senior and Tier 2 bonds.

When initiating new Relative Value trades, we are focusing on a combination of three factors:

- Key credit metrics (latest CET1 level released and buffer vs MDA, particularly relevant for AT1s investments, Cost of Risk, Asset Quality and overall Profitability)
- Momentum (currently positive in the Spanish banking sector due to potential near term M&A activity, negative in the UK with odds of a hard Brexit that have recently increased)
- Arbitrage within the bank capital structure (seeking for best value among AT1/T2/NPS debt structure given recent compression/decompression moves)

Finally, with a hefty cash position (in the high teens), the team is ready to deploy opportunistically as the market unfolds.

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We hope the above helps explain the Fund's positioning in the current environment.

Should you wish to arrange a follow-up discussion, please do not hesitate to contact us:

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Disclaimer:

Estimations reflect conservative modelling assumptions, but do not reflect the best and worst case scenarios. Estimates are based on the market conditions at the time of modelling and are therefore, subject to change. Stress Tests present a set of hypothetical scenarios that assume changes for one or more market variable in order to assess the effect on the portfolio. The results shown represent estimated gross performance of the Fund under the market conditions stated. Chenavari has made assumptions that it deems reasonable anduses 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. Please refer to Offering Document for risk parameters.

Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program.

One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or to adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results.