

AXA IM PRIME

Hedge Fund Strategy Overview

Q2 2024



Hedge Fund Strategy Overview

Strategy Outlook Dashboard

Strategy	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24
Event Driven	Neutral	Neutral	Neutral	Positive	Positive	Positive
Quantitative	Positive	Positive	Positive	Positive	Positive	Positive
Stock Picking	Positive	Positive	Positive	Positive	Positive	Positive
Multi-Strategy	Positive	Positive	Positive	Neutral	Neutral	Neutral
Global Macro	Positive	Positive	Positive	Positive	Positive	Positive
Managed Futures	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral
Fixed Income Arbitrage	Positive	Positive	Positive	Positive	Positive	Positive
Convertibles Arbitrage	Positive	Positive	Positive	Positive	Positive	Positive
Credit/Distressed	Positive	Positive	Positive	Positive	Positive	Positive

Hedge Fund Strategy Overview

Event Driven

Definition

Event Driven funds aim to profit from significant events affecting a company where the uncertainty regarding the outcome creates an opportunity. They generally combine long and short positions across all asset classes they view to be mispriced, often in an arbitrage type trade.

Approaches are split between those who try to predict events and those that only get involved once events are announced, such as mergers and corporate actions. Once the team has predicted the outcome of the event and has determined an investment horizon, they analyse the securities available and select the best tool to profit, usually ranging across credit and equity. At the same time, they consider the potential risks, in terms of: volatility, liquidity, market and sector risks. Usually, the most significant risk is the potential of the event not happening. Finally, they must determine how to close the position, and the probability of each of the possible outcomes.

Sub-Strategies

Merger Arbitrage

Merger Arbitrage strategies exploit inefficiencies in merger transactions by capturing the spread between the offered price and the traded price of a given security being acquired. The spread reflects the risk of the deal not going through.

Key success factors include the ability to assess deal risk, trading around the spread, properly working out the hedging ratio for complex transactions, and using options as a return enhancer or in order to mitigate risk. The best environment for the strategy is one with plenty of M&A deals, low deal breaks and wide spreads which is driven by interest rates levels, riskiness of deals and liquidity

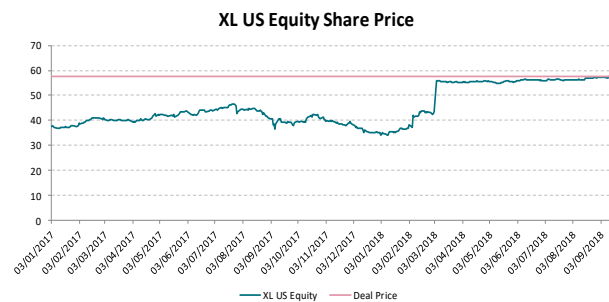
Equity Special Situations

These funds target targeting companies involved in actions such as corporate transactions, management changes, share buy backs, special dividends or restructurings. Funds will take positions based upon announced and pre-announced events and some managers may also become activist, engaging with companies to encourage catalysts. The strategy works best in benign equity markets with ample liquidity.

Distressed Securities

Funds in this space invest in companies facing financial or operational issues such as bankruptcy or capital restructurings. These securities tend to trade below their intrinsic value, creating an opportunity for managers who combine fundamental analysis of the company with their deep understanding of the restructuring or bankruptcy process to determine whether a distressed company is a worthwhile investment.

Trade example



Source: Bloomberg 09/03/18

AXA made an offer to acquire XL in March 2018.

The deal was seen by the market as being likely to go through and so XL's share price jumped to near to the deal price following the announcement. Merger arbitrage funds were able to take advantage of the closing of the spread by analysing the likelihood of the deal closing and taking a position accordingly. Although the spread was relatively small, funds used leverage to amplify returns

Key Risks

Deal breaks: managers, especially merger arbitrage specialists, are exposed to confirmed deals collapsing for unexpected reasons.

Rival event: catalysts can be rendered irrelevant by a different catalyst, causing spreads to move unpredictably.

Market beta: although usually event trades have very reduced beta, in times of market stress there can be a lack of buyers and higher beta.

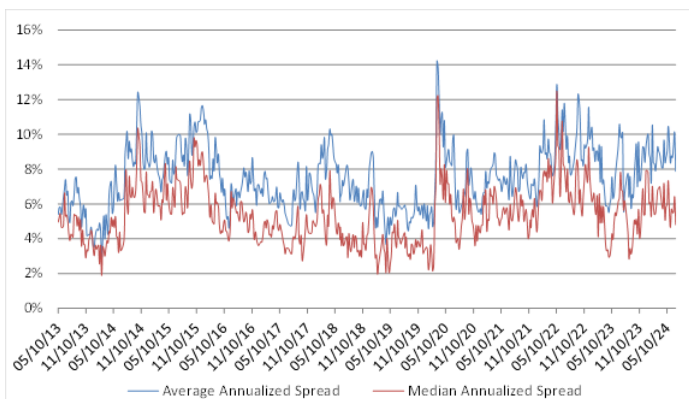
Hedge Fund Strategy Overview

Event Driven

Q2 Performance Drivers

- Event strategies were broadly positive for the quarter, despite modest declines for Merger Arb and Special Sits.
- The HFRI Event Driven TR Index was up +0.3% for the quarter bringing it to +2.7% YTD.
- The HFRI Merger Arbitrage Index was down -0.1% for the quarter bringing it to +0.2% YTD.
- The HFRI Special Situations Index was down -0.7% for the quarter bringing it to +1.3% YTD.
- The sell-off in equities in April was felt across strategies followed by recovery in May and a further bout of volatility in June around elections in Europe.
- The \$60bn mega-merger between Exxon and Pioneer closed in May leading to gains for arbitrageurs, but spreads widened for Chevron-Hess. Continued regulatory and political involvement e.g. Nippon/US Steel has kept spreads wide and extended the timeframe for deals.
- Global deal flow remained robust in Q2 with volumes in excess of \$1tn and a total of \$1.9tn YTD. North America accounted for approx. two thirds of activity.
- The Equity IPO market remained slow with 377 new issues in Q2 raising \$23bn (according to Bloomberg). Secondary activity was resilient, with 1,991 deals raising \$130bn.

Average Deal Spread (0-30%)



Source: UBS 01/07/24

Outlook

- Buoyant equity markets and tight credit spreads remain supportive for deal activity, reflected in the CEO Confidence Index hovering around 7.0 (compared to an average of the L3Y of 6.4).
- Robust economic activity, low volatility and stable or falling interest rates add to the positive backdrop.
- There remain some regulatory and political risks with uncertainty surrounding the US election as well as continued scrutiny of deals by the FTC and DOJ, leading to elevated spreads in deals most at risk e.g. Ansys/Synopsys.
- Take-private deals could be one of the more active areas, particularly in the Europe and UK, where public market valuations are well below privates, further helped by currency effects, creating an attractive 'arbitrage' that could draw the attention of large pockets of PE 'dry powder'.
- Volatility in Merger Arb means deal spreads remain elevated with the average around 8-10% (according to UBS). Combined with a 5%+ risk free rate implies the strategy offers low-to-mid-teens returns.
- IPO activity continues to recover from a cyclical low with increasing deal flow and expectations this will follow through into 2025 as conditions improve.
- Secondary and Follow-On deal flow is likely to be a more important contributor to ECM strategies in this environment. Here, deal flow remains robust with an annualized rate of \$612bn some 45% above the average 2022-23 level.

Rating: Positive

Hedge Fund Strategy Overview

Quantitative

Definition

Quantitative Equity Market Neutral funds use systematic processes in order to build portfolios of long and short equity positions in equal proportions.

Returns can be driven by statistical, factor or fundamental analysis, with the aim to isolate intended risk factors from market beta. This can take the form of tight pair trades or broader longs and shorts that are uncorrelated. Positions are often an amalgamation of multiple alpha signals.

Leverage tends to be an important factor as alpha can be low on an absolute basis, leading to highly diversified portfolios. Additionally, there is often the need for extra hedging in order to ensure that all unintended risks are eliminated.

Sub-Strategies

Multi-factor Quantitative Equity Market Neutral:

This system uses a series of style factors to analyze and predict stock movements. Some of the most common factors used are Value, Growth, Quality, and Momentum. Funds may look to allocate statically across these factors or to combine style factors into an overall alpha signal. Additionally, managers will generate their own, proprietary, style factors based on either statistical or fundamental drivers.

This model usually involves significant risk management to ensure that hedges are correctly positioned to strip out beta and highlight alpha signals. These models can combine different time horizons to enhance the alpha signals.

Statistical Arbitrage

This system uses statistical relationships between stocks to generate trades. Usually this takes the form of pair trading based on the relationship between two stocks or a basket of stocks. Usually, analysis is built solely on price action and involves some form of mean reversion or break-out analysis.

These strategies are designed to be run very tightly within pre-defined pairs or baskets so less hedging is needed. The alpha signals can be limited in absolute size and significant leverage is required.

Trade Example



Source: AXA IM PRIME 01/07/24

In this example we see an example of a pair trade based on price ratios. Here, alpha signals are driven by longer term rolling price ratios combined with standard deviation bands. When the price ratio gets outside of the expected bands, a signal is generated. The other consideration for this trade is momentum of the spread; trades are only entered when a trend has been established as moving back to the mean.

Key Risks

Model deterioration: over time models produce less alpha as competitors discover the opportunity.

Transaction costs: some models may rely on marginal gains and frequent trading, if spreads widen or costs rise alpha can be wiped out.

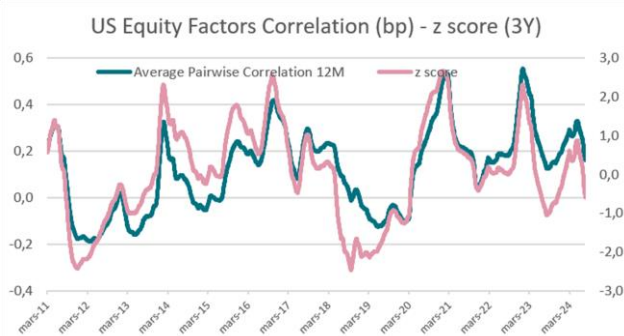
Crowding: deleveraging can have a significant impact, especially those with reactive risk management.

Hedge Fund Strategy Outlook

Quantitative

Q2 Performance Drivers

- The HFRI Equity Market Neutral Index was up +2.0% in Q2 and +6.3% YTD.
- The Momentum factor continued to lead and is up +18.2% YTD (+4% in Q2) in the US followed by the Growth factors up 10% YTD (up 4% in Q2). Size was actually the strongest factor in Q2 up 8% as small cap stocks benefited from rate cut expectations. Value remains flat YTD.
- Multifactor quant strategies performed strongly in the US while price based strategies underperformed in a constantly low volatility environment. Intraday strategies performed better. US focused managers outperformed European ones due to some dislocation in European equities following the European elections.
- Our China fund generated solid gains over Q2. Fundamental and Sentiment models continue to dominate P&L generation and high quality growth stocks were a strong contributor. Our manager was able to increase significantly its leverage as China A-shares single name shorts were introduced after a thorough investigation into the liquidity and availability of stock borrow. This should contribute to increase alpha short opportunities.



Source Bloomberg data, AXA IM PRIME calculation 01/07/24

Outlook

- Equity factor correlations started breaking down from June and now sit below their historical average which is positive for multifactor quant funds. The sharp pull back in the momentum factor in July has also exacerbated that decorrelation with value being the best factor so far in Q3.
- Equity correlations remain low and is providing an attractive opportunity set for alpha generation.
- The Chinese market continues to offer unique features including:
 - Retail investors participation has trended down from over 80% to 65% of volume but remains twice the level of DM equity markets. This is leading to behavioral anomalies that can be harvested through Technical models
 - High level of idiosyncratic opportunities and elevated dispersion
 - Low correlation with DM equities
- Our preference goes to diversified QEMN funds which can benefit from a diversified stream of uncorrelated strategies over various investment horizons (statistical arbitrage to fundamental models) and across multi asset classes.
- Innovation in QEMN has led to the emergence of pure Machine Learning funds that have the potential to identify complex relationships in Financial Markets. Dispersion in this group of managers has increased making it harder to identify sustainable opportunities.

Rating : Positive

Hedge Fund Strategy Overview

Stock Picking

Definition

Discretionary Equity Long/Short funds look to take advantage in movements in the equity markets by taking long and short positions in individual stocks. Typically decisions are made based on fundamental work undertaken by analysts and portfolio managers.

Funds in this space can have varying beta exposure to market, and that exposure can be relatively static or vary considerably. Typically, one can expect leverage to be inversely proportional to net exposure. Some managers are also more concerned with hedging out style, country and sector exposure than others. Investment time horizons can vary greatly, whilst some managers are also active in trading around positions frequently.

Funds can usually be split into a number of broad investment styles. Value managers look for mispriced assets and liabilities. Growth managers look for mispriced growth and potential growth. Momentum managers look for improving or deteriorating trends, usually in earnings. GARP (Growth At a Reasonable Price) managers try to combine value and growth strategies. Company financial accounts and earnings statements are usually the key areas that managers focus on, although there can be an element of technical analysis to highlight entry and exit points.

Sub-Strategies

Trading

Some managers invest based mostly on price action, flows and perhaps only a surface level knowledge of the underlying company. Turnover tends to be high, with tight stop losses and an overall opportunistic approach to investing. Additionally, gross and net can be very variable, driven by the day-to-day opportunity set.

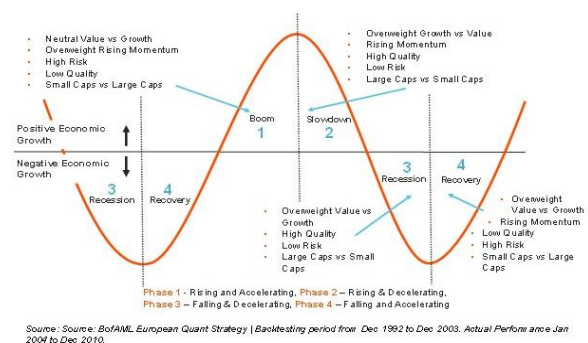
Earnings Predictions

Some managers are focused on correctly predicting earnings surprise, either positive or negative. This tends to mean that their investment time horizon is until quarter end, at which point they have an event, the earnings announcement, that either confirms or refutes their investment thesis. In practice they can hold positions over multiple quarters, but they will re-underwrite each time.

Buy and Hold

Some managers look to undertake significant due diligence on a company before investing in a stock, with the aim of holding on to the position over a multi-year time horizon. Typically, these managers are more agnostic to short term “noise” such as style factors, sector and country biases, and beta exposures. Typically, they expect returns to be driven by a combination of earnings enhancement and, more importantly, multiple re-rating as the company realizes the potential they see.

Trade Example



This chart shows how difference style factors can drive stock prices at different points in a market cycle.

Key Risks

Beta Risk: Managers in this space can be heavily exposed to style, country, sector and market risks

Financial risk: Risk derived from the financial position of a company and its capital structure. This could include liquidity and credit risk, inconsistent earnings or high levels of debt.

Business risk: Internal issues effecting the efficiency of a firm as well as poor management and procedures can have a great impact on the price of a firm’s shares.

Hedge Fund Strategy Overview

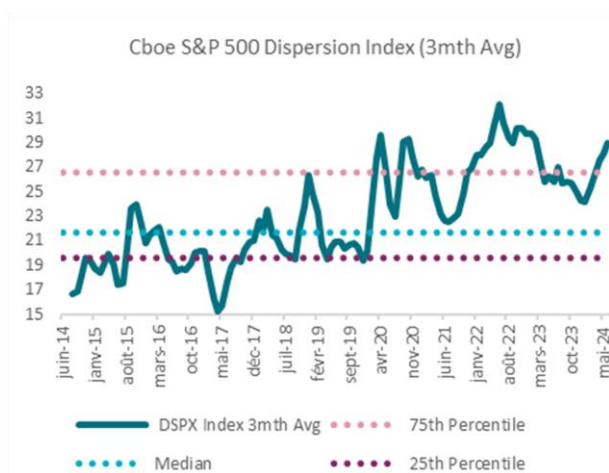
Stock Picking

Q2 Performance Drivers

- The HFRI Equity Hedge Index added 1.0% in Q2, bringing YTD returns to 6.1%. The MSCI World was up 2.6% over the quarter and 11.8% YTD.
- In April, equity hedge strategy had negative returns due to higher-than-expected inflation. US tech, healthcare, and small-cap stocks struggled. Japan faced challenges due to momentum unwinding and index selling.
- In May, tech managers gained from AI optimism, and US utilities stocks rose due to AI-related power demand. Healthcare faced challenges from a deleveraging event. "Roaring Kitty" returned but the event had a modest impact, as funds had limited exposure to meme stocks.
- Performance was mixed in June, despite an upward global equity market. Most sectors faced challenges, with AI-second derivative plays like utilities underperforming. Large-cap growth, driven by AI, was up. Momentum and growth were the top-performing factors in June and over the past 12 months. European managers faced negative returns due to beta exposure affected by an unexpected French election.

Outlook

- Managers observed that the environment has become increasingly favorable for alpha on both the long and short sides. Market responses to news and earnings reports have more closely aligned with company fundamentals. We've seen an uptrend in alpha year-to-date for managers who were challenged in their sectors, such as Industrials, and Healthcare, last year, and are optimistic that higher expected dispersion, as per the DSPX Index, will continue to support stock picking. This is despite the dominance of certain mega-cap stocks.
- Exposure to themes, sectors, factors, and market caps has significantly influenced relative performance this year. This is especially true for AI. While its momentum factor has been strong, managers are finding attractive opportunities for both long and short positions over the next 2-3 years. They are focusing on areas where AI-related stocks aren't widely recognized yet to avoid volatility from AI-focused baskets. Examples include the software and energy industries.
- The outlook and performance for Japanese equity managers is positive, as companies continue to enhance corporate governance with the support of regulatory changes. We have increased our exposure to this strategy last year and remain confident in its prospects.
- Our focus on managers that have strong shorting abilities and can combine fundamental underwriting with an ability to trade actively continues to be relevant.



Source Bloomberg data, AXA IM PRIME calculation 01/07/24

Rating: Positive

Hedge Fund Strategy Overview

Multi-Strategy

Definition

Multi-Strategy funds combine multiple investment strategies to create a diversified portfolio. Strategies tend to be managed separately and capital is allocated between them based upon the risk appetite and return target. The aim is to provide broadly uncorrelated strategies that dampen volatility.

Usually, there is a central figure or committee that oversees risk management and capital allocation, either through a discretionary decision-making process or through a model driven approach derived from correlations and quality of returns. Often, portfolio managers are deployed in silos with limited overlap between strategies, although this can vary.

The largest multi-strategies can look more like complete asset management companies, offering access to multiple return streams either on an individual or combined basis with hundreds of portfolio managers.

Characteristics

Diversified Returns:

Multi-strategy funds can offer a diversified return by allowing smaller managers with more niche strategies to gain access to established infrastructure. These managers may be unable to perform as stand-alone strategies but, with the processes and capital a multi-strategy fund could have access to they can get off the ground and provide a differentiated return stream for the fund as a whole.

Flexibility:

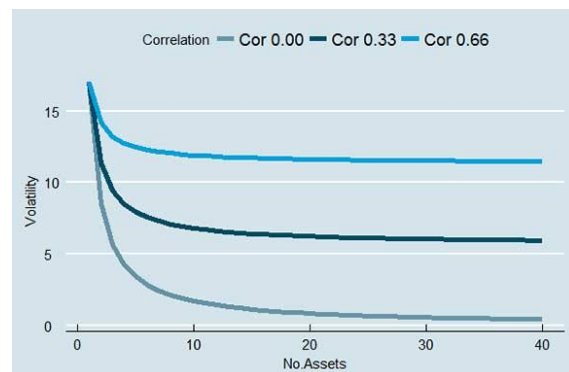
There can be a greater degree of flexibility as allocations between strategies can be manipulated more frequently based on opportunity set and performance.

Risk Management:

There is often an emphasis on centralised, robust risk management processes. Specialist risk teams will monitor the individual strategies and the portfolio as a whole and ensure that stringent guidelines are adhered to.

Investment Teams and Greater Talent Development:

Analysis of multi-strategy funds tends to pay particular attention to the internal workings of the fund and how the individual strategies work together. Rather than maintain poor performing managers, multi-strategy funds are often focused on refreshing talent to improve the quality of overall returns.



Source AXA IM PRIME illustration 01/07/24

By employing strategies that are uncorrelated, the benefits of diversification can be amplified to reduce risk.

Key Risks

Talent Retention: There is significant competition for portfolio managers within multi-manager shops.

Fees: Some funds charge full pass-through costs, which can lead to very high expense ratios.

Diversification: Over-diversifying into non-core areas can be difficult, sometimes leading to muted or negative returns as new strategies bed in.

Hedge Fund Strategy Overview

Multi-Strategy

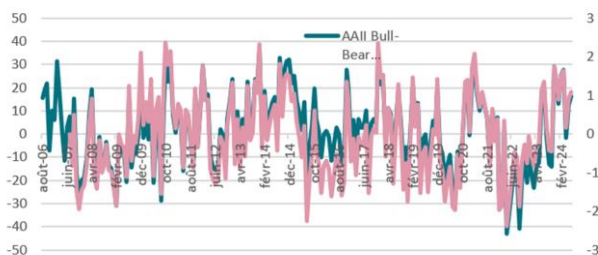
Q2 Performance Drivers

- The HFRI RV Multi-Strategy Index was up +0.7% in Q1 and +2.9% YTD
- Fundamental Equity was the best performing strategy. Alpha generation remained strong. Dispersion strategies also performed well as single name vol expanded vs index vol.
- Quantitative strategies performed strongly and Systematic Macro strategies proved more challenging
- Discretionary Macro and Fixed Income is where the action was the most problematic. June alone brought 4 surprises around elections. A Mexican left wing landslide victory knocked off the Mexican peso, the European elections led to a surprise French parliamentary election which sent the EUR and European equities down, and periphery spreads up. In the US the 1st debate ahead of the November election led to markets pricing a higher probability of a Trump win which drove the USD higher and caused the US curve to steepen.
- Commodities were quite volatile with initial weakness in oil prices followed by a sharp rally in June. Managers with exposure to Nat Gas continued to benefit from attractive spread opportunities.

Outlook

- The market continues to be bifurcated between Top Tier firms and their peers. Top Tier firms have continued to attract talent but are now finding it hard to deploy capital and have started more aggressively allocating to external managers. Their peers are finding it harder and harder to compete in such an environment of talent scarcity and inflationary packages.
- Equity Long Short continues to be a significant source of P&L with increased stock dispersion.
- Commodity strategies remain a key focus and tend to be run across spread based strategies but only a handful of managers have been able to scale.
- Fixed Income and Macro which underperformed YTD vs the last 3 years could see significant opportunities once the US starts their rate cutting cycle.
- Event Driven remains an attractive opportunity for those still invested as a number 2nd tier platforms had to reduce their exposure in the face of widening spreads.
- Credit remains under-represented given the difficulty to run hedged strategies.
- We are therefore downgrading our Rating to NEUTRAL

AAII Bull-Bear Spread (%) - z score (3Y)



Source Bloomberg data, AXA IM PRIME calculation 01/07/24

Rating : Neutral

Hedge Fund Strategy Overview

Global Macro

Definition

Global Macro funds focus on macroeconomic factors, taking positions according to the changes they see in the economic environment. They tend to make their profit from early identification of market moves in either direction.

Macro investing is very different from the investment strategies applied by other hedge fund managers, as it is more an overall approach than a precise strategy. Most funds will implement a top-down view and develop a global picture of markets to take advantage of opportunities when they appear across multiple asset classes. Once they have identified an interesting trade, they will often use a bottom-up approach in order to determine the most effective way to express their view.

Macro funds can use both quantitative and qualitative approaches at any stage of the investment timeline. They analyse economic cycles, political events and a variety of other indicators, often through interaction with policy makers and economists. Whilst some funds may base their top-down view on a manager's sentiment, others could apply models to notify them when a set of factors has moved and are likely to lead to a mispricing.

Sub-Strategies:

Relative Value

Relative Value managers seek to reduce their directional exposures to asset classes and instead exploit spreads between related securities. These could include trades of bonds of the same tenure but issued by different governments or intra-curve trades, trading bonds issued by the same government but of different maturities. Equally, managers could look to capture spreads between different asset classes exposed to the same economic risks that they believe are priced differently.

Directional

Directional managers aim to have positions based on their broader assessment of the market. This requires a strong conviction and tends to come on the back of deep fundamental work to understand a multitude of potential drivers and risks. These managers tend to take longer term, structural type views and trade through noise to enhance risk/reward profiles.

Quantitative

Quantitative Macro managers use systematic processes to identify the same types of trades implemented by discretionary macro traders. These can be trend based, more like a CTA, based on factors such as momentum, carry or value, or arbitrage trades based more on price action.

Trade Example

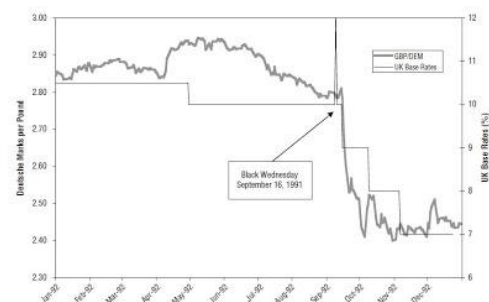


FIGURE 2.5 Sterling/Mark and UK Base Rates, 1992
Source: Bloomberg.

Source Bloomberg 1992

In this famous trade, George Soros correctly predicted that the Bank of England would be unable to maintain GBP inside the ERM, shorting the currency for a significant profit.

Key Risks

Choppy trends: managers tend to trade with momentum, if no trends establish themselves they can get whipped around.

Concentration: many managers employ concentrated positions, which increase risk.

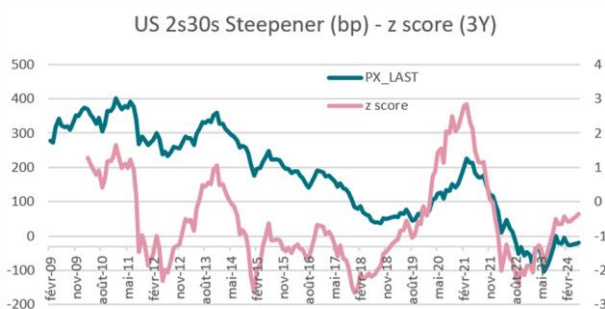
Stagnant policy: managers struggle without changes in macroeconomic conditions and policies in major global economies.

Hedge Fund Strategy Overview

Global Macro

Q2 Performance Drivers

- The HFRI Macro Total Index was down -0.8% in Q2 and +5.4% YTD.
- In the US a picture of moderating activity leading to rate cuts from the Fed in the second half of this year remains on the table. Steepener positions remain the preferred expression and contributed positively with a move higher in the 2s30s curve.
- EU govies spread widening entered on the news of the French election contributed positively.
- In Japan short positions in Fixed Income created losses as the move away from rate hikes in the BOJ June meeting lead to a rally in bonds. The end of month weakness on the back of FX intervention rumours wasn't enough to compensate for all the losses.
- In commodities, long positions in gold detracted on the news that China had not added to its reserves in May. The view remains that Gold could perform well in a higher inflationary environment and act as a safe haven.



Source Bloomberg data, AXA IM PRIME calculation 01/07/24

Outlook

- Political elections will continue to dominate markets for the remainder of 2024.
- The focus in the US has shifted to a potential Trump election which would lead to higher inflation expectations, yet lower short term rates, steeper rate curve and a weaker USD.
- Europe seems to be facing its own challenges and the consequences of US elections. Potential increased tariffs in the US would bring disinflation to Europe through imported Chinese goods. This would further weaken European industries already struggling with subdued demand from China and the loss of cheap Russian energy.
- Desinflation is not yet priced in European markets through nominal or breakevens, while in the US a Trump election could lead to higher breakeven rates than what's priced in by the market.
- In Japan short positions at the front end have been pushed out to the 5Y point. The BOJ is about to announce its plans for a lower bond purchase program over the next 2 years and is unlikely to announce a rate hike simultaneously.
- EM remains attractive but as been challenging. Despite further signs of falling inflation pressures in Brazil, investors are now pricing around 200 bps of rate hikes over the next 12 to 18 months. This is driven both by skepticism around policy makers and unwinding by some funds.

Rating : Positive

Hedge Fund Strategy Overview

Managed Futures

Definition

Managed Futures funds, also known as Commodity Trading Advisors (CTAs), are a group of funds which employ a systematic, non-discretionary strategy to invest in liquid futures contracts. Strategies typically employ leverage as they invest in unfunded instruments.

The signals used in the strategies are predominantly based on momentum or trend following strategies using techniques such as weighted moving averages and Relative Strength Indicators. This strategy can take either long or short positions in a particular market and there is no inherent long or short bias.

CTAs usually invest across a broad range of markets such as Equities, Fixed Income, Commodities and FX in order to benefit from diversification. Strategies are spread across markets as well as time-frames i.e. they employ signals which can have a horizon ranging from intraday to several months.

Sub-Strategies

Trend Following

Mathematical models identify patterns or trends in market movements and take positions on the assumption that these trends will continue. Based on historical data, a set of criteria will be established and, once met, a position will be taken. When the criteria cease to be met, the position is closed and the information fed into the model is updated.

Moving Averages

When the short-term moving average or price of a contract crosses the bounds of a longer-term one, it can trigger a buy or sell signal. Not only does this technique identify current trends but it can construct an entry/exit strategy.

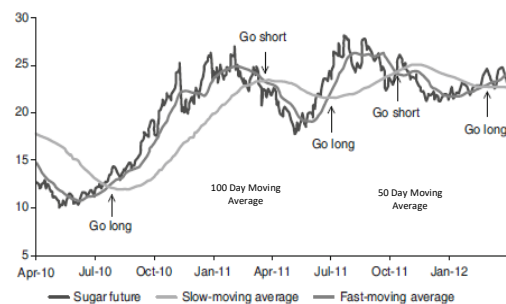
Trend Reversal

These funds look to benefit from inflection points in price trends. They tend to be shorter-term and take positions once a reversion has begun to gather momentum.

Contrarian:

Funds applying this strategy seek to identify the inflection points themselves, aiming to buy at the trough and sell at the peak. They are often betting against immediate market sentiment in order to capture the greatest difference and maintain tight stop losses.

Trade Example



Source AXA IM PRIME illustration 01/07/24

In this example, signals to buy are triggered when the 50 day moving average price cuts the 100 day moving average from below, indicating positive price momentum. A sell signal is activated when the opposite is true.

Key Risks

Volatile Markets: If trends struggle to gain traction in markets that are frequently reverting, funds can get caught offside

Flat Markets: Without significant enough trends for a fund to catch onto or position themselves against, CTAs will have a limited number of opportunities. In such a case, short positions can generate losses from cost of carry factors.

Crowding: Positions can get crowded by similar market participants, which can amplify reversals.

Hedge Fund Strategy Overview

Managed Futures

Q2 Performance Drivers

- The HFRI Macro Systematic Diversified was down -1.7% in Q2 and +8.0% YTD.
- Trend following was down -1.5% in Q2.
- Commodities detracted the most over Q2 but remains the largest contributor over H1. Cocoa prices finally came down which created some losses, although most trend managers had reduced their exposure as the trend reversed.
- FX was the best asset class driven by short positions in JPY Futures which remains one of the largest allocation.
- In Fixed income losses were generated as the term structure rallied across the 2, 5 and 10 year points with yields falling by 15-20bps which hurt managers that all add short duration positions across US and Europe. In Credit Short positions in the iTraxx Europe index detracted from performance the most, as European credit spreads widened in response to Macron's unexpected election call.
- In Equities, positioning in some of the major US equity index benchmarks realized among the most positive P&L, notably exposure to the mini-S&P as the S&P 500 set new record highs. Risk assets found favor as key US inflation metrics reinforced a growing consensus about declining price pressure. Major tech stocks contributed the most.



Source Bloomberg data, AXA IM PRIME calculation 01/07/24

Outlook

- Short Term and Trend Following CTAs have had a strong start in 2024 driven by gains in Commodities and FX.
- Current signals are bullish stocks/credit, bearish bonds, bullish US\$ and metals:
 - Equities: managers continue to be long Nasdaq, VIX, S&P and Euro Stoxx Futures
 - Bonds: managers have reduced their short duration bias
 - Credit: still bullish especially across US markets where carry remains attractive
 - Currencies: Shorts in JPY is the largest position
 - Commodities: long Gold, Silver and Cocoa and short in Soybeans, corn and palladium. CTAs continued to buy energy commodities as well.
- Most CTAs employ medium-term trend following signals which means they are typically not very well equipped to deal with intra-week or even intra-day trend reversals.

Rating : Neutral

Hedge Fund Strategy Overview

Fixed Income Arbitrage

Definition

Fixed Income Arbitrage funds aim to exploit perceived mispricing amongst and between fixed income instruments and their derivatives. Often, opportunities for these relative value strategies are the result of capturing temporary anomalies in price relationships between fixed income instruments while keeping an overall market neutral exposure. This strategy typically requires large amounts of leverage in order to exploit these small pricing discrepancies.

Opportunities for Fixed Income Arbitrage trades can arise for both fundamental and technical reasons. Many investors prefer unfunded products, such as futures, as part of their hedging strategies, which can cause dislocations versus the underlying cash market, especially during times of market stress. At these times investors prefer futures due to better liquidity and lower funding costs/balance sheet impact as witnessed during the 2008/9 period.

Technical reasons that can generate opportunities for Fixed Income Arbitrage investments can be large amounts of issuance of Fixed Rate Bonds, which issuers want to swap back into floating, and can lead to potential tightening of swap spreads. Fundamental spreads exist between fixed income instruments related to the same underlying asset but with different durations or conditions, which can lead to an opportunity for those that can successfully model and hedge the risks.

Sub-strategies

Yield Curve Arbitrage:

Funds seek arbitrage opportunities across different sections of a yield curve, i.e. where one section is overpriced relative to fundamental value and another is under-priced. Yield Curve steepeners/ flatteners/ butterflies are commonly used strategies in intra-curve arbitrage. In each case, the fund will take long and short positions where they believe the shape of the yield curve is likely to change.

Cash vs Futures Basis

In this case, funds aim to take advantage of the price discrepancies between a futures contract and the securities deliverable at expiry.

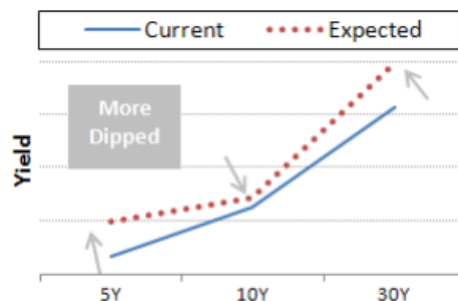
Issuance Driven Trades

Funds look to profit from distortions in the price of securities with very similar maturities based on their issuance. Predominantly this means trading the On-The-Run bond vs Off-The-Run bonds.

Swap Spread Trades:

Funds may take positions in both the fixed and floating sides of an interest rate swap with the intention of benefitting from predicted widening or tightening of the spread.

Trade Example



Source AXA IM PRIME illustration 01/07/24

The example above is a yield curve butterfly. The fund believes that the yield will increase in the 5 and 30Y sectors but decrease in the 10Y. As such they would go short the 5Y and 30Y securities (the wings) and long the 10Y (the belly).

Key Risks

Cost of Carry: Short positions in a fixed income security require the holder to pay the interest. In such a case, rising rates can make holding a short position very expensive.

Prepayment Risk: Within asset backed sub-strategies, an early return of principal means that future interest payments aren't paid to a fund.

Liquidity and Borrowability: Given that fixed income funds tend to employ a lot of leverage, lack of available balance sheet makes borrowing more expensive.

Hedge Fund Strategy Overview

Fixed Income Arbitrage

Q2 Performance Drivers

- In Q2, developed rate markets saw numerous trading opportunities due to diverging growth and inflation data globally. The Bank of Canada and the ECB are expected to cut rates soon due to significant inflation decreases, while the BOE and the Federal Reserve remain cautious as inflation persists in the UK and US.
- Market participants focused on value as the likelihood of further rate hikes diminished, benefiting existing positions. The U.S. Treasury market experienced a shift with delayed easing expectations and reduced rate hike chances, increasing volatility around economic data. Concerns over the U.S. budget deficit led to market selloffs, pushing 10-year notes above 4.6%.
- Despite an overall easing of inflation, stubborn services inflation remains a concern. The Bank of Canada is expected to cut rates in June, the ECB in June or July, and the BOE towards the end of the year. Implied volatility trended lower, with rates markets stabilizing by month's end. Forward trades benefitted from these expectations.
- Upcoming political conventions and ongoing economic debates will impact rates markets as summer approaches, potentially affecting volatility and liquidity.

Outlook

- Our view is that the opportunity set remains positive driven by continued supply and demand imbalances in the cash funding market. The strategy generally performs in all environments with idiosyncratic loss events that only become apparent ex-post, usually centred around stress in the banking system.
- With delivered volatility low, the margin requirements at the brokers remain small, allowing significant capital efficiency for relative value trades. Butterfly trades and other bond versus bond trades maximise cross margining and are favoured by our selected managers rather than e.g. futures or swaps hedges.
- Adopting a more macro lens, all eyes are on the forthcoming US elections and the possible bifurcation in the direction of rates. Most commentators seem to feel that a Trump victory will give rise to higher inflation and hence a higher rates environment, with the opposite true of a Democrat win.
- Due to the binary nature of the election result, we favour relative value strategies over directional ones in the fixed income arbitrage space.

The trend lower in rates volatility continues....



Source: Bloomberg 01/07/24

Rating : Positive

Hedge Fund Strategy Overview

Convertibles Arbitrage

Definition

Convertibles Arbitrage is a relative value strategy, focused on the relationship between a convertible bond and the underlying equity. The vanilla convertible arbitrage trade is going long the convertible bond and short the underlying stock, as to the upside, the positive convexity in the bond results in the gains exceeding losses on the short stock hedge, and the opposite applies in a downside scenario as the short stock position acts as a hedge against the long convertible position. Convertible Arbitrage managers seek to provide equity participation to the upside and principal protection to the downside, whilst monetizing convexity through market equity volatility and extracting alpha from special situations and events.

Convertible arbitrageurs will generally seek CBs that exhibit high equity volatility, low conversion premium, high gamma, high liquidity and that are trading cheap versus theoretical fair value. Returns are driven by carry (the income earned from the coupon on the CB), monetization of market equity volatility through gamma trading, and new issues, which typically trade cheaply to fundamental fair value.

CBs can behave as yield instruments (bond-like in nature, sensitive to credit spreads), total return instruments (moderate yields, balanced with relatively high gamma which enables dynamic hedging of the underlying stock) and equity alternatives (high theoretical deltas, low yields – these are in the money and equity-like in nature)

Sub-strategies

Synthetic Put Options:

The convertible is trading close to its parity value (the value of the underlying shares if investors convert). The conversion option is in the money and the conversion premium is low – this is a high delta, equity-like trade. By going long the convertible bond and short the underlying equity, you can generate P&L in a significant equity sell-off as the returns on the short stock position will exceed losses on the convertible (these losses will be capped as the bond can be sold 'put' at the bond floor).

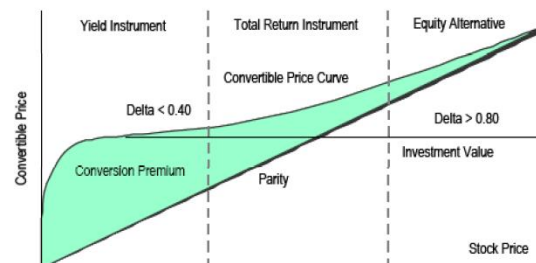
Balanced Arbitrage

The vanilla convertible arbitrage trade. The option embedded in the convertible bond is close to its strike price, so gamma (how much the option delta changes for a given change in the underlying equity) is at its maximum. This is a long volatility position, generating P&L via gamma trading.

New Issuance Driven Trades

Funds look to profit from new issues trading cheaply to theoretical fair value, as these convertibles typically quickly revert (richen) to theoretical fair value, providing opportunity for P&L generation through holding the position over a short period.

Convertible Bond Profile



Source AXA IM PRIME illustration 01/07/24

Convertible bonds are bonds yielding regular coupon payments but can be converted into a pre-determined number of common shares at certain times over the life of the bond, usually at the discretion of the bondholder.

Key Risks

Credit: Given much of the market is non-rated, valuations may be impacted by a flight to quality.

Interest Rates: Convertibles could underperform in a rising rate environment.

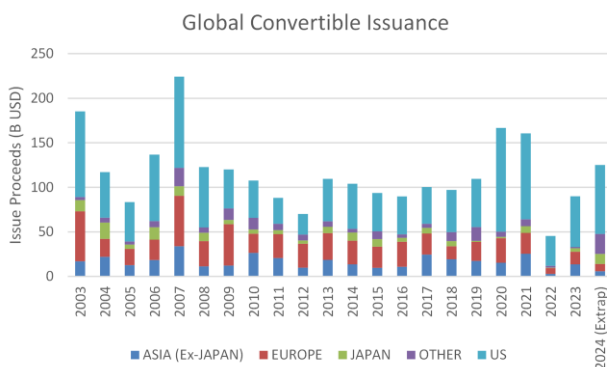
Market stagnation: If volatility is suppressed and the new issuance calendar is sparse, generating returns could prove challenging.

Hedge Fund Strategy Overview

Convertibles Arbitrage

Q2 Performance Drivers

- Performance was diversified with the asset class making steady progress through the quarter helped by supportive risk markets, moderate volatility and active issuance.
- The HFRI RV Fixed Income Convertible Arbitrage Index returned +1.0% for the quarter, bringing it to +5.4% YTD.
- Higher base interest rates continue to underpin carry levels within the strategy.
- The Barclays Global Converts Hedged TR index (long-only, currency hedged) gained +0.3% over the same period bringing it to +3.1% YTD.
- Valuations across regions softened during the quarter, leaving joining the US at theoretical fair value, according to Jefferies, while Europe and Asia ex-Japan moved to approx. 1.3% cheap.
- Issuance continued to pick up with \$35bn of new paper globally for the quarter, an annual equivalent of \$125bn, well ahead of 2023's level of \$90bn. With companies looking to refinance for the first time since rates rallied, CBs remain an attractive source of funds at lower yields compared to straight debt.



Source: Refinitiv 01/07/24

Outlook

- The outlook for convertible issuance remains positive against a backdrop of higher interest rates and all-in bond yields, as companies seek cheaper financing options. This leads to opportunities both in the primary market from discounts on issue as well as second order effects as long-only accounts rotate into new issues, selling paper cheaply to do so.
- Volatility remains sufficient within the key sectors where converts are more prominent such as Tech and early stage Pharma, allowing profits to continue to be extracted from active delta-hedging strategies. Sectors such as REITS and Medical Equipment also feature in the issuance tables.
- Distressed paper, which drove returns in 2023, is now less significant. Instead managers are tilting towards higher delta names which can be set up with heavy hedges in the form of 'synthetic puts', which will generate gains in a risk-off environment while costing little to hold if markets remain elevated.
- Supportive language from the Fed in terms of the direction of interest rates allows hedges to be run light with the potential for gains when an easing cycle begins.
- While no big theme dominates, solid issuance, modest cheapness and higher trading volumes are all indicators of the health of the convertible bond market.

Rating : Positive

Hedge Fund Strategy Overview

Credit/Distressed

Definition

Credit Managers look to profit by investing in debt or debt-like instruments related to individual companies, employing some combination of directional, relative value and arbitrage strategies.

The corporate credit space is delineated through structure and rating: from Investment Grade to High Yield and Junk. Additionally, there are various structures that managers can utilize, from plain vanilla bonds through to CoCos and CLOs. Managers can specialize in one area or move actively across different strategies. These complexities can make it difficult for non-specialists to correctly understand and value individual instruments, creating investment opportunities.

Net exposure amongst managers can vary considerably, with some managers looking to strip out market direction via active shorting or arbitrage plays, whilst other managers are more focused on carry and value opportunities. Typically, a manager will take a view on a bond based on a fundamental approach that identifies mispricing, for example if earnings or debt repayments are ahead/behind schedule.

Sub-Strategies:

Credit Long Short

Managers look to build portfolios of long and short corporate credit positions based on their opinion of the fundamentals of the company and their analysis of their ability to repay their bonds. Shorts may take the form of alpha generative trades or be more pure hedges to strip out market beta

Credit Relative Value

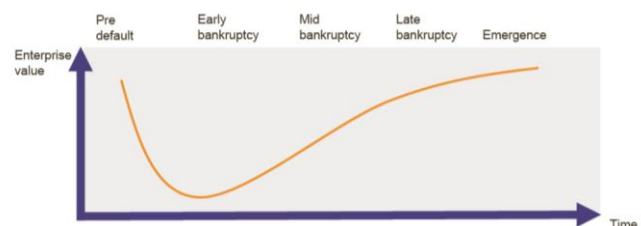
Managers look to capture the relative mispricing between two credit instruments. Trades can be expressed by going long or short cash vs synthetic bonds, senior vs subordinated debt, debt vs equity and term structure.

Distressed

Distressed debt investing involves looking at companies which are in distress or already defaulted and whose debt is trading at severely impaired level. This involves taking a view on the recovery value of the debt through a detailed understanding of the capital structure and enterprise value of the company after the restructuring process.

Later, in in the early to mid-bankruptcy stages, the fund may purchase bonds they view as cheap. In the late-emergence stages, the fund could substitute their loans for either, or a combination of, new bonds or post-reorganization equities in the restructured firm.

Trade Example



Source AXA IM PRIME illustration 01/07/24

This graph shows a typical distressed cycle for a company undergoing bankruptcy and then recovering. Managers can enter and exit the trade at various times based on their analysis of the likelihood of recovery.

Key Risks

Credit risk: This is the risk of borrower default and failing to make the required repayments. This can lead to the loss of both the principal and the intermediate coupon payments.

Cyclical factors: Depending on the stage of the business cycle, firms may struggle repaying creditors as a result of decreased demand.

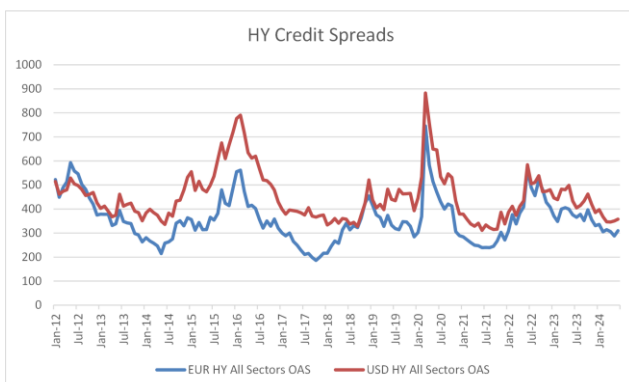
Liquidity Risk: Bonds can become illiquid in stressed markets.

Hedge Fund Strategy Overview

Credit/Distressed

Q2 Performance Drivers

- Credit spreads remained close to cyclical tightness in Q2 with carry driving returns; there were signs of increased default rates notably among loans.
- Spreads on the Markit CDX North America HY Index expanded by +14bps during the quarter to 344bps. In Europe, the iTraxx XO index widened by +22bps to 319bps.
- The Barclays Global Corporate HY index gained +1.0% for the quarter (+3.2% YTD) as positive carry offset the move wider in spreads. The CS Leveraged Loan Index rose +1.9% over the same period, leaving it up +4.4% YTD.
- The HFRI RV: Fixed Income-Corporate Index gained +1.6% for the quarter, taking it to +4.8% YTD. The HFRI ED: Distressed / Restructuring Index rose +2.3% over Q2 and +4.9% YTD.
- CCC spreads came in during the quarter: having been north of 1400bps in Europe in Q1 they pulled back to below 1000bps. In the US they ended the quarter below 800bps, in from >1000bps.
- Defaults on Levered Loans rose to 7% globally (compared to 2% in 2022).
- Carry remained an attractive component of returns with all-in yields on High Yield bonds in the US rising to 7.9% and holding at 7.2% in Europe. Levered Loans yield 9.3%. In the US 30y mortgage rates rose slightly, ending the quarter at 7.0%.



Source: Bloomberg data, AXA IM PRIME calculation 01/07/24

Outlook

- Credit markets continue to adjust to a higher interest rate environment. While inflation has moderated it remains above target levels and expectations for interest rate cuts have moderated significantly, implying yields stay higher for longer.
- In Europe, the ECB cut rates by 25bps in June despite inflationary pressures, in part motivated by the impact of higher borrowing costs on lower rated corporates where stress is evident.
- While credit technicals overall remain strong, the CCC segment continues to trade at very wide levels with spreads close to 1000bps. This dispersion has given rise to an estimated universe of \$215bn of stressed credit in Europe, e.g. Altice, Ardagh, Thames Water - all trading at very wide levels.
- On top of this we are beginning to see signs of an anticipated pickup in leverage loan defaults - to around 7% - which could in turn have implications for the \$1tn CLO mkt. HY default rates are approx. 4%. All of this creates opportunity, with the added tailwind of higher base rates.
- Meanwhile the rolling crisis in Commercial RE continues. New issue CMBS are pricing well but legacy paper, especially with high exposure to US Office property, is likely to remain challenged for several years creating an extended opportunity set for specialists.
- US Agency mortgage spreads hovered around 150bps. The Fed continues to unwind exposure at the same time as prepayment speeds stay low, creating an unusual opportunity set in the space.

Rating : Positive

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AXA IM Prime: July 2024

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