

Informed Investor: Alpha/Beta Allocator Q1 2019

By Marlène Hassine Konqui, Head of ETF Research, Jean-Baptiste Berthon, Cross Asset Strategist and Kristo Durbaku, ETF Research Analyst

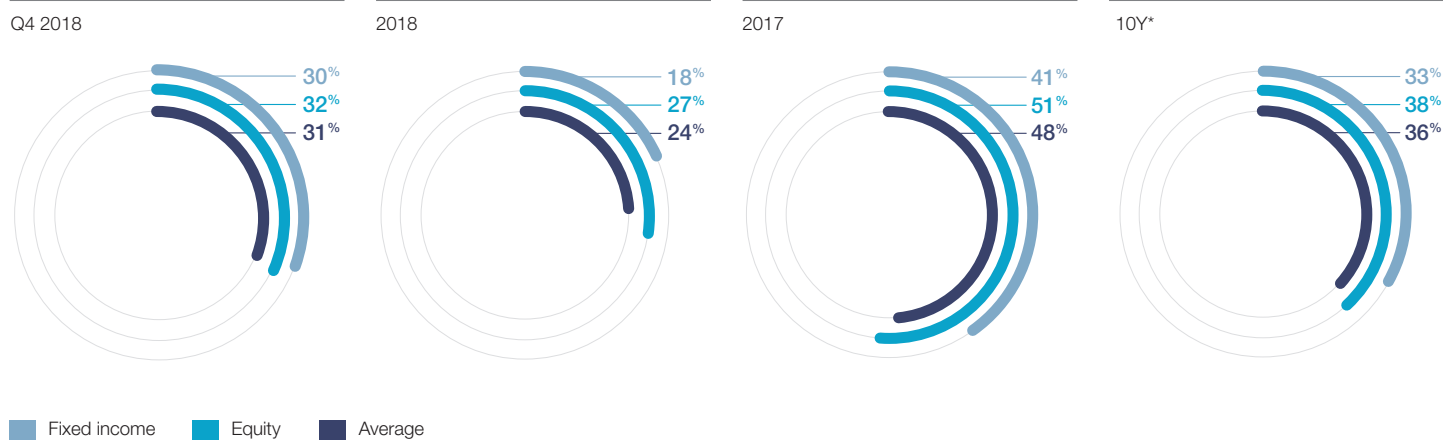
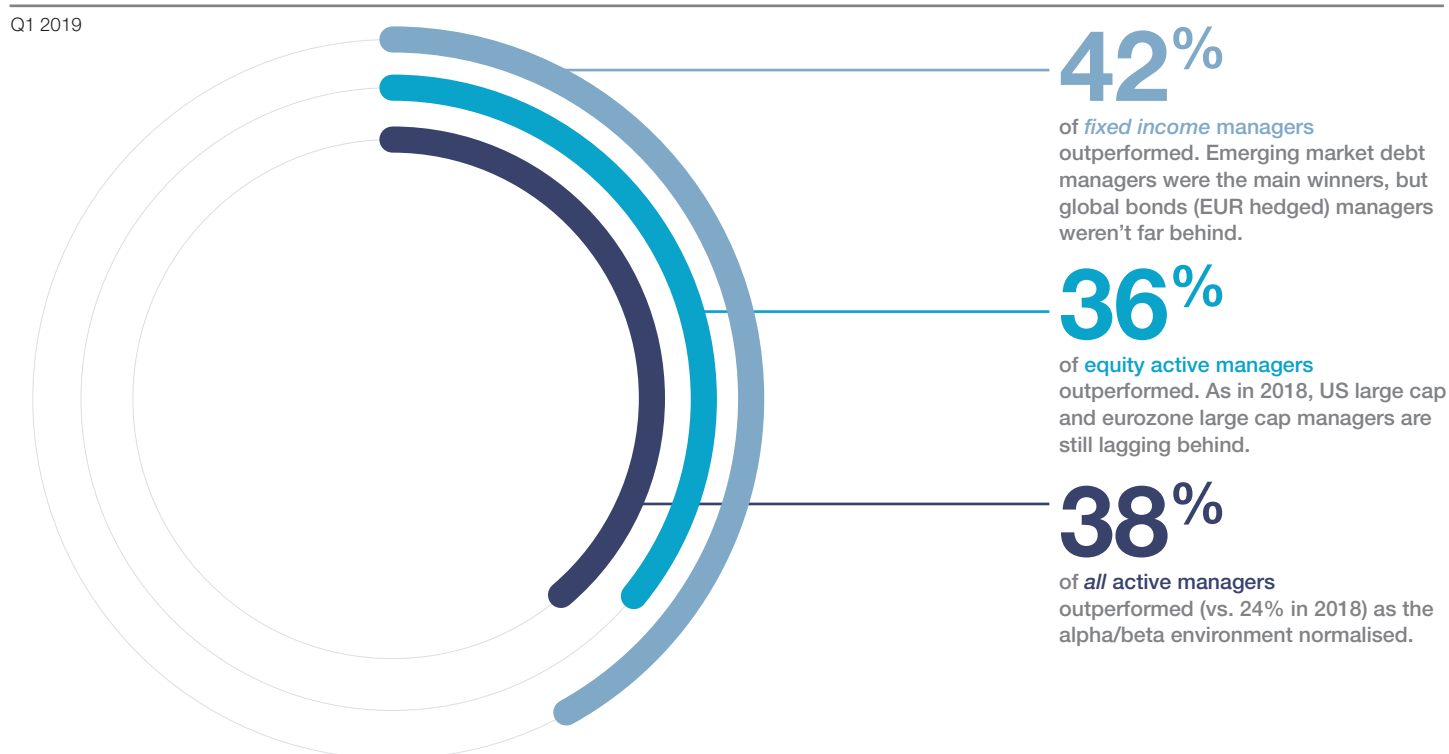
The Alpha/Beta Allocator

6 steps to a better portfolio

1. Look back at how active managers performed in Q1 2019

After a disappointing year in 2018, active managers have bounced back to a degree, notably in fixed income.

Fixed income Equity Average



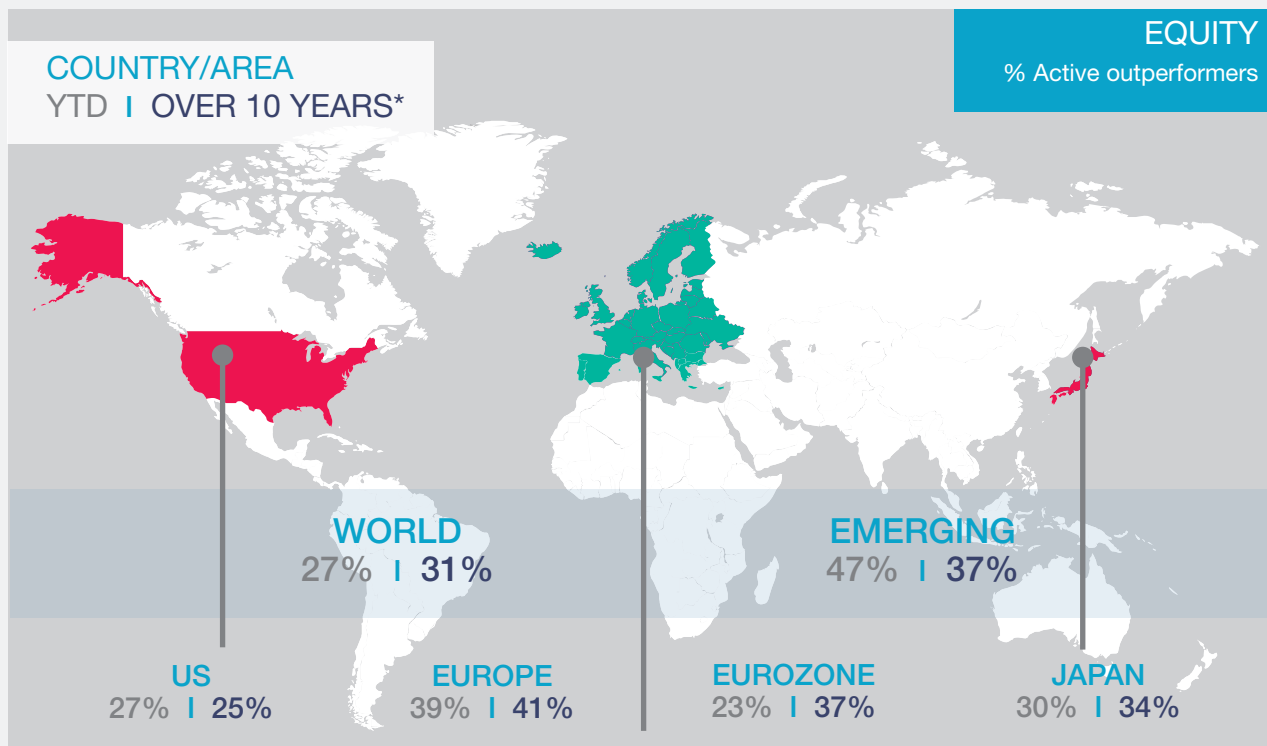
Source: Morningstar & Bloomberg, data from 31/12/2008 to 29/03/2019. Past performance is no guide to future returns. *Yearly average over the last 10Y.

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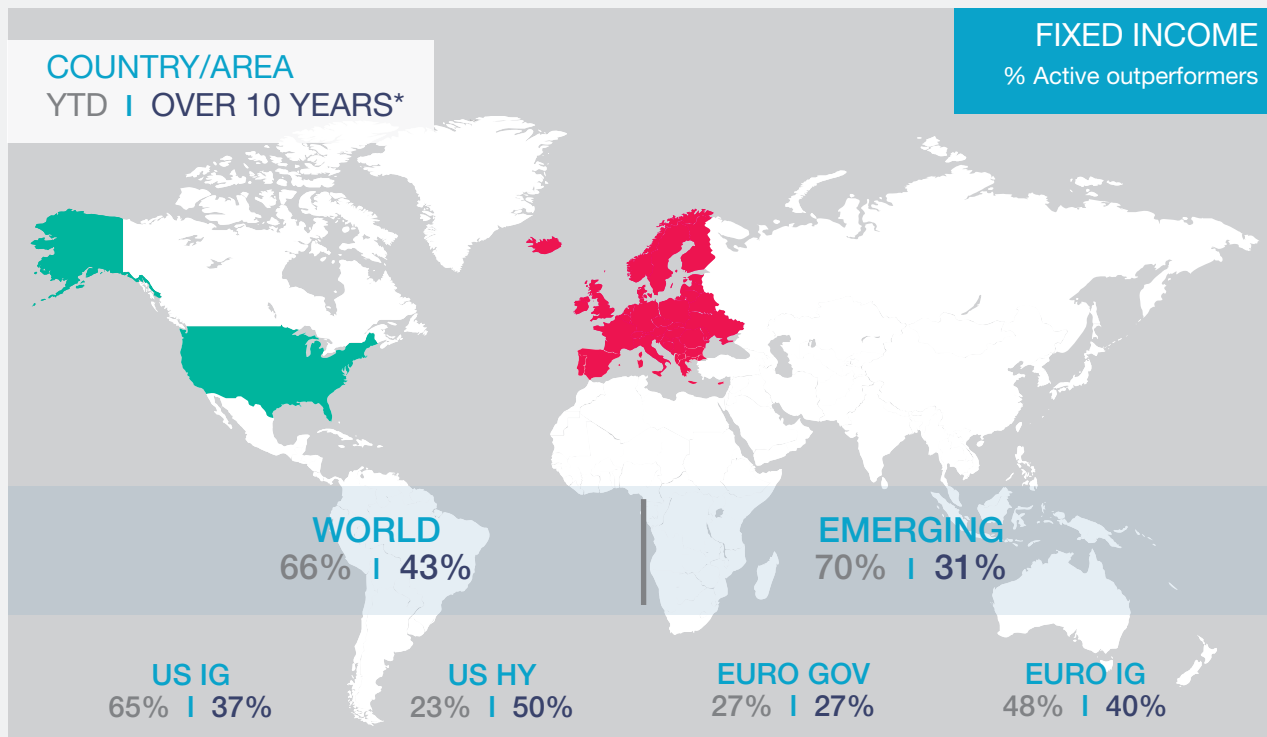
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2. Explore the equity and fixed income highlights for Q1

Alpha opportunities were most evident for emerging market equity managers.



After a disappointing 2018, emerging debt managers did well as did US and Europe investment-grade credit managers.



Source: Morningstar & Bloomberg, data from 31/12/2008 to 29/03/2019. *Yearly average over the last 10Y. Past performance is no guide to future returns.

Hit Miss

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3. Q1 Analyse the full results

EQUITY

European equities (% of funds outperforming the benchmark)

The best Q1 results for active equity managers were found among emerging market equities. Support from world central banks, stimulus spending in China and receding policy uncertainties lifted sentiment and improved liquidity. Conditions were more difficult in the eurozone, US and world markets.



Source: Morningstar & Bloomberg, data from 31/12/2008 to 29/03/2019. 50% and 33% represent the best and worst results after we divided the universe we cover into 3 sub-groups. Between those limits, "hits" and "misses" are set comparing the current quarter's result vs. the long-term averages. Past performance is no guide to future returns. *Yearly average over the last 10Y.

3. Q1 Analyse the full results (continued)

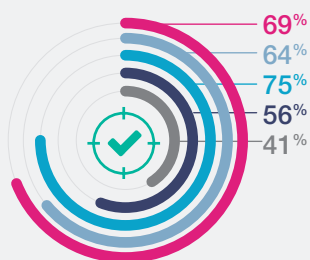
EQUITY

Ex-European equities (% of funds outperforming the benchmark)

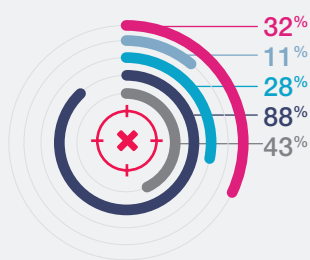
Q1 2019 Q4 2018 2018 2017 10 year*

✓ Hit: when YTD results are >50% or >10yr figure
✗ Miss: when YTD results are <33% or <10yr figure

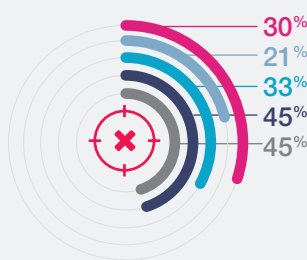
US Equity Growth



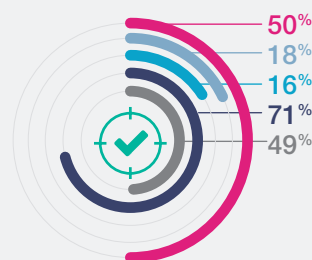
US Equity Value



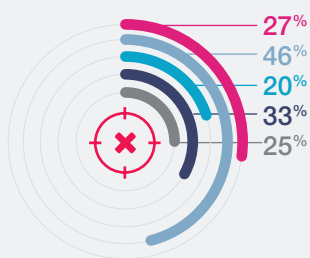
Europe Equity Growth



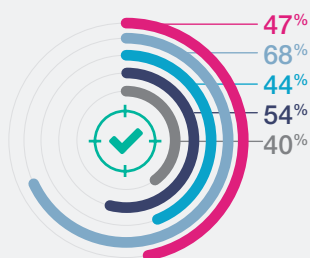
Europe Equity Value



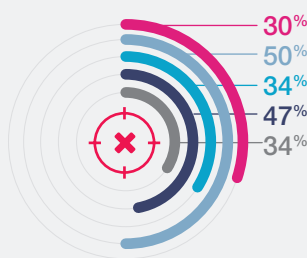
US Large Caps



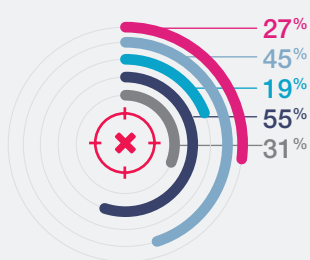
US Small Caps



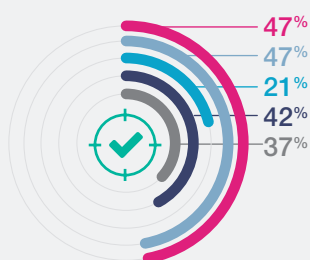
Japan All Caps



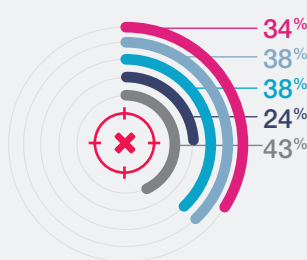
World Large Caps



Emerging Markets Large Caps



China Large Caps



Q1 2019 Q4 2018 2018 2017 10 year*

✓ Hit: when YTD results are >50% or >10yr figure
✗ Miss: when YTD results are <33% or <10yr figure

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3. Q1 Analyse the full results (continued)

FIXED INCOME

(% of funds outperforming the benchmark)

In Q1, global bond and IG managers benefited from an improvement in the credit cycle but government bond managers suffered as interest rates decreased. Emerging debt funds also experienced a very strong rebound, helped by dovish DM and EM central banks and signs of recovery in China.



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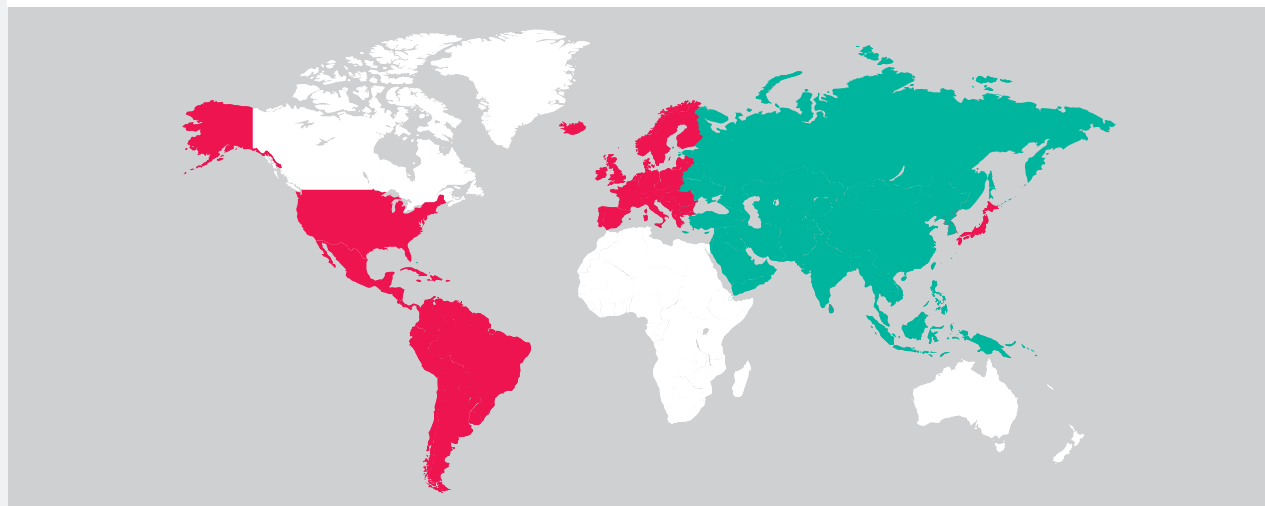
4. Read our views on where to find alpha over the next few months

Investment conditions are normalising after two polarised periods of performance in recent months. For much of Q4 last year, a trade-led slowdown was amplified by a sudden tightening in global liquidity, sending asset prices plunging and hindering both active and passive styles. Since December however, central bank support, stimulus in China and receding policy uncertainties have lifted markets and helped passive and active mutual funds to outperform. We expect less differentiation between passive and active funds this quarter. The economic and market recoveries will be relatively shallow, as each of the main drivers have limitations and are already partly priced in. This modestly positive trend should still favour passive overall. Any move towards more fundamentals-based pricing would improve alpha generation. A tilt towards active might prove opportune later this year. Whether political and policy uncertainties endure, or are resolved, will ultimately prove decisive.

Emerging Markets

While a US-China trade agreement and intensifying Chinese stimulus are broadly priced in already in emerging markets, secondary effects on capex and confidence should contribute positively. Meanwhile, dovish DM and EM central banks, benign inflation and a stabilising dollar should help EM economies and markets recover further. We are positive on the outlook for passive, but also favour those active managers who are capable of generating alpha out of very differentiated country situations. Supply chain changes in Asia, sanctions in Russia and reform implementation in Latin America all offer opportunity.

Verdict: HIT



US

The US economy is gradually converging with the rest of the world, as reflation policies fade and it feels the effects of its trading partners' weaknesses. That said, still resilient domestic data, Fed support and a bottom in earnings revisions could boost passive styles after some short-term consolidation. A move to fundamentals-based pricing, wider sector leadership, less crowded positioning, and a period of less disruptive policymaking ahead of next year's elections would help active funds. Small-cap focused managers should do well, and we also see opportunities at a sector level, where differentiation in pricing and business rationales is appealing (notably in consumer-related areas, healthcare and finance).

Verdict: MISS – except for non-mainstream active.



EU

The European economy is still impeded by its export sensitivity and member weaknesses. Political uncertainties have also had an effect and won't disappear just yet. Brexit may baffle for another six months, depriving companies and active managers of the clarity needed to make good investment decisions. Auto tariffs are a wildcard. However, a soft Brexit looks likelier and a positive surprise in Italy shouldn't be ruled out. We see some catch-up potential for passive, provided data improves more enduringly. Active managers may struggle in the mixed conditions – an absence of clarity and decisive catalysts means bolder stances will require bravery.

Verdict: MISS



Japan

We expect more of the same in Japan. A US-China trade agreement and greater access to Chinese markets would ease pressure on exporting sectors. However, distortions from a dovish Bank of Japan, greater sensitivity to movements in the yen and a lack of catalysts ahead of the VAT tax hike may constrain active managers. Those focusing on specific sectors will find limited differentiation between stocks. We favour passive styles on a relative basis, but they may also lack for compelling catalysts and positive directionality.

Verdict: MISS



Source: Source: Lyxor ETF & Cross Asset Research teams. All views & opinions as at 15 April 2019.

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5. Optimise your portfolio for this environment

	US	Europe	Japan	EM Markets
Passive				
Broad	✓	✓	=	=
Countries		✗		=
Sectors	✗	✗	✗	✗
Smart Beta				
Factors	✗	=	=	
Active				
Long/Traditional	=	=	✗	=
Long/Short Hedge Funds	✓	✗	✗	✓
Countries		✗		✓
Sectors	✓	=	✗	✓

✓ Overweight ✗ Underweight = Neutral

The above marks summarize our analysis of Passive and Active environments for the next 3M. They are based on the screening of a wide set of macro-economic and market data, broken down at a regional level.

6. Choose the relevant ETFs

US

Beta at reduced cost	Beta	Sectors/Countries	Style
Core Morningstar (LCUS)	S&P 500 (SP5)	Banks (BNKU)	Russell 2000 (RU2K)

Europe

Beta at reduced cost	Beta	Theme
Core STOXX Europe 600 (MEUD)	MSCI Europe (MEU)	Min Var Europe (MVAE)

Emerging Markets

Beta at reduced cost	Beta	Sectors/Countries
MSCI EM Asia (LCAU)	MSCI Emerging Markets (LEM)	Hwabao WP MSCI China A (CNAA)

Source: Lyxor ETF & Cross Asset Research teams. All views & opinions as at 15 April 2019 unless otherwise stated.

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Knowing your risk

It is important for potential investors to evaluate the general risks described below and in the fund prospectus on our website www.lyxoretf.com

Capital at risk

ETFs are tracking instruments: Their risk profile is similar to a direct investment in the Underlying index. Investors' capital is fully at risk and investors may not get back the amount originally invested.

Replication risk

The fund objectives might not be reached due to unexpected events on the underlying markets which will impact the index calculation and the efficient fund replication.

Counterparty risk

With synthetic ETFs, investors are exposed to risks resulting from the use of an OTC swap with Société Générale. In-line with UCITS guidelines, the exposure to Société Générale cannot exceed 10% of the total fund assets. Physically replicated ETFs may have counterparty risk if they use a securities lending programme.

Concentration risk

Smart Beta ETFs select stocks or bonds for their portfolio from the original benchmark index. Where selection rules are extensive, it can lead to a more concentrated portfolio where risk is spread over fewer stocks than the original benchmark.

Underlying risk

The Underlying index of a Lyxor ETF may be complex and volatile. For example, when investing in commodities, the Underlying index is calculated with reference to commodity futures contracts exposing the investor to a liquidity risk linked to costs such as cost of carry and transportation. ETFs exposed to Emerging Markets carry a greater risk of potential loss than investment in Developed Markets as they are exposed to a wide range of unpredictable Emerging Market risks.

Currency risk

ETFs may be exposed to currency risk if the ETF is denominated in a currency different to that of the Underlying index they are tracking. This means that exchange rate fluctuations could have a negative or positive effect on returns.

Liquidity risk

Liquidity is provided by registered market-makers on the respective stock exchange where the ETF is listed, including Société Générale. On exchange, liquidity may be limited as a result of a suspension in the underlying market represented by the Underlying index tracked by the ETF; a failure in the systems of one of the relevant stock exchanges, or other market-maker systems; or an abnormal trading situation or event.

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