A memorable Black Friday

- *Lyxor Chenavari UCITS Credit Fund is up c. +2.7% (SI USD) and c. +2.3% (SI EUR) year-to-date as of 26 November, with November down c. 70 bps net MTD after Friday's movements (est.)*
- *Friday's price action in a nutshell: our book had a mild long exposure; our hedges were mainly for interest rates to rise (inflation) whilst Omicron triggered a move in the opposite direction*
- *Sentiment and the economic impact of precautionary government actions will drive the market in the coming days, as little will be known about the new variant before a week or two*
- *The new market conundrum has triggered us to substantially reduce our hedge on interest rates and start building some tail protection*
- *The repricing may give rise to interesting buying opportunities*

Disclaimer: The performance figures indicated in this letter are preliminary, unaudited numbers to give our investors some immediate colour on our book on the back of the sudden market movements that took place on Friday 26 November. Official NAV figures are yet to be released.

Dear Investors,

The news of the variant B.1.1.529 ("Omicron") spreading rapidly and showing multiple mutations on its spike protein, hence questioning the efficacy of vaccines, has taken markets in a whirlwind.

The suddenness of the move comes as a stark contrast to Q1 2020, when markets showed complacency against the mounting newsflow before reacting violently, leaving us time to adjust our positioning efficiently.

We entered Friday with the following positioning:

Figure 1: Fund's risk positioning as of the opening of Friday 26 November

	PV10
FUND LEVEL	**-0.73%**
o.w. Corporate Book	-0.52%
o.w. Financials Book	-0.21%

Source: Chenavari Risk Team

This meant that for a widening of credit indices of 10% ("PV10"), our predicted drawdown was -0.73%, according to the model of our Risk team. We would consider this as a "mild long" exposure, which was mostly stemming from the Corporate book (as Figure 1 shows, contributing to 52 bps of the predicted 73 bps drawdown), whilst the Financials book had a much more muted exposure.

As Figure 2 shows, Friday's movement was sudden and quite significant, with European credit indices widening by 8%, with Investment Grade slightly outperforming High Yield.

Figure 2: Performance of key reference indices on 26 November 2021

Key Indices	*26-Nov-21*
Main s36 5y (IG)	+7.7%
XO s36 5y (HY)	+8.3%
SNRFIN s36 5y	+8.1%
SX5E (EUROSTOXX 50)	-4.7%
SX7E (EUROSTOXX Banks)	-6.4%

Note: for credit indices, performance is expressed in spread variations (spreads increase as markets fall)
Source: Bloomberg

The reaction of our Fund on the day was in line with our risk sensitivities: after Friday's move, the Fund registered an estimated 60 bps downward move against an actual widening of credit indices by c. 8%.

Our performance therefore came in line with the predicted model against this abrupt market move. Unsurprisingly as well, the performance breakdown between the books came in line with the risk profile of each, with Corporate down 47 bps and Financials down 13 bps.

Whilst we saw little opportunities in Financials, the Corporate book had indeed increased its market exposure in the past few weeks. Our focus was on themes which had little to do with the emergence of a new Covid strain (inflation, supply chain disruption, etc.). Regarding the portion of our book most vulnerable to Covid fears, we note that they are cash rich companies which were trading wide when compared to pre-covid levels. Obviously, they were our largest underperformers on Friday (Cirsa, Gamenet, Vallourec, Wintershall).

When looking at the detail of our book, we see that **our hedges did not suffice to mitigate the drawdown on our long bucket**.

Why is that?

Before Omicron derailed the market, we had actively hedged interest rates to protect the book from Central Banks reacting to inflationary fears and increasing rates. This was the prevalent theme in our view. The fears stemming from Omicron took interest rates to the opposite direction, with the US 2Y dropping by 18.8% at 0.52 and the US 10Y by 8.1% at 1.50. Our interest rate hedge wiped out the benefit of our other shorts and hedges such as our shorts on Heidelberg, ArcelorMittal or Lanxess, ultimately adding to the drawdown of the long book instead of protecting it.

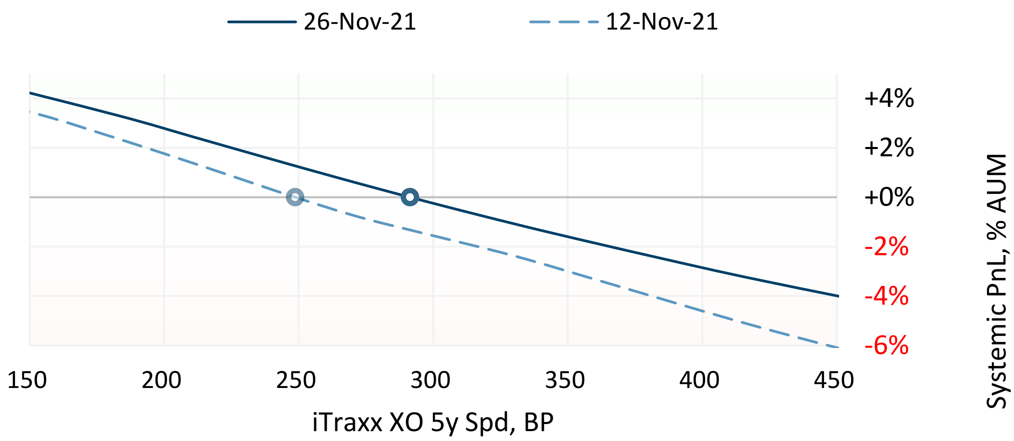
Positioning

It is impossible to take an educated stance on the outcome of the Omicron variant before a proper analysis is conducted and statistically relevant metrics are released. This will take a few days at best. In the meantime, **market will likely be driven by sentiment (with a lot of room for fear as the strain spreads across the world), and the impact of precautionary government actions.** As of Sunday morning, many governments had stepped up their level of response with a direct impact on their economy, such as Israel closing its frontiers to foreigners[1], the Netherlands imposing a curfew from 5pm every day for non-essential businesses[2], and Switzerland imposing a 10-day quarantine to UK visitors even if they are vaccinated[3].

During Friday's trading, we notably substantially cut our hedge on rates, as we believe that the inflationary theme will be overshadowed in the coming few days by Omicron. We also started buying a bit of protection (via put options) to protect the book in the case of a tail event.

The new positioning of the Fund, and how it evolved since our previous portfolio review on 12 November, is highlighted on Figure 3.

Figure 3: Fund level systemic stress as a function of on-the-run iTraxx Crossover 5Y spread (the dot representing the position of the iTraxx Crossover index at the time of the Curve)

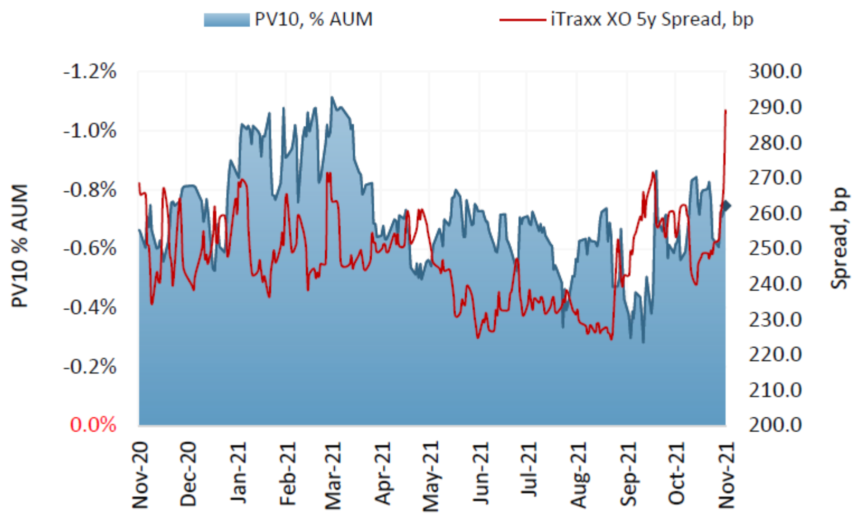


Source: Chenavari unaudited estimates, 26 November 2021

Locally, the PV10 of the book is broadly similar to where it was on Friday. This means that **a further widening of credit indices by 10% would trigger a further 75 bps drawdown (according to our risk model)**. The evolution of the iTraxx Crossover index (in red) and our PV 10 is shown in Figure 4.

[1] https://www.bbc.com/news/world-middle-east-59448547.amp
[2] https://business.gov.nl/regulation/corona-rules-shops/
[3] https://www.gov.uk/foreign-travel-advice/switzerland/entry-requirements

Figure 4: Fund PV10 versus iTraxx Crossover level over the past 12 months



Source: Chenavari Risk Team

Note however that our positioning is a static observation as of Sunday 28 November.

We endeavour to be as nimble as can be, and our positioning can evolve very rapidly based on news flow and market developments. There is little doubt that our positioning will evolve significantly in the coming few hours and days in order to try to meet our targets of (i) protecting the Fund as much as we can in the event of a significant market dislocation, and (ii) participating to the upside should the market bounce back.

* * *

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

Vincent Laurencin

Chenavari Deputy CEO, Chair of the UCITS Portfolio Review

PLEASE REVIEW THE IMPORTANT HYPOTHETICAL DISCLAIMER AT THE END OF THIS DOCUMENT

Appendix – Some thoughts on the recent Omicron developments

Even before news of the Omicron variant made the headlines on 25 November, the increase of Covid cases across many European countries had led to the implementation of new restrictions, notably with regards people who had opted against vaccination.

This had not bothered markets much, notably because we were dealing with a known virus, and the increase in cases had not translated into a significant rise in ICU occupancy and deaths.

The trigger was really pulled on the evening of Thursday 25 November as the disclosure of the Omicron variant led several countries to suspend travels with South Africa and its neighbours. Omicron has 50 mutations of which 32 in the exposed spike protein[4], raising questions particularly on (i) its transmissibility and (ii) its resistance to vaccines (but also on its lethality, a key element obviously).

We are market participants and not health experts. Trying to take a step back, we observe the following.

- The news flow around the C.1.2. South African variant toward the end of Summer 2021 was quite alarmist, with initial indications that it was highly transmissible; it ended up being quite manageable.

- Precautionary government actions are meant to slow down an early exponential rise of an unknown variant; they are an indication of the uncertainty around the new strain, not of its dangerousness.

- It will take time before the matter is resolved with facts, so there will be room for more fear in the coming days and week(s) as the virus spreads across many countries and yet more restrictive actions are announced around the world.

- Our understanding is that the new anti-virus pills have nothing to do with the spike protein and should therefore be as effective with the new strain as they are with the existing ones.

- The bull case scenario would be that Omicron is more contagious but less severe than previous variants of the Virus. This has been suggested by the South African Medical association, but sample assessed so far is too small to have any meaningful scientific relevance.

- As a reasonable base case scenario, Omicron will be quite contagious, more resistant to vaccines, but they will still be efficient for more severe conditions. An adhoc booster will need to be developed.

- As a reasonable worst-case scenario, mRNA vaccines seem capable of reacting within 3 to 4 months as per Moderna's rather reassuring press release[5]. mRNA technologies are meant to allow for swift updates of the vaccine "software" enabling it to adjust to resistant mutations.

- Even if severe conditions are significantly reduced by existing vaccines, higher transmissibility could impact low-vaccinated parts of the world, most notably emerging markets (unless the new strain turns out to be less dangerous)

[4] Financial Times. 'What we know about the Omiron variant that has sparked global alarm', Clive Cookson and Olivier Barnes. 26 November 2021
[5] https://investors.modernatx.com/news-releases/news-release-details/moderna-announces-strategy-address-omicron-b11529-sars-cov-2

- In any case, the Omicron saga shows how a new strain can shake the world. The Covid risk premium should increase a bit even in a blue-sky resolution of the situation. In developed markets, the pressure for people to get fully vaccinated should increase significantly as variants pop where unvaccinated people prevail. The noise around Omicron is a forceful reminder that a vaccinated world will fight a much easier battle against the mutations of Sars-Cov2.