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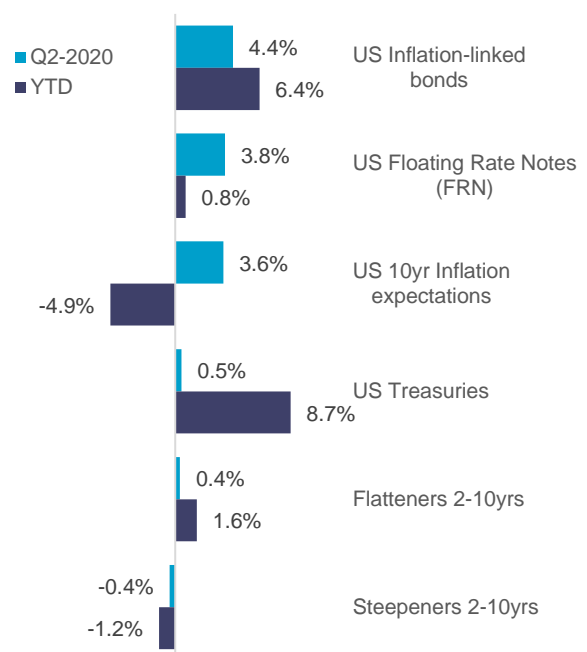
US Inflation & Rates Explorer: Q2 2020

The US Inflation & Rates explorer monitors the performance of selected US Fixed Income strategies. We review the main trends in the US Fixed Income market over the past quarter, and how these trends influenced the performance of the indices.

Key takeaways

- **Inflation-linked strategies led the pack in Q2 2020** thanks to a recovery in inflation expectations and a slower rate of decline in inflation prints. There was a strong recovery in flows into US inflation-linked exposures over the quarter.
- **Floating Rate Notes (FRN)** benefited from the strong compression of financial corporate bond spreads and lower 5Y bond yields. Flows into US IG corporate bonds were also well supported.
- **Curve strategies** posted marginal performance during Q2 due to the lack of direction at both ends of the US yield curve.

Performance overview*



*Performance is stated in USD and in gross total return. Past performance is not a reliable indicator of future performance. For indices' full names please refer to index glossary on p.4. Data as at 30/06/2020. Sources: Bloomberg, Lyxor International Asset Management.

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Market & performance overview

Inflation-linked led the pack in Q2

Q2 was a quarter of contrasts for the US inflation market. In April, US inflation prints collapsed to their lowest level since 2008 (-0.8% YoY), although this seems to have been temporary. Inflation-linked bonds and inflation-expectations strategies recovered strongly during the second half of the quarter (see p.5-10 for the full performance review).

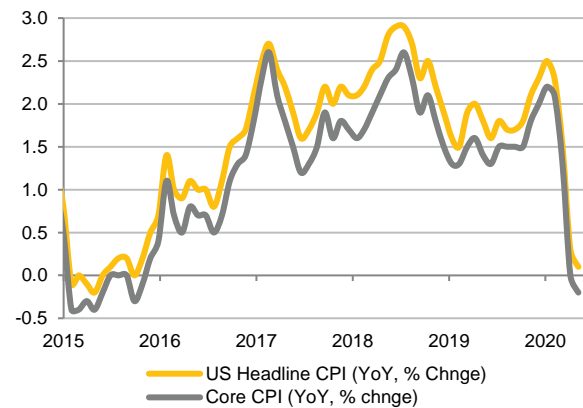
The contribution of CPI components to the overall measure over Q2 was heavily distorted compared to history. Unprecedented measures to contain the Covid-19 pandemic caused changes in US consumer behaviour, drastically reducing purchases of key components in the CPI basket, such as air travel and clothing. Auto insurance companies also slashed premiums due to the decline in car trips. Conversely, the cost of groceries surged over Q2, as many households increased grocery spending due to lockdown. Meanwhile, the oil price eventually stabilised around \$40/bbl, after touching record lows and briefly going negative at the height of the crisis.

A strong disconnect between actual inflation prints and US consumers' inflation expectations also emerged in Q2. Data from the University of Michigan's consumer sentiment report showed that US consumers see year-ahead inflation at 3.2%, more than 3% ahead of May's inflation prints.

Investors reallocated into US inflation-linked exposures over the quarter, after funds and ETPs recorded severe outflows at the peak of the market downturn. The pick-up in flows was strongest in the final week of June 2020, and ETPs benefited the most over the period with +€2.3bn cumulative net inflows into inflation-linked products.

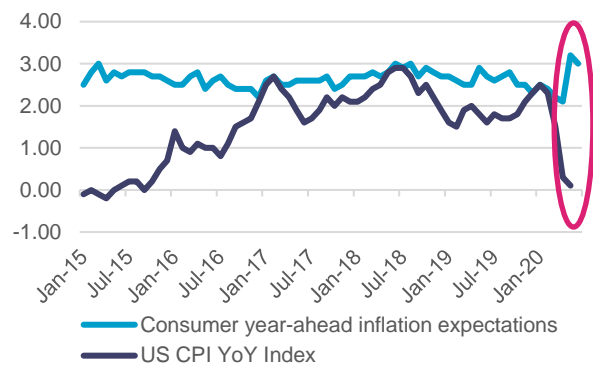
US CPI rate collapsed to multi-year lows in Q2 2020

US CPI YoY (Headline & Core)



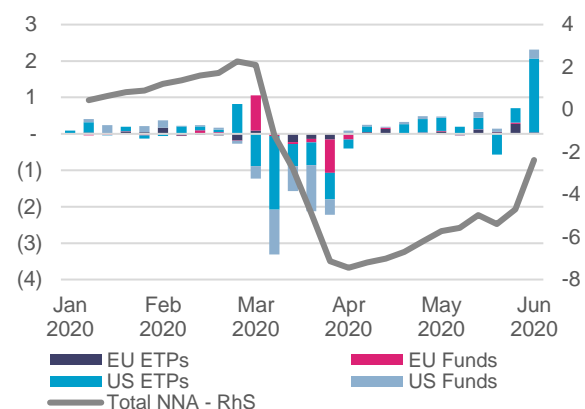
US consumers anticipate a jump in inflation in 2021

US consumer inflation expectations vs. US CPI YoY



Investors reallocated into inflation-linked bonds

US inflation-linked weekly flows (Funds and ETFs in €bn)



Sources: Bloomberg, Morningstar, Lyxor International Asset Management. Data as at 30/06/2020. Past performance is not a reliable indicator of future returns

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Floater supported by credit spread compression

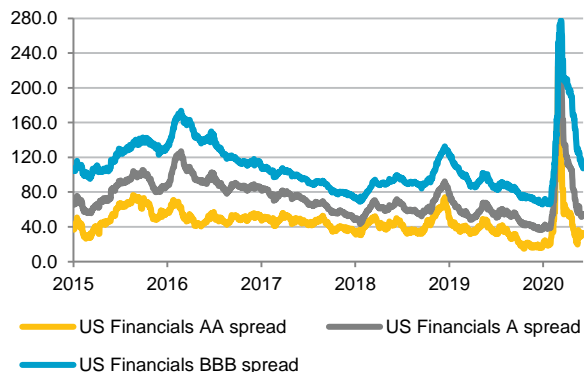
The Fed gave extraordinary support to the corporate bond market in Q2, including broad purchases of corporate debt. The \$75bn purchase programme allowed for strong credit spread compression and improved liquidity conditions. Floating Rate Notes performed well in this context – see the index’s performance review on p.11. Flows into US IG corporate bonds were also well supported over the quarter.

Limited yield differential for the US curve

The US 2-10yr yield curve lacked direction during Q2, following its strong flattening in Q1. This shift was triggered by the Fed’s aggressive stance on Fed funds rates during the crisis along with unprecedented measures to support liquidity. In this context, curve strategies focusing on 2-10yr US treasuries recorded little performance (see p.13 for more).

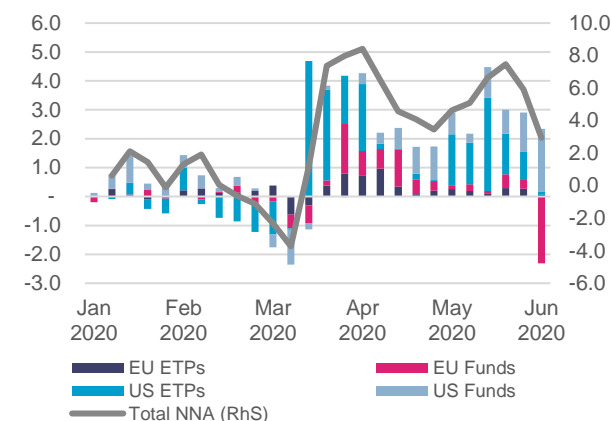
Unprecedented Fed actions supported corporate bond spread compression...

US Financial corporate bond spreads (3yrs, bps)



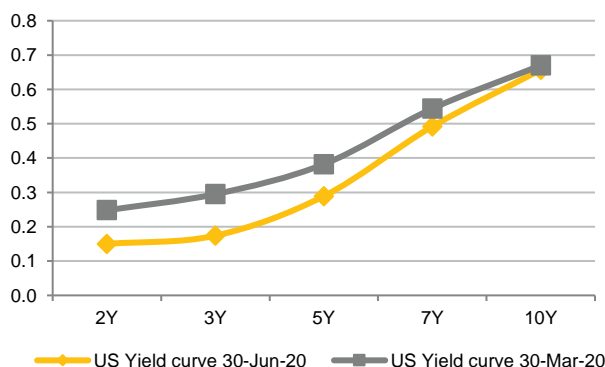
...and revived inflows into US IG Corporate credit

US Corporate IG weekly flows (Funds and ETFs in €bn)



Limited yield differential for 2-10yr Treasuries yields

US Treasuries yield curve (31/03/2020 vs 30/06/2020, in %)



Sources: Bloomberg, Morningstar, Lyxor International Asset Management. Data as at 30/06/2020. Past performance is not a reliable indicator of future returns

Index definition

Index Exposure	Index name	Bloomberg ticker
US Inflation-Linked bonds	Bloomberg Barclays US Govt Inflation-Linked All Maturities TR Index The index offers an exposure to the US Treasury Inflation Protect Securities (TIPS Market)	BCIT1T Index
US 10-Year Inflation Expectations	Markit iBoxx USD Breakeven 10-Year Inflation Index The index is representative of the performance of a long position in the 6 last issuances of U.S. 10-year Treasury Inflation-Protected securities and a short position in U.S. Treasury bonds with adjacent durations. The difference in yield between these bonds is commonly referred to as a "breakeven rate of inflation" and is considered to be a measure of the market's expectations for inflation over a specified period of time.	IBXXUBF1 Index
US Treasuries	Bloomberg Barclays US Treasury TR Index The Index measures US dollar-denominated, fixed rate, nominal debt issued by the US Treasury	LUATTRUU Index
US Floating Rate Notes	Bloomberg Barclays MSCI USD Corporate Liquid FRN 0-5 Year SRI Sustainable Index The index is representative of the performance of USD denominated investment grade floating rate notes issued by US and non-US corporates, with maturities ranging from 1 month up to, but not including, 5 years. The bonds in the index have a variable coupon which is adjusted according to changes in the 3m USD LIBOR. Additionally, the index only includes issuers with an MSCI ESG Rating of BBB or higher, and negatively screens issuers involved in certain values-based business involvement criteria, including activities related to controversial military weapons, and those with a "red" MSCI ESG Controversy Score.	I34979US Index
US Flattener 2-10 years	Solactive USD Daily (x7) Flattener 2-10 Index The index tracks the investment performance of a systematic strategy whose returns are directly linked to changes in the US treasury yield curve. The index is constructed such that for a 1bp decrease in the steepness of the curve, the index is expected to increase roughly 7bps, though market factors may cause some deviation. The index consists of two underlying components: a short position in the 2Y US Treasury Bond Futures and a long position in the 10Y US Treasury Ultra Bond Futures.	SOD7FTT Index
US Steepener 2-10 years	Solactive USD Daily (x7) Steepener 2-10 Index The index tracks the investment performance of a systematic strategy whose returns are directly linked to changes in the US treasury yield curve. The index is constructed such that for a 1bp increase in the steepness of the curve, the index is expected to increase roughly 7bps, though market factors may cause some deviation. The index consists of two underlying components: a long position in the 2Y US Treasury Bond Futures and a short position in the 10Y US Treasury Ultra Bond Futures.	SOD7STT Index

Source: Bloomberg, Solactive, IHS Markit Lyxor International Asset Management.

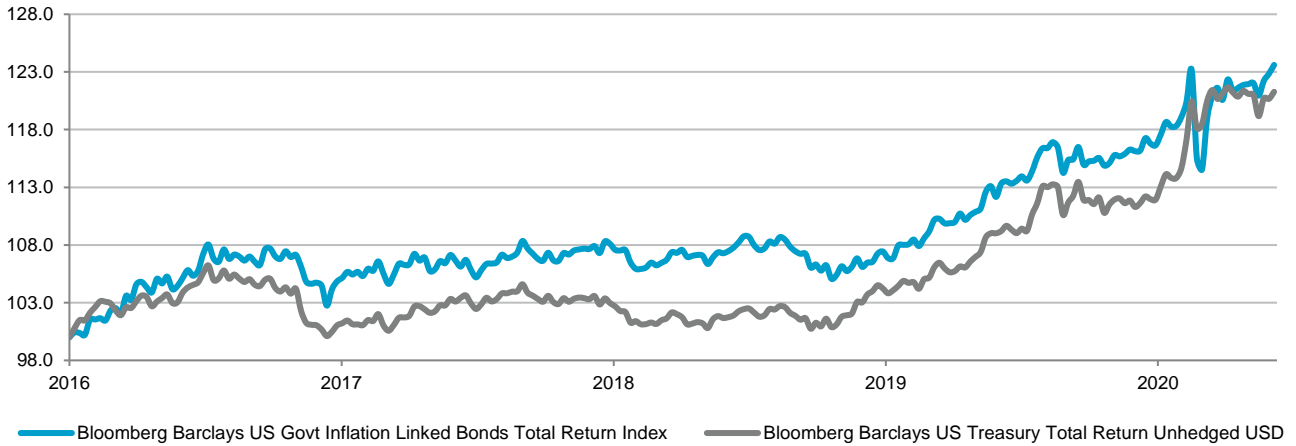
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Inflation-linked bonds

Bloomberg Barclays US Government Inflation-Linked Bond Index

Index performance

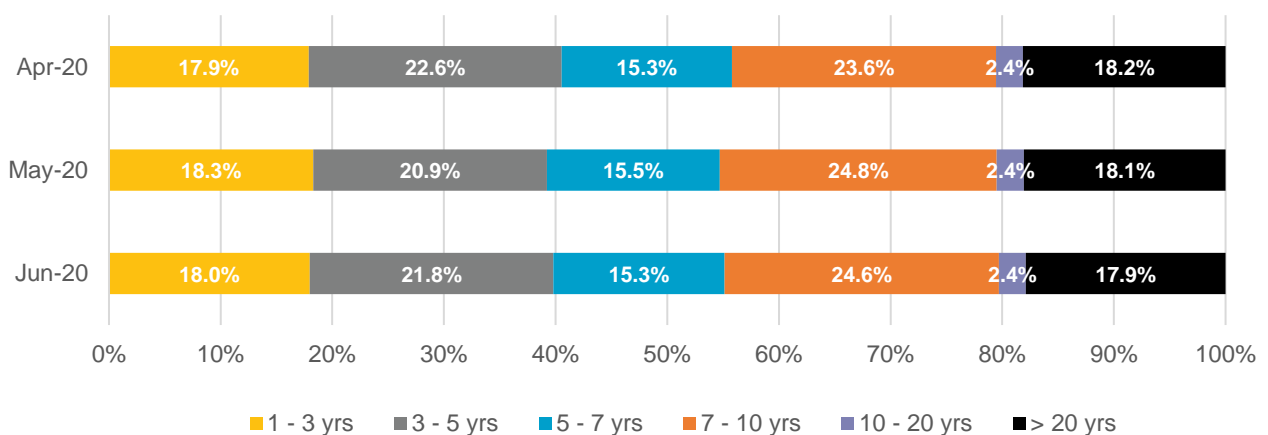


Base 100 = 01/06/2016
 Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
 Past performance is not a reliable indicator of future returns

	Total return (%)					
	Q4-20	Q3-20	Q2-20	Q1-20	YTD	2019
Bloomberg Barclays US Government Inflation-linked bond index	-	-	4.4%	1.93%	6.4%	8.75%
Bloomberg Barclays US Treasury total return index	-	-	0.5%	8.20%	8.7%	6.86%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
 Past performance is not a reliable indicator of future returns

Index breakdown by maturity buckets



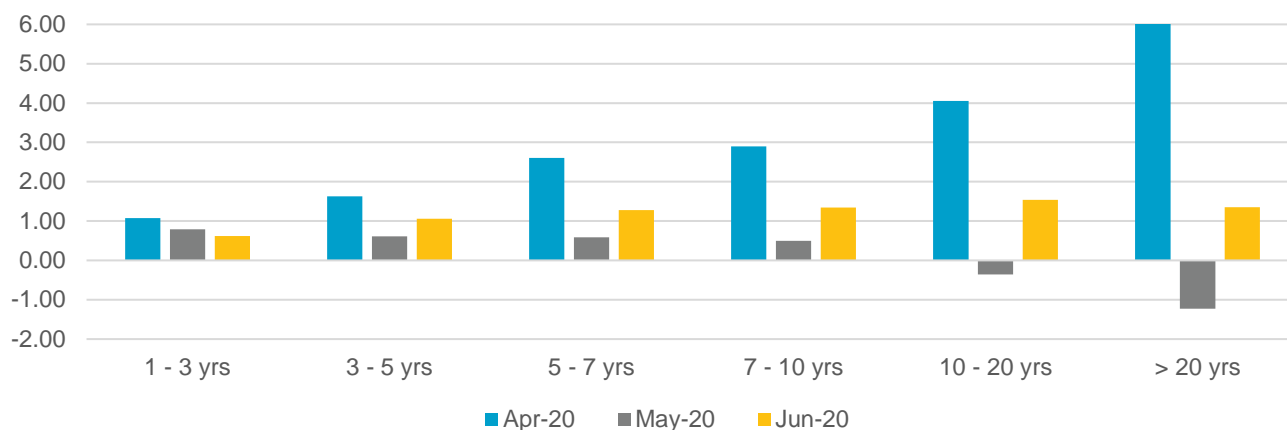
Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
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Index return by maturity buckets



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
Past performance is not a reliable indicator of future returns

Date	Total	Total return (%)					
		1-3 yrs	3-5 yrs	5-7 yrs	7-10 yrs	10-20 yrs	>20 yrs
30/04/2020	100%	6.5%	12.5%	13.5%	23.2%	3.3%	41.0%
29/05/2020	100%	56.3%	49.9%	35.7%	47.9%	-3.3%	-86.6%
30/06/2020	100%	9.7%	20.2%	17.1%	28.7%	3.2%	21.1%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
Past performance is not a reliable indicator of future returns

Index turnover

Date	In	Out
30/04/2020	-	-
29/05/2020	-	US912828Q608
30/06/2020	-	-

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.

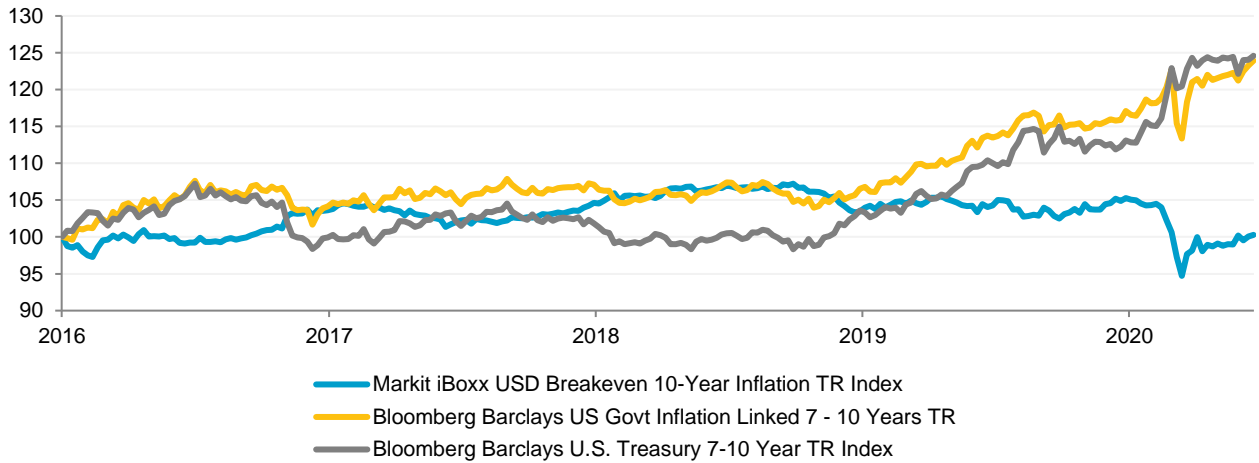
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10 Year Inflation Expectations

Markit iBoxx USD Breakeven 10-Year Inflation index

Index performance



Base 100 = 01/06/2016

Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

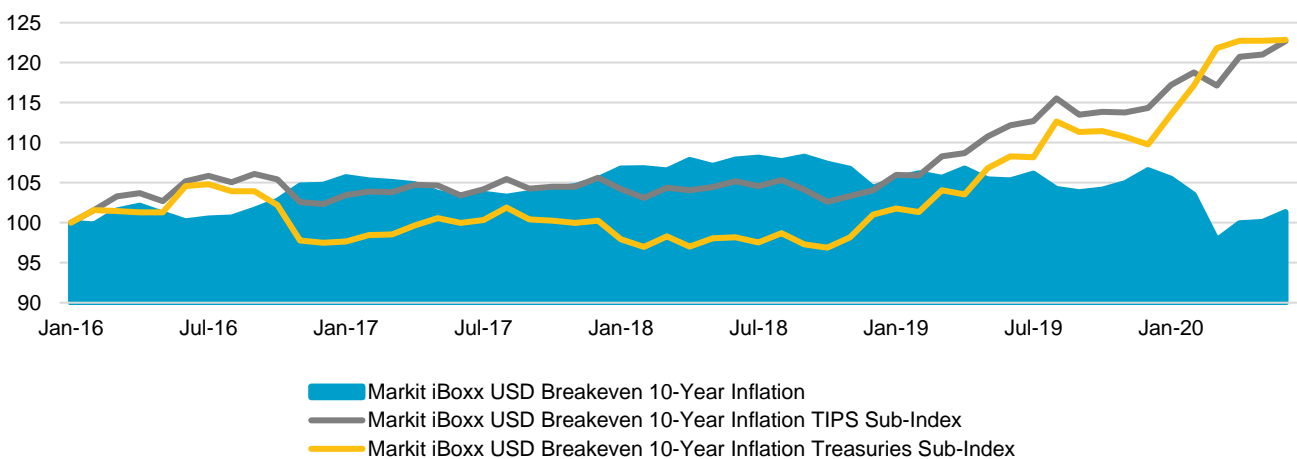
Past performance is not a reliable indicator of future returns

	Total return (%)					
	Q4-20	Q3-20	Q2-20	Q1-20	YTD	2019
Markit iBoxx USD Breakeven 10-Year Inflation Index	-	-	3.63%	-8.22%	-4.89%	2.15%
Bloomberg Barclays US Government Inflation-Linked 7 to 10Y Bond Index	-	-	4.79%	2.04%	6.93%	9.43%
Bloomberg Barclays US Treasury 7-10 Year Total Return Index	-	-	0.89%	10.15%	11.13%	8.49%

Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

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Index performance breakdown by component



Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

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The index performance is the result of:

- The difference between the realised daily returns of the Inflation-Linked Bonds (ILB) basket and the US Treasuries (UST) bond basket
- This performance is adjusted for the cost of repo and rebalancing, when applicable.

	2020 Q2	2020 Q1	2019 Q4	2019 Q3	2019 Q1	2019	2018
Index return	3.63%	-8.22%	2.65%	-1.43%	1.24%	2.15%	-1.08%
TIPS basket performance (Long)	4.73%	2.48%	0.74%	1.16%	4.06%	9.85%	-1.46%
US Treasuries basket performance (Short)	0.85%	10.98%	-1.41%	2.79%	3.01%	8.65%	0.77%
Average Scaling Factor (SF)	110.91%	107.19%	108.78%	109.37%	111.76%	109.96%	108.49%
Average Repo return (*) (R)	-0.05%	0.25%	0.34%	0.47%	0.52%	1.85%	1.49%
Total Rebalancing costs (RC)	-0.00%	-0.04%	0.00%	-0.04%	-0.04%	-0.09%	-0.18%
Estimated net performance							
Long US TIPS – SF * (Short US Treasuries – R) – RC	3.73%	-9.06%	2.64%	-1.41%	1.23%	2.29%	-0.86%

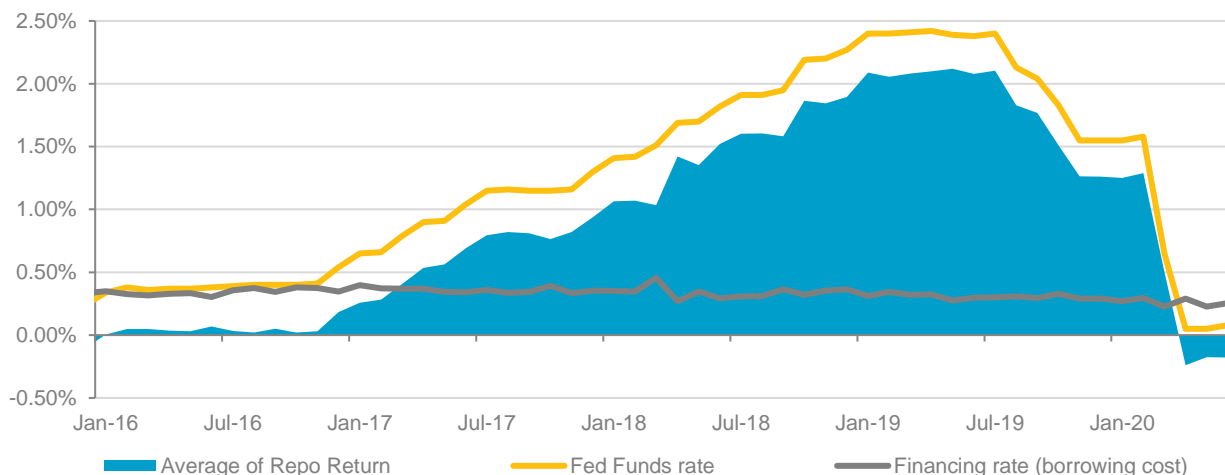
* Average of repo: the average return over the period for the net repo (Fed Funds minus Financing Rate as defined by Markit).

This may lead to estimations deviations when the actual repo level is not constant over the period.

Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

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Average repo return



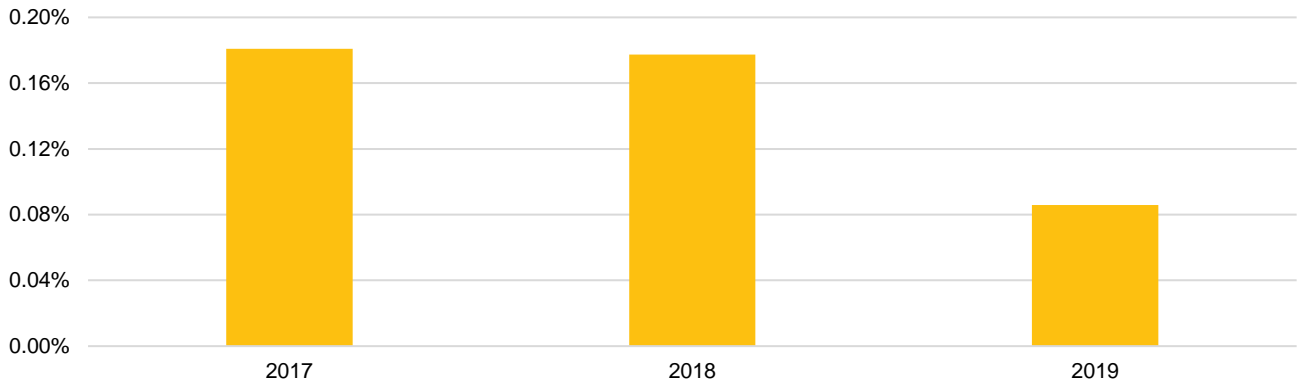
Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

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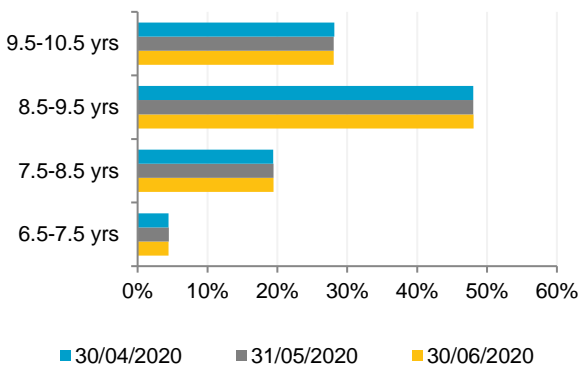
Historical rebalancing costs



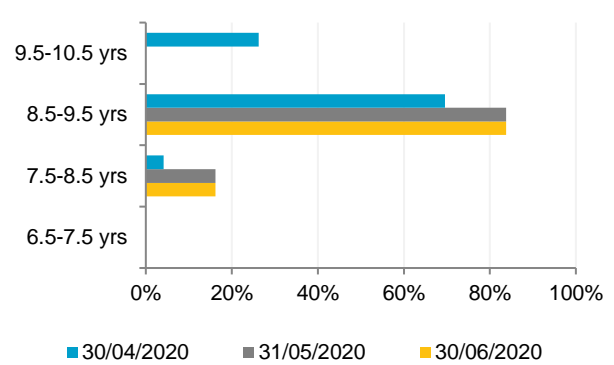
Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.
Past performance is not a reliable indicator of future returns

Maturity breakdown

TIPS basket

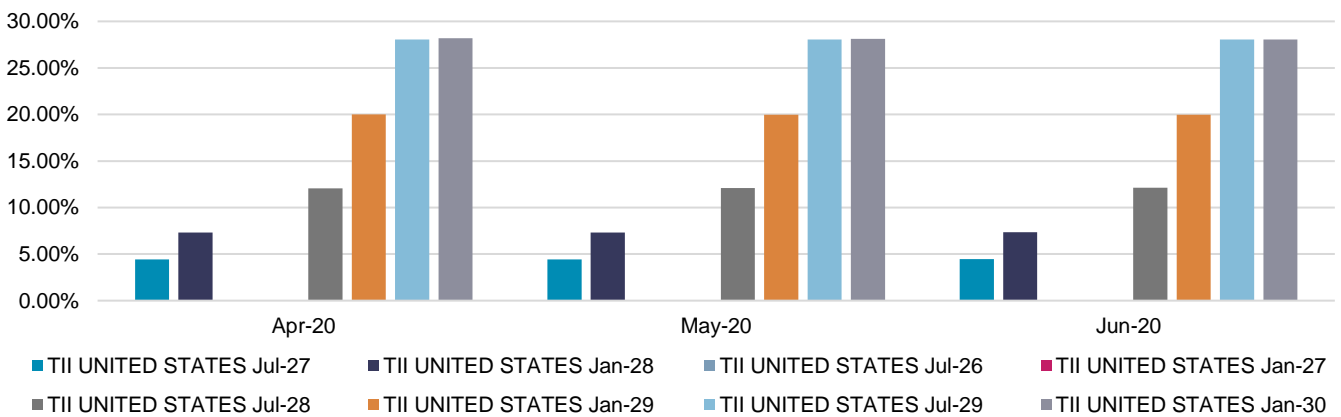


Treasuries basket



Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.
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Index turnover



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.
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How does the index behave vs. the theoretical US breakeven inflation rate?

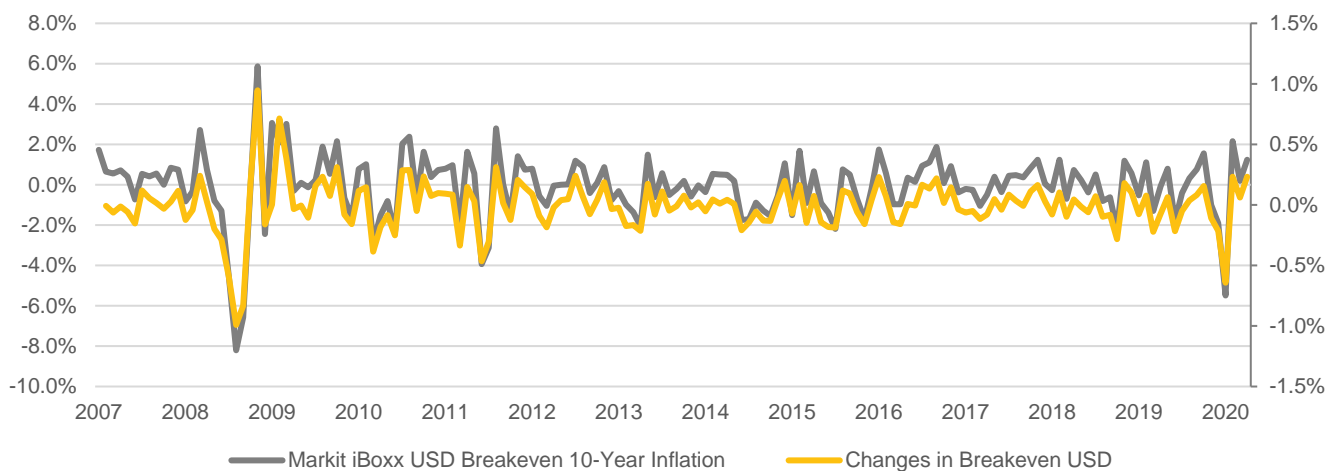
The index is designed to capture changes in the 10-year breakeven inflation rate. Due to the non-linear relationship between changes in yield, return and fluctuations in market supply and demand, the magnitude of Index movements compared to changes in breakeven inflation varies from time to time.

The comparison between the index level and the breakeven rate can only be directional. The relationship between the changes in the two series is, however, clearly visible (chart below).

Historically, across the entries sample period, a **1% absolute change in the breakeven inflation rate corresponded to an approximately 8% change in the index level.**

The correlation level can vary over time and should not be used as a systematic rule.

Markit iBoxx USD breakeven 10-year inflation vs changes in average breakeven*



*based on monthly observation

Sources: Lyxor International Asset Management, Markit. Data as at 30/06/2020.

Past performance is not a reliable indicator of future returns.

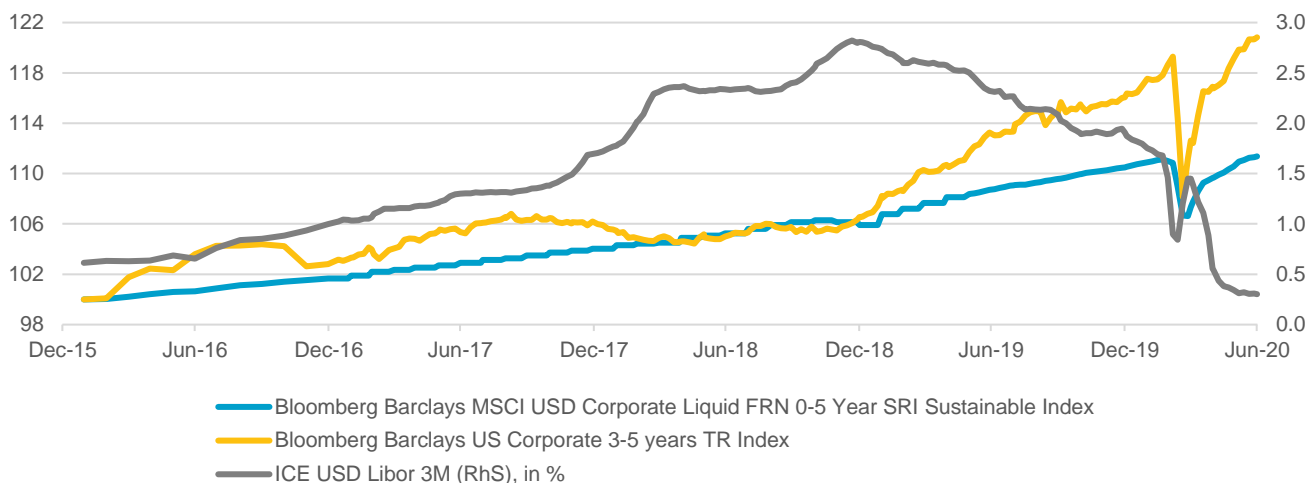
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Floating Rate Notes

Bloomberg Barclays MSCI USD Corporate Liquid FRN 0-5 year SRI Sustainable

Index performance



Base 100 = 01/06/2016

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.

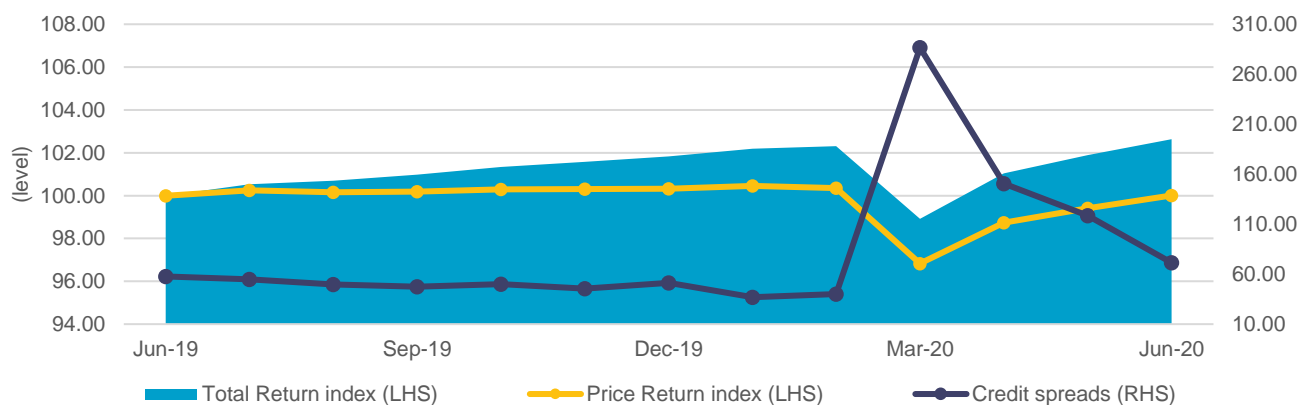
Past performance is not a reliable indicator of future returns

	Total return (%)					
	Q4-20	Q3-20	Q2-20	Q1-20	YTD	2019
Bloomberg Barclays MSCI USD Corporate Liquid FRN 0-5 Year SRI Sustainable Index	-	-	3.76%	-2.87%	0.79%	4.33%
Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index Unhedged USD Index	-	-	6.95%	-6.83%	-0.36%	5.74%
Bloomberg Barclays US Treasury 3-5 Year Total Return Index	-	-	7.29%	-2.97%	4.10%	8.93%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.

Past performance is not a reliable indicator of future returns

Index return breakdown



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.

Past performance is not a reliable indicator of future returns

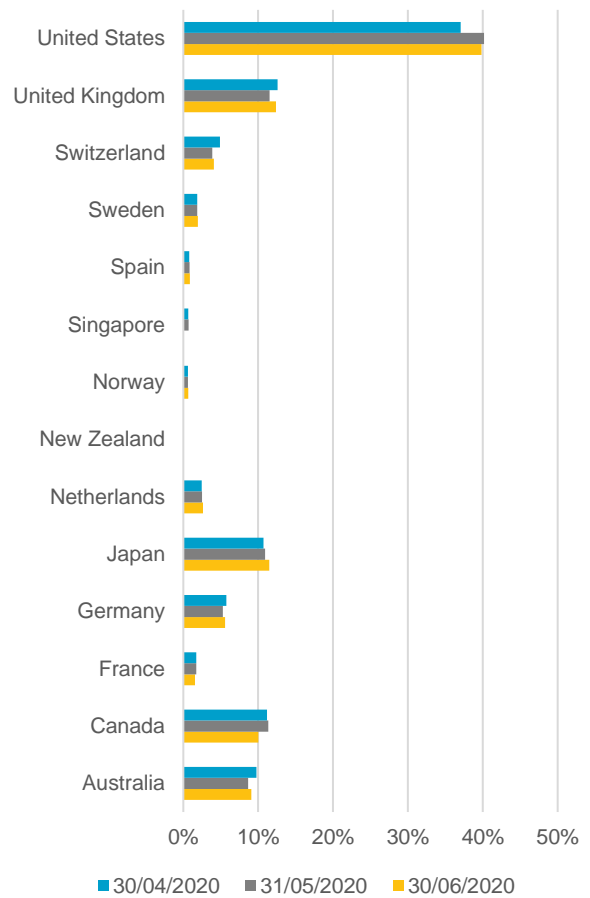
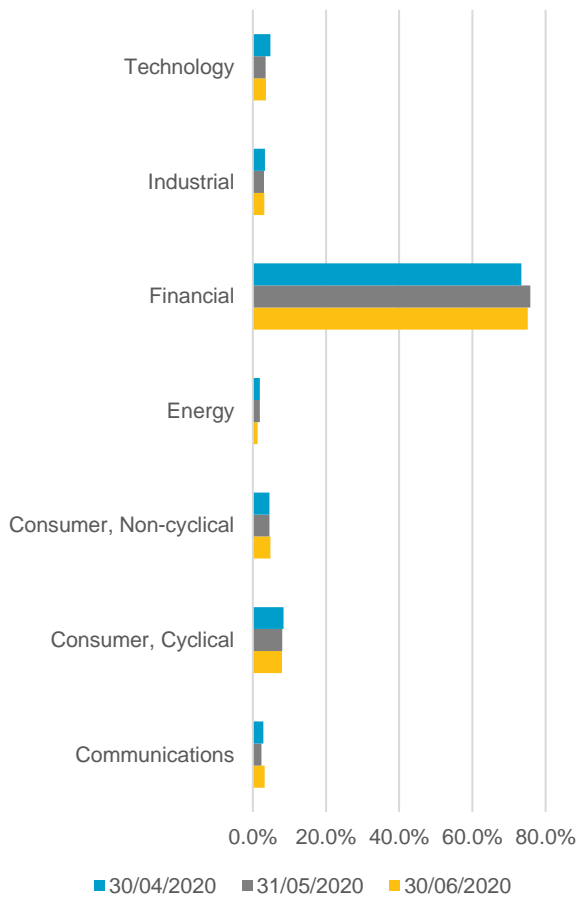
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Index composition analysis

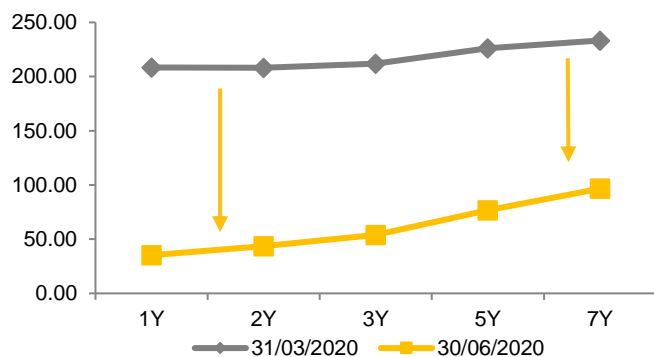
Sector & country breakdown



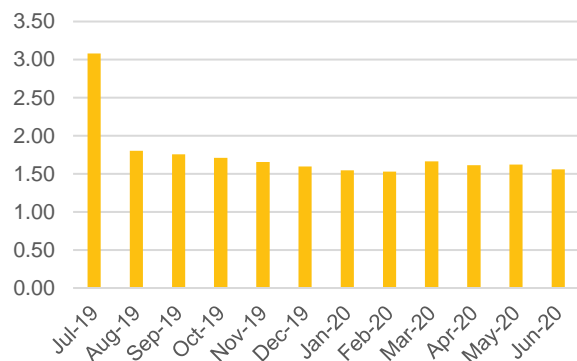
Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020. Past performance is not a reliable indicator of future returns

Credit spread analysis (in bp)

US Financials A-rated spread to US treasuries



Average credit spread sensitivity (in years)



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020. Past performance is not a reliable indicator of future returns

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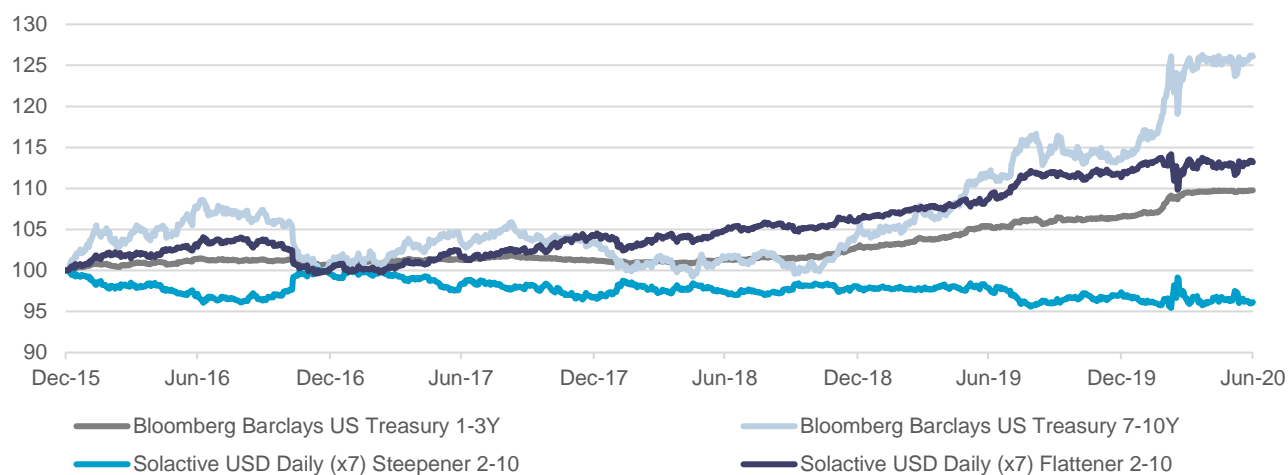
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Curve strategies

Solactive USD Daily (x7) Flattener 2-10 Index

Solactive USD Daily (x7) Steepener 2-10 Index

Index performance



Base 100 = 01/06/2016

Sources: Lyxor International Asset Management, Solactive, Bloomberg. Data as at 30/06/2020.

Past performance is not a reliable indicator of future returns

	Total return (%)					
	Q4-20	Q3-20	Q2-20	Q1-20	YTD	2019
Solactive USD Daily (x7) Flattener 2-10 Index	-	-	0.4%	1.27%	1.2%	5.00%
Solactive USD Daily (x7) Steepener 2-10 Index	-	-	-0.4%	-0.81%	-1.6%	-0.72%

Sources: Lyxor International Asset Management, Solactive, Bloomberg. Data as at 30/06/2020.

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Index performance analysis

	Performance		Average weight over the period	
10Y Future basket	0.75%	F^{10Y}	78.83%	(a)
2Y Future basket	0.07%	F^{2Y}	368.94%	(b)
Cash	0.01%	Csh		
Transaction costs	0.07%	TC		

	Flattening	Steepening
	$(a)*F^{10Y} - (b)*F^{2Y} + Csh - TC$	$-(a)*F^{10Y} + (b)*F^{2Y} + Csh - TC$
Estimated performance	0.28%	-0.38%
Actual index performance	0.36%	-0.41%

Sources: Lyxor International Asset Management, Solactive, Bloomberg. Data as at 30/06/2020.

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How does the index behave vs. the 2-10yr differential in US Treasury yields?

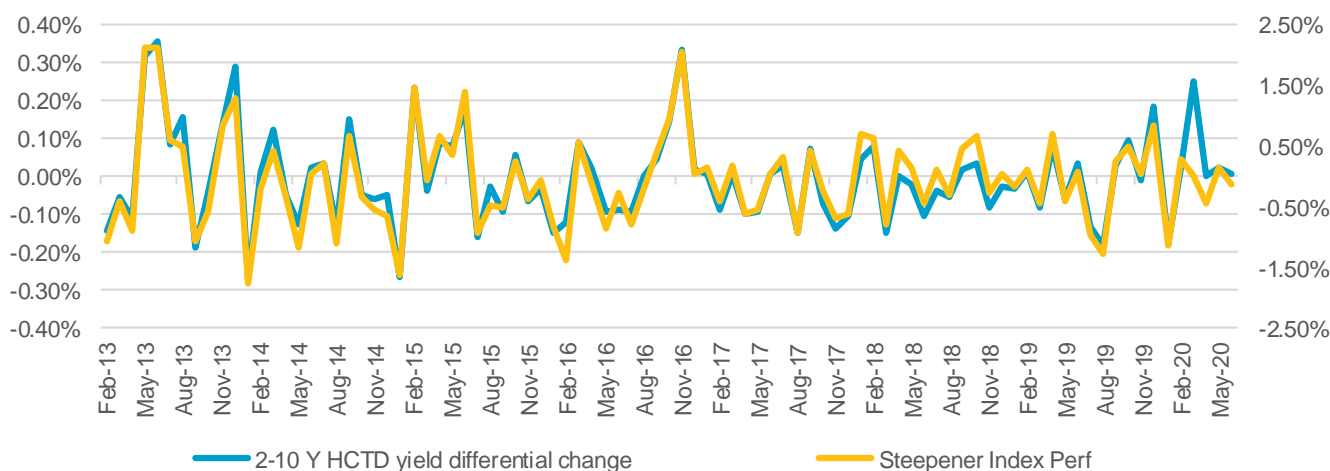
The index is designed to capture changes in the 2-10Y yield differential in US Treasuries. Due to the non-linear relationship between changes in yield and return and fluctuations in market supply and demand, the magnitude of Index movements compared to changes in breakeven inflation varies from time to time.

The comparison between the index level and the yield differential can be only directional. The relationship between the changes in the two series is, however, clearly visible (chart below).

Historically, across the entries sample period, **a 1bp absolute change in the 2-10yr US Treasury yield differential corresponded to an approximately 7bp change in the index level.**

The correlation level can vary over time and should not be used as a systematic rule.

Solactive USD Daily (7x) Steepener 2-10yr vs changes in average 2-10yr yield differential*



*based on monthly observation

Sources: Lyxor International Asset Management, Solactive, Bloomberg. Data as at 30/06/2020.

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Knowing your risk

It is important for potential investors to evaluate the 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 Societe Generale. 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

Thematic and 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.

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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 Societe Generale. 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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