Confidence must be earned

Amundi ASSET MANAGEMENT

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INFLATION AND HEDGE FUNDS: A POSITIVE BUT COMPLEX RELATIONSHIP

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Current Macroeconomic Context

After decades of accommodative monetary policies and low rates environment, inflation is back under the spotlight and among the main concerns for investors around the world. This phenomenon, exacerbated by a number of factors such as ongoing geopolitical tensions and energy shocks, deeply influences investment decisions and fund selection in general.

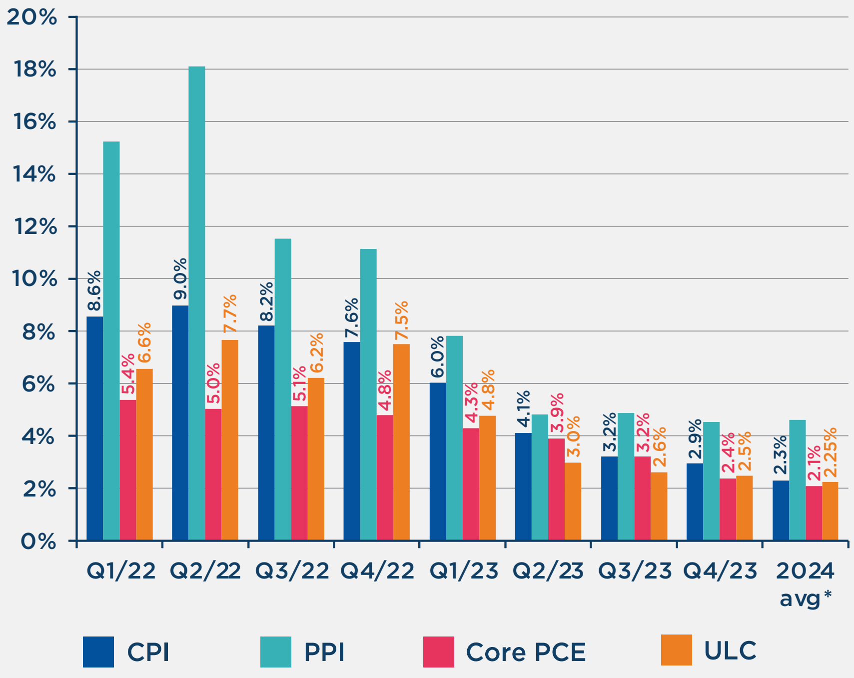
This influence can take different forms. For instance, certain assets might be more resilient to a sudden increase in inflation. Hence, funds exposed to these assets or sectors might be a choice for those wishing to protect the purchasing power of their invested capital.

Amundi's Inflation Phazer outlook for 2022-2024

A regime switch from *Hyperinflation* to *Inflation* is expected to occur in Q2 2023

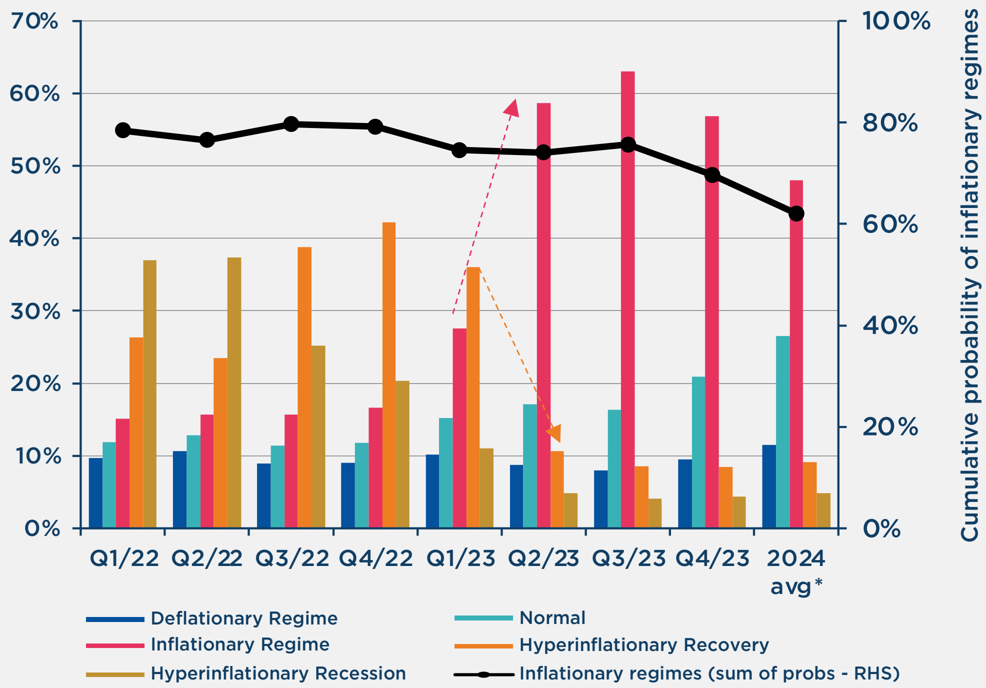
Amundi US Inflation forecasts

YoY Quarterly



Inflation Phazer

Quarterly probabilities 2022-2024



*Average YoY quarterly

Source: Amundi Research. Data as of November 2022.

*Probabilities for 2024 are based on average YoY quarterly forecasts

Source: Amundi Institute. Data as of November 2022.

02

Inflation and hedge funds – Setting up the framework

In the case of alternative assets such as hedge funds, there is a statistical correlation between them and inflation. However, before trying to explain this non-linear but complex relationship, there are a number of points that should be considered first:

01 **The nature of inflation:** actual inflation, such as headline and core CPI and inflation surprises, should be distinguished from traded inflation assets;

02 **The source of inflation:** there are two kinds of inflation, the so-called "good" one, which is demand-driven, normally resulting from the economic momentum and the "bad" inflation, which is usually the result of supply shocks and geopolitical issues among others;

03 **Inflation as a cause or a consequence:** since inflation can be both, separate analysis should be performed on economic drivers such as growth, liquidity, monetary and fiscal policies;

04 **Hedge fund's return breakdown:** there are three main sources of return: beta, alpha and sometime cash[1]. Inflation would influence each component in different ways: structurally for the beta, tactically for the alpha and mechanically for the cash rate;

05 **Inflation sequences:** the importance of the period we are looking at as hedge funds do not behave symmetrically when inflation normalizes or when it firms up.

[1]The beta return is usually measured by the return of the market. For example, the beta return of a hedge fund entirely exposed to US stocks would typically be the return of the S&P 500. Cash is the rate at which the cash can be remunerated. The alpha return is the outperformance of the hedge fund over its market.

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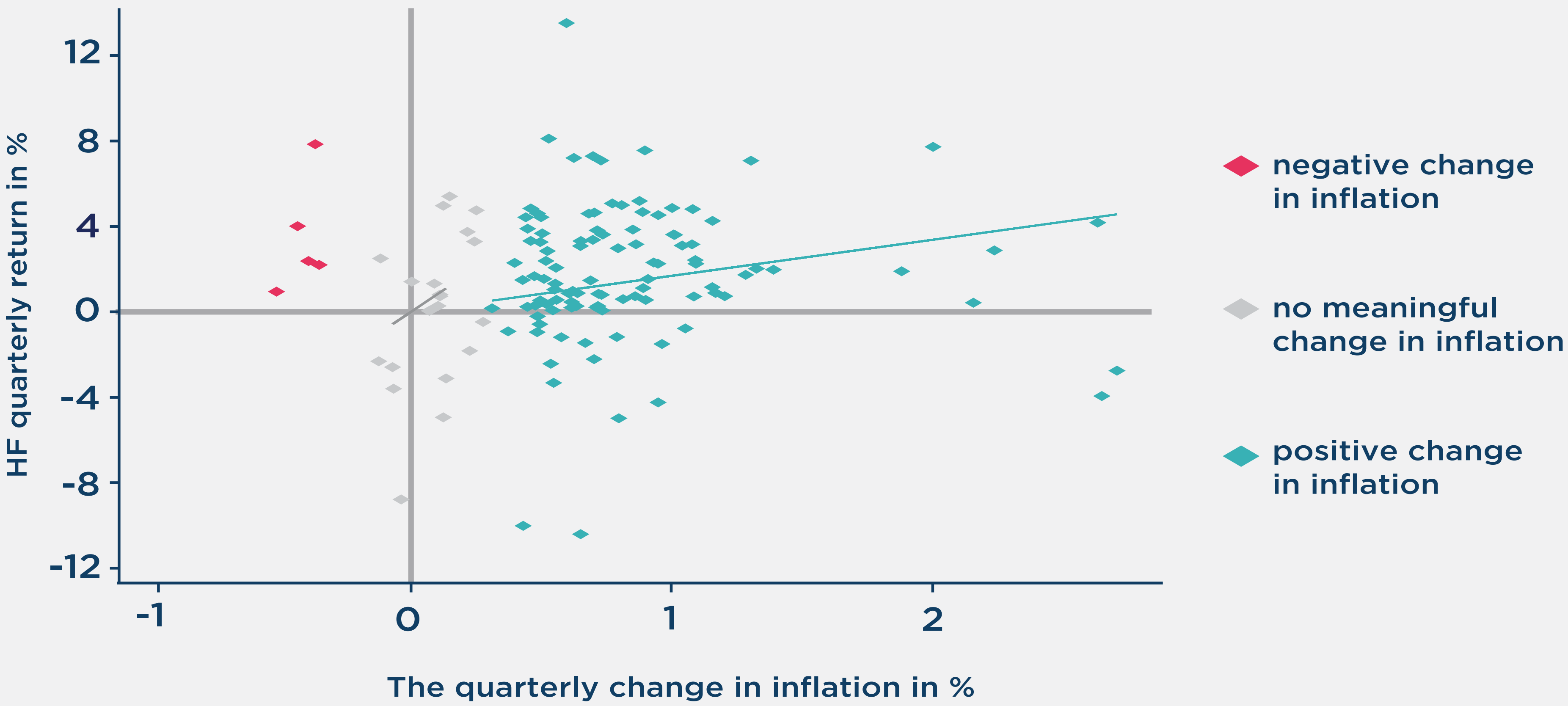
Hedge Funds positively correlated to inflation

Hedge Funds vs. Inflation Convexity



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03

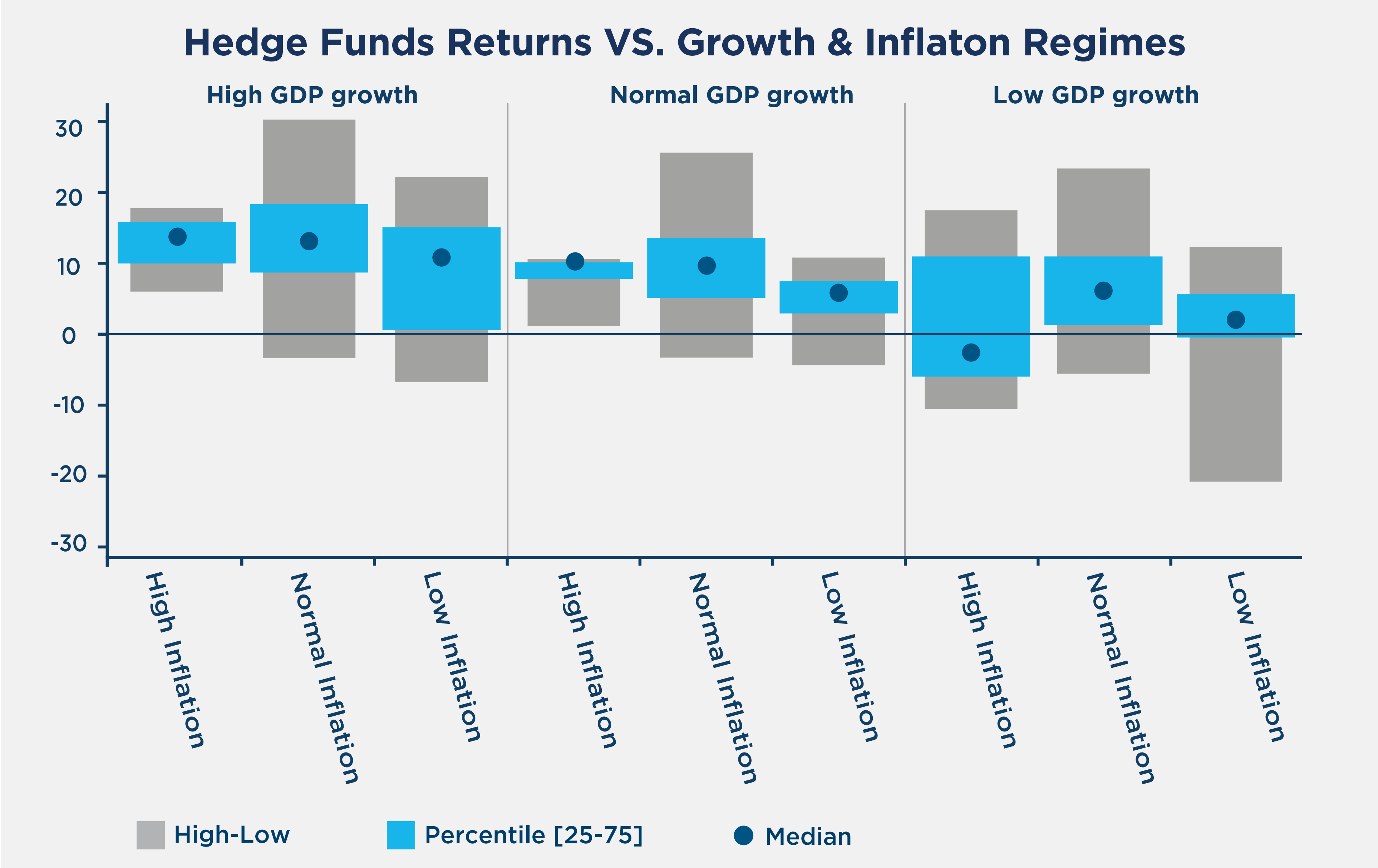
Inflation influences hedge fund return at different levels

The main finding of our study[2] is that hedge funds are not always directly influenced by inflation but more often by many other factors, depending on where we stand in the economic cycle and which return component we are looking at.

Actual inflation shifting up or down, potentially combined with rising growth uncertainty, tends to indirectly influence the beta return of hedge funds due to their overall long exposure to risky assets that are in turn structurally influenced by inflation and economic cycles.

During periods of major shifts in inflation, direct influence normally comes into play with hedge funds tactically trading inflation and actively holding assets linked to inflation into the core of their portfolio, creating alpha.

[2]Source: Amundi Institute, Hedge Funds' Positive But Complex Relationship With Inflation, 23 November 2022.


Hedge Funds Returns VS. Growth & Inflaton Regimes
High GDP growth
Normal GDP growth
Low GDP growth
30
20
10
0
-10
-20
-30
High Inflation
Normal Inflation
Low Inflation
High Inflation
Normal Inflation
Low Inflation
High Inflation
Normal Inflation
Low Inflation
High-Low
Percentile [25-75]
Median

04

Beyond inflation, strategy and manager selection remains key

In conclusion, while "bad inflation" can be a difficult force to deal with, hedge funds' positive and dynamic inflation exposures could be attractive in inflationary backdrops. Having said this, the hedge fund universe encompasses a wide set of strategies that operate differently. Given the wide dispersion in the hedge fund universe, strategy selection but also manager selection are key.

Typical HF strategies' behaviors over inflation cycles

HF Strategies returns over inflation regimes	'Good' Inflation	'Bad' Inflation	Inflation normalizes	Strength of relationship
HFRI FoHF	🟢	🔴	🟢 🟢	Medium
L/S Equity Diversified	🟢 🟢	🔴 🔴	🟢	Strong
L/S Equity Neutral	🟢	⚫/🔴	🟢	Low
L/S Equity EM focus	🟢 🟢	🔴 🔴	🟢	Strong
Merger Arbitrage	🟢	⚫/🔴	⚫/🟢	Low
Special Situation	🟢 🟢	🔴 🔴	🟢 🟢	Strong
L/S Credit	🟢	🔴 🔴	🟢	Medium
Sovereign FI RV	⚫/🟢	🔴	🟢 🟢	Strong
EM Focused FI RV	🟢 🟢	🔴 🔴	🟢 🟢	Strong
Global Macro Discretionary	⚫/🟢	⚫/🟢	🟢 🟢	Medium
Global Macro Systematic	⚫	🟢	🟢 🟢	Strong
Global Macro EM focus	⚫/🔴	🟢	🟢 🟢	Medium
CTAs	🔴	🟢	🔴	Low

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Important Information

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