

# US and EUR yield curve strategies

## Navigate steepening and flattening yield curves

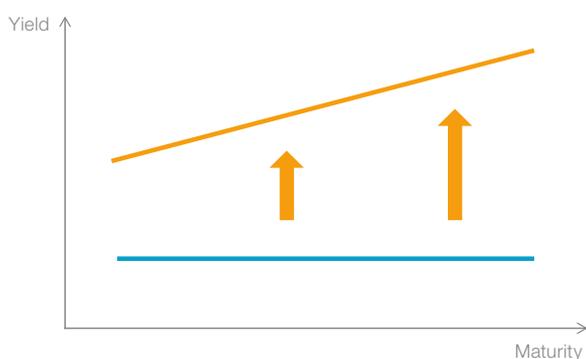
As part of Lyxor’s growing range of innovative problem solvers, our unique US and European yield curve strategies are designed to benefit from changes in the shape of the yield curve. Our ETFs are built to exploit either a steepening or a flattening of the 2-10Y portion of the yield curves.

### Understanding the concept

- ▶ The slope of the yield curve can be influenced by factors such as:
  - ▶ Central banks’ monetary policy
  - ▶ Market expectations on policy action
  - ▶ Inflation expectations
- ▶ Investors can potentially profit from a change in shape of the yield curve
- ▶ The difference in interest rates between short and long-term government bonds is known as the **yield differential**
- ▶ A curve *steepening* strategy benefits from an *increase* in the yield differential
- ▶ A curve *flattening* strategy on the other hand benefits from a *decrease* in the yield differential
- ▶ Performance is thus tied to changes in the yield differential between two rates, and not an overall shift of the yield curve

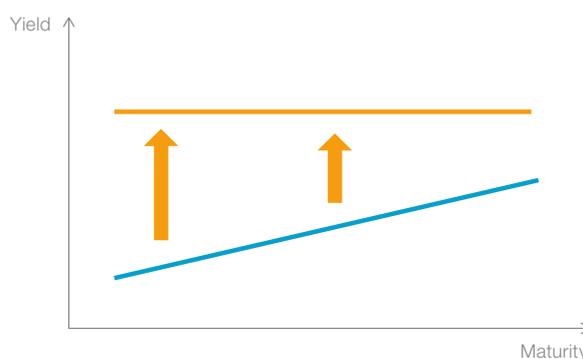
### Steepening

- ▶ The spread between short term and long term rates increases, or widens



### Flattening

- ▶ The spread between short term and long term rates decreases, or narrows



| Yield curve strategy | Action                      | Low duration leg | High duration leg |
|----------------------|-----------------------------|------------------|-------------------|
| Steepening           | Buy the yield differential  | Long             | Short             |
| Flattening           | Sell the yield differential | Short            | Long              |

Source: Lyxor International Asset Management. For illustrative purposes only. This is not a recommendation.

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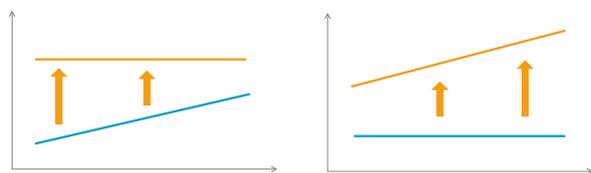
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### Making the theory investable

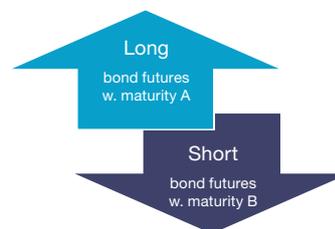
#### Yield curve strategies

- ▶ Theoretical measure
- ▶ Non-investable, yield based
- ▶ Driven by the variation in yields between bonds of differing maturities



#### Lyxor yield curve ETFs

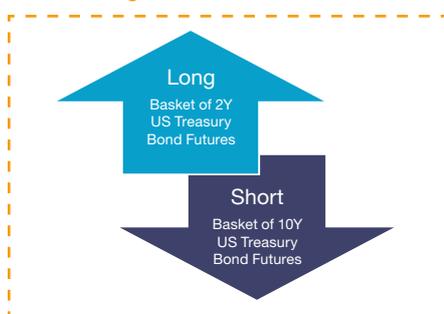
- ▶ An investable proxy
- ▶ Based on a systematic long/short strategy
- ▶ Driven by the performance of a long leg of government bond futures with maturity A, and a short leg of government bond futures with maturity B



Source: Lyxor International Asset Management. For illustrative purposes only. This is not a recommendation.

### How the index works – US steepening example

#### Index holdings



=

Exposure to a steepening of the 2-10 year portion of the US Treasury yield curve

#### Index objectives

- ▶ Isolate the 2-10Y movement in the yield curve
- ▶ For a **1bp** steepening of the curve, the index is expected to increase roughly **7bps** (and vice-versa)\*
- ▶ Leverage on each leg adjusted daily using the duration of the futures' CTD\*\* in order to protect against parallel shifts in interest rates

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### Looking under the hood – index details

|                   | US Strategy<br>US Treasury yield curve  | European strategy<br>German government bond yield curve   |
|-------------------|---|---|
| <b>Steepening</b> |   |   |
|                   |   |   |
| Index name        | Solactive USD Daily (x7) Steepener 2-10 Index   | Solactive EUR Daily (x7) Steepener 2-10 Index   |
| Index holdings    | Long basket of 2-year US Treasury Bond futures, short basket of 10-year Treasury Ultra Bond futures   | Long basket of Euro Schatz futures, short basket of Euro Bund futures   |
| Index description | The index is constructed such that for a <b>1bp</b> steepening of the curve, the index is expected to increase roughly <b>7bps</b> , though market factors may cause some deviation.* | The index is constructed such that for a <b>1bp</b> steepening of the curve, the index is expected to increase roughly <b>7bps</b> , though market factors may cause some deviation.* |
| <b>Flattening</b> |   |   |
|                   |   |   |
| Index name        | Solactive USD Daily (x7) Flattener 2-10 Index   | Solactive EUR Daily (x7) Flattener 2-10 Index   |
| Index holdings    | Long basket of 10-year US Treasury Ultra Bond futures, short basket of 2-year US Treasury Bond futures  | Long basket of Euro Bund Futures, short basket of Euro Schatz Futures   |
| Index description | The index is constructed such that for a <b>1bp</b> flattening of the curve, the index is expected to increase roughly <b>7bps</b> , though market factors may cause some deviation.* | The index is constructed such that for a <b>1bp</b> flattening of the curve, the index is expected to increase roughly <b>7bps</b> , though market factors may cause some deviation.* |

\*The multiplier of 7 is an approximation only. Factors such as cash returns (this is a funded strategy), compounding effects from daily leverage, and/or futures roll costs may affect the index performance. Further index details and methodology may be found at [www.solactive.com](http://www.solactive.com)

\*\*Cheapest to Deliver.

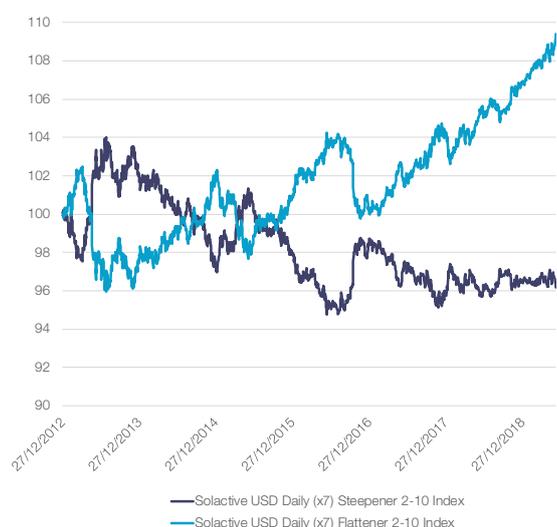
How did the indices perform in H1 2019?<sup>1</sup>

| US curve – flattening/steepening 2-10Y |             |                  |                                |     |                                 |  |  |
|--|-------------|------------------|--------------------------------|-----|---------------------------------|--|--|
|  | Performance |                  | Average weight over the period |     |                                 | Flattening<br>(a)*F <sup>10Y</sup> - (b)*F <sup>2Y</sup><br>+ Csh - TC | Steepening<br>- (a)*F <sup>10Y</sup> + (b)*F <sup>2Y</sup><br>+ Csh - TC |
| 10Y futures basket                     | 5.93%       | F <sup>10Y</sup> | 85%                            | (a) | <b>Estimated performance</b>    | 2.24%  | -0.05%   |
| 2Y futures basket                      | 1.00%       | F <sup>2Y</sup>  | 388%                           | (b) |                                 |  |  |
| Cash                                   | 1.18%       | Csh              |                                |     | <b>Actual index performance</b> | 2.42%  | -0.10%   |
| Transaction costs                      | 0.09%       | TC               |                                |     |                                 |  |  |

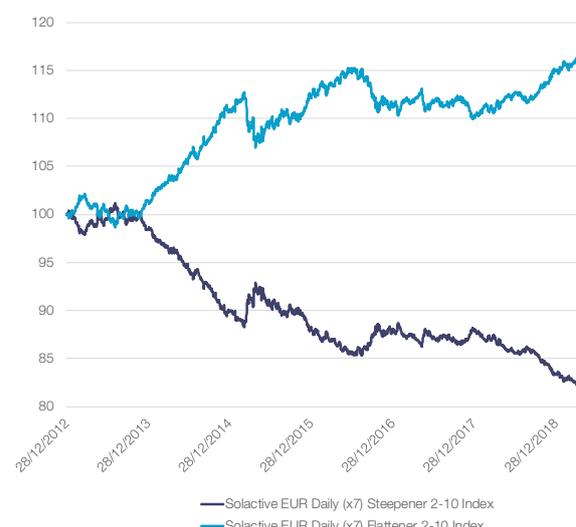
| EUR curve – flattening/steepening 2-10Y |             |                  |                                |     |                                 |  |  |
|---|-------------|------------------|--------------------------------|-----|---------------------------------|--|--|
|   | Performance |                  | Average weight over the period |     |                                 | Flattening<br>(a)*F <sup>10Y</sup> - (b)*F <sup>2Y</sup><br>+ Csh - TC | Steepening<br>- (a)*F <sup>10Y</sup> + (b)*F <sup>2Y</sup><br>+ Csh - TC |
| 10Y futures basket                      | 5.72%       | F <sup>10Y</sup> | 80%                            | (a) | <b>Estimated performance</b>    | 3.12%  | -3.61%   |
| 2Y futures basket                       | 0.33%       | F <sup>2Y</sup>  | 370%                           | (b) |                                 |  |  |
| Cash                                    | -0.18%      | Csh              |                                |     | <b>Actual index performance</b> | 3.12%  | -3.49%   |
| Transaction costs                       | 0.06%       | TC               |                                |     |                                 |  |  |

Long term performance – steepening and flattening indices are near mirror images<sup>2</sup>

US curve indices



European curve indices



ETFs to consider

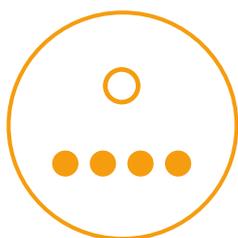
| ETF name                                  | Bloomberg tickers | Trading currencies | Replication type | TER <sup>3</sup> |
|---|-------------------|--------------------|------------------|------------------|
| Lyxor US Curve Steepening 2-10 UCITS ETF  | STPU, UCT2        | USD, EUR           | Synthetic        | 0.30%            |
| Lyxor US Curve Flattening 2-10 UCITS ETF  | FLTU              | USD, EUR           | Synthetic        | 0.30%            |
| Lyxor EUR Curve Steepening 2-10 UCITS ETF | STPE, ESTP        | EUR                | Synthetic        | 0.30%            |
| Lyxor EUR Curve Flattening 2-10 UCITS ETF | FLTE              | EUR                | Synthetic        | 0.30%            |

Important information and risks to be aware of

- ▶ These ETFs are designed for tactical use by professional investors; we do not recommend retail investors invest in these funds
- ▶ Underlying index performance is calculated using daily returns of the long and short legs, resulting in a compounding effect
- ▶ As a result of this compounding effect, we do not recommend these funds as long term “buy and hold” investments

<sup>1</sup>Source: Lyxor International Asset Management, Solactive. Data over period from 01/01/2019 to 28/06/2019. Past performance is not a reliable indicator of future results. <sup>2</sup>Source: Lyxor International Asset Management, Bloomberg. Data over period from 28/12/2012 to 11/07/2019. Past performance is not a reliable indicator of future results. <sup>3</sup>Source: Lyxor International Asset Management. TERs correct as at 02/09/2019.

## Why Lyxor for yield curve strategies?



### Unique

The first and only range of yield curve strategy ETFs in Europe<sup>1</sup>



### Innovative

Simple access to curve steepening or flattening using a long/short strategy



### Far reaching

A complete range covering the US and European yield curves

<sup>1</sup>Source: Lyxor International Asset Management, as at 02/09/2019.

## 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](http://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.

### 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.

### Important information

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### 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.

### Leverage risk

Leveraged products amplify both gains and losses by a given leverage factor. Losses can therefore be substantial.

### Compounding risk

The performance of yield curve strategy ETFs is calculated on a daily basis. This means there is a compounding effect as the daily return will always be based on the previous day's closing price. This slippage can be significant over periods longer than 1 business day, meaning these ETFs are typically unsuitable for investors planning to hold them for longer than one trading session. Any positions in these ETFs should be monitored on an ongoing basis.

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