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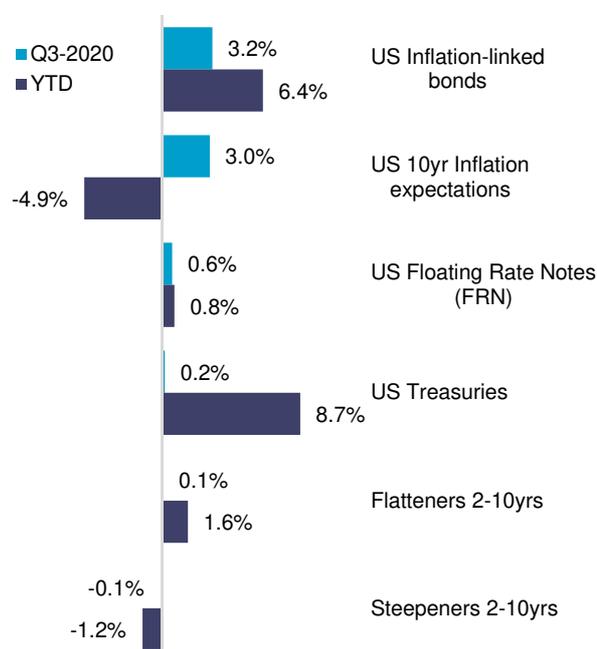
# US Inflation & Rates Explorer: Q3 2020

Lyxor's US Inflation & Rates Explorer monitors the performance of selected US Fixed Income indices. 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 bond performance in Q3:** Inflation expectations got a further boost after the Fed announced it would adopt average inflation targets at the end of the summer. Flows into US inflation-linked ETPs remained strong over the quarter.
- ▶ **Floating Rate Notes (FRN)** had a strong Q2 but a modest Q3. Corporate credit spreads hardly changed after the strong compression seen in Q2, while the USD 3-month Libor rates hit new lows of 0.2%. Flows into US IG corporate bonds were also much lower in Q3 than in Q2.
- ▶ **Curve strategies** suffered from the lack of direction in the 2-10y US yield curve in Q3. US Treasury yields stayed anchored at rock-bottom levels across maturities.

## 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 30/09/2020. Sources: Bloomberg, Lyxor International Asset Management.

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## Summary

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## MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY

## Market &amp; performance overview

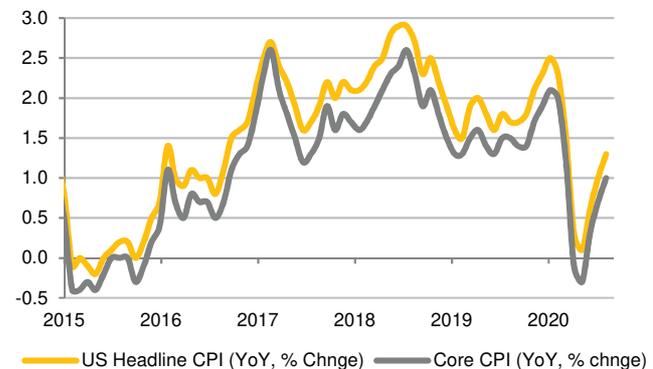
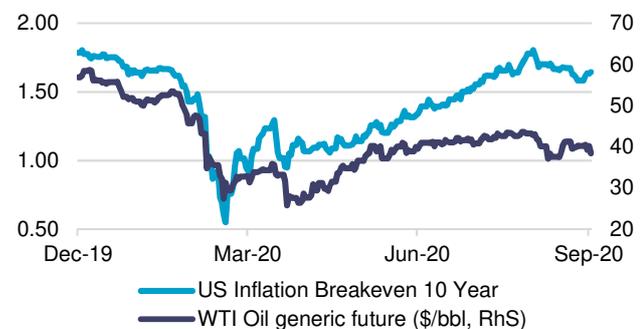
## Fed inflation target changes boosted inflation-linked bonds

US inflation rose further during Q3, supported by higher demand for goods and services as economic activity recovered. In August, a surge in second-hand vehicle costs (+5.4% MoM) accounted for 40% of the gain in core CPI. Apparel and airfares also rose over the period, while college tuition and fees fell the most since 1978 (-0.7% MoM) as many schools transitioned to remote learning. Meanwhile, the oil price stayed in a tight range around \$40/bbl.

The recovery in inflation expectations was supported not only by the stabilisation of oil prices and the economic recovery, but also by the Fed's decision to adopt an average inflation target. In previous cycles, inflation expectations were dampened when inflation was near 2.0% as markets anticipated hikes in the policy rate. The new guidance suggests that inflation could temporarily overshoot its target without triggering an immediate policy reaction. This should give the Fed more flexibility in meeting targets before tightening monetary policy.

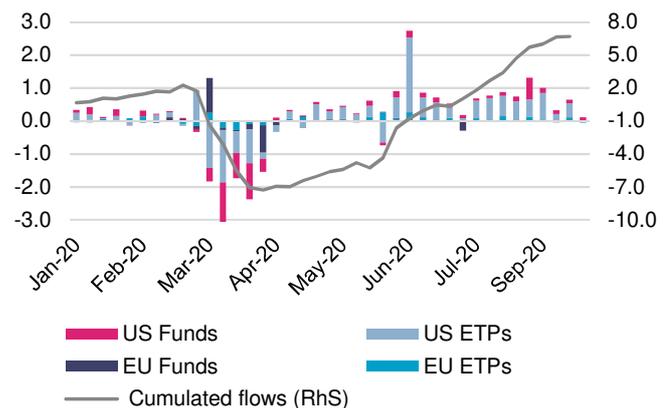
Investors reallocated to US inflation-linked exposures over Q3, especially using ETPs. Inflation-linked ETPs recorded €7.5bn of inflows, while funds lost €0.5bn since the beginning of the year.

Supported by these factors, the performance of inflation-linked bonds and inflation-expectations strategies was strong over the third quarter (see p.5-10 for full performance review).

US Inflation edged up from multi-year lows  
US CPI YoY (Headline & Core)Recovery in inflation breakeven – not just an oil story  
US 10Y inflation breakeven & Oil prices

## ETPs accounted for most of the reallocation into inflation-linked bonds exposure

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



Sources: Bloomberg, Morningstar, Lyxor International Asset Management. Data as at 30/09/2020. Past performance is not a reliable indicator of future returns

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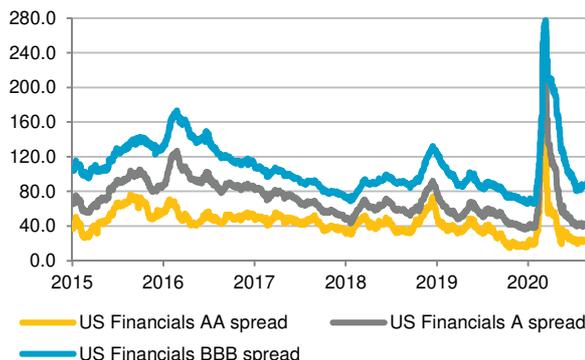
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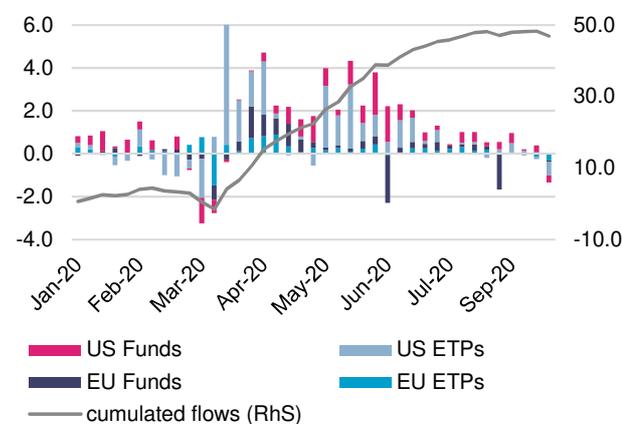
**Modest Q3 for floaters with tight corporate credit spreads**

There was little news flow for corporate credit in Q3, particularly after the Fed’s extraordinary support to the corporate bond market in Q2, which included broad purchases of corporate debt. Corporate bond spreads were little changed after the strong spread compression of Q2. Additionally, USD 3-month Libor rates, on which FRNs’ coupons are based, reached new lows over the quarter with only 0.2% yield at end-September 2020 compared to 2.1% a year earlier. Consequently, floating rate notes recorded only marginal upside over the quarter – see the index’s performance review on p.11.

**Corporate bond spreads remained tight in Q3**  
*US Financial corporate bond spreads (3yrs, bps)*



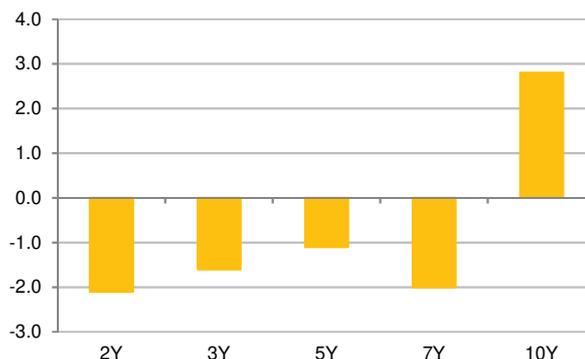
**More modest flows into US IG Corporate credit**  
*US Corporate IG weekly flows (Funds and ETFs in €bn)*



**Limited yield differential for the US curve**

The US 2-10yr yield curve lacked direction during Q3, after the strong flattening of the US Treasury curve at the height of the crisis. Since then, US Treasury yields remained well anchored across maturities. In this context, the performance of curve strategies focusing on 2-10yr US Treasuries was flat in Q3 2020 (see p.13 for more).

**Limited yield differential for 2-10yr Treasuries yields**  
*US Treasuries yield differential Q3 2020*  
*(30/06/2020 vs 30/09/2020, in bp)*



Sources: Bloomberg, Morningstar. Lyxor International Asset Management. Data as at 30/09/2020. Past performance is not a reliable indicator of future returns.

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## Index definition

Index Exposure	Index name	Bloomberg ticker
<b>US Inflation-Linked bonds</b>	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
<b>US 10-Year Inflation Expectations</b>	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
<b>US Treasuries</b>	Bloomberg Barclays US Treasury TR Index The Index measures US dollar-denominated, fixed rate, nominal debt issued by the US Treasury	LUATTRUU Index
<b>US Floating Rate Notes</b>	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
<b>US Flattener 2-10 years</b>	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.	SODU7FTT Index
<b>US Steepener 2-10 years</b>	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.	SODU7STT Index

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

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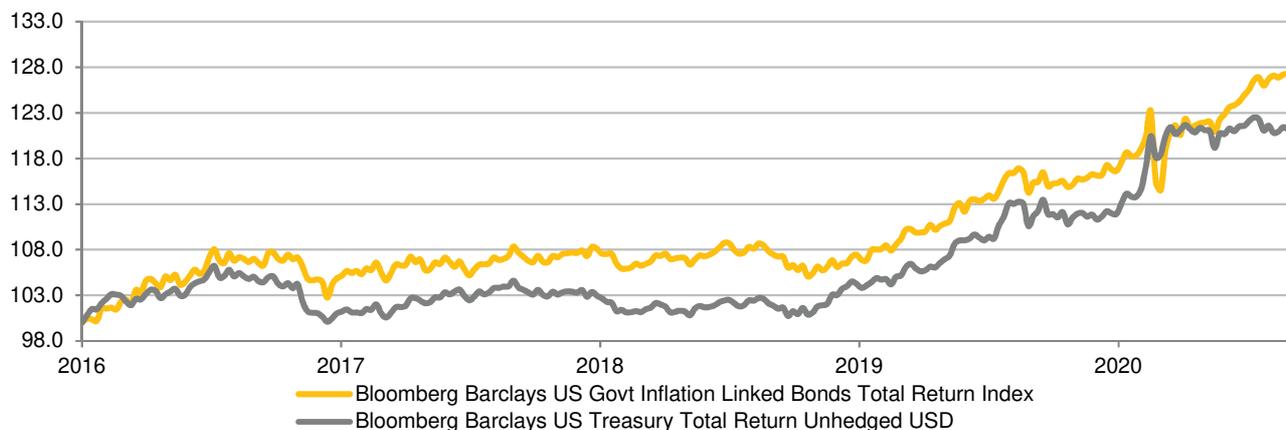
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## Inflation-linked bonds

## Bloomberg Barclays US Government Inflation-Linked Bond Index

## Index performance



Base 100 = 01/06/2016

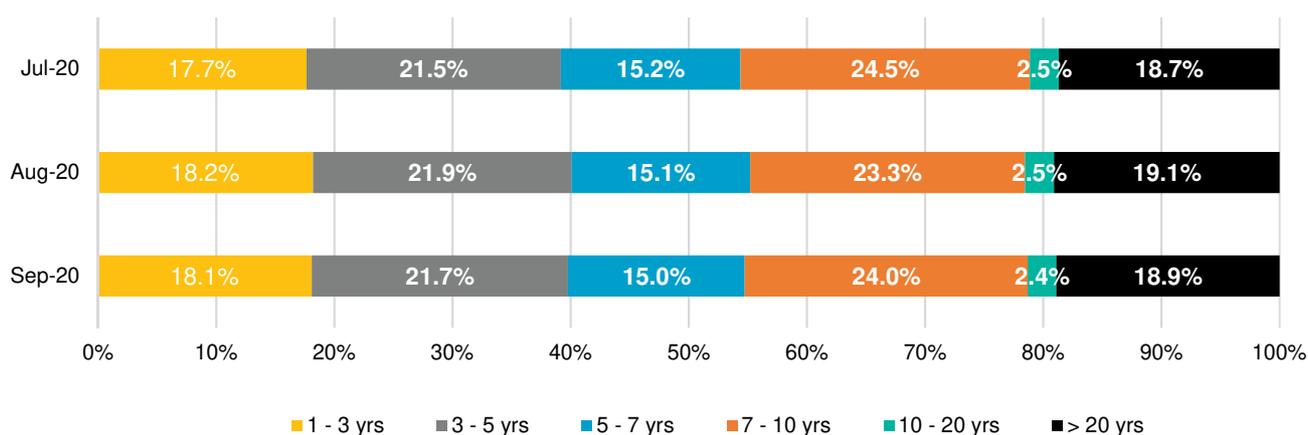
Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/06/2020.

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	-	3.18%	4.36%	1.93%	6.37%	8.75%
Bloomberg Barclays US Treasury total return index	-	0.17%	0.48%	8.20%	8.71%	6.86%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020. Performance is stated in USD and in gross total return. 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 30/09/2020.

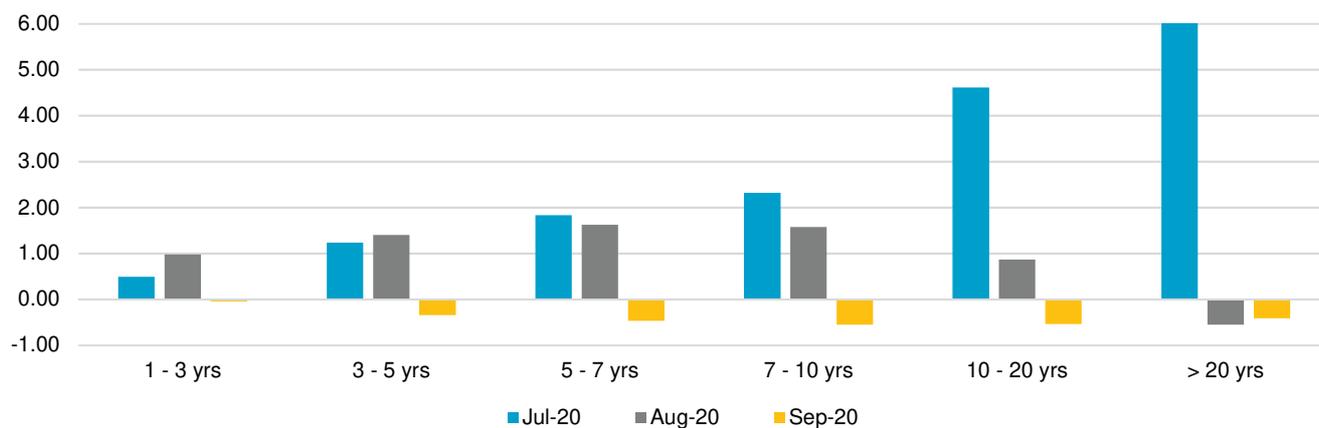
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## Index return by maturity buckets (in %)



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.  
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Date	Total	Total return (%)					
		1-3 yrs	3-5 yrs	5-7 yrs	7-10 yrs	10-20 yrs	>20 yrs
31/07/2020	100%	3.4%	10.3%	10.8%	22.0%	4.4%	49.1%
31/08/2020	100%	17.6%	30.3%	24.2%	36.2%	2.1%	-10.5%
30/09/2020	100%	2.2%	20.0%	18.5%	35.0%	3.5%	20.9%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.  
Past performance is not a reliable indicator of future returns

## Index turnover

Date	In	Out
31/07/2020	-	TII 0 % 07/15/21
31/08/2020	-	-
30/09/2020	-	-

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.

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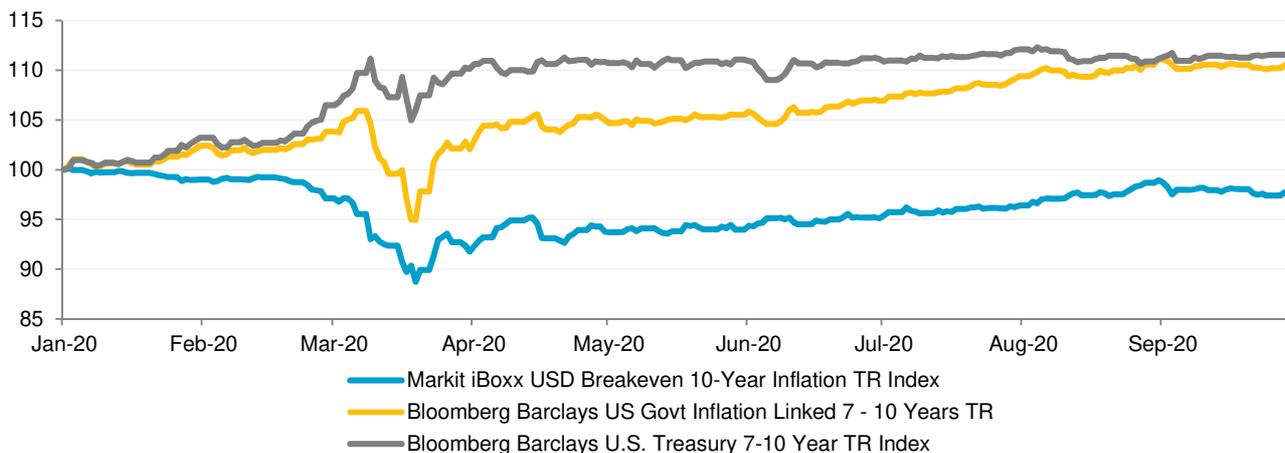
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## 10 Year Inflation Expectations

### Markit iBoxx USD Breakeven 10-Year Inflation index

#### Index performance



Base 100 = 01/06/2016

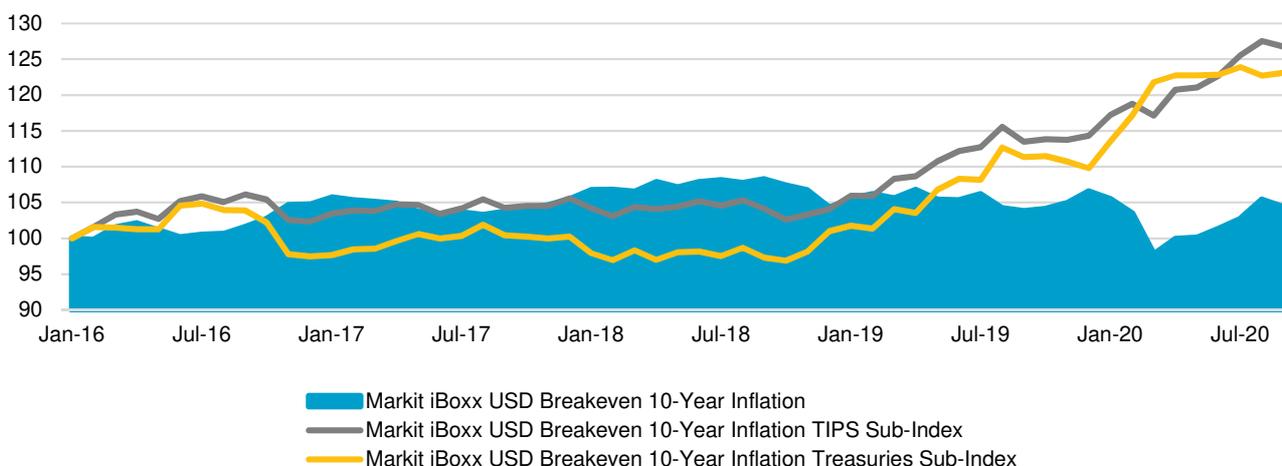
Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020.

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	-	3.01%	3.63%	-8.22%	-4.89%	2.15%
Bloomberg Barclays US Government Inflation-Linked 7 to 10Y Bond Index	-	3.36%	4.79%	2.04%	10.53%	9.43%
Bloomberg Barclays US Treasury 7-10 Year Total Return Index	-	0.28%	0.89%	10.15%	11.44%	8.49%

Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020. Performance is stated in USD and in gross total return. Past performance is not a reliable indicator of future returns

#### Index performance breakdown by component



Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020.

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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.

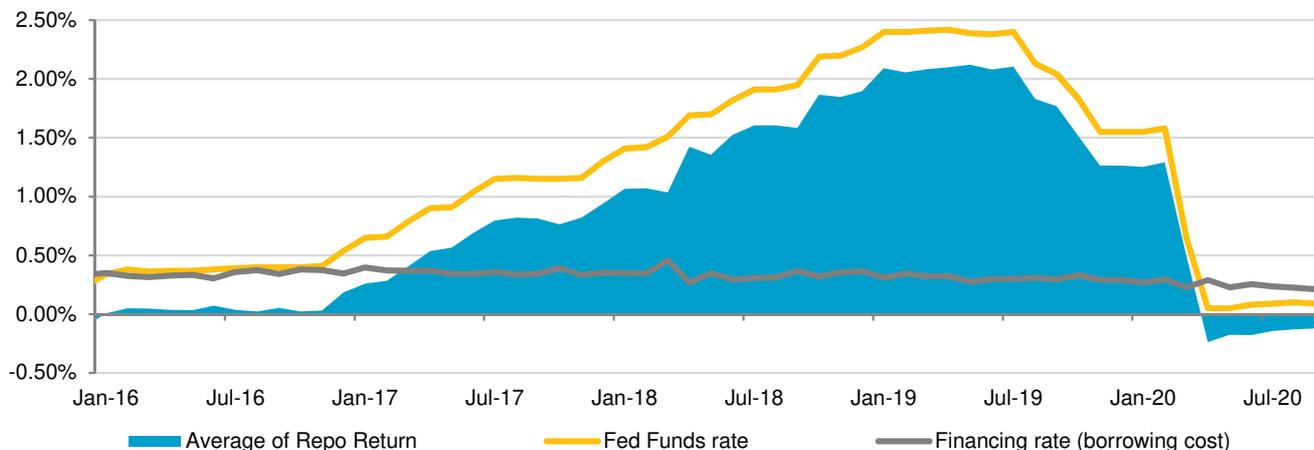
	2020 Q3	2020 Q2	2020 Q1	2019 Q4	2019 Q3	2019	2018
<b>Index return</b>	<b>3.01%</b>	<b>3.63%</b>	<b>-8.22%</b>	<b>2.65%</b>	<b>-1.43%</b>	<b>2.15%</b>	<b>-1.08%</b>
TIPS basket performance (Long)	3.32%	4.73%	2.48%	0.74%	1.16%	9.85%	-1.46%
US Treasuries basket performance (Short)	0.19%	0.85%	10.98%	-1.41%	2.79%	8.65%	0.77%
Average Scaling Factor (SF)	106.95%	110.91%	107.19%	108.78%	109.37%	109.96%	108.49%
Average Repo return (*) (R)	-0.03%	-0.05%	0.25%	0.34%	0.47%	1.85%	1.49%
Total Rebalancing costs (RC)	-0.04%	-0.00%	-0.04%	0.00%	-0.04%	-0.09%	-0.18%
<b>Estimated net performance</b>							
Long US TIPS – SF * (Short US Treasuries – R) – RC	3.04%	3.73%	-9.06%	2.64%	-1.41%	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 30/09/2020.

Past performance is not a reliable indicator of future returns

**Average repo return**

Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020.

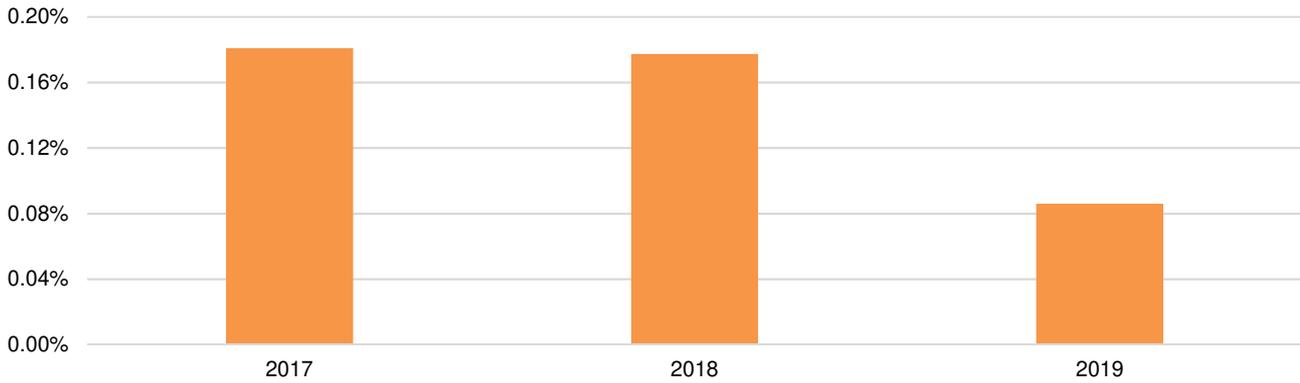
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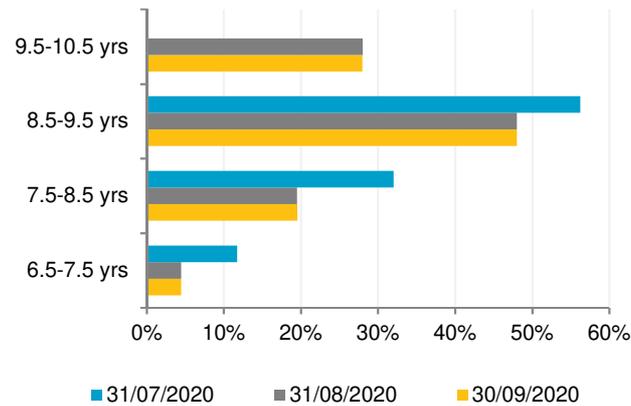
**Historical rebalancing costs**



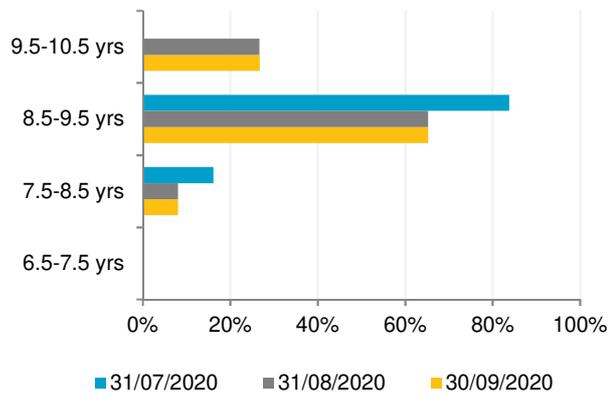
Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020.  
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**Maturity breakdown**

*TIPS basket*

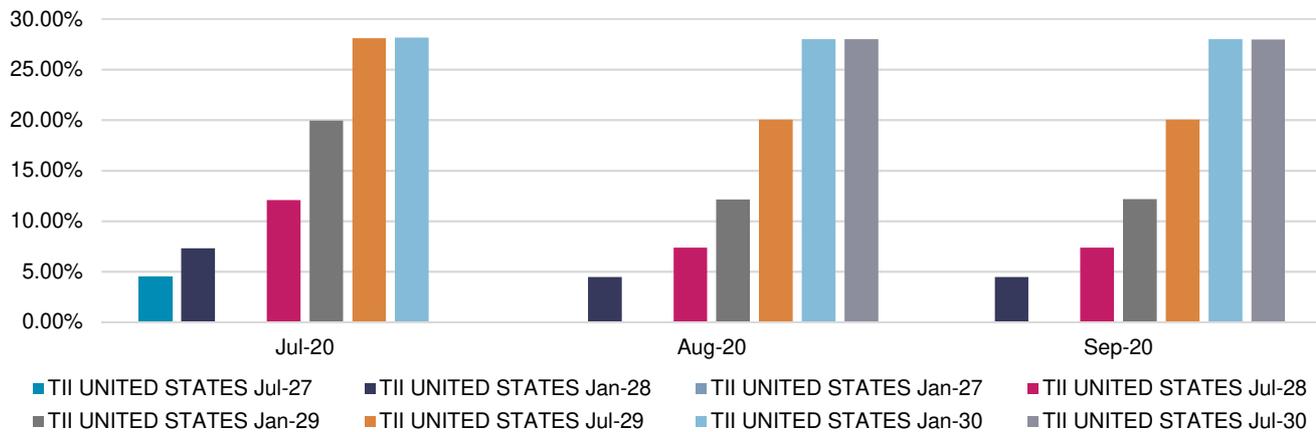


*Treasuries basket*



Sources: Lyxor International Asset Management, Markit. Data as at 30/09/2020.  
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**Index turnover**



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.  
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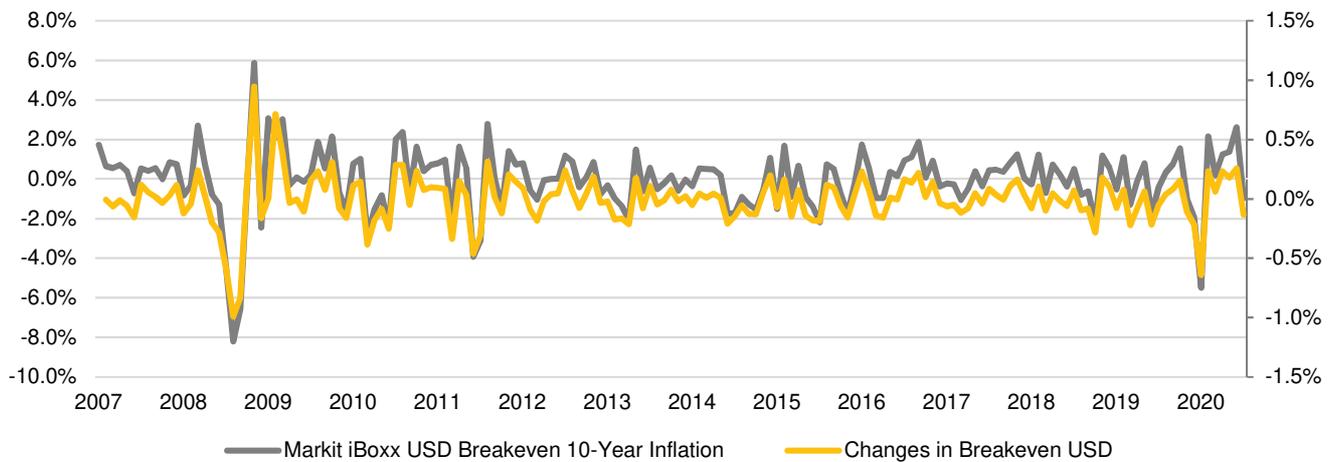
**MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY****How does the index behave vs. the theoretical US breakeven inflation rate?**

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 30/09/2020.

Past performance is not a reliable indicator of future returns.

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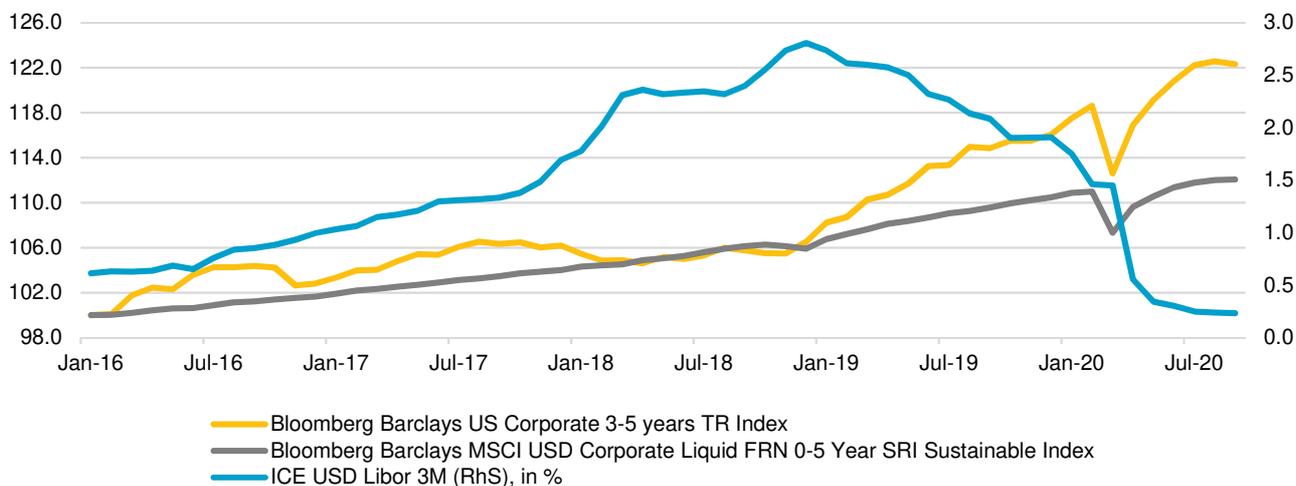
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## Floating Rate Notes

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

## Index performance



Base 100 = 01/06/2016

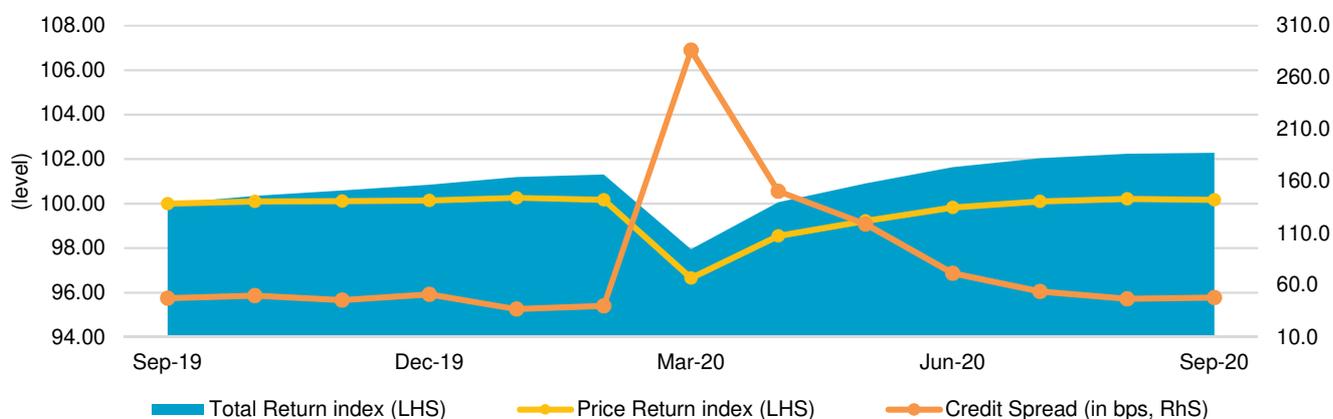
Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.

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	-	0.64%	3.76%	-2.87%	0.79%	4.33%
Bloomberg Barclays US Corporate FRN 2-7 Year Total Return Index Unhedged USD Index	-	0.89%	6.95%	-6.83%	1.25%	5.74%
Bloomberg Barclays US Treasury 3-5 Year Total Return Index	-	0.18%	7.29%	-2.97%	6.23%	8.93%

Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020. Performance is stated in USD and in gross total return. Past performance is not a reliable indicator of future returns

## Index return breakdown



Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020.

Past performance is not a reliable indicator of future returns

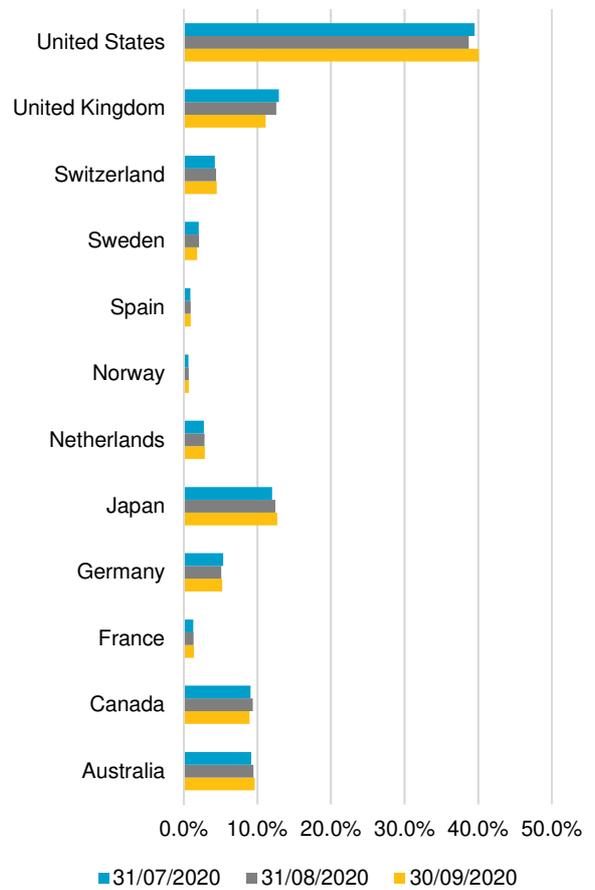
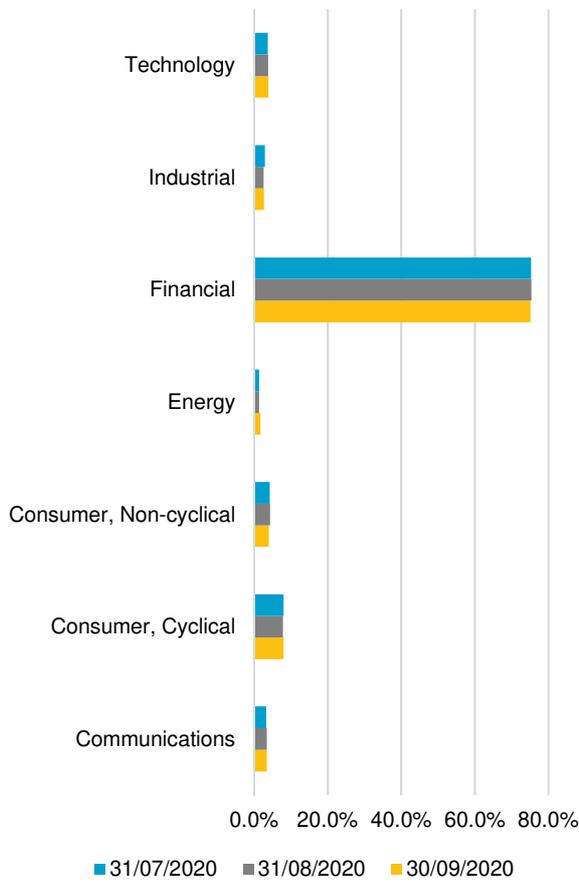
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Index composition analysis

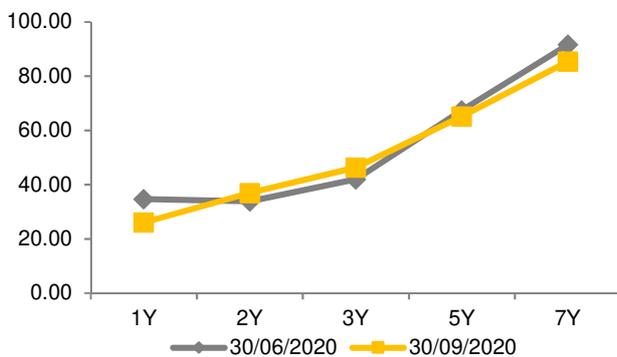
Sector & country breakdown



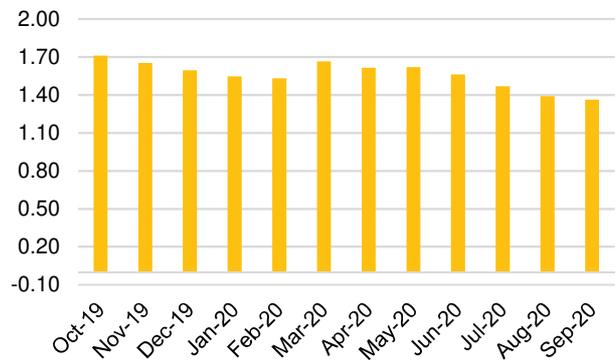
Sources: Lyxor International Asset Management, Bloomberg Barclays. Data as at 30/09/2020. Past performance is not a reliable indicator of future returns

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 30/09/2020. Past performance is not a reliable indicator of future returns

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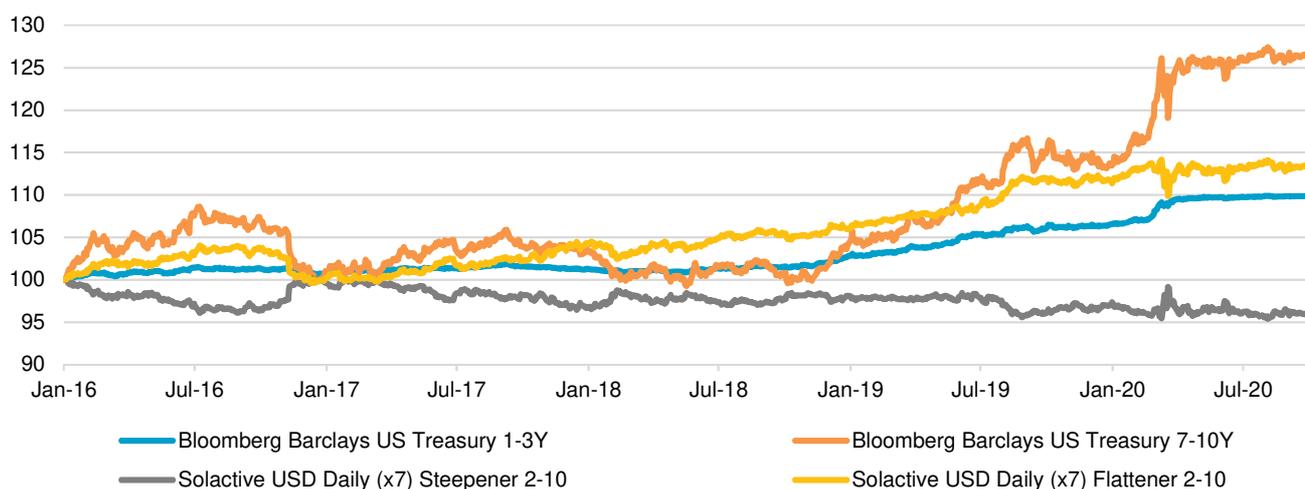
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## Curve strategies

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 30/09/2020.

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	-	0.07%	0.36%	1.27%	1.64%	5.00%
Solactive USD Daily (x7) Steepener 2-10 Index	-	-0.08%	-0.41%	-0.81%	-1.22%	-0.72%

Sources: Lyxor International Asset Management, Solactive. Data as at 30/09/2020. Performance is stated in USD and in gross total return. Past performance is not a reliable indicator of future returns.

## Index performance analysis

	Performance	Average weight over the period
10Y Future basket	0.22% <b>F<sup>10Y</sup></b>	77.20% <b>(a)</b>
2Y Future basket	0.02% <b>F<sup>2Y</sup></b>	368.17% <b>(b)</b>
Cash	0.02% <b>Csh</b>	
Transaction costs	0.04% <b>TC</b>	

	Flattening (a)*F <sup>10Y</sup> - (b)*F <sup>2Y</sup> + Csh - TC	Steepening - (a)*F <sup>10Y</sup> + (b)*F <sup>2Y</sup> + Csh - TC
Estimated performance	0.06%	-0.09%
Actual index performance	0.07%	-0.08%

Sources: Lyxor International Asset Management, Solactive, Bloomberg. Data as at 30/09/2020.

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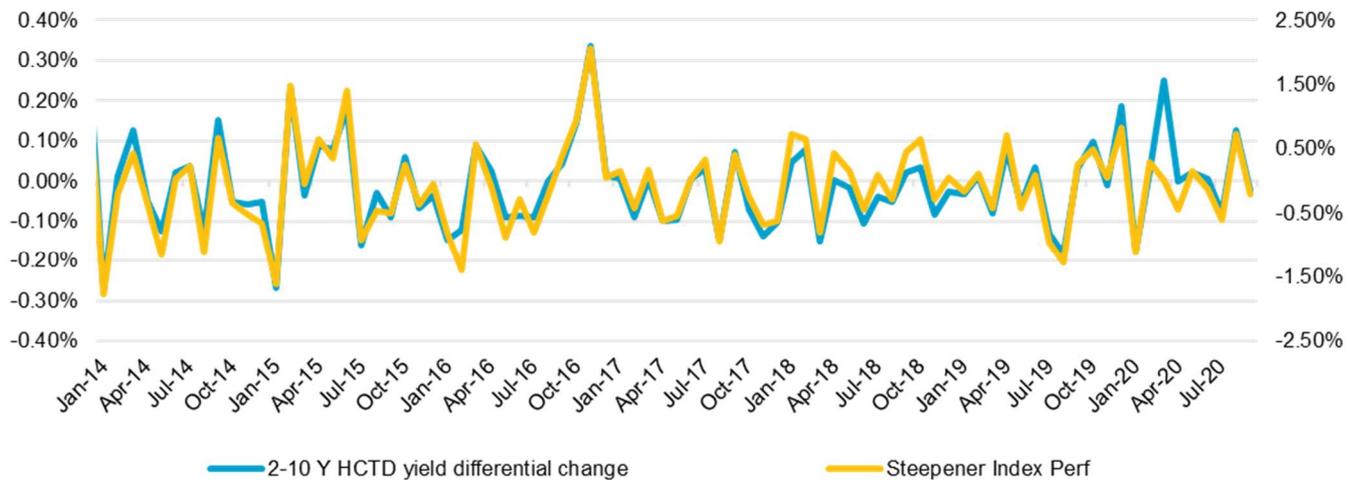
**MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY****How does the index behave vs. the 2-10yr differential in US Treasury yields?**

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 30/09/2020.

Past performance is not a reliable indicator of future returns

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**MARKETING DOCUMENT - FOR PROFESSIONAL AND QUALIFIED INVESTORS ONLY****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.

**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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