

# LYNX PROGRAM 2022 MIDYEAR REVIEW





# Summary

The Lynx Program ended the first half of 2022 up 34.93% net of fees<sup>1</sup>, the strongest start to a calendar year since the inception of the program in May 2000. While gains were generated in every asset class traded in the portfolio, fixed income and commodities were particularly profitable. Trend-following and diversifying models generated positive results across timeframes with returns in line with their respective allocations. The positive result brings annualized net performance since inception to 10.39%<sup>1</sup> with an annualized standard deviation of 14.73%.

Entering the year, escalating geopolitical tensions in Eastern Europe and rising global inflationary pressures – along with the corresponding changes in monetary and fiscal policy expectations – were the primary macro factors influencing markets. The Russian invasion of Ukraine in late February and stubbornly high inflation readings continued to have the most significant impact on financial and commodity markets as the months progressed, although concerns regarding global growth began to emerge late in the period. Rising COVID-19 cases in China, speculation that Russia could cut off energy supplies to Europe and somewhat softer economic data in the US generated concern that developed market economies could be heading toward recession. Significant moves across asset classes in response to these factors throughout the year created an exceptionally attractive trading environment for Lynx.

Midyear result<sup>1</sup>

**34.9%**

Lynx Program  
total assets

**8.9 bn**  
USD

Annualized performance  
since inception<sup>1</sup>

**10.4%**

Annualized standard  
deviation

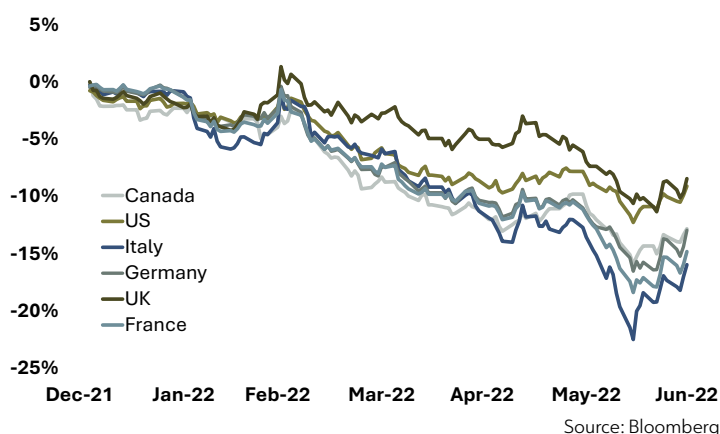
**14.7%**

<sup>1</sup> The net performance figures include interest, costs and fees and reflect the standard leverage Lynx Program with a 1% management fee and a 18% (20% up until 1 July 2018) performance fee for a USD investment. For the period 1 May 2000 up until 31 March 2004 pro forma numbers have been calculated based on a SEK investment and thereafter an equivalent investment in USD.

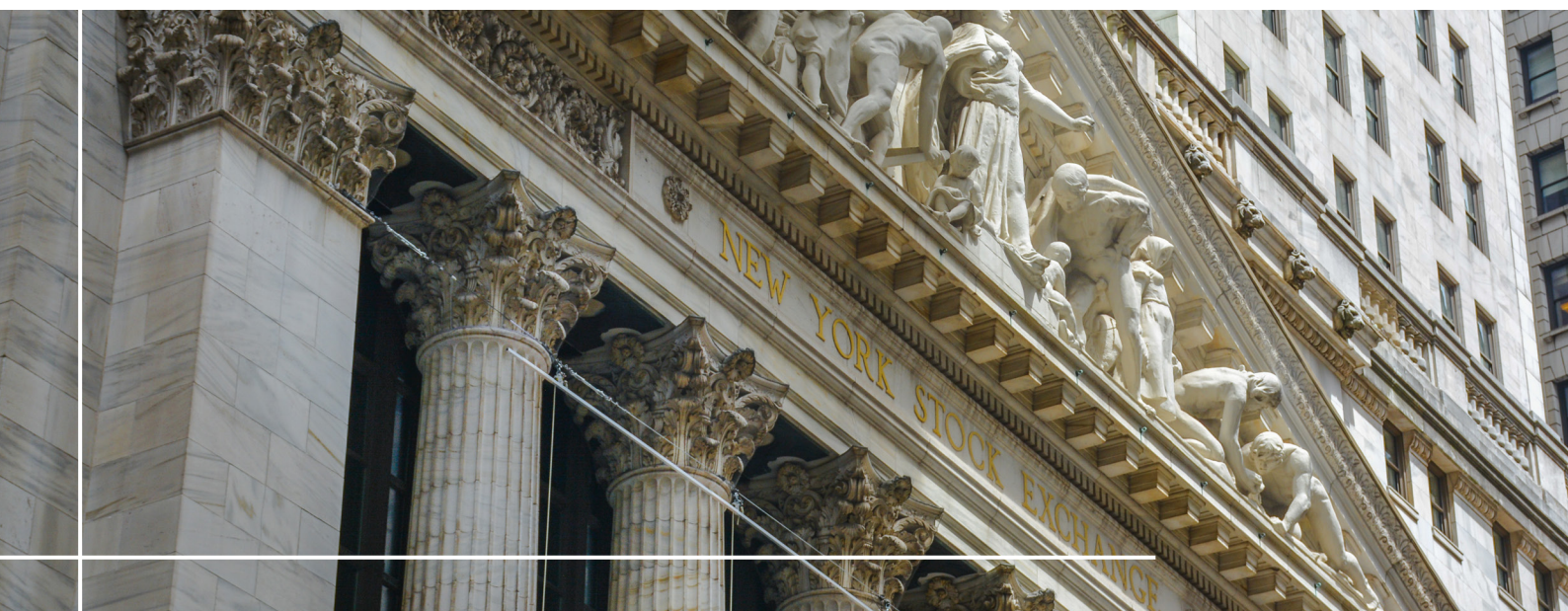
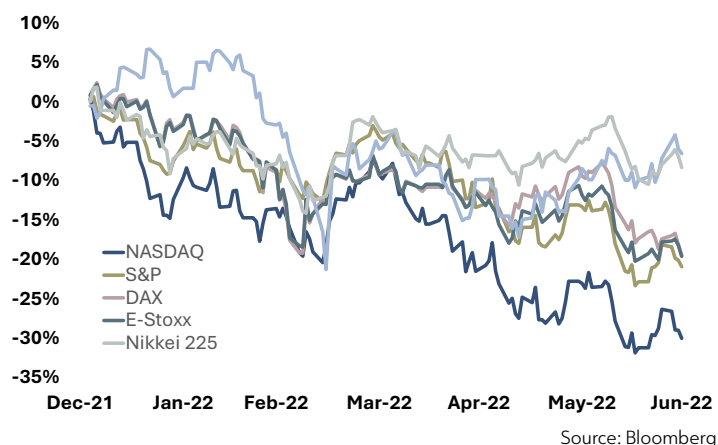
# Market Developments

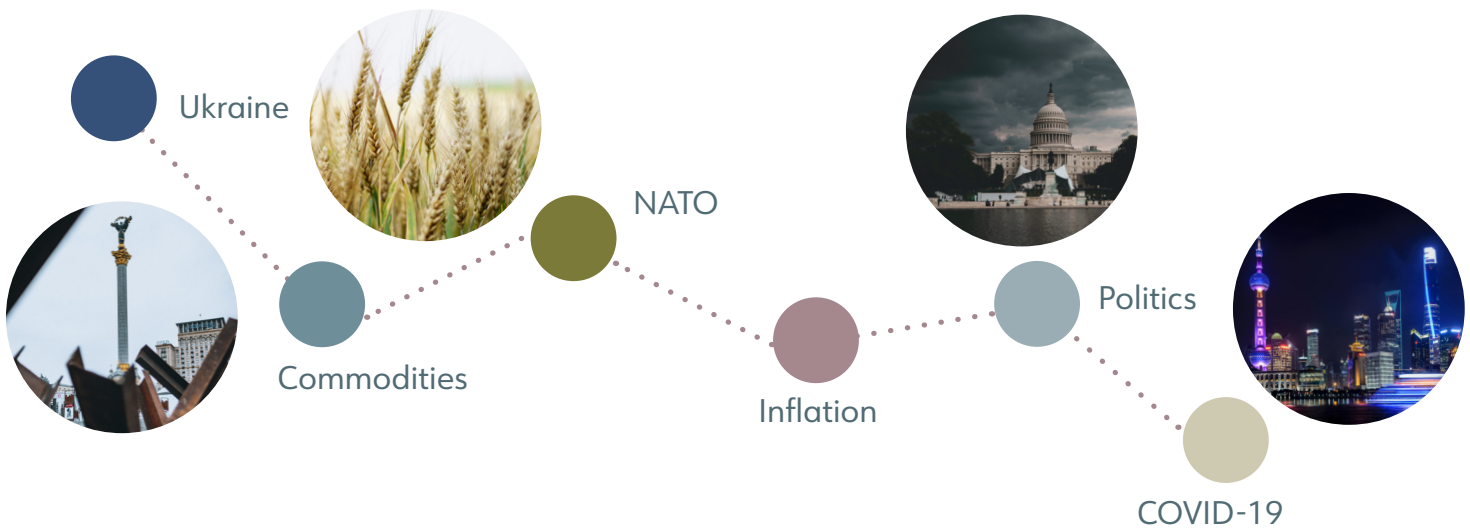
Rising inflation, tighter monetary policy, geopolitical conflict in Europe and an ongoing COVID-19 pandemic all contributed to a brutal six-month period for traditional financial markets. European equities had their worst start to a year since the onset of the global financial crisis in 2008, while US stocks had not experienced such a challenging first half in over 50 years. Concurrently, government and investment grade corporate bonds in those regions suffered their worst historical losses in modern times; while record books tracking prices have relatively short histories, Deutsche Bank estimated that a similar decline had not been realized since 1788. Markets in Asia fared significantly better, although it was a challenging period across the globe.

**North American and European 10-Year Government Bond Performance**



**Global Stock Index Performance**





## Ukraine

After amassing troops on the border of Ukraine beginning in November 2021, Russia invaded their neighbor on February 24, 2022, with President Vladimir Putin announcing a "special military operation" to "demilitarize and denazify" the sovereign nation. While Western intelligence sounded alarms prior to the invasion, the move nevertheless shocked much of world and sparked a humanitarian crisis with wide-ranging implications. Over 8 million Ukrainians fled the country, the largest refugee migration since World War II, and millions more were displaced from their homes. Images of the devastation taken by satellites, media and personal smartphones and impassioned pleas from Ukrainian president Vladimir Zelensky seeking military and diplomatic aid captured the attention of the globe and prompted world leaders to act.

The EU, US and other allies responded immediately with sanctions meant to hold Moscow accountable for the military action and limit their ability to fund an ongoing operation. Key Russian banks were denied access to SWIFT, blocking their capacity to execute financial transactions and payments with other

banks around the globe, while the central bank was effectively denied access to a vast majority of their international reserves. The Russian ruble collapsed in response and multinational corporations, recognizing the challenges of operating within the country, began divesting local assets or ceasing operations altogether. Notably, the ruble later recovered – ultimately trading at a seven-year high against the US dollar – as capital controls prevented the currency from leaving the country and higher energy prices provided a ballast to the economy.

## Commodities

As Russia was a major supplier of oil and natural gas to Europe, there were limits to what the EU was prepared – or even capable – to do. In 2021, approximately half of all Russian crude oil and three quarters of natural gas exports were directed to OECD Europe accounting for approximately 25% of those nations' oil consumption and 40% of their natural gas supply. Initially, EU sanctions against Russia excluded energies, but increasing international pressure eventually resulted in the announcement of a partial ban on oil in early June and plans to restrict all seaborne crude imports by the end of the year.





No such restrictions were placed on Russian gas. Unlike crude oil which can be shipped across vast distances by tanker, truck or rail, natural gas in its gaseous form can only be transported by pipeline from one storage facility to another, or directly to the consumer. By the end of June, speculation was high that Russian energy giant Gazprom would close off pipelines to all Western Europe after previously cutting the flow to Bulgaria and Poland in April and others in the following months for their failure to pay in rubles. Natural gas can be liquified for easier transport, although the process is costly and there are relatively few facilities globally. An explosion at one of these locations in Texas at the beginning of June placed additional pressure on the EU to find alternative energy sources quickly.

Meanwhile, global food prices climbed to their highest level in over 30 years according to the UN's Food Price Index as grain prices spiked with the escalating crisis. Ukraine grows an estimated 16% of corn and 12% of wheat for global markets and had produced a record crop in 2021, while Russia contributes approximately 17% of wheat traded globally. Historically, a majority of Ukrainian exports have shipped through the country's ports on the Black Sea, al-

though that route was effectively closed due to the conflict. Concerns emerged that food shortages in Africa and the Middle East could continue beyond this year as Ukraine had already lost a considerable amount of arable land to advancing Russian troops. However, improving crop conditions in the US mitigated some of these fears and prices retreated back to levels from the end of March.

Nickel prices were climbing even before the military conflict in Ukraine due to increasing demand for the production of electric vehicle batteries, although prices spiked following the invasion. While Russia only supplies approximately 9% of global production, expectations that sanctions would be imposed on exports resulted in concern that tight conditions would tighten further. Prices eventually eclipsed US \$100,000 per metric ton, a 250% premium to where they were immediately before the conflict, in what was widely believed to be a "short squeeze" catalyzed by a major Chinese mining conglomerate who had over-hedged future production. In an unprecedented move by the London Metal Exchange, not only was trading suspended in the metal, but all trades that had occurred on the day prices doubled were cancelled.

## NATO

One of the main concerns voiced by Vladimir Putin upon launching the “special military operation” in Ukraine was the unchecked expansion of NATO in Eastern Europe – all the way to the border with Russia. Hoping to restore the balance from the Cold War, Putin claimed to be acting in the best interest of national security and to protect ethnic Russians across the region. Interestingly, the invasion altered the relationship with some of their Nordic neighbors who had previously remained out of the alliance, specifically Finland and Sweden. Sharing a 1340 km (830 mi) border with Russia, Finland had maintained friendship treaties with Russia since 1948 precluding them from joining hostile military alliances or allowing passage of attacking foreign forces through the nation. Similarly, Sweden had remained neutral during European conflicts dating back over 200 years.

## Inflation

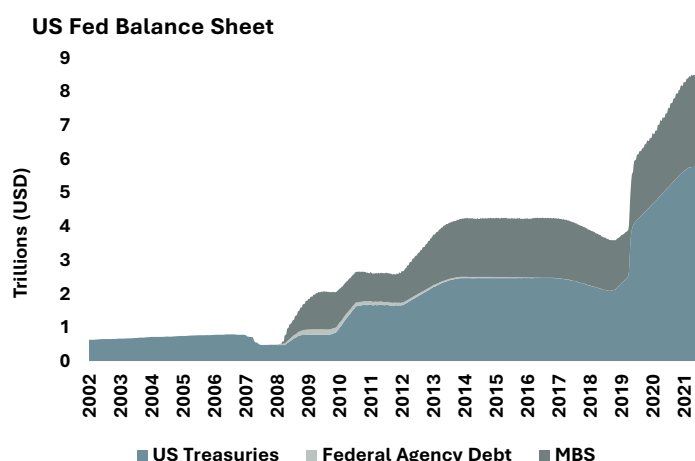
The conflict further exacerbated inflationary pressures which had already been building considerably in 2021. However, it was not the primary cause for inflation reaching the highest level in 40 years across much of the developed world. For the ten years following the global financial crisis, extraordinarily accommodative monetary policy remained in place even as financial conditions improved markedly. While largely espousing inflation-based mandates, many developed market central banks seemed to unofficially shift towards a macroprudential policy framework as financial market stability seemed to take precedence over most other considerations.

Exceptionally low inflation readings for over a decade confounded central bankers who struggled to get numbers anywhere close to their targets. As the tide began to turn, it took time for many of them to



accept that heightened inflation readings were not just some anomaly or residual of COVID-related imbalances and they were slow to apply the brakes. However, price pressures continued to accelerate entering 2022 and policy needed to catch up quickly. In the US, the FOMC hiked rates by 75 basis points in June, the first increase of that magnitude since 1994, and provided guidance that similar increases were likely on the horizon. Removing key language from their statement indicating that the committee no longer expected the “labor market to remain strong” as they battled to reach their 2% inflation target resulted in increasing concern over a hard landing and a potential recession. Additionally, the Fed began reducing their balance sheet in June by allowing up to US \$30 billion in Treasury securities and US \$17.5 billion in agency mortgage-backed securities to mature without reinvesting the proceeds. The expected pace of this quantitative tightening was accelerated in 2021 as inflation began to get out of control and coincided with sharper-than-expected increases in the benchmark lending rate.



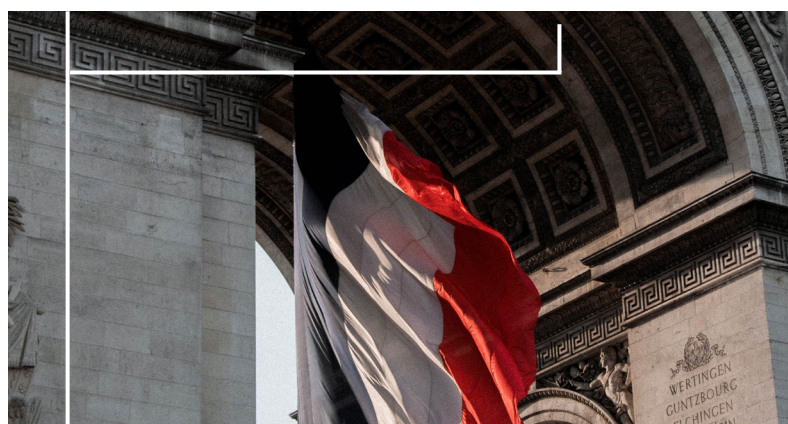


Meanwhile, with Eurozone headline inflation reaching 8.6% year-over-year, the European Central Bank seemed on track for their first rate hike in 11 years in July. Relatively hawkish comments from ECB President Christine Lagarde and another planned policy tightening in September had some speculating that European growth might also fall victim to the bank's desire to get prices under control. The ECB similarly announced a quicker exit from pandemic-era stimulus programs than had been previously indicated due to rising inflation on the continent. While they subsequently decided to use some of the proceeds to support those countries most vulnerable to rising rates "with a view to preserving the functioning of the monetary policy transmission mechanism," the path towards normalization was set.

## Politics

In the US, over a year has passed since Donald Trump left office as President of the United States, but the legacy of his last days in office were central to the ongoing investigation of the January 6th riot at the US Capitol. While many still view the proceedings as purely partisan politics – an attempt to harm the reputation of a man likely to run for office again in two years and that of his party looking to regain control of Congress in midterm elections – testimony from those in the White House at the time painted a damning picture of the events that transpired.

In France, incumbent president Emmanuel Macron was reelected, defeating Marine Le Pen in the runoff, although the result reflected the best showing for a far-right candidate in over sixty years. Across the rest of the globe, the move away from globalization and towards nationalist policies continued on the same trajectory as in recent years. The response from global financial markets to these events was muted, although shifting political agendas could have longer-term implications on a variety of issues from global trade to military alliances.



## COVID-19

While other events garnered more headlines, the COVID-19 pandemic continued to have an influence on global markets. In what has been a controversial and unpopular decision, China adopted a zero COVID policy in an attempt to control the community spread of the virus. Entire cities were locked down – including some of the largest in the nation – as case counts rose. The effect on the Chinese economy has been severe as factories have been temporarily shuttered in impacted regions, domestic demand has collapsed, and export growth has slowed to a level not seen in two years. The potential consequence for the rest of the globe added to recession concerns as June came to a close. Meanwhile, new COVID variants continued to spread outside of China, although most governments embraced a more laissez-faire approach than in prior years. While the pandemic may not be over, much of the world seems ready for it to be.

# Performance attribution

Lynx ended the first six months of 2022 up 34.93% net of fees<sup>1</sup>. While gains were generated in every asset class traded in the portfolio, fixed income and commodities were particularly profitable. Both trend-following and diversifying models contributed strongly to the positive result, commensurate with their relative allocations. Similarly, all timeframes were profitable, also in line with their risk allocation.

Fixed income  
**20.6%<sup>2</sup>**

Increasing inflation, expectations of normalizing monetary policy and the announced termination of asset purchase programs in the US and Europe late

last year all contributed to a sharp increase in interest rate expectations entering 2022. Despite starting the year with a small net long bond position, a solid gain of 20.6%<sup>2</sup> was generated in the asset class after the program quickly built significant short exposure as prices declined. The Russian invasion of Ukraine in February and increasing concerns of an impending recession later in the period mitigated some of the gains, although rates in the US and Europe ended June markedly higher than where they started the year. While gains were generated across the yield curves in Europe and the US, slight losses were realized in Australia and Korea. Both trend and diversifying models were profitable in the asset class, with trend models capturing gains across timeframe. Amongst the diversifying component of the portfolio, short and medium-term models were positive, while long-term models underperformed.

Commodities  
**15.7%<sup>2</sup>**

Energies were responsible for a vast majority of the 15.7%<sup>2</sup> profit in commodities as prices continued their meteoric rise from the end of 2021 on increasing industrial demand and supply disruptions. Strong gains were realized across the crude oil complex as prices reached levels not seen since 2014. A long position in natural gas was also solidly profitable, although some early gains were given back after prices in the US collapsed following an explosion at an LNG facility in Texas. In other commodities, an unprecedented move in LME nickel resulted in a solid gain in base metals as Russian supply concerns contributed to a short squeeze which drove prices up by over 100% in a day before the exchange suspended trading and cancelled trades. Finally, profits in agricultural commodities were due largely to long positions in corn and wheat as prices climbed early in the year on supply disruptions due to the conflict in Ukraine. Trend-following models generated gains in commodities across timeframe, while profits in diversifying models were due to medium and long-term timeframes.



<sup>2</sup> Gross return includes commissions and trading expenses, but excludes management fee, performance fee and interest income. Performance figures that are stated gross of management fees must be accompanied by corresponding performance figures net of management fees. Please see the first footnote.



## Equity indices

3.3%<sup>2</sup>

The program entered the year with a sizeable long position in global equity indices and initially generated a loss in the sector as markets collapsed.

However, models quickly responded to the changing dynamics and the program reversed to a net short position by the third week of January, remaining short the remainder of the period. Ultimately, aggregate profits of 3.3%<sup>2</sup> were generated in Asia, Europe and North America although performance was somewhat mixed within regions. In Asia, trading in the Korean Kospi was responsible for much of the gain as positioning in Japan detracted from the result. In Europe, largest profits were generated in Germany while modest losses accrued in France and Italy. And in North America, trading gains in the US were mitigated by a small decline in Canada. Both the trend-following and diversifying segments of the portfolio were profitable as medium-term trend and long-term diversifying models were primarily responsible for gains in their respective groups; a long-term diversifying model with a structural short beta to equities was the best performing model in the sector.

## Foreign exchange

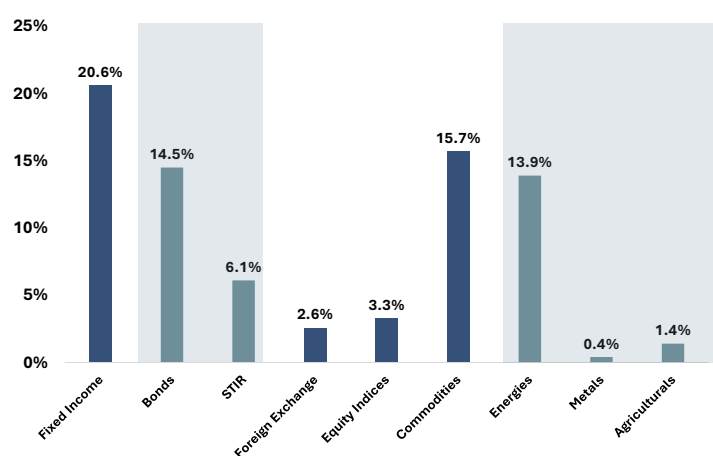
2.6%<sup>2</sup>

Finally, foreign exchange accounted for a gain of 2.6%<sup>2</sup> as profitable trading in developed market currencies offset a loss in emerging market counterparts.

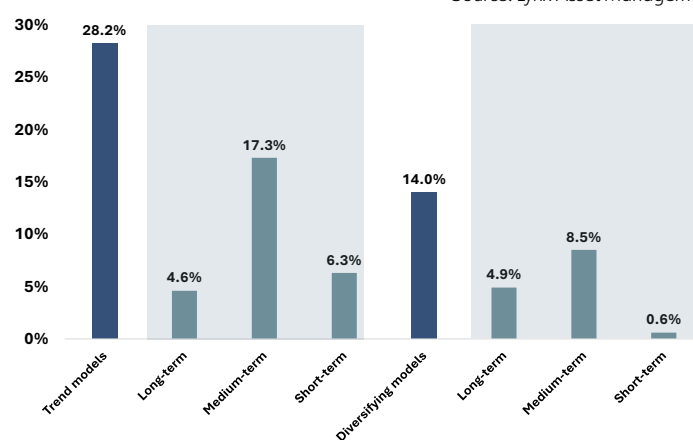
Net US dollar exposure fluctuated broadly over the course of the first six months of the year, ranging from approximately 169% long to 12% short as models attempted to forecast exchange rate moves across the globe. Largest gains were realized in the Japanese yen as the BoJ main-

tained exceptionally easy monetary policy despite rising domestic inflation. A significant profit was also generated in a short euro position as the currency approached parity against the US dollar. Conversely, largest losses accrued in long positions in the South African rand and Chinese renminbi as those currencies depreciated against the greenback. As was the case with the other three asset classes, both the trend-following and diversifying segments of the portfolio contributed positively although, in this case, diversifying models outperformed trend. Small profits were realized across all timeframes in trend, while long-term models were responsible for much of the diversifying gain.

The charts below show a summary of gross returns by asset class and model category, respectively.



Source: Lynx Asset Management



Source: Lynx Asset Management



# Outlook

The macroeconomic and geopolitical pressures that have been responsible for much of the price action in 2022 have not dissipated. Inflation remains elevated, central banks continue on a path towards policy normalization and the conflict in Ukraine does not appear to be resolving in the immediate future. As growth expectations come down due to tighter financial conditions, policy makers will face a difficult challenge when determining monetary and fiscal policy. Price stability is the principal mandate for most developed market central banks. While the relative strength of financial markets may influence their macroeconomic forecasts, it should not impact their policy decisions as some central bankers have reiterated in recent weeks. Recession risks have risen and the likelihood that inflation concurrently remains elevated creates a potentially dangerous cocktail: stagflation, particularly in lower to middle-income countries, could have a devastating effect on the global economy.

The environment has been exceptionally attractive for the Lynx program so far this year, but a continuation of the current regime is not an imperative for positive performance to persist in the second half. The changes in market equilibrium across asset classes have been extraordinary. Whether inflation continues to climb at the current pace or falls back to longer-term targets will necessarily affect how equity and bond prices will behave going forward. Similarly, the conflict in Ukraine (or any other geopolitical crisis that may emerge) will likely impact

investor sentiment, supply chains and other market dynamics which could have a dramatic effect on all markets from foreign exchange to commodities. Stagflation could pose a host of unique challenges for financial assets, as well. However, these events in and of themselves will not define our performance.

As we mention whenever we provide our outlook on the market environment, Lynx is a systematic manager dependent on the forecast accuracy of our models to prosper. Our opinions on macroeconomic factors and geopolitical events have no impact on our trading. Most of our models need markets to trend; a continuation of recent moves or a reversion back to prior levels could both offer attractive opportunities for the program should those moves extend over time. Much has changed in the world and many imbalances remain which will eventually need to be corrected. We hope to be there when they do.

As always, Lynx remains committed to managing your capital responsibly and profitably. We are invested alongside our clients in every program we manage, aligning our interests directly with our investors. We were encouraged by positive performance during the first six months of the year, pleased to have been able to provide our investors with differentiated results and are optimistic that we can continue to capitalize on new opportunities as they emerge.

Lynx Asset Management



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