NATIXIS
GLOBAL ASSET MANAGEMENT

INVESTOR INSIGHTS SERIES

DOUBLE DOWN

Faced with increased volatility, institutions embrace the risk

EXECUTIVE SUMMARY

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Following a year of political volatility that brought Brexit, a Trump presidency, the resignation of the Italian Prime Minster Renzi and the impeachment of both Brazil's Dilma Rousseff and Korea's Park Geun-hye, institutional investors see geopolitical upheaval continuing through 2017 and they are betting it will lead to increased market volatility across the globe.

Beyond politics, institutional investors are feeling the added pressure that a decade of accommodative monetary policy places on their ability to manage long-term liabilities. An anticipated policy shift in the U.S. may help to moderate yield concerns in the long run, but it could double the short-term challenge by putting downward pressure on the value of current bond holdings.

Faced with greater volatility and continued rate pressures, the 500 decision makers included in this, our fifth annual Global Survey of Institutional Investors, appear to be doubling down on their bets by increasing allocations to equities, private equities, and other high-risk assets seeking to generate returns. Institutional investors will have their hands full balancing three critical objectives:

- Managing risk – Navigating higher volatility and low yields is a risk management challenge which is compounded by more stringent solvency requirements, which 71% of respondents say creates too much bias for shorter time horizons and more liquid assets.
- Generating returns – Institutions are not shying from volatility and will look to active management to help capitalize on opportunity. Nearly three-quarters (73%) say today's market favors active managers and 86% say it's the better choice for generating alpha. Alternative investments and private assets also feature prominently in institutional return plans.
- Managing the portfolio – A large number of respondents see the need for outside help in managing more complex portfolio strategies. Four in ten (41%) report turning to outsourced CIOs or fiduciary managers; most frequently they are looking to outside managers for specialized capabilities.

Volatility and uncertainty may be the cards institutions are dealt in 2017, but they are willing to bet on positive investment outcomes. They are coming to the table with a strategy for managing the risks and have clear asset preferences. How well they play their hand will determine their success in meeting their number one goal: delivering higher risk-adjusted returns.

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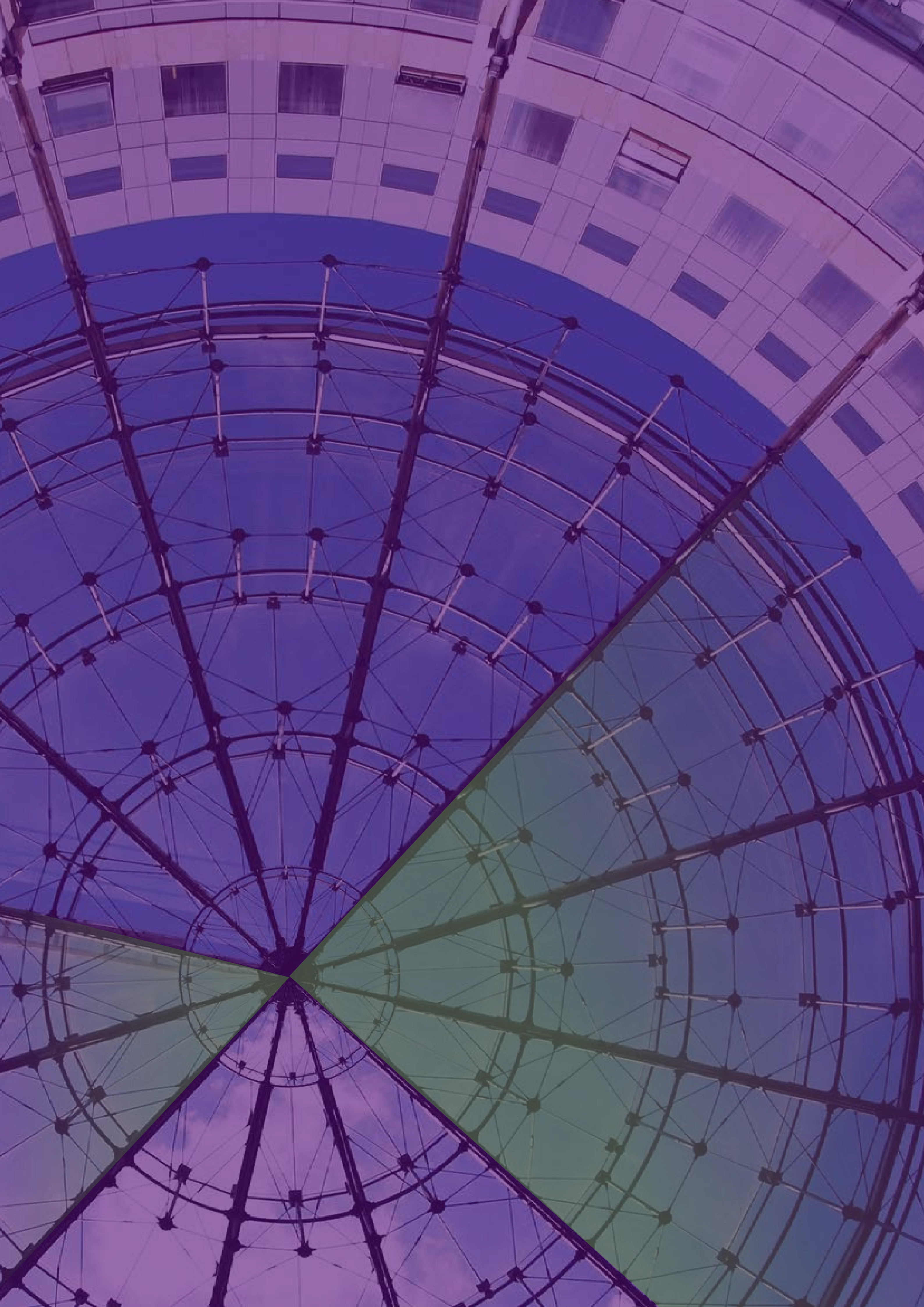


INTRODUCTION

Double Down

Faced with increased volatility, institutions embrace the risk

On January 26, 2016, with the Dow Jones in the throes of the worst New Year's slump in history, if you had been given one-million-to-one odds that, one year later, the Dow would be at 20,000, the U.K. would be navigating its exit from the European Union, and a former reality television personality would be the president of the United States, would you have taken the bet?

These are the table stakes with which institutional investors, often considered the "smart money," are playing as they look to manage assets earmarked for pension payouts, insurance settlements, and funding for endowments over the next 40 years. Faced with prospects for increased market volatility and rising interest rates (at least in the U.S.), institutions are doubling down on risk in pursuit of better returns and much-needed yield.

> "Faced with greater risk, institutional decision makers say they will increase allocations to equities, private equities and other higher risk assets in the year ahead.

TOP ORGANIZATIONAL CHALLENGES

% yes, multiple answers allowed

60% Balancing growth objectives and short-term liquidity needs

46% Gaining a consolidated view of portfolio risk

39% Complying with new regulations

34% Manager selection

27% Ensuring good internal governance

Our 2016 Global Survey of Institutional Investors provides a view into the reality of those responsible for managing assets on behalf of public and private pensions, foundations and endowments, insurance companies and sovereign wealth funds, and finds the smart money anticipating increased volatility as a by-product of a world in tumultuous change. Faced with greater risk, institutional decision makers say they will increase allocations to equities, private equities and other higher risk assets in the year ahead – seeking to better position themselves to meet their three most important objectives: delivering the highest risk-adjusted returns (28%), growing capital (18%) and effectively managing return volatility (17%).

The tables have turned, maybe

While nearly a decade of accommodative monetary policies has helped to buoy market returns for institutional investors, it has also stymied their need to address long-term liabilities. Policies implemented nine years ago to stave off a global credit crisis have kept interest rates artificially low, making it increasingly difficult to find yield. Rates have also had an equalizing effect on equity markets, keeping dispersion[1] low and equally rewarding the companies with middling results alongside the companies that could demonstrate meaningful earnings growth. Topping off the challenge are regulatory and liquidity requirements that have limited the choices for professional investors as they look to make up the difference.

> “Increased risk and volatility are the cards institutional investors have been dealt as they look to generate returns in a low-yield world.

Now, the effects of historic global geopolitical change may be amplified by divergent global monetary policy, and institutions anticipate the likely outcome will be increased market volatility. Facing this new gambit, institutional decision makers must manage three critical factors that could determine their long-term success:

- **Assessing and managing risk:** Volatility may be the biggest risk concern for institutions in the year ahead, and from the aftermath of the U.S. election to a hard Brexit, a softening market in China, and interest rates, they see many potential sources. While they believe it’s within their abilities to handle the risk, many may be second-guessing the strategies they’ll deploy to manage it.
- **Generating returns:** Global populism has not only upset political convention, it’s also sparked volatility in markets around the globe. Reignited market performance in the U.S., coupled with interest rate concerns globally, has institutions returning to active management and delving into private markets for return potential, while upping alternative investment [2] allocations for diversification.
- **Portfolio management:** Given the challenges of today’s market, the mechanics of managing institutional portfolios goes well beyond traditional asset allocation considerations. In-house investment capabilities may not be enough as institutions report an uptick in outsourced management for at least a portion of assets. Adding to the challenge is the need to manage long-term liabilities and sustainability mandates alongside market risk.

Increased risk and volatility are the cards institutional investors have been dealt as they look to generate returns in a low-yield world. Seeking to beat the odds, many are reassessing risk parameters, resetting investment priorities and revisiting strategy. In the end, the risk factors may change, but the goal for institutional investors remains the same: deliver long-term results while navigating short-term market pressures.

1 Dispersion refers to the variability of returns among individual indexes and stocks within each index.

2 Alternative investments involve unique risks that may be different from those associated with traditional investments, including illiquidity and the potential for amplified losses or gains. Investors should fully understand the risks associated with any investment prior to investing.

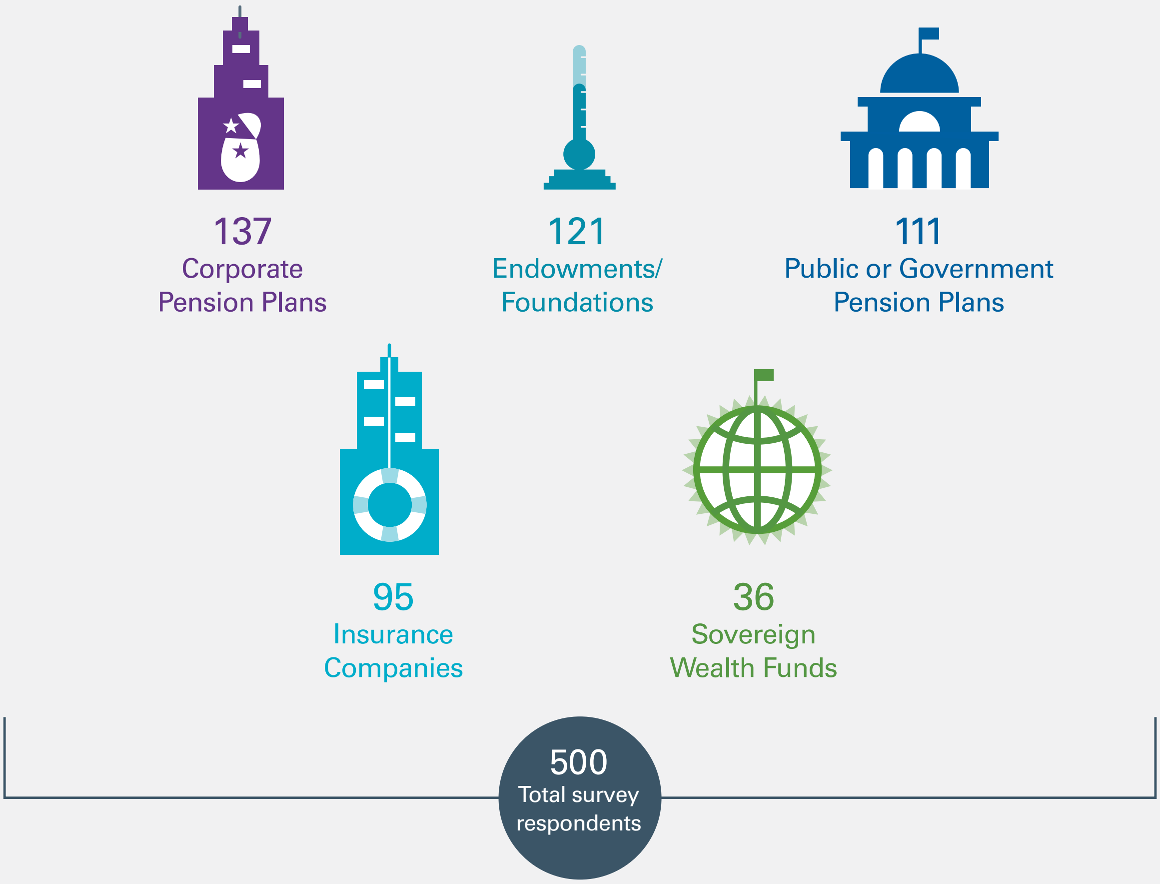
Diversification does not guarantee a profit or protect against a loss.

All investing involves risk, including risk of loss. Analysis does not constitute investment advice and should not be construed as a recommendation for investment action.

2016 Global Survey of Institutional Investors

ABOUT THE SURVEY

Natixis Global Asset Management commissioned CoreData Research to conduct a global study of institutional investors, with the aim of gaining insight as to how they are managing investments and meeting various challenges in today's world.



PROJECT BACKGROUND AND METHODOLOGY

2016 marks the fifth year in which Natixis Global Asset Management has conducted its Global Institutional Investor Survey.

The 2016 Institutional Investor Survey is based on fieldwork conducted in 31 countries in October and November 2016. The survey was delivered through an online quantitative study of approximately 40 questions and was hosted by CoreData Research. The sample consisted of 500 institutional investors.

In addition, this year's study was split into two respective samples of 340 and 160 institutions. The first wave (340) was spoken to prior to the U.S. election on November 8, while the remaining (160) respondents were spoken to following the results of the election to see what impact this would have on their respective investment outlooks and subsequent allocations.

SECTION ONE

Volatility on a hot streak

From the surprise results of Brexit and Trump, to the rejection of constitutional reform in Italy, to rising populism in the Netherlands, France and Germany, volatility continues to be a dominant theme in world politics. Many institutions believe that political volatility has the potential to jump to investment markets in the next 12 months.

“Many institutions believe that political volatility has the potential to jump to investment markets in the next 12 months.

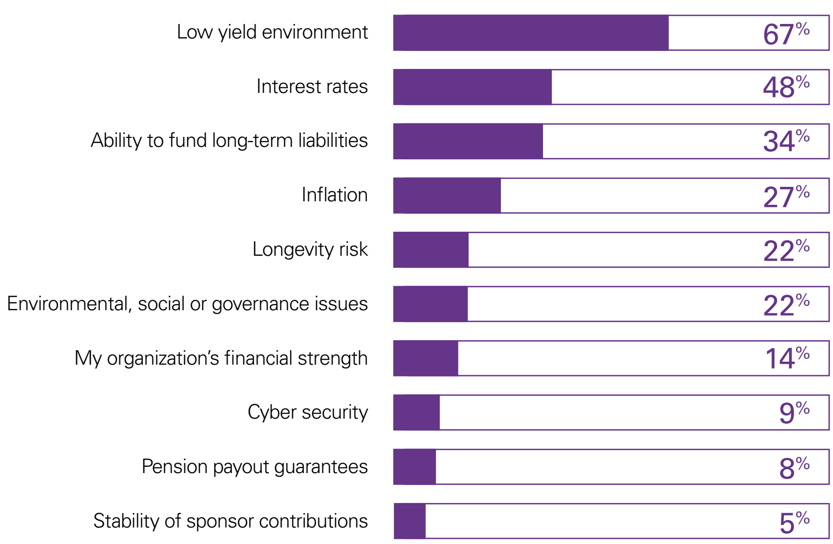
Faced with prospects of increased volatility, six in ten institutional decision makers believe they are prepared to handle the risks in 2017, but given the economic complexities, coupled with ongoing political upheaval, only 2% offer up strong convictions in their ability to succeed in this critical endeavor.

If they have any reservations about their ability to navigate markets, it may come from the change, uncertainty and potential instability looming over the investment landscape. On one hand, new political leadership could result in decreased regulation, which could spur business growth. On the other, it could dramatically alter the trade and security alliances that have been the backbone of global market expansion. Divergent monetary policy may reset interest rate expectations in some regions, but could hamper currency valuations in others. Low yields, which rank as the top organizational concerns among our survey base, are likely to persist even as interest rates, whether stagnant or rising, will continue challenging institutions to fulfill their long-term liabilities.

Buckle up for a bumpy ride

The effects are uncertain and, as a result, market volatility (50%) ranks as the biggest threat to investment performance for institutional investors. Not far behind in their risk concerns are geopolitical events (43%), followed by interest rates (38%). Risk and volatility are inextricably linked in the institutional mindset, and politics dominates their views on which forces will most influence market turbulence.

BIGGEST CHALLENGES IN MANAGING RISK



While 65% cite geopolitical events as the driver of greater volatility, it's notable that fallout from the U.S. election (38%) still weighs as heavily on their minds as interest rates (37%) and even more than the potential impact of a market downturn in China (29%) and issues in the European market (23%). Given the need to generate returns, avoiding risk is not an option for institutional investors. But a majority of respondents (75%) wonder if investors are taking on too much risk in pursuit of yield.

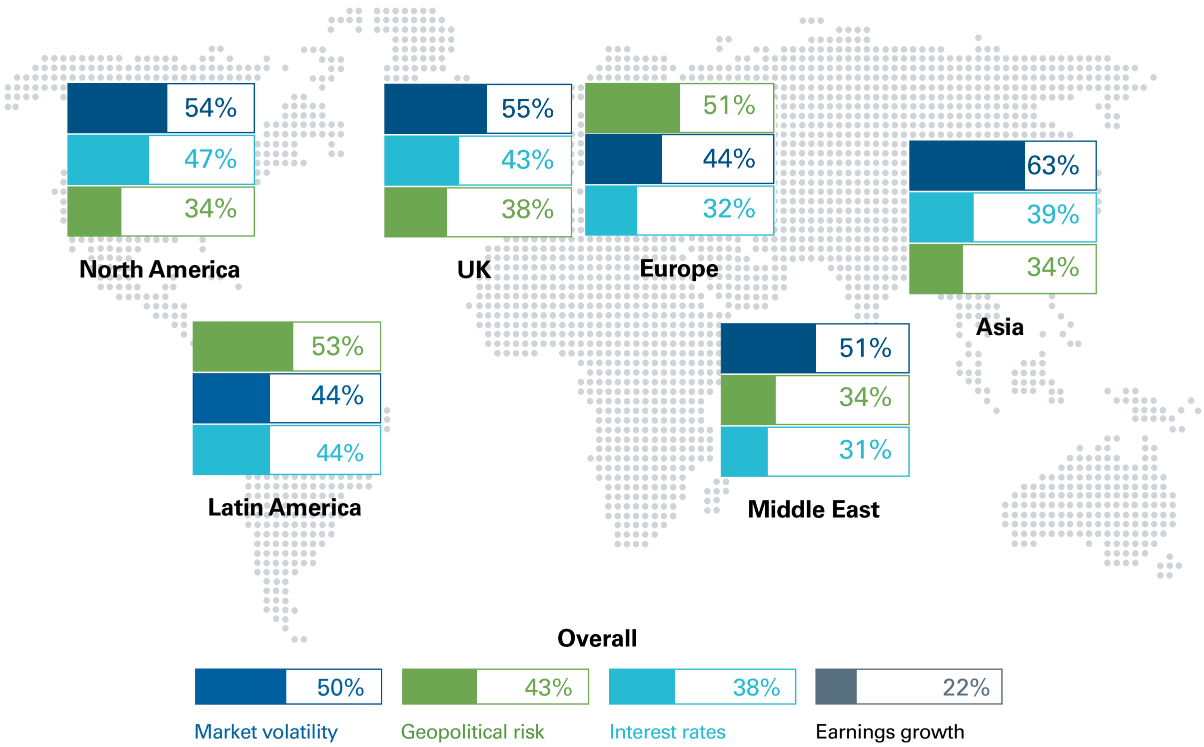
The unintended consequences of reform

Some risks are out in the open; others may lurk in the shadows. One of the stealthier risks institutions must manage is the unintended consequences of regulation and reform. Many institutional decision makers (71%) believe more stringent solvency and liquidity requirements established by regulators around the world have resulted in a greater bias for shorter time horizons and more liquid assets. This can be a significant challenge for investment teams that must prioritize meeting liabilities that stretch out over multiple decades. In the aftermath of a collapse in oil prices, the pressure appears to be greater for sovereign wealth fund managers, eight in ten of whom identify the bias, an increase of 9% over 2015.[3]

> “One of the stealthier risks institutions must manage is the unintended consequences of regulation and reform.

Given the prospects for greater volatility and the persistence of low interest rates, regulatory pressures have the potential to result in sub-optimal decisions, as they limit the ability of money managers to access alternative investments and private markets in pursuit of their investment objectives. Circumstances may call for investments with longer time horizons and lower levels of liquidity to shore up an income stream needed to meet long-term liabilities that is not readily available within traditional markets.

MARKET VOLATILITY SEEN AS THE BIGGEST THREAT TO INVESTMENT PERFORMANCE IN 2017



3 Natixis Global Asset Management, Global Survey of Institutional Investors conducted by CoreData Research, October 2015. Survey included 660 institutional investors in 29 countries.

Growth, liquidity and risk in the balance

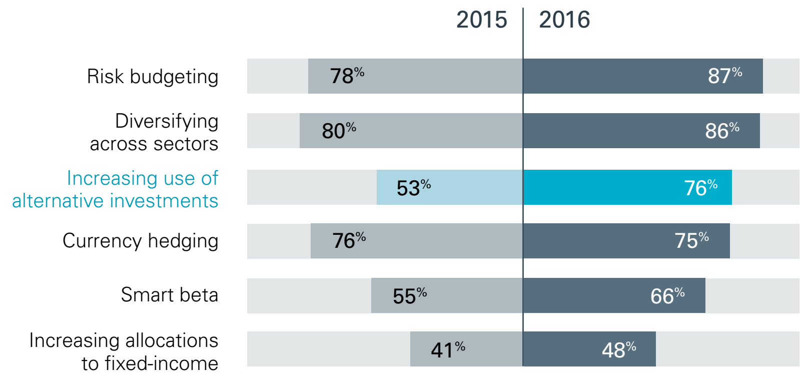
This same challenge is evident in what respondents cite as their top risk management concern: balancing long-term growth objectives with long-term liquidity needs. The risks are many and managing exposures is complicated. Forty-six percent report that one of their biggest challenges is simply getting a consolidated view of risk across the portfolio.

> “As they consider their options, institutions may be second-guessing the efficacy of long-standing portfolio strategies.

In their efforts to manage risks, institutions have a number of strategies at their disposal. But where yields remain low, few say they will rely on the traditional risk management strategy of increasing fixed-income allocations. Instead, they believe the more effective techniques include risk budgeting (87%), diversifying holdings across sectors (86%), currency hedging (75%), and increasing their use of alternative investments (76%). It is interesting to note that sentiment for alternatives has grown significantly from a lukewarm 53% in 2015.[3] This may be partly the result of frustration with the limitations of traditional assets and partly the result of greater dispersion of returns brought on by more volatile markets.

The pressure to manage risk cannot be underestimated, and institutional managers are hedging their bets. Nearly seven in ten report they are willing to underperform their peers to ensure downside protection. As they consider their options, institutions may be second-guessing the efficacy of long-standing portfolio strategies. Just 54% of those surveyed believe that diversifying across traditional asset classes can provide adequate downside protection. Just 3% say they strongly believe that strategy will be enough to protect portfolios in the coming year.

ALTERNATIVES PLAY AN INCREASING ROLE IN MANAGING PORTFOLIO RISK



3 Natixis Global Asset Management, Global Survey of Institutional Investors conducted by CoreData Research, October 2015. Survey included 660 institutional investors in 29 countries.

SECTION TWO

Recalculating the odds on return generation

Lacking the necessary dispersion, markets have not rewarded research and equity selection in recent years. As a result institutions, like other investors around the world, have turned to passive investments as a way of generating market returns while managing fees. But the severity of recent political and economic events gives many reason to pause so they can reset market assumptions and reevaluate the investment strategies that will be deployed in pursuit of higher risk-adjusted returns.

In examining their goals, 70% of those surveyed believe their return expectations are achievable, but confidence may not be as strong as it seems on the surface. Half of the institutions we spoke with said they expect to decrease return assumptions in the next 12 months. One reason for moderating their convictions is the challenge to find returns: three-quarters of those surveyed say alpha[4] is becoming harder to come by as markets become more efficient.

> “Half of the institutions we spoke with said they expect to decrease return assumptions in the next 12 months.

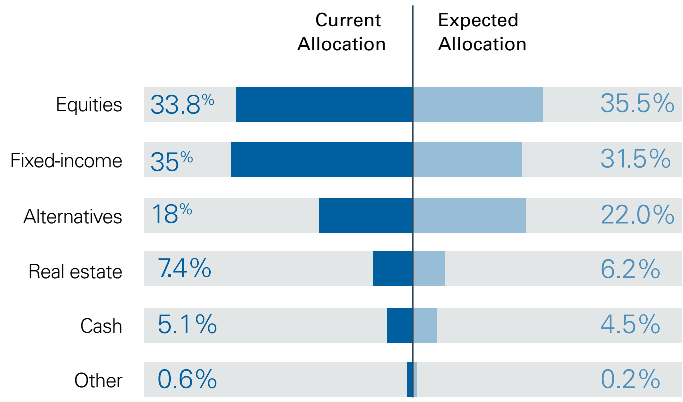
Allocation bets reflect need to generate returns

Overall, institutions anticipate that they will increase allocations to alternative investments by 4% in 2017, increase equity allocations by 1.7%, and reduce fixed-income holdings by 3.5%. While these adjustments may appear to be small, under the surface they may indicate a bigger transition in portfolio strategy. We see three clear trends emerging in portfolio construction:

- Active management is returning to favor as more volatile markets create more dispersion in returns, presenting an opportunity for active managers to identify genuine opportunities from market noise.
- Alternative investments are figuring more prominently in risk management regimes as low yields globally and rising rates in the U.S. moderate the effectiveness of bonds.
- Private markets are gaining greater attention from institutions as they look to generate higher levels of return than they might find with publicly traded securities.

4 Alpha is a measure of the difference between a portfolio’s actual returns and its expected performance, given its level of systematic market risk. There is no guarantee that any investment will generate alpha.

EQUITIES AND ALTERNATIVES SET TO RISE



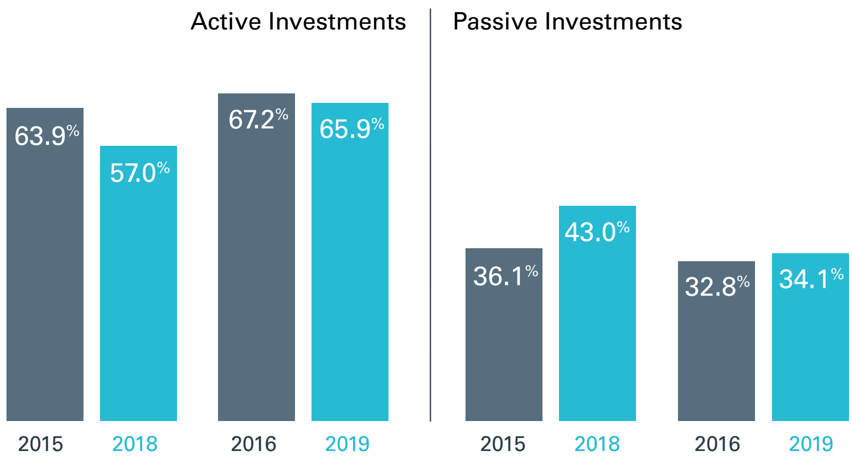
> Nearly three-quarters of institutional investors believe today's markets are more favorable to active managers.

Institutions see markets as more favorable to active management

In looking at the potential for increased volatility, nearly three-quarters (73%) of institutional investors believe today's markets are more favorable to active managers, compared to 67% of respondents viewing the prevailing macroeconomic factors as favorable for active management in our 2015 results.[5] This change in the long-term institutional views of active management can be seen clearly in projections for the amount they will allocate to these strategies.

Institutions were likely frustrated by homogenous and muted market returns in 2015 and ready to commit significant assets to passive investments. At the time they assumed a 7% increase in allocations to passive within three years. Projections from 2016 survey respondents demonstrate a significant moderation of sentiment, with institutions anticipating an increase of just over 1% by 2019. This change of direction is directly in line with institutional views on the strengths of each investment approach.

PROJECTED ALLOCATIONS RELY LESS ON PASSIVE STRATEGIES



Market projections favor active management

Asked to compare the relative strengths of active and passive investments, institutional investors give the nod to active managers for a number of vital investment functions:

5 Natixis Global Asset Management, Global Survey of Institutional Investors conducted by CoreData Research, October 2015. Survey included 660 institutional investors in 29 countries.

INSTITUTIONAL INVESTOR SENTIMENT ON ACTIVE MANAGEMENT

Objective	Active	Passive
Generating alpha	X	
Providing risk-adjusted returns	X	
Taking advantage of short-term market movements	X	
Generating stable income	X	
Exposure to non-correlated asset classes	X	
Accessing emerging market opportunities	X	
ESG investing	X	
Minimizing management fees		X

When it comes to addressing the need for returns, 86% say active is better suited to generating alpha and 64% say it's better suited to generating risk-adjusted returns. Respondents also give the advantage to active management for accessing emerging market opportunities (76%) and ESG[6] investing (75%).

As institutions increase allocations to alternatives, many are likely to shun passive investments as 71% say active management is better suited for providing exposure to non-correlated asset classes. Prospects for more volatile markets are also leading institutions to active managers, as 63% say they are better suited to taking advantage of short-term market movements.

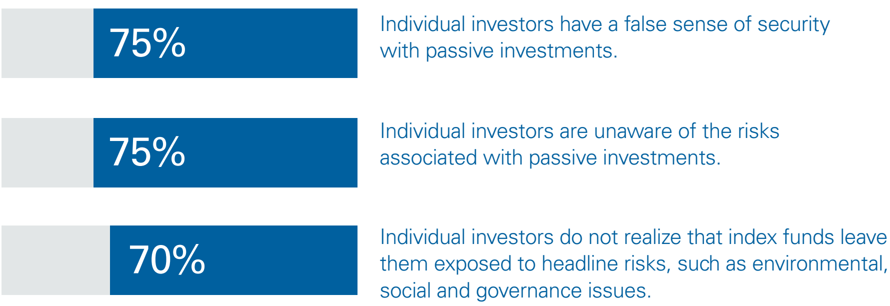
In essence, it's important to avoid transferring greater benefits from the index feature of market exposure at a lower cost. Index funds still leave investors exposed to market risks.

While they may give passive an advantage in fee management, institutional managers worldwide have clear views on the value of active managers with 78% saying they are willing to pay a higher fee for outperformance. Of course, as with all investments, active management involves risk, including risk of loss, and there is no guarantee that it will outperform an index.

> "As institutions increase allocations to alternatives, many are likely to shun passive investments.

INVESTORS MAY NOT SEE THE RISKS OF PASSIVE

% Agree



6 ESG investing focuses on investments in companies that relate to certain sustainable development themes and demonstrate adherence to environmental, social and governance (ESG) practices, therefore the universe of investments may be reduced. A security may be sold when it could be disadvantageous to do so or forgo opportunities in certain companies, industries, sectors or countries. This could have a negative impact on performance depending on whether such investments are in or out of favor.

Beware the closet tracker

A distinction should be made between true active management and “closet trackers”[7] who charge an active management fee for what amounts to an index portfolio. While the debate about closet trackers has become louder in recent years, the problem is not new: a 2006 Yale School of Management study of examined active share among actively managed mutual funds in the U.S. found that almost one-third were closet indexers.[8]

A WORD OF CAUTION FOR INDIVIDUAL INVESTORS

While institutional investors have specific objectives for passive investments, they see potential problems for individual investors who have come to rely heavily on indexing.

- **75%** say individuals are unaware of the risks of indexing.
- **75%** say individuals have a false sense of security about indexing.

The facts on alternative investments

Challenged to find yield in recent years, a majority of institutions believe they must replace traditional portfolio construction techniques if they are to achieve results. As a result, alternative investments are an increasingly important consideration in portfolio construction. As institutions grapple with interest rate concerns, many are turning to alternatives to play the ballast role traditionally filled by bonds; three in four say that increased use of alternatives can be an effective tool to help diversify portfolio risk.

To better position their portfolios for the low yield environment, more than half of institutions report they are increasing exposures to alternatives. Insurers serve as a prime example of this trend with 55% of these institutions increasing their use of alternatives, likely because their long-term liabilities and liquidity concerns normally place a heavy emphasis on bonds. Insurers anticipate a significant 5.5% decrease in fixed-income (from 63.8% down to 58.3% of total assets) and a 3.7% increase in alternative investments (from 13.8% to 17.5%) between 2016 and 2017.

ILLIQUIDITY A MAJOR BARRIER TO FURTHER INVESTMENT

% Agree

Liquidity seen as less of a barrier

While liquidity limits the ability of 55% of institutions to invest in alternatives, the concern may be waning as almost the same number (56%) report that their organization is embracing illiquid assets today more than three years ago. When faced with the decision on alternatives, seven in ten (71%) of institutional decision makers claim that the return potential of illiquid assets makes them worth the risk, a sentiment shared by three-quarters of the insurers included in our respondents.

Adoption of alternative investments is not just limited to institutional growth portfolios, as 77% of respondents say alternatives have a role in liability-driven investing as well. It stands to reason that liquidity may be less of a concern in the ultra-long time horizons of liability matching.

The attractiveness of this risk-return trade-off for institutional investors is evident in the growing level of allocations to private investments within portfolios.

Private investments take on greater importance

Challenged to produce results with public securities, institutional investors are increasingly turning to private markets in search of more attractive returns. In 2015, 93% of those surveyed plan to maintain or increase investments in private debt, while 87% plan to maintain or increase investments in private equity. It would appear that the focus on private investments has paid off for many institutions, as 69% are satisfied with the performance of the private debt investments in their portfolios and 67% are satisfied with the performance of their private equity holdings.

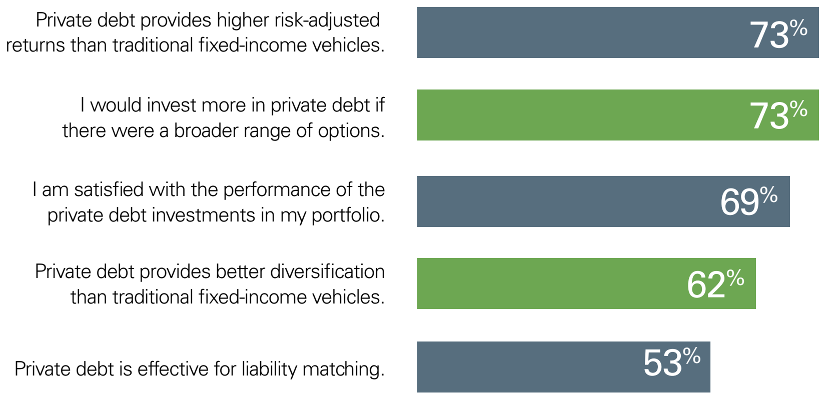
7 Closet trackers or indexers refers to the practice of fund managers claiming to manage portfolios actively when in reality the fund mimics the performance of a benchmark.

8 Yale SOM, 21 August 2006

While institutions see significant value in private markets, there are limitations that may keep them from committing more assets. Half of those surveyed say a lack of transparency keeps them from investing in private equity, while 73% say they would invest more in private debt if a broader range of options was available to them.

PRIVATE DEBT A STRONG RIVAL TO TRADITIONAL FIXED-INCOME

% Agree



TANGIBLE BENEFITS FROM REAL ASSETS

About one-third of institutions report that they are planning to increase allocations to real assets including real estate, infrastructure and aircraft financing in the next 12 months. As seen with their broader views on private markets, institutional decision makers will invest in real assets with the goal of earning higher returns. Liquidity concerns may be keeping institutions from investing more into the asset class, as 62% cite this as a barrier to entry.

Better diversification than traditional assets

Whether it is debt or equities, private investments fill important roles within institutional portfolios. Six in ten institutional investors say private debt provides better diversification than traditional fixed-income vehicles, while more than half say private equity provides a similar advantage over investment in traditional equities. Institutional investors agree that both private debt (73%) and private equity (67%) are better suited to helping to deliver on their number one investment goal: delivering higher risk-adjusted returns.

When it comes to selecting private debt investments in the next 12 months, institutional investors are most likely to consider direct lending (44%), followed by collateralized debt and special situations (34% each). Sentiment does not run as strong for mezzanine (27%), distressed debt (26%) and venture debt (24%) investments.[9] In looking to private equity opportunities, respondents favor three sectors: Technology, media and telecom (37%) ranks as their pick for the most attractive opportunity in the next 12 months, followed by infrastructure (34%) and healthcare (26%).

Private investments may provide some relief for managers searching for more attractive investment returns. Private debt, in particular, may help in one of the core portfolio objectives facing institutions: managing long-term liabilities.

9 Mezzanine: layer of financing between a company's senior debt and equity, filling the gap between the two. Structurally it is subordinate to a senior debt but senior to equity in the capital structure of a company. Distressed debt: debt of companies that are under some sort of financial distress. Venture debt: loans provided to small companies for working capital purpose. They come with rights to purchase equity.

SECTION THREE

Managing the house money

The reality for institutions seeking to produce the highest risk-adjusted returns is that portfolio management goes far beyond asset allocation and manager selection. Many times investment goals must be balanced with organizational objectives. Risk management must address not just market risk, but also organization risk. In many instances, meeting risk/return objectives can require decision-makers to go outside of their own team for specialized capabilities.

> "A growing number of institutional managers are looking outside their own walls for investment talent.

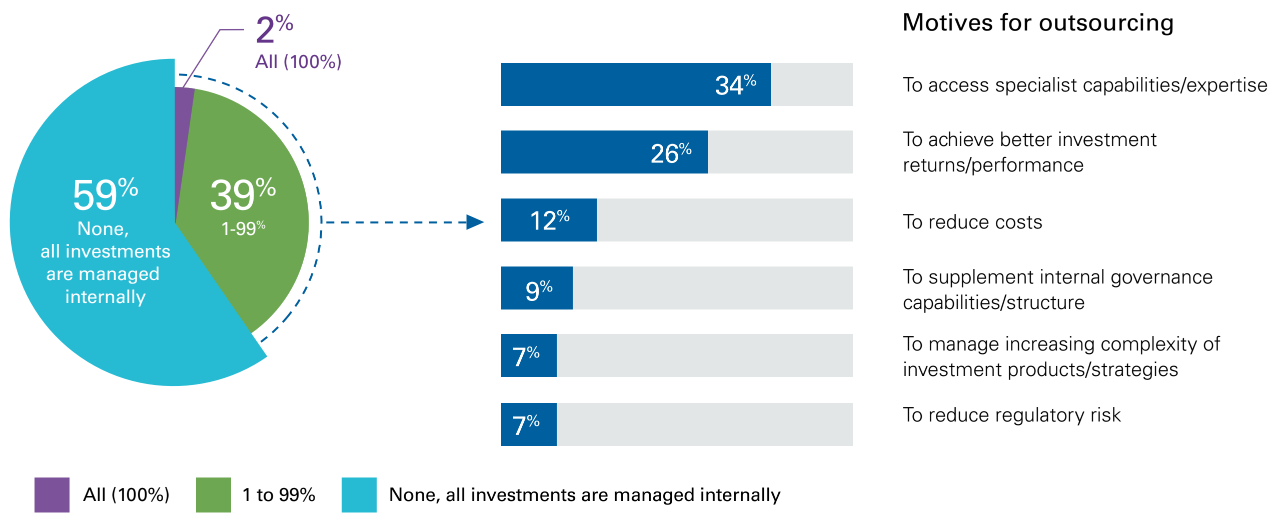
Perhaps the most telling statement of the current state of affairs for institutional investors came from Harvard University in January 2017, when it was announced that Harvard Management, the unit responsible for the largest school endowment in the U.S., would lay off half of its 230 employees. In discussing his decision to outsource investment management, new endowment chief N.P. Narvekar said the "organizational complexities and resources" needed to run these investments could no longer be justified.[10]

Outsourcing on the rise

Like the management team at the Harvard endowment, a growing number of institutional managers are looking outside their own walls for investment talent. Whether motivated by organizational efficiency and fee management or the need to access specialized help for investing in more complex and uncertain markets, a growing number of institutions are outsourcing management for at least part of their portfolio.

Four in ten institutions in our survey report that they use outsourced CIOs and/or fiduciary managers. On average those organizations that outsource have turned over management for 37% of their total portfolio to the specialists. The trend is likely to continue as another

EXPERTISE, PERFORMANCE, AND COST DRIVE OUTSOURCING DECISIONS



10 Harvard Management Company, Inc., "Message from the CEO"; N.P. "Narv" Narvekar, January 2017.

13% of institutions are considering outsourced solutions in the next 12 months. Today, sovereign wealth funds (59%) are most likely to get outside help, while insurance companies (37%) are the least likely.

Most frequently institutional decision makers cite their ability to gain access to specialist capabilities and expertise (34%) as a primary motivation for outsourcing. Another key factor in the decision to outsource is seeking to enhance investment performance (26%).

Managing headline risk

In managing portfolios investment teams must also be on the watch for exposure to reputational and headline risks. ESG investing strategies are often deployed, in part, to screen out companies and sectors with poor governance or environmental records, or potentially negative social factors. But ESG investing is taking on broader dimensions for investment teams, providing a measure for identifying companies and investment trends that may provide long-term growth potential to the portfolio.

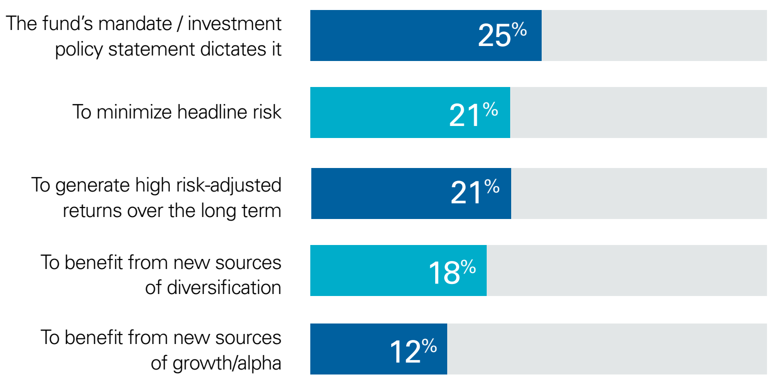
> "62% of institutions believe ESG will be a standard practice for all managers in the next five years.

While 62% of institutions believe ESG will be a standard practice for all managers in the next five years, one in four respondents report that ESG factors are already incorporated in their organization's investment policy statement. While one in five report that they also integrate ESG to help minimize headline risk, the same number also report that the discipline is deployed to help generate higher risk-adjusted returns over the long term. While some have said it is difficult to measure the performance of these investments, they are finding more tools available to help gauge the financial and non-financial impact of these factors.

More measures available for ESG

Measurement could become less of a concern as Morningstar has introduced sustainability rankings for investment managers. Working with research provider Sustainalytics, the Morningstar ratings compare a range of environmental, social and governance factors for companies relative to their peer category with the goal of providing

REASONS FOR INCORPORATING ESG



a tool for comparing more than 20,000 funds based on their underlying investments. Dow Jones's financial weekly, *Barron's*, also introduced a ratings system in 2016 that tracks performance of 200 funds investing in sustainable companies.

In France, regulators have gone one step further, creating in 2016 a certification system for ESG investments that compares the economic contributions of an investment product with positive social and environmental impact. To qualify, a fund must exclude 20% of its investment universe based on ESG criteria and have an ESG rating higher than its benchmark index.

While only 36% of institutions say ESG factors are now an important part of their investment selection process, four in ten say evaluation of these factors is as important as fundamentals when analyzing securities. Despite their skepticism, almost six in ten (58%) institutional investors believe there is alpha to be found in ESG investing.

"Almost six in ten institutional investors believe ESG investing generates alpha.

A large number of institutions believe this approach can mitigate risks such as loss of assets due to lawsuits, social discord or environmental harm (58%). But many respondents may be seeing only half of the equation on ESG, thinking of the discipline predominantly in terms of the negative screens deployed in socially responsible investing.

ATTITUDES TOWARD ESG

Where SRI relies on negative screens, many ESG strategies also deploy thematic strategies aimed at capitalizing on long market trends, such as sustainable cities, renewable energy, and clean water, to capitalize on growth potential. With institutional focus on infrastructure growing, this more comprehensive approach is likely to become more widely accepted.

Liability management

Liability management is a top of mind concern for institutional decision makers as a persistent low-rate environment makes it increasingly difficult to fund future liabilities. Pension plans may be feeling the greatest pain, as their funded ratios tend to decrease with each rate decrease. The problem has been building over time. As far back as 2011 the Organization for Economic Cooperation and Development noted: "low interest rates magnify the present value of future increases in longevity." For insurers and pensions, it was postulated that a protracted period of low interest rates could affect both assets and liabilities.[11]

11 The Economic Impact of Protracted Low Interest Rates on Pension Funds and Insurance Companies, OECD Journal: Financial Market Trends. Volume 2011 - Issue 1.

Investment managers must consider a wide range of concerns including demographic, economic and geopolitical factors. As a result, many are conflicted between making short-term gains and delivering long-term security. This is where many feel the effects of increased regulation, which can put greater emphasis on short-term performance in the decision-making process than critical long-term liability matching. With solvency requirements creating a bias for shorter time horizons and highly liquid assets, institutional teams are challenged to balance growth objectives with liquidity needs.

Our research finds that seven in ten institutions have adopted asset-liability matching strategies to help them align asset sales and income streams to future expenses with the goal of managing liquidation risk. Many of these strategies are implemented with high-quality fixed-income securities, but the toolbox has expanded and institutions are deploying a wider range of instruments in liability-driven investing (LDI).

Alternatives earn a role in LDI

Most frequently institutions are implementing hedging strategies (47%), inflation-linked bonds (44%) and nominal bonds (37%) in their LDI portfolios. But they are also looking for a broader set of options. Three-quarters of institutional investors (77%) say alternatives have an important role to play in LDI portfolio management, as they offer valuable diversification and risk mitigation and complement the overall portfolio.

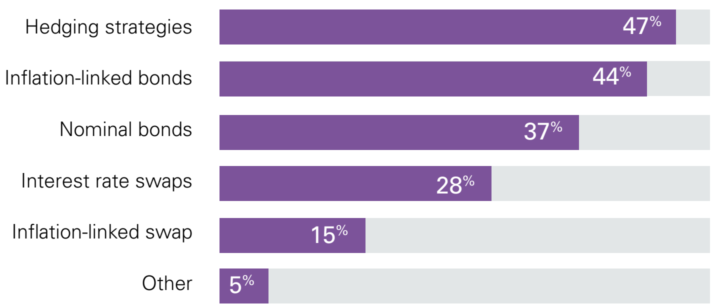
> “Institutions are anxiously awaiting greater innovation in the LDI market so they can be better positioned to meet liability-matching objectives.

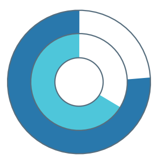
However, the need for innovation is clear as many feel they are failing to meet long-term liability objectives. Institutions are anxiously awaiting greater innovation in the LDI market so they can be better positioned to meet liability-matching objectives. A significant number (62%) believe that despite using LDI strategies, most organizations will fail to meet their long-term objectives. Three in five (60%) agree there is a lack of innovation in LDI solutions, although not as many (41%) are willing to pay a premium for innovative LDI solutions.

LDI is representative of the broader challenges facing institutions. As they look to generate the returns needed to meet long-term obligations, it will require a process of constantly balancing and rebalancing risk/reward trade-offs.

INSTRUMENTS/ASSETS ORGANIZATIONS USE TO MANAGE LIABILITIES

% yes, multiple answers allowed



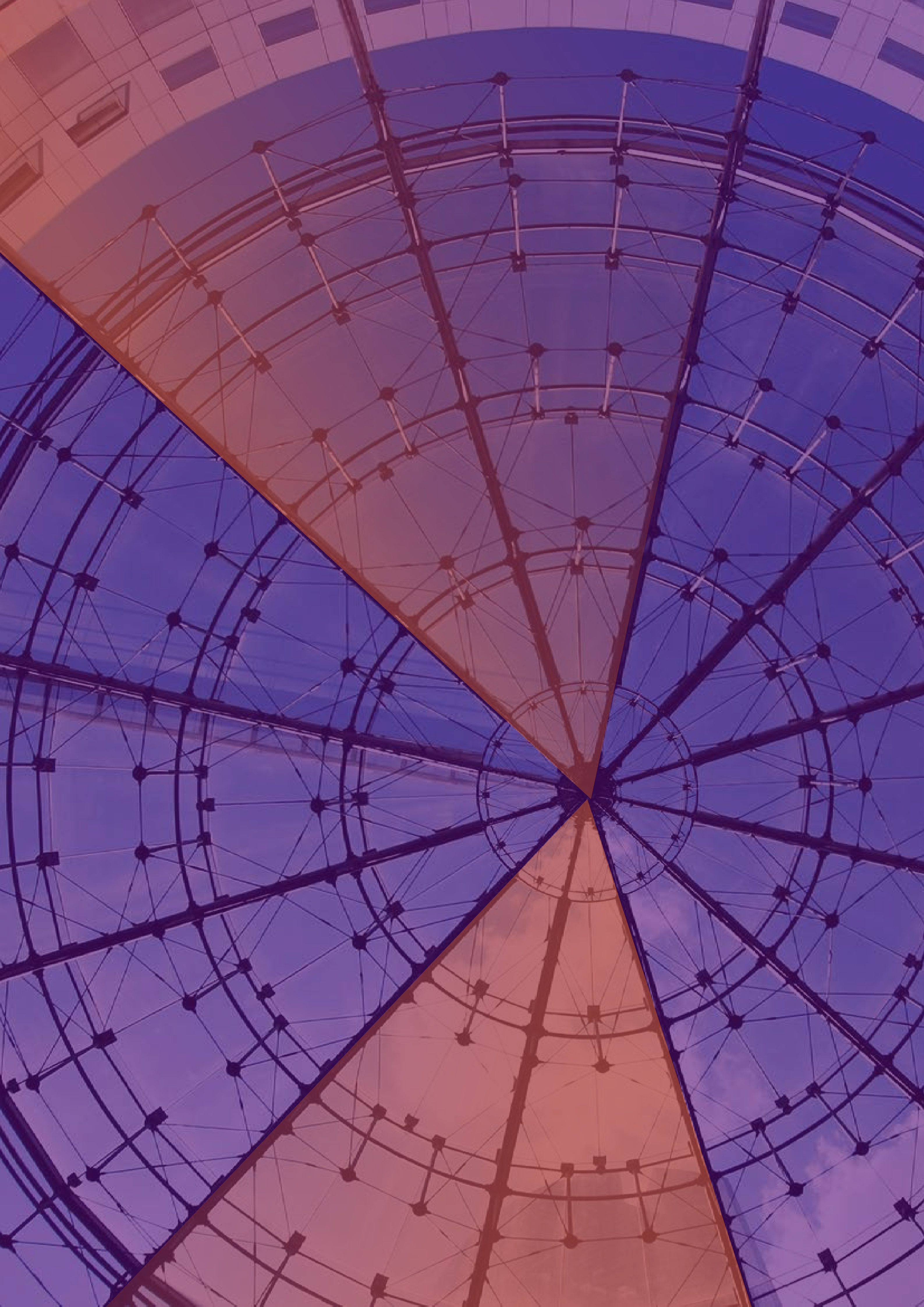


77%

agree that alternatives have a place in LDI portfolio management

69%

incorporate asset-liability management into their portfolio strategy



CONCLUSION

Evening the odds

From political turmoil, to interest rate woes, to regulatory pressures and organizational demands, it's a risky world for institutional investors. But recognizing that risk is on the rise does not mean shying away from it; instead, institutional teams are embracing the risk to pursue vital investment goals for return generation and yield replacement. Even as they double down on risk, they have a conscious plan for how it can work for them.

Amidst growing uncertainty, most anticipate increased market volatility in 2017 and are taking measures to cushion the blow. But plans are not set solely from a defensive posture. Investment and allocation decisions are being made with one eye on mitigating the risks and another on seeking to exploit risk for investment growth.

> "Investment and allocation decisions are being made with one eye on mitigating the risks and another on exploiting risk for investment growth.

A time for active management

Greater volatility may signify greater investment opportunity for institutions. With volatility comes greater dispersion of returns, and nearly three-quarters say it's a market that will favor active management. As a result, we see that institutional plans to increase allocations to passive strategies have moderated considerably as they look to capitalize on a market driven by earnings rather than monetary policy.

Private investments can offer better results

Private markets will provide another avenue for pursuing return potential and finding more attractive yield than can be offered by traditional fixed-income instruments. Despite the potential downside of liquidity constraints, most have been satisfied with the performance of their private investments:

- 73% believe private equity and private debt provide better risk-adjusted returns than traditional fixed-income investments.
- 73% would invest more in private equity and private debt if there were a broader range of investments available to them.
- 62% say private equity and private debt provide better diversification.

Alternatives aid in risk management

Bonds were once the ballast in institutional portfolios, providing a degree of stability in the face of volatile markets. Now, with a low-yield environment, interest rate and longevity too great, and markets turning volatile, alternative investments may fill the void.

- More than half (55%) of institutions say they plan to increase alternative exposures.
- 77% say alternatives have a role in liability matching.

Strategy realized in portfolio construction

Institutional strategy is not limited to asset allocation. Investment teams are implementing strategies that help meet long-term liability matching goals and organizational goals around environmental, social and governance objectives.

- Seven in ten institutions have adopted liability matching strategies, but six in ten say greater innovation is needed.
- ESG factors are becoming a key portfolio consideration, as 58% believe they can mitigate risk loss of assets from lawsuits, environmental harm or social discord.

Putting risk first

Geopolitical events may have dealt them a wild card in planning for 2017, but institutional investors are ready to play their hand. While they plan to double down on risk assets to provide much-needed growth potential, institutions are also looking to alternative investments for ballast. Even as they embrace the risk, they have a plan for managing their exposures.

FIVE TENETS OF
DURABLE PORTFOLIO CONSTRUCTION®

Put risk first

Maximize diversification

Use alternative investments

Make smarter use of traditional asset classes

Be consistent

Toward more durable portfolios

In markets across the globe we have seen investors of all types challenged to meet the competing priorities of generating returns through short-term market cycles and funding long-term financial liabilities. In our view, meeting these modern market challenges demands a more consistent investment framework.

We believe **Durable Portfolio Construction®** can make a difference to individuals, advisors and institutions as they look to build portfolios that can help address risk concerns while also pursuing long-term asset growth. Our tenets for Durable Portfolio Construction include:

Put risk first – Use risk parameters as the main input for asset allocation to manage volatility. Durable Portfolio Construction targets a consistent range of risk rather than a potential range of returns. The result is added predictability and, ultimately, durability in the portfolio.

Maximize diversification – Consider the broadest possible range of asset classes and investment strategies – long and short exposures to global equities, global fixed-income, commodities and currencies – with a goal of managing volatility in the overall portfolio.

Use alternatives – Alternatives may be an effective means of diversification. They also may lower correlations, temper volatility and offer new sources of return. For example, alternative strategies well suited to a durable portfolio include long or short exposures to commodities, currencies or real estate for new sources of return, or hedging to help reduce risk.

Make smarter use of traditional asset classes – Seek new, efficient ways to capitalize on the long-term potential of stocks and bonds. Smarter use of equities includes techniques and strategies that have the potential to enhance long-term returns or reduce short-term risk. Smarter use of fixed-income may include inflation-aware bond strategies and multisector bond funds.

Be consistent – Maintain a consistent portfolio construction process to focus on the big picture and withstand short-term market changes. Choosing and using a rational, repeatable construction process is the hallmark of a durable portfolio – and perhaps the most important principle of Durable Portfolio Construction.

Durable Portfolio Construction® does not guarantee a profit or protect against a loss.

PROGRAM OVERVIEW

About the Durable Portfolio Construction Research Center

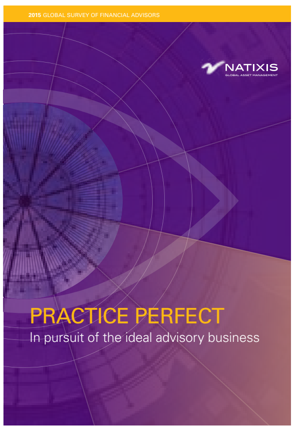
Investing can be complicated: Event risk is greater and more frequent. Volatility is persistent despite market gains. And investment products are more complex. These factors and others weigh on the psyche of investors and shape their attitudes and perceptions, which ultimately influence their investment decisions. Through the Durable Portfolio Construction Research Center, Natixis Global Asset Management conducts research with investors around the globe to gain an understanding of their feelings about risk, their attitudes toward the markets, and their perceptions of investing.

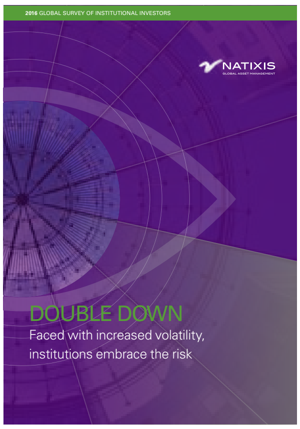
Research agenda

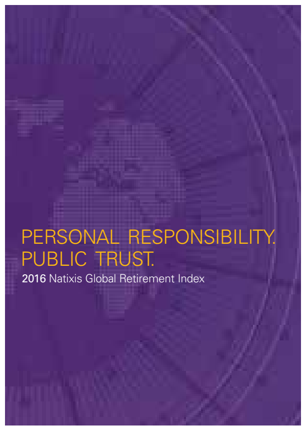
Our annual research program offers insights into the perceptions and motivations of individuals, institutions and financial advisors around the globe and looks at financial, economic and public policy factors that shape retirement globally with:

- Global Survey of Individual Investors – reaches out to 7,100 investors in 22 countries.
- Global Survey of Financial Advisors – reaches out to 2,550 advisors in 15 countries.
- Global Survey of Institutional Investors – reaches out to 500 institutional investors in 31 countries.
- Natixis Global Retirement Index – provides insight into the environment for retirees globally based on 18 economic, regulatory and health factors.

The end result is a comprehensive look into the minds of investors – and the challenges they face as they pursue long-term investment goals.







About the surveys referenced in this paper

2015 Global Survey of Institutional Investors – Natixis Global Asset Management commissioned CoreData Research to conduct a global study of institutional investors, with the aim of gaining insight as to how they are managing investments and meeting various challenges in today's world.

Interviews were conducted throughout October and November 2015. The study involved 660 institutional investors in 29 countries.

Helping to build more durable portfolios

Natixis Global Asset Management is committed to helping advisors build better portfolios that stand up to the challenges of modern markets. To learn more about our **Durable Portfolio Construction®** philosophy, visit durableportfolios.com.

Views and opinions of the survey referenced herein are as of March 14, 2017. There can be no assurance that developments will transpire as may be forecasted in this material.

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