The Age of Anxiety

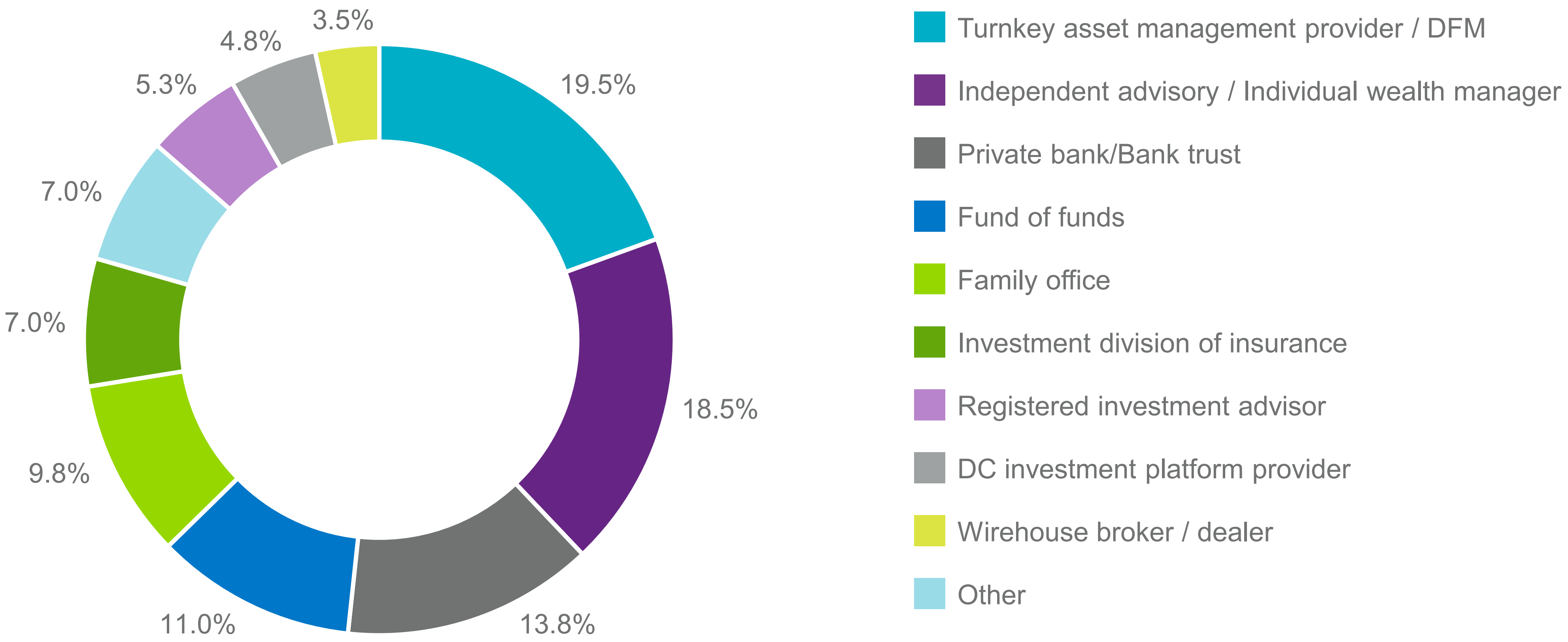
Professional fund buyers seek alpha, diversification – and defense

While nobody could have predicted the historic levels of volatility experienced in markets across the globe since February, more than half (54%) of professional fund buyers surveyed around the world in Q4 2019 believed we would see a market crisis within one to three years and had already been preparing for a shift in market fortunes as they began 2020. Professional buyers were worried that 2019's 25% for the MSCI World Index[1] market runup could not continue into the new year. Facing this environment, they were already looking to diversify and build downside protection into portfolios – even as they were seeking sources of growth and yield. To those ends, results show they were upping allocations to alternatives and favoring the active managers they think can truly add alpha.[2]

About the survey

Natixis 2019 Global Survey of Professional Fund Buyers, conducted by CoreData Research in October and November 2019. Survey included 400 respondents in 23 countries through North America, Latin America, Asia, the United Kingdom and EMEA (Europe, Middle East and Africa).

The professional fund buyers in the survey, who are researchers and analysts responsible for the fund selection process, work in a variety of institutions at the following types of organizations:



1. Assumptions no longer holding up

Portfolio allocations are locked in for the long term

2019

43.6% Equities
34.3% Fixed Income
14.1% Alternatives
5.8% Cash
2.3% Other

2020

42.6% Equities
34.0% Fixed Income
15.2% Alternatives
5.9% Cash
2.3% Other

Portfolio allocations are locked in for the long term. Fund buyers were not projecting any significant shifts, with allocations within about a percentage point of 2019 projections.

1. Assumptions no longer holding up

Fund buyers' allocation plans for 2020

		Increase	No Change	Decrease	Do Not Invest
Equity	Emerging Market Equities	38%	33%	14%	15%
	European Equities	34%	29%	26%	11%
	Asia-Pacific Equities	26%	45%	16%	14%
	Global Equities	23%	43%	20%	15%
	US Equities	22%	27%	44%	7%
Fixed Income	Emerging Market Debt	28%	29%	16%	27%
	Investment Grade Corporate Debt	24%	37%	29%	11%
	Government-Related (Sovereign Debt, Treasury)	22%	31%	37%	11%
	Green Bonds	21%	21%	2%	56%
	High Yield Corporate Debt	19%	30%	34%	18%
	Securitized Debt (Mortgage-Backed Bonds, etc.)	15%	38%	20%	28%
Alternatives	Private Equity	28%	25%	10%	36%
	Real Estate / REITs	27%	35%	17%	21%
	Infrastructure	24%	29%	10%	37%
	Hedge Fund Strategies	22%	31%	18%	30%
	Private Debt	21%	25%	13%	41%
	Commodities	18%	31%	12%	39%
	Other	3%	16%	5%	76%
	Cash	20%	52%	18%	10%

Blue highlighting is for illustrative purposes only to call attention to larger decreases in allocation.

Fund buyers' allocation plans reveal that they had expected equity-market leadership to shift from North America to emerging markets and Europe. Given the severity of the global downturn this clearly isn't unfolding now, but it's likely buyers will return to strategy at some point the future.

With developed market sovereign bonds paying low to negative yields and credit spreads compressed, the yields on EM debt likely look attractive by comparison. This is especially true now, given that central bankers are making rate cuts a critical first line of defense in shoring up markets

Interest in alternatives grows as alternatives are expected to make up about 15% of buyers' portfolios in 2020 as buyers look for sources of return and yield with the potential to diversify their portfolio.

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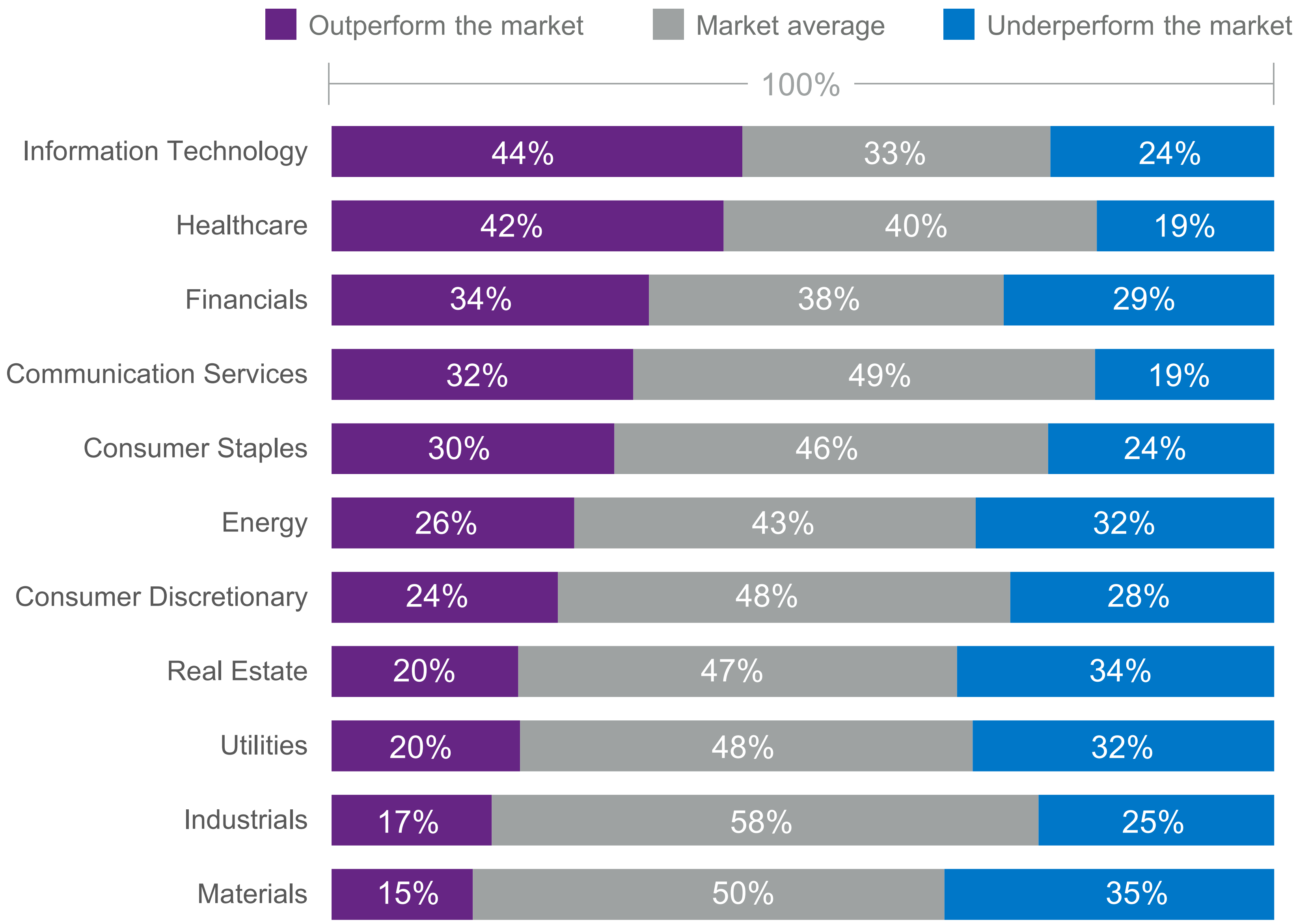
1. Assumptions no longer holding up

Sector preferences reveal a neutral outlook



Buyers' sector preferences indicate expectations for weak economic growth. Few buyers expect the pro-cyclical materials and industrials sectors to outperform, while they're most optimistic about sectors with strong secular growth drivers.

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1. Assumptions no longer holding up

Buyers are more concerned about negative market factors

Top 5 Negative

75% Trade disputes

61% Hard Brexit

60% Slow economic growth

57% Asset bubbles

51% High correlation between asset classes

Top 5 Positive

39% Interest rate movements

33% US presidential election

21% Low yield environment

15% Asset bubbles

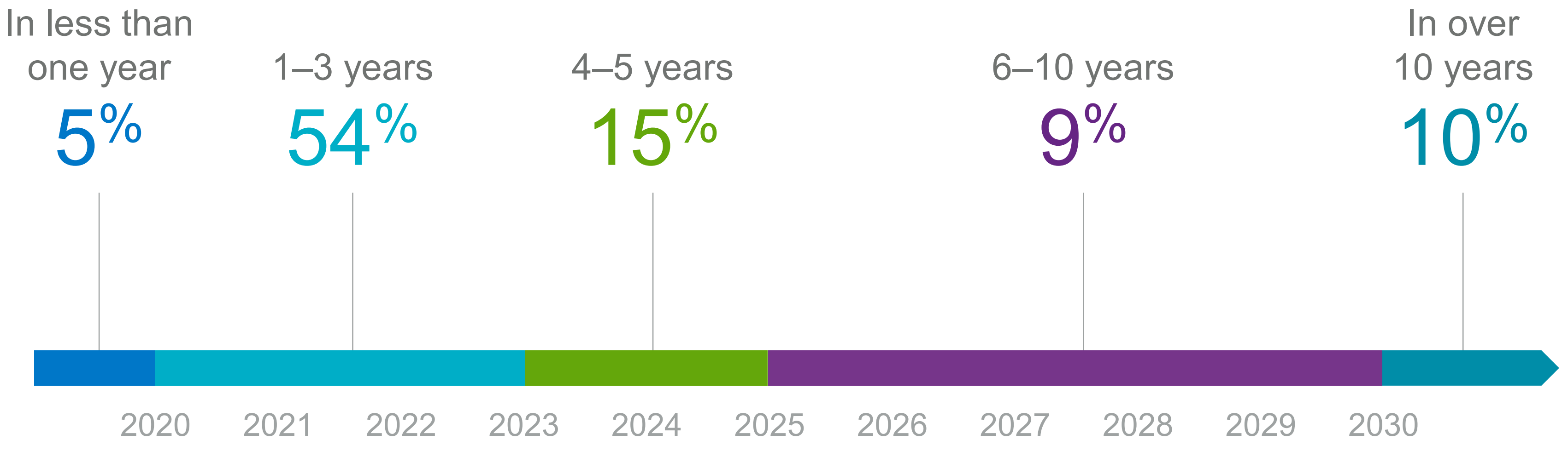
11% Currency/FX volatility

In the absence of strong economic growth, buyers are more concerned about negative drivers of market performance than they are the positive drivers.

2. Buyers projected more risk for 2020

Near-term and long-term risks ahead

- While many buyers expected increased market risks including higher equity volatility (79%), bond volatility (72%) and currency volatility (59%) few could have foreseen a crisis in this order of magnitude.
- Many pointed to interest rates as one of the drivers of market risk, and buyers worried that central banks had few tools left to address a crisis or economic downturn if one occurs.
- Liquidity issues were also cited as a reason for higher volatility. Post-crisis regulations have restricted liquidity in the bond and cash markets, highlighted by the spike in the rates on US repurchase agreements last fall.
- The rise of passive investment strategies has created a mismatch between the liquidity of the vehicles and their underlying securities.



Looking out to the future, 54% saw a global financial crisis looming within one to three years. To most, a market crisis wasn't a question of if but when, as three-quarters (73%) forecasted a crisis within five years. This may be an outgrowth of the central bank-driven market environment: In essence, buyers figured that yesterday's policies would keep working until they didn't.

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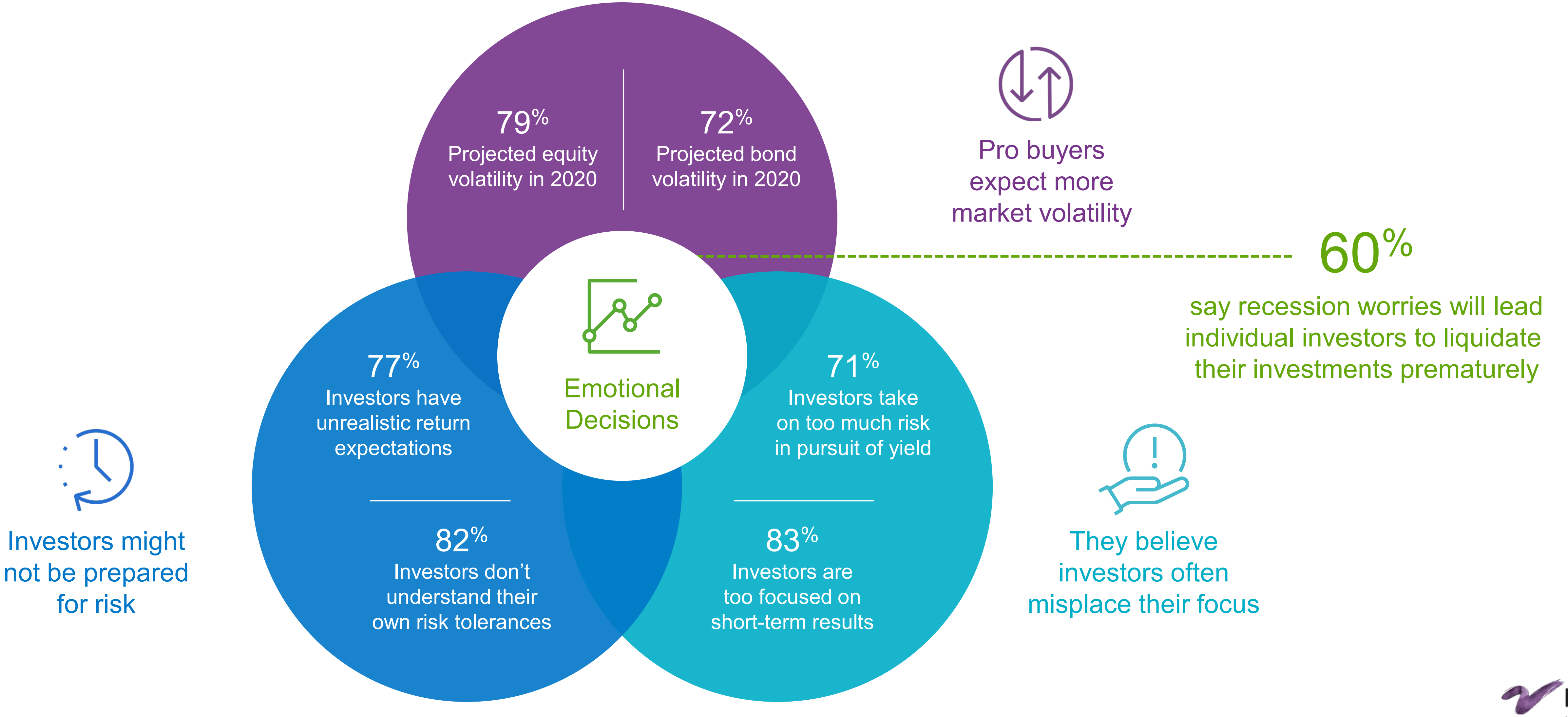
2. Buyers projected more risk for 2020

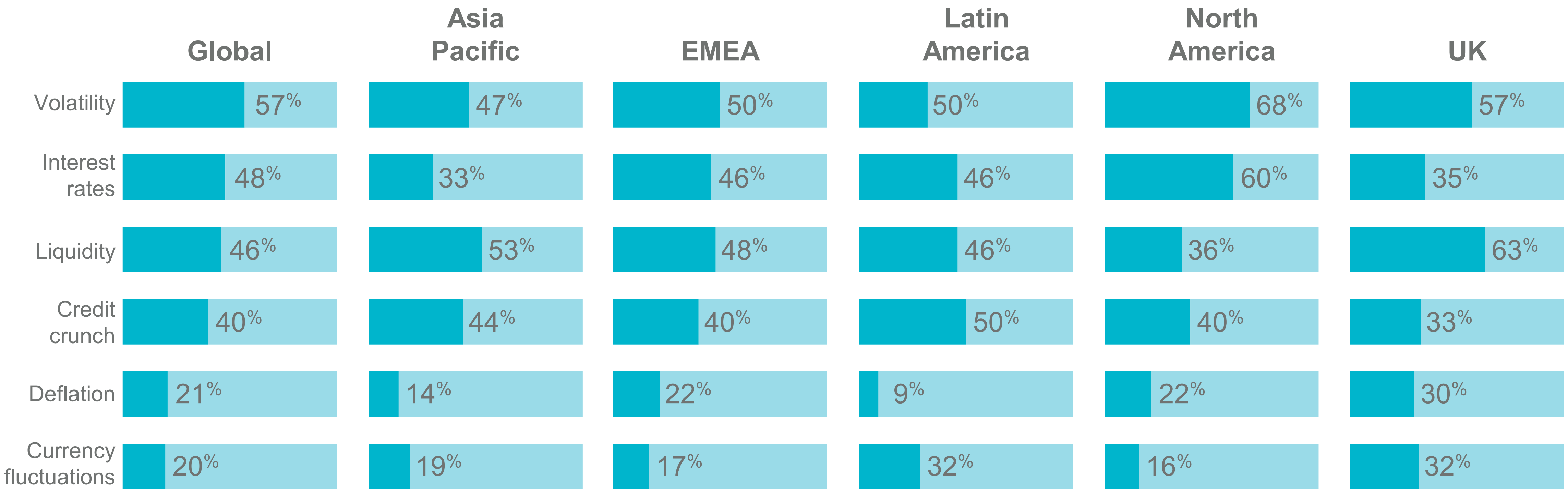
Investors may not be prepared for risk

When investors don't understand and prepare for risk, they can panic when the markets get volatile. They can make emotional decisions that damage the progress they've made against their long-term financial goals.



2. Buyers projected more risk for 2020

Top 5 portfolio risks by region



Volatility and interest rates were cited as the top portfolio risks globally, but there are distinct regional differences. The UK cited liquidity as the top portfolio risk, while the credit crunch was tied with volatility for the top spot in Latin America.

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2. Buyers projected more risk for 2020

Election year sparked geopolitical concerns

1. **Performance impact of the US presidential election**
   - Globally, fund buyers are split with about one-third believing there will be a positive impact (33%), negative impact (29%) or no impact (38%) on portfolio performance.
2. **The campaign will be a source of volatility**
   - Globally, 66% believe the campaign will result in market turbulence.
   - Asian professional fund buyers (72%) were most likely to project campaign-induced volatility, but the UK (69%) and North America (68%) are not far behind in their concerns.
3. **Market reaction to a new president**
   - About half see a favorable market reaction for a change in leadership; regional differences vary greatly.
   - Only 35% in North America see an upside, while Latin America (64%), Asia (56%), Europe (50%) and the UK (41%) see markets rallying for a new US president.
4. **A Democratic sweep of Congress**
   - Nearly 6 in 10 project a negative impact from this scenario. North America (70%), EMEA (58%) and the UK (54%) have the strongest negative reaction.
   - Asia (47%) and Latin America (36%) see negatives in a Democratic sweep.
5. **The global problem of foreign election interference**
   - Seven in ten professional fund buyers believe election interference is an increasing problem. Eight out of ten in North America agree.

Top 5 measures to counter geopolitical risk

1.	Scenario analysis	51%
2.	Capital buffers/reserves	45%
3.	More nimble/agile approach	37%
4.	Establish criteria for prioritizing risk	34%
5.	Create signposts for tracking risk	25%

3. Alternatives: Seeking a more efficient frontier

- 7 in 10 professional fund buyers (73%) are willing to underperform their peers in exchange for greater downside protection.
- 61% say an allocation to alternatives is a must in the current market environment.
- 8 in 10 buyers (82%) say low yields from bonds will trigger a shift towards alternatives.

Fund buyers who are either maintaining or increasing allocations to alternatives:

63% Real estate / REITs

54% Private equity

53% Infrastructure

52% Hedge funds

49% Commodities

46% Private debt

Buyers are looking to wring growth and yield out of their portfolios, with a greater emphasis on downside protection. The hunt for yield likely explains the interest in income-related alternative assets such as infrastructure, real estate and private debt.

4. Active for alpha

Professional fund buyers see a market primed for active management

Percent of fund buyers expecting increases in:

+79%	+72%	+55%
Equity volatility	Bond volatility	Dispersion*

74%

agree that the market is favorable for active management

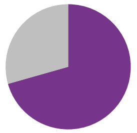
Professional fund buyers think the climate they projected favors active management, likely because they think greater dispersion and volatility will give active managers opportunity to find value. They also identify the popularity of passive investments as a potential source of systemic risk and volatility, which may exacerbate the effects of the current downturn just as it may have amplified the previous run-up.

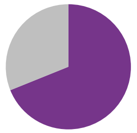
*Dispersion is the spread between security prices.

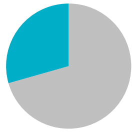
4. Active for alpha

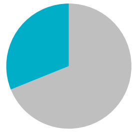
Buyers maintaining majority allocation to active investments

Active/Passive Allocations: 2019 Survey









	Currently	3 years from now
Active Investments	71%	69%
Passive Investments	29%	31%

More than three-quarters (77%) of professional fund buyers say alpha has become harder to obtain, so 75% are willing to pay higher fees for potential outperformance. Fund buyers predict active investments will remain as dominant in portfolios three years from now as they are today.

5. ESG on the rise

The investment case for ESG clearer to more buyers

- Buyers are feeling demand from clients and want to align their investment strategies with investor values (62%).
- Europe has pioneered the implementation of ESG and continues to take the lead, with higher rates of implementation and active ownership, in which investment firms enter into a dialogue with companies around ESG issues, exercising both ownership rights and voice to effect change.

	2017*	2019	Increase
ESG can help alpha	45%	56%	11%
ESG will be standard practice for all managers within five years	51%	67%	16%
ESG helps mitigate risk	45%	56%	11%

When asked about their firms' take on environmental, social and governance-related investing, buyers' responses suggest they increasingly see the investment case for ESG.

*Natixis Investment Managers, Global Survey of Professional Fund Buyers conducted by CoreData Research in September and October 2017. Survey included 200 respondents in 23 countries.

5. ESG on the rise

Professional fund buyers are implementing ESG in a variety of ways

49% **Exclusionary screening**

Avoiding investments based on traditional moral values, standards and norms

33% **Thematic investing**

Investing that is based on trends, such as social, industrial, and demographic trends

42% **ESG integration**

Incorporating ESG considerations where material to investment analysis

32% **Impact investing**

Investing with the intent to generate and measure ESG benefits alongside financial return

36% **Best in class investing**

Preferring companies with better or improving ESG performance compared to peers

24% **Active ownership**

Entering a dialogue with companies on ESG issues; exercising ownership rights to effect change

Two-thirds of professional fund buyers say their firm is integrating ESG into its client offering. One in five say ESG can help minimize headline risk (22%), generate high risk-adjusted returns over the long term (21%) and benefit from new sources of diversification (19%).

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Navigating the age of anxiety

1. **Assumptions no longer holding up**– Portfolio allocations are locked in for the long term, and in the absence of strong economic growth, buyers were more concerned about negative drivers of market performance than they are the positive drivers.
2. **Buyers projected more risk for 2020** – In a year of predicted higher volatility, more than half of professional fund buyers saw a global financial crisis looming within one to three years.
3. **Alternatives: Seeking a more efficient frontier** – Buyers are looking to wring growth and yield out of their portfolios, with a greater emphasis on downside protection.
4. **Active for alpha** – More than three-quarters (77%) of professional fund buyers say alpha has become harder to obtain, so 75% are willing to pay higher fees for potential outperformance.
5. **ESG on the rise** – Professional fund buyers are increasingly seeing the investment case for ESG.

IMPORTANT INFORMATION

1 MSCI World Index (Net) is an unmanaged index that is designed to measure the equity market performance of developed markets. It is comprised of common stocks of companies representative of the market structure of developed market countries in North America, Europe, and the Asia/Pacific Region. The index is calculated without dividends, with net or with gross dividends reinvested, in both U.S. dollars and local currencies. You cannot invest directly in an index. Indexes are not investments, do not incur fees and expenses and are not professionally managed.

2 Alpha is a measure of the difference between a portfolio's actual returns and its expected performance, given its level of systematic market risk. A positive alpha indicates outperformance and negative alpha indicates underperformance relative to the portfolio's level of systematic risk.

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