INVESTOR INSIGHTS SERIES

Out of the Chaos and into Conflict

Investor sentiment ten years after the global financial crisis

On September 15, 2008, the world woke up to the reality of a financial system in crisis. Lehman Brothers, the venerable 158-year-old investment bank, had gone bankrupt. Investors learned that banks, investment managers, and insurance companies were exposed to the same kind of toxic assets that brought Lehman down, and anxieties were raised across the globe.

Wall Street opened. Bond spreads widened, stocks plummeted, and even the most rational investors panicked. By mid-morning, the chaotic sell-off resulted in a 4.7% drop in the S&P 500. By the end of 2008, the index would lose more than 38% – the S&P's single worst one-year loss ever.

Fear spread and losses mounted across markets in the UK, Europe, and Asia. Soon, it felt like the global financial system was on the brink of collapse. It would take years for markets to recover and confidence to be restored.

The decade after the crisis seemed like a different world. By September 15, 2018, the longest bull market in history continued to reach ever upward and interest rates hovered at historic lows. Up until October 2018, investors racked up big gains while feeling little in the way of prolonged volatility.

Things have been very good for investors for a very long time. So why is it that after a decade-long market run-up, eight in ten investors worldwide still say they prefer safety over investment performance?

- **7 out of 10 investors** feel secure about their finances today, but the same number cannot say that the world is more secure than it was ten years ago.
- **Two-thirds** claim to know the difference between active and passive investing. But many have critical misconceptions about these strategies.
- **More than half** say they are comfortable taking risks in order to get ahead, but when asked to choose, 8 in 10 say they prefer safety over investment performance.

Our 2018 Global Survey of Individual Investors finds that despite the gains they've made since 2008, investors are wary of a world that's changed dramatically and struggle to make sense of what it all actually means for their investments. In the end, they are struggling to resolve three critical conflicts:

- Trust and security: Investors may feel secure about their finances in 2018, but after a decade of dramatic changes few trust that the world is any more secure than it was in 2008.
- Active vs. passive: Investors are predisposed to favor active investment strategies, but their quest to lower investment costs may be setting unrealistic expectations for what passive investments can actually deliver.
- Risk and return: Investors may think they have a realistic view on the risks that come with investing, but in reality they struggle with just how much risk they're willing to take in pursuit of double-digit returns.

Given all that's been thrown their way since 2008, it's no wonder investors are conflicted about how to approach investing in today's markets.

Trust, security and a preference for more connections

It's strange to say the first decade of the 21st century was a simpler time, but it was. In 2008, mobile computers were held on your lap, not in your back pocket. Social media was for reuniting with your college friends, not getting your daily news. Driverless cars were testing the limits of artificial intelligence, not delivering your pizza from Domino's.

Over this stretch of time, the world got smaller, more connected, and more diverse. But politics have been polarized and migration has begun to reshuffle the demographic order of Europe and North America. In the end, the pace and amplitude of change leaves many individuals uncertain and unsettled.

With markets running strong for a long time, there's good reason for the majority of investors (71%) to tell us they feel financially secure today. But beyond the balance sheet, investors are not quite as confident.

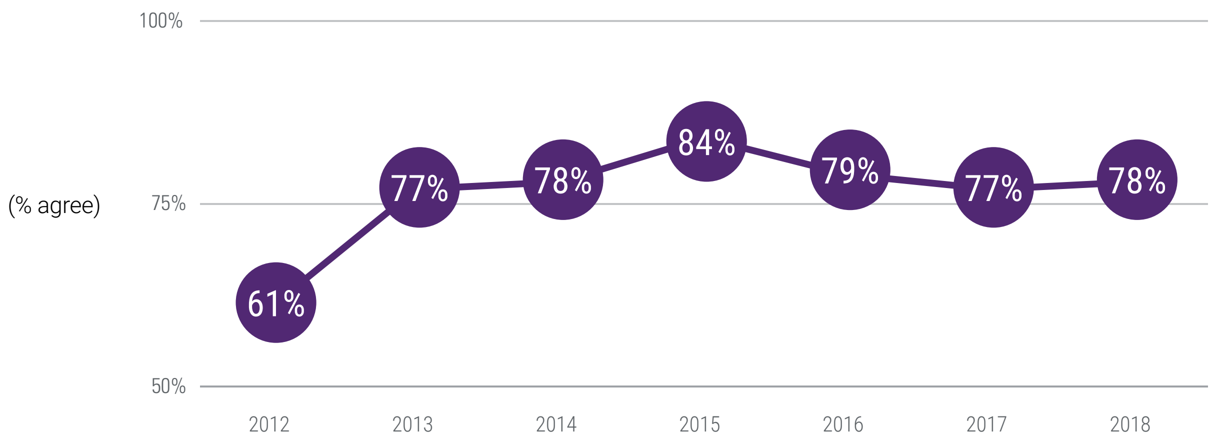
Seven in ten cannot say the world today is a more secure place than it was ten years ago, and it shows in who and what they trust.

Trust is hard-earned

The response to these world changes has been a rise in populism, but only 19% of those surveyed trust the Populist movement completely and half of investors say they don't trust populism at all. Government (25%/44%) and the media (26%/41%) do not fare much better. Technology has been at the root of much of the rapid social change, and while it has produced many positives in daily life, many individuals express reservations. Cryptocurrencies are most squarely in the sights of skeptics, as almost half do not trust this new asset. Investors seem less suspicious of and willing to trust algorithms (37%), disruptive innovations (33%) and Big Data (35%).

In a stark contrast, investors seem to have forgotten or forgiven some aspects of the global financial crisis. They are more likely to put complete trust in institutions (32%), financial systems (39%) and experts (55%). While much can be learned by examining the extremes of sentiment in any of these areas, it is important to note that the majority of investors are in the "trust somewhat" camp on each of these issues.

Investors Continue to Prefer Safety over Performance



ABOUT THE SURVEY

Natixis Investment Managers surveyed 9,100 investors globally in September 2018, with the goal of understanding their views on the markets, investing and measuring progress toward their financial goals. Investors from 25 countries are represented in this, the ninth annual survey of individual investors.

An online quantitative survey of 44 questions was developed and hosted by CoreData Research. Each of the 9,100 individual investors had minimum net investable assets of US $100,000 (or Purchase Price Parity [PPP] equivalent).

Who and What Do Investors Trust?

	Not Trustworthy (1–4)	Unsure (5–6)	Trustworthy (7–10)
Experts (e.g. academics, scientists, doctors, etc.)	12%	33%	55%
Financial systems	24%	37%	39%
Algorithms (e.g. Amazon's recommendations, automated advice, etc.)	31%	32%	37%
Big Data	28%	37%	35%
Disruptive innovations (e.g. Uber)	30%	37%	33%
Institutions	27%	42%	32%
Social media	46%	27%	27%
The media	41%	34%	26%
Government	44%	31%	25%
Protectionist policies (e.g. tariffs)	39%	36%	25%
Cryptocurrencies	49%	30%	21%
Populist movement	52%	29%	19%

Personal connections may be more secure

Beyond these macro issues, trust shows up in more personal aspects of investing. When asked who they trust when making financial decisions, nine out of ten investors say they trust themselves. But at a time when the cost of professional advice is under scrutiny, investors clearly see its value and 87% say they trust their financial advisor – a number that's 13% higher than those who say they trust their family and friends when making financial decisions.

Individuals are less likely to trust less personal sources, with only 55% reporting that they trust the financial media in their decision-making process. And fewer than one-third of investors (30%) say they would trust what they learn about investing over social media. Despite their reservations about the media, it's clear that investors have not ignored the headlines altogether.

Caught in the crossfire of the active vs. passive debate

Since the crisis, the virtues and shortcomings of active and passive investing have shown up front and center in the financial press and cable TV. It appears that investors may have only heard part of the story. In many cases the dialogue has focused on fees, leaving investors with an incomplete understanding of what passive investments can provide and what they cannot. While 83% of investors say fees are an important consideration in selecting investments, many may be confusing these lower fees with greater value.

Two-thirds of investors (66%) claim to know the difference between active and passive investing, and to some extent they do. Seven in ten (71%) understand the basic premise that passive investments give them market returns, while 57% also recognize that passive investments have lower fees, which is the basic argument in favor of this approach. But it appears that while investors may understand this basic argument, they see a lower fee and extrapolate much greater advantages for passive investments than index funds can deliver.

Six in ten investors worldwide (63%) believe index funds are less risky. They're not. Index funds have no built-in risk management. Investors' assets are exposed to the same level of risk that's presented by the markets at large. Two-thirds of investors also believe passive investments will help them minimize losses. They can't. Investors may get the gains when markets are up, but they also get the losses when markets are down.

Essential preferences favor active management

Even while they extol the virtues of passive investments, it's ironic that 72% of investors worldwide say they prefer to have an expert find the best investment opportunities in the market. Two-thirds also expect their mutual funds will have a portfolio that looks substantially different from the benchmark. In addition to having this kind of predisposition toward the basic premise of active management, investors have expectations that passive strategies would be hard pressed to deliver on.

Three-quarters of investors say that when it comes to investing, it's important to beat the benchmark. Almost the same number (74%) say it's important to take advantage of short-term market movements. Nine out of ten also say it's important to be protected from volatility. According to those who responded to our survey of institutional investors, our survey of professional fund buyers, and our survey of financial advisors, active investments are best suited to pursuing each of these investment objectives. While these preferences should add up to a ringing endorsement of actively managed investments, it appears that the actions – or inactions as the case may be – of some managers may be bringing down all active managers in their eyes.

Misconceptions about Passive Investments

	The Professional Opinion[1]	
	Active	Passive
Generating stable income	✓	
Taking advantage of short-term market movements	✓	
Exposure to non-correlated asset classes	✓	
Accessing emerging market opportunities	✓	
Providing risk-adjusted returns	✓	
Integration of material ESG factors	✓	
Downside protection	✓	
Minimizing management fees		✓

The Investor Opinion

Two-thirds of investors claim to know the difference between active and passive investing

57% recognize that passive investments have lower fees

71% understand that passive investments give them market returns

63% believe index funds are less risky **(they're not)**

67% believe passive investments will help them minimize losses **(they can't)**

Wary of the posers and wannabes of active

Investors are wary of closet benchmarkers, or those asset managers who charge an active management fee but build portfolios that closely resemble their benchmark. Seven out of ten (72%) worry that a lot of fund managers charge high fees even if they're just tracking an index.

Six in ten investors worldwide still have faith that asset managers provide value for money, and the same number believe asset managers are upfront about fund performance.

> Despite their concerns, many individuals can see past the sins of the closet trackers and find integrity among asset managers.

As the discussion on active/passive has been generalized into a showdown of good and bad, investors are caught in crossfire and need help understanding a more nuanced argument for each approach. Investors may also need this kind of clarity in their understanding of risk and reward.

Risk, return and effects of time

Ten years is a long time to get used to bull market returns. It's also a long time to forget about the risk of market losses. Half of investors (53%) say this run has made them feel secure about their investments. But investment professionals think differently.

Eight in ten respondents (79%) in our 2018 survey of financial professionals believe the prolonged bull market has actually made investors complacent about risk. The same number also believe investors don't recognize risk until after it's been realized in their portfolios. As a result, investors could be facing a perfect storm when markets turn from up to down.

It appears that investors may have a grasp of the relationship between risk and reward. More than half (54%) say they are comfortable taking risks to get ahead, while seven in ten say that sudden 10 percent fluctuations are a normal part of investing. Despite sharing this pragmatic view, only 30% of investors actually believe that volatility creates opportunity, while another 39% think of it as something they have to endure.

Risk understood in theory but avoided in practice

But just because they are able to intellectualize the concept of risk, it does not mean investors are willing to accept risk in their portfolio, as six in ten say that volatility undermines their ability to achieve savings and investment goals. One in five go so far as to say volatility is something they have to avoid, while 12% simply say they do not understand it at all.

1 Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in September and October 2017. Survey included 500 institutional investors in 30 countries.

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.

Natixis Investment Managers, Global Survey of Financial Professionals conducted by CoreData Research in March 2018. Survey included 2,775 financial professionals in 16 countries.

Misconceptions about risk and volatility may be further clouded by unrealistic return targets. Even though three-quarters of investors say they know the real returns (return above inflation) they will need to achieve their goals, investors have unrealistic expectations. Globally, individuals believe they will need 10.4% above inflation to meet their goals.

Normally this would translate into nominal returns of 13% or more. Achieving this level of returns would mean taking on considerable equity exposure and assuming much more of the risk to which investors demonstrate a clear aversion. This is likely why financial professionals say 5.5% above inflation is a more realistic expectation.

A potential blind spot on market risks

Despite the disconnect between return hopes and risk concerns, 77% believe they understand the risks of the current market and 64% believe they are prepared for a market downturn. Financial professionals are not as optimistic about investors' abilities to cope with risk, as only 44% say investors understand current risks and only 42% think investors are prepared for a downturn.

Based on their market view, investors will need to be prepared. While they do not believe the world is in for a major crisis, two-thirds believe we are due for a market correction. Past behavior may belie the challenges that many investors would face in a correction or crisis. About four in ten investors (39%) admit that they tend to sell off assets when markets are volatile. Virtually the same number (40%) say that the Global Financial Crisis led them to sell off some (33%) or all (7%) of their assets.

Coincidentally, the same number of investors (40%) say they are predominantly focused on short-term results. Financial professionals think this brand of short-termism is more common than investors would let on, as 82% believe that investors are too focused on short-term results.[2]

Six in ten investors say that volatility undermines their ability to achieve savings and investment goals.

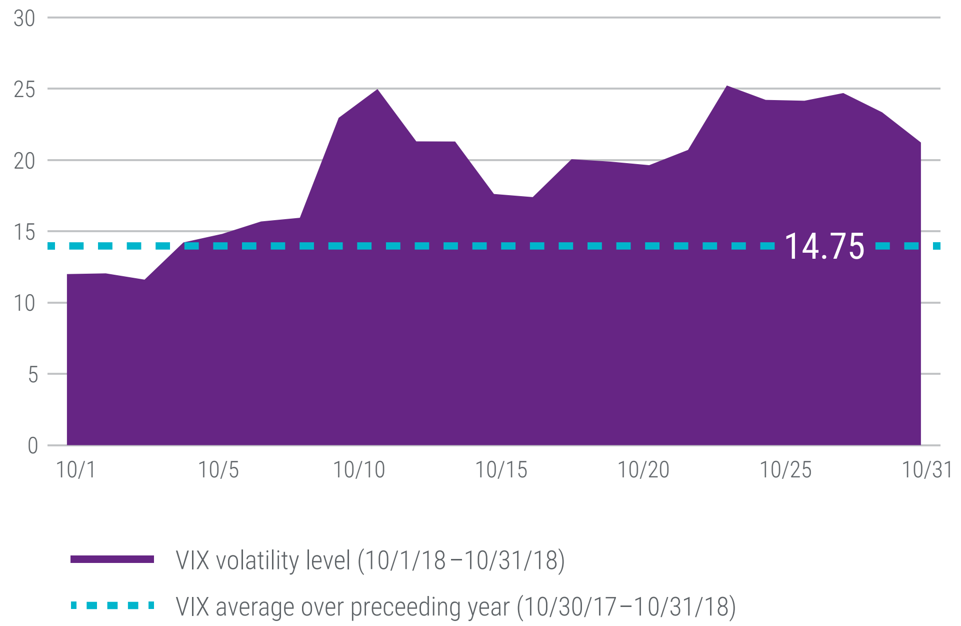
It would appear that many of those who sold out of the 2008–09 downturn may have learned a lesson about the value of a more long-term outlook. With ten years in the rearview mirror, 28% say they wish they had held their investment during the crisis while 41% wish they had gotten back in the market sooner. They will want to remember these lessons in the future as new factors have to be calculated into their investment assumptions.

A timely reminder of how quickly sentiment can change

Perhaps the biggest concern on the horizon for investors is interest rates. After ten years at historic lows, interest rates present a new conundrum for investors as they watch rates begin to inch up. In the first two weeks of October, interest rates and inflation seemed to be on the minds of investors as markets experienced three sessions in which the CBOE Volatility Index® (VIX, or the Fear Index), doubled from a mere 12% on October 1 to 24.98% on October 11.

2018 Volatility Has Been a Break from the Norm

Investors who had grown accustomed to low levels of volatility have been feeling the shocks of more volatile markets, particularly in October 2018.

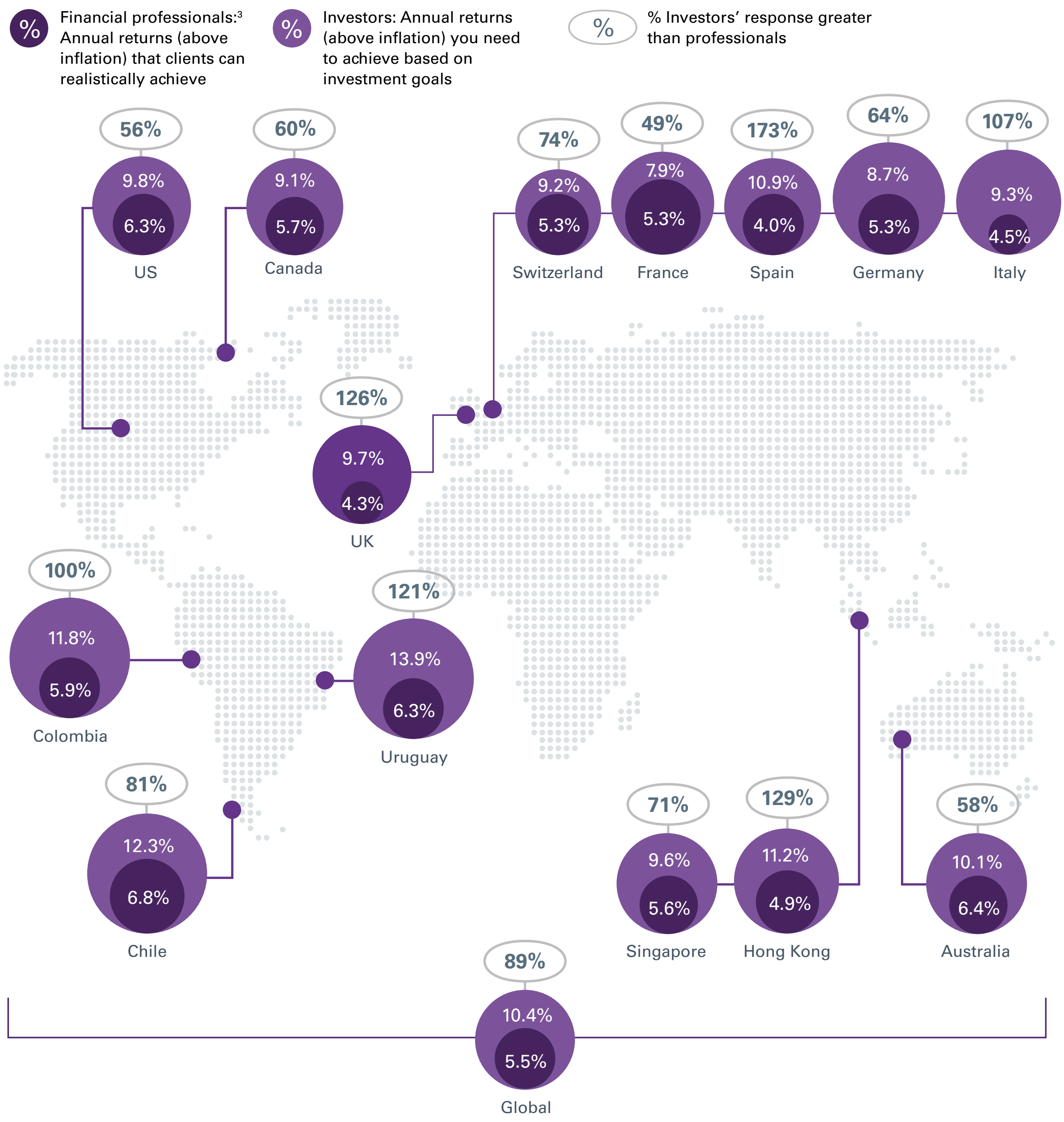


Source: CBOE VIX Index Historical Data

2 Natixis Investment Managers, Global Survey of Financial Professionals conducted by CoreData Research in March 2018. Survey included 2,775 financial professionals in 16 countries.

Bridging the Gap

The difference between what investors think they need for returns and what professionals say they can expect



The value of professional advice

Financial professionals and investors aren't always on the same page about returns – which underscores the need for professional financial education and advice. Even though more than half of investors say the long-running bull market has made them feel secure about their investments, nearly eight in ten financial professionals say it's simply made investors complacent about risk.

3 Natixis Investment Managers, Global Survey of Financial Professionals conducted by CoreData Research in March 2018. Survey included 2,775 financial professionals in 16 countries.

It's important to bear in mind that this followed the Fed's announcement from two weeks prior of a target interest rate range of 2%–2.25%. At any other point in time, these rates would have seemed incredibly low. But after ten years at near zero, the market finally found the point that made many investors unnerved.

With ten years in the rearview mirror, 28% of investors say they wish they had held their investment during the crisis while 41% wish they had gotten back in the market sooner.

Our research shows that investors are conflicted about what this means for their assets. Just over six in ten (62%) say they are worried about the negative effects that rising interest rates could have on their investments. At the same time, two-thirds believe that in the long run, interest rate hikes will be good for their investments.

A continuum of conflict

It is likely that conflict will continue to flummox investors into the future, and it's clear that they will need help. Investors may have made it through the chaos of the financial crisis, but today, they grapple with conflicted feelings. They have to rationalize their perceptions of trust and security, reexamine mixed messages about active and passive investing, and reconcile their return expectations with their risk tolerance.

This is where the value of professional advice comes across loudest: a professional opinion to help investors make sense out of the market noise. Investors see the value too, as seven out of ten surveyed say that they believe investors who have a professional investment advisor are more likely to meet their goals.

PROGRAM OVERVIEW

About the Natixis Center for Investor Insight

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. The Center for Investor Insight 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 professionals 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 9,100 investors in 25 countries.
- Global Survey of Financial Professionals – reaches out to 2,775 professionals in 16 countries.
- Global Survey of Institutional Investors – reaches out to 500 institutional investors in 30 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.

To learn more:
Visit: im.natixis.com/research

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