INVESTOR INSIGHTS SERIES

Ready. Steady. And waiting.

Professional fund buyers taking active steps to tackle 2019's anticipated volatility and uncertainty

Seeking risk to provide performance in a world of low returns. Limiting risk to preserve wealth amid the world's widespread uncertainty. Successfully pursuing each goal is difficult; trying to achieve the two simultaneously is tougher still. But despite their seemingly contradictory challenges, professional fund buyers are confident they can tackle what they see coming in 2019 – equity and fixed income markets that are likely to be more volatile, yet offer opportunities for discerning buyers; interest rates that are expected to rise, but could stabilize as a result of policy shifts; and a global economic environment marked by trade and geopolitical uncertainties. If anything, the stock market's plunge in last year's final quarter and its full bore return early in the new year underscore the value of the group's focused, disciplined approach that is prepared for the worst while attempting to capture the best, whenever and wherever that occurs.

In short, the next 12 months probably won't be easy for professional fund buyers, who are responsible for selecting funds for insurers and funds of funds, as well as recommending and/or choosing funds for the platforms of broker-dealers, private banks and trust companies. The results of this year's global survey of 200 of these key investment decision-makers reveal the directions they are likely to take to satisfy the demands of their firms' clients.

Professional fund buyers have lowered long-term return expectations to 7.7% from 8.4% last year.

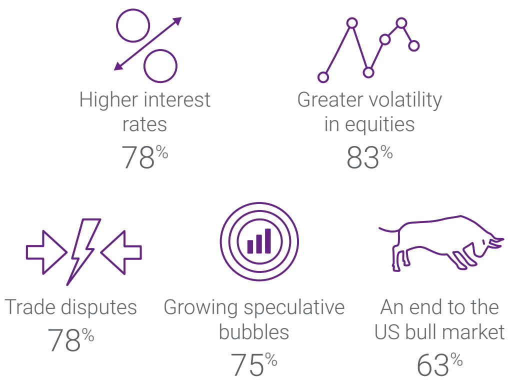
Projected portfolio allocations for 2019 remain unchanged, but they anticipate making meaningful changes within asset classes.

Three-quarters of professional fund buyers say this market environment is favorable for active management.

Rising concerns, lower performance expectations

While December 2018's market decline came after this year's survey results were collected, the cautious mindset revealed by the responses of professional fund buyers indicate that their wide-ranging concerns are well grounded. Reflecting the more difficult year they expect, professional fund buyers reduced their long-term rate-of-return assumptions to an average of 7.7% from 8.4% last year.

Among their expectations and concerns for 2019



- **Higher interest rates** – anticipated by the vast majority of respondents and considered a top portfolio risk by more than half. More than the absolute level of interest rates, professional fund buyers are concerned about the pace of central bank rate hikes.
- **Greater equity market volatility** – concerns half of respondents, and is expected by an overwhelming majority.

Portfolio allocations locked in for the long term

	Equities	Fixed Income	Alternatives	Cash	Other
2017[1]	43.6%	32.5%	13.7%	6.0%	4.2%
2018 (current)	44.2%	31.9%	14.6%	6.6%	2.1%
2019	43.0%	31.7%	15.8%	7.1%	1.6%

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

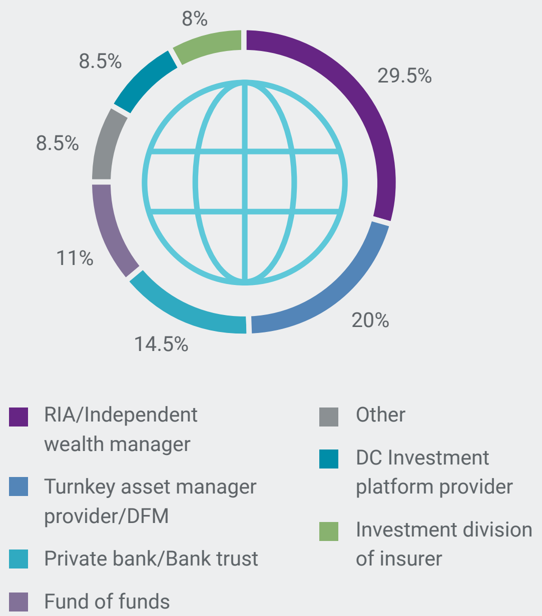
- **Performance pressure** – from forces including central bank unwinding of quantitative easing, geopolitical disruptions and trade disputes.
- **An end to the US bull market within 12 months** – a timetable with which almost two-thirds of respondents either agree or strongly agree. While only a handful expect a global financial crisis in 2019, six in ten believe that regulation put in place after the 2008–09 crisis has done little to mitigate current and future market risks.
- **Market bubbles** – individual investors are unaware of emerging speculative bubbles, say the vast majority of professional fund buyers, who see the most danger in cryptocurrencies, followed by technology, the bond market and real estate.

Despite their concerns, professional fund buyers around the world are staying the course. For 2019, they are planning to make relatively small changes to the share size of each asset class allocation within their portfolios, but anticipate making some meaningful changes within each of the asset classes.

ABOUT THE SURVEY

The Natixis Investment Managers Global Survey of Professional Fund Buyers was conducted by CoreData Research in October and November 2018. The survey included 200 respondents in 22 countries throughout North America, Latin America, the United Kingdom, Continental Europe and the Middle East.

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:



Equities: Looking beyond national borders

While concerned about volatility and the effects of Federal Reserve tightening, professional fund buyers are trimming their overall equity allocation by just 1.2 percentage points from 2018. Within the asset class, however, they are taking a broad global view and are willing to venture far from home to seize opportunities. They anticipate making several moves, including a notable one involving emerging markets:

	INCREASE	DECREASE	NO CHANGE	DO NOT INVEST
European	35%	30%	30%	6%
Emerging market	39%	17%	27%	18%
Asia-Pacific	29%	18%	43%	11%
US	20%	44%	29%	8%

- **US equities:** Perhaps because of the age of the US bull market and opportunities elsewhere in the world, almost half of professional fund buyers (44%) say they plan to decrease their allocation to American stocks, while roughly one-quarter (28.5%) plan to stay the course.
- **European equities:** Conflicted by persistent worries about Brexit and Italian banks in the face of favorable valuations and earnings outlooks, respondents are almost evenly divided over increasing, decreasing and maintaining their allocations.
- **Asia-Pacific:** The recent trade fracas is causing US importers to seek new supply chains outside China, which will lead to new opportunities throughout the region. For that reason, perhaps, and because even slower China growth is greater than growth elsewhere, respondents are holding steady in their allocation to the region.
- **Emerging markets:** Perhaps reflecting what they see as a turn in the market cycle, most respondents say they plan to increase their allocation to this diverse equity category.

Within equities, professional fund buyers anticipate that the financials, healthcare and information technology sectors will outperform the market in 2019. In contrast, they see materials and real estate as likely underperformers. Sectors in the "market average" performance category include communication services, consumer discretionary, consumer staples, energy, industrials and utilities.

Fixed income: Safety first

Most respondents plan no change in their allocation to fixed income investments. Among fixed income classes, however, many professional fund buyers intend to direct less of their debt dollars into high yield bonds due to worries over rising interest rates, a potentially weaker economy, and the financial wherewithal of high yield issuers. By fixed income type, they anticipate making the following shifts:

	INCREASE	DECREASE	NO CHANGE	DO NOT INVEST
Investment grade corporate debt	21%	32%	39%	10%
Government related	29%	22%	38%	12%
Securitized debt	15%	17%	47%	23%
Emerging market debt	19%	23%	31%	28%
High yield corporate debt	21%	34%	30%	16%
Green bonds	22%	4%	19%	57%

- **Government and agency securities:** In their efforts to keep portfolios safe, more than one-third of respondents intend to keep their allocation to these highly rated debt instruments as is, while nearly one-third plan to increase their allocation.
- **Asset-backed debt:** In this category, which includes mortgage-backed securities and other securitized debt, almost half of those surveyed anticipate making no change.
- **High yield bonds:** Since high yield securities are often considered the debt market's closest equivalent to equities in terms of risk, it's probably not surprising that one-third of professional fund buyers are trimming their high yield sails.
- **Emerging market debt:** While enthusiastic about emerging market equities, professional fund buyers for the most part intend to keep their allocation to emerging market debt securities steady.
- **Green bonds:** Fewer than half of respondents invest in this category, but among those who do, the largest share intend to increase their allocation to bonds issued by companies deemed to satisfy environmental and other social criteria.

Alternatives: A route to returns, diversification and safety

Currently constituting 14.6% of portfolios, on average, and projected to increase to 15.8% in 2019, the diverse range of alternative investments and strategies used by professional fund buyers are seen as valuable tools to help meet performance objectives, manage risk and diversify holdings.

	INCREASE	DECREASE	NO CHANGE	DO NOT INVEST
Infrastructure	19%	8%	33%	41%
Private debt	15%	13%	31%	42%
Private equity	17%	11%	33%	40%
Real estate/ REITs	22%	15%	41%	23%
Hedge fund strategies	19%	16%	35%	31%
Commodities	10%	13%	34%	44%

Because of the preferences of their individual investor clients, who do not typically share the decades-long time horizons of many institutional investors, a resounding 70.1% of professional fund buyers' alternatives allocations go to liquid alternative investments. The survey included questions about several alternative asset types available in liquid versions including real estate and REITs, hedge fund strategies, commodities, infrastructure and others, as well as less liquid alternatives including private equity and private debt, and questions about respondents' preferences regarding the choices.

- **Enhancing returns:** When asked which strategies are the best for potentially enhancing returns, most of the professional fund buyers surveyed identified long-short equity, long-short credit and private debt as their top choices.
- **Risk reduction:** Most opt for market neutral strategies.
- **Diversification:** Honors went to multi-alternative, global tactical asset allocation and real estate strategies, while for protection against volatility, managed futures was the winner.
- **Option writing:** Respondents were almost evenly split on its advantages in return enhancement (22%), volatility protection (20%) and the ability to generate steady income (23%).

Within their overall alternatives allocation for 2019, most professional fund buyers plan no change in the share directed to each asset or strategy type.

Cash: Receiving its due

Rising volatility, concerns about the economy and worries about the continuation of the equities bull market are three reasons that cash is once again being appreciated as an asset class diversifier. Having a cash cushion to seize buying opportunities as well as to dampen the impact of potential losses in other assets can lessen risk in portfolios and improve returns — as well as allay client fears. Assisting in this reburnishing of cash's role in a portfolio are higher short-term interest rates, which have shifted cash from an asset acting as a performance drag to one making a modest contribution to gains.

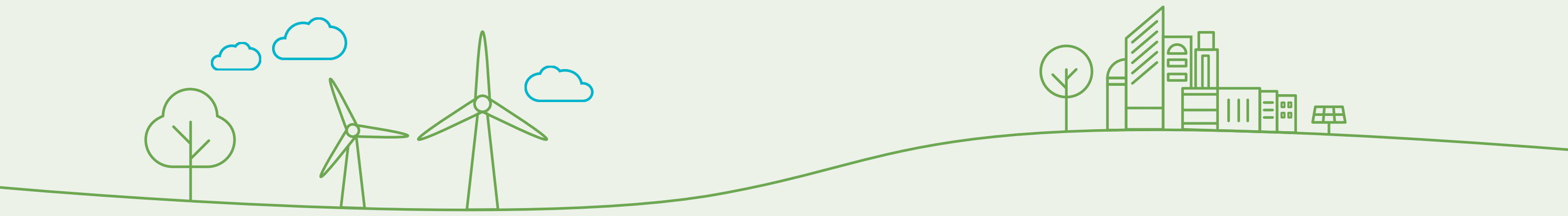
While half of professional fund buyers plan no change in their cash allocation in 2019, one-quarter plan to increase their allocation. Overall, cash is anticipated to account for 7.1% of portfolios in 2019, up from 6.6%.

	INCREASE	DECREASE	NO CHANGE	DO NOT INVEST
Cash	26%	13%	48%	14%

The markers of professional fund buyer decision-making

The role of the professional fund buyer is often that of gatekeeper and arbiter, analyzing and selecting investments for others – typically individual investors who are clients of the buyer's organization, and often the advisors who serve those clients. Because of their role as intermediary decision-makers, professional fund buyers must take into account their own organization's demands as well as those of advisors and end clients, and make choices that try to satisfy all those they serve. The role presents unique tensions regardless of where in the world the professional fund buyer is employed, or by which organization. As a consequence, this small but influential group of investment professionals has developed certain preferences over time that shape their outlook and their choices. Here are four significant markers of the professional fund buyer mindset confirmed by results of the survey:

- **A bias toward risk assets.** Even while slightly lowering their 2019 allocation to equities, professional fund buyers still favor that asset class. As study after study about investment returns has concluded, equities offer the potential for greater returns over time than other asset classes, despite the greater risk. Even when market turndowns and crises test their clients' risk tolerance, and although they are not blind to potential speculative bubbles, professional fund buyers continue to take the path indicated by experience and choose equities.



ESG investing: Another year closer to becoming standard practice

Not so long ago, the use of investment criteria that incorporated attention to environmental, social and governance (ESG) factors was considered fringe. Now, whether due to the growing proportion of Millennial investors for whom ESG investing often is a priority, concerns about global warming and the environment, or because governance problems have proven to be at the root of several major corporate meltdowns, ESG investing has become mainstream.

When asked about ESG investing, half say ESG factors are important in their organization's current manager selection process, and two-thirds say they will increase their allocation to ESG strategies in 2019. More than half of those surveyed contend that there is alpha to be found in ESG investing.

The top two reasons professional fund buyers incorporate ESG considerations into investment decision-making and analysis are to align investment strategies with their organizational values and because ESG investing is mandated by their investment policy statements and those of their clients.

> Two-thirds of professional fund buyers say that including ESG factors will be standard practice for all investment managers within five years.

Most often cited as challenges in ESG investing are a lack of demonstrated performance track records, the difficulty in measuring financial and non-financial performance, concerns that companies may be "greenwashing" reported data to enhance their public image, and the conflict between short-term return goals and long-term sustainability objectives.

- **Time horizons suited to client needs.** Unlike investment professionals at endowments who effectively have an infinite time horizon, professional fund buyers must select investments that achieve long-term goals for end-clients, such as building a retirement nest egg, while also satisfying the more immediate demands of clients and their advisors for above-average performance. As a result, the long-term time horizon of professional fund buyers is shorter than that of many institutional investors but longer than the actual (not self-professed) time frame of individual investors, as demonstrated by the holding period of their investments. Half of survey respondents say they base their organization's long-term return assumptions on a ten-year time frame, while 40% used a five-year period.

- **Preference for liquidity.** Probably because of the shorter time horizons and liquidity needs of their clients, who often do not clear the hurdles surrounding many private investments, professional fund buyers tend to favor liquid alternative investments and liquid versions of strategies used by hedge funds. Most do not invest in private equity or private debt, for example, or in infrastructure investments.

- **Strength of convictions.** Professional fund buyers have confidence in their abilities and in the quality of their investment selections. More than eight in ten believe or strongly believe that their return assumptions are realistically achievable.

Why professional fund buyers choose active management

Since slightly more than one-quarter of portfolios overseen by professional fund buyers are managed passively, investment professionals obviously acknowledge the role of index-based investing. Yet almost three-quarters of their portfolios consist of actively managed investments, which means that professional fund buyers strongly support the value added by high-quality active managers.

Active features prominently in portfolio plans

Almost two-thirds of respondents agree or strongly agree that actively managed investments outperform passive portfolios in the long run. In fact, even in their passive holdings, over half are allocating more to smart beta choices than they were three years ago.

Asset managers: What professional fund buyers want

No question, performance is the key determinant of asset manager selection among professional fund buyers. But other factors enter into their decision-making.

Chief among these are:

- Access to portfolio specialists
- In-depth performance attribution reporting
- Independent fund analysis
- Timely market insights
- Direct access to fund managers
- Sharing of investment philosophy
- Strength of support services.

While another three-quarters of respondents agree or strongly agree that alpha is becoming increasingly difficult to obtain as markets become more efficient, they are willing to pay higher fees for potential outperformance and agree that the 2019 market environment is likely to be favorable for active portfolio management.

Facing challenges with confidence

Like travelers venturing outdoors when weather forecasters warn of the possibility of a storm, professional fund buyers are prepared for what might be coming in 2019. Almost half have trimmed their assumed rate of return in anticipation of stock market declines and rising interest rates, which tend to reduce the value of fixed income investments.

But they are not holing themselves up and avoiding what may come. Instead, they are selectively using alternative investments, especially of the liquid variety, to meet their clients' needs for growth and safety, as well as continuing to rely on the performance potential of active management. Professional fund buyers overwhelmingly agree that the unfolding market environment, however challenging it may be, is likely to be favorable for active management.

PROGRAM OVERVIEW

About the Natixis Center for Investor Insight

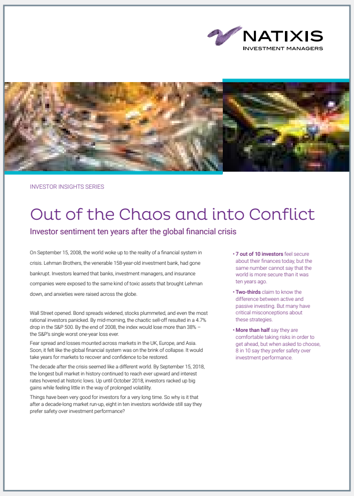
Investing can be complicated: Event risk is greater and more frequent. Volatility is persistent despite market gains. And investment products are more complex. These factors and others weigh on the psyche of investors and shape their attitudes and perceptions, which ultimately influence their investment 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 28 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.



Out of the Chaos and into Conflict

Investor sentiment ten years after the global financial crisis

Rise against the machines

Financial professionals focus on human dynamics in response to growing digital competition

2018 Global Retirement Index

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