The waiting game: Ten market trends institutional investors are watching in 2020

2020 Institutional Outlook
Executive Overview

Despite big gains for stocks and bonds during 2019, institutional investors are worried that stalled trade talks, slow global growth, and low yields could hurt portfolio performance in 2020. But even as they see a wide range of risks for 2020, portfolio projections show institutional investors aren't willing to make big bets or changes. Instead their strategy appears to be "Let's wait and see."

1. Market volatility becomes a portfolio reality
2. Uncertain markets call for active management
3. Asset allocations remain in a holding pattern
4. Sector preferences reveal limited hope for growth
5. Markets are due for a correction, but which market…and when?
6. Politics are the elephant in the room
7. Central banks, interest rates and the viability of negative yields
8. Going private to get better results
9. ESG (Environmental, Social & Governance) gains greater adoption as motivations gain clarity
10. Institutions worry about how individual investors will react

About the survey

Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in October and November 2019. Survey included 500 institutional investors in 29 countries throughout North America, Latin America, the United Kingdom, Continental Europe, Asia and the Middle East.

500 total survey respondents

145
Corporate Pension Plans

102
Endowments/ Foundations

103
Public or Government Pension Plans

127
Insurance Companies

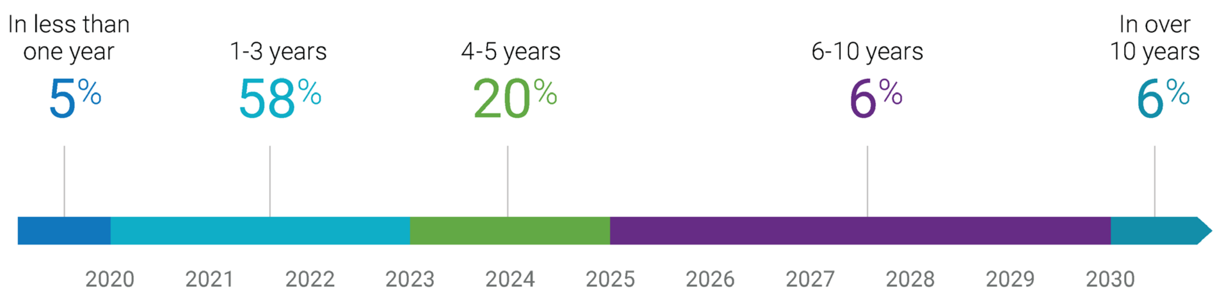
23
Sovereign Wealth Funds

The waiting game

The question isn't which risk will do the damage, it's more a question of when. Our recent survey reveals that institutional investors say they expect the next global financial crisis within the next 5 years.

- Almost three-quarters (73%) project trade will have a negative impact on performance.
- Institutional investors also believe slow growth will have a negative impact on investment performance.
- Six in ten institutions also believe the low yield environment will hamper investment performance in 2020.
- 58% see the potential for asset bubbles to thwart performance.
- Nine out of ten (89%) are concerned about the impact of rising public debt on global financial security.

When do institutional investors think the next crisis will hit?



6% of institutional investors do not think there will be another global financial crisis.

1

Market volatility becomes a portfolio reality

Institutions see volatility as a predictable outcome for markets in 2020 and rank it as their top portfolio concern for 2020.

- Three-quarters of institutional investors believe stocks will be more volatile.
- Two-thirds predict greater volatility for bonds.
- 52% predict an uptick in currency volatility.
- US politics have a big influence on views about equity volatility – many believe impeachment proceedings and the looming presidential race could both present shocks to the system.
- Calls for bond volatility are more surprising since current policies leave little room for central banks to maneuver.
    - In the past year, investors pinballed from rate hike fears to a series of cuts, resulting in volatility.
- The above factors like these may be why institutions rank volatility (53%) as their top portfolio risk for 2020, but perennially low interest rates (50%) finish a close second.

Top 5 portfolio risk concerns for 2020

Volatility	53%
Interest rates	50%
Credit crunch	37%
Liquidity	35%
Deflation	20%

74% of institutional investors agree that the current market environment is favorable to active management.

2

Uncertain markets call for active management

With volatility rising, about half of institutions (46%) believe dispersion will be up, too. The resulting increased spread between security prices may be one reason why three-quarters of institutional investors say today's markets favor active management.

- 71% find it harder to generate alpha as markets become more efficient.
- Institutions have been increasing allocations to active over the past three years.
    - They will maintain their 70% to 30% passive split over the next three years.
- 74% think individual investors have a false sense of security about index funds.
- Institutions see significant risks in outsized flows into passive investments.
    - 64% say it amplifies volatility.
    - 54% think it shows that the market is ignoring fundamentals.
    - 57% worry the phenomena has concentrated control in the hands of too few shareholders.

Active features prominently in portfolio plans

	Active/Passive Allocations: 2016 Survey [1]		Active/Passive Allocations: 2019 Survey	
	Currently	3 years from now	Currently	3 years from now
Active Investments	67%	66%	71%	70%
Passive Investments	33%	34%	29%	30%

74% of institutional investors agree that the current market environment is favorable to active management.

1 Natixis Investment Managers, 2016 Global Survey of Institutional Investors conducted by CoreData Research, October and November 2016. Survey included 500 institutional investors thoughout North America, Latin America, the United Kingdom, Continental Europe, Asia and the Middle East.

Unlike passive investments, there are no indexes that an active investment attempts to track or replicate. Thus, the ability of an active investment to achieve its objectives will depend on the effectiveness of the investment manager.

3

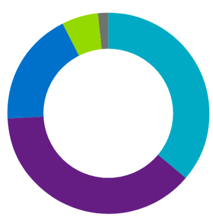
Asset allocations remain in a holding pattern

Even though they see challenges on the horizon, institutions aren't planning significant allocation shifts. In fact, current allocations are within one or two percentage points of what institutions projected for 2019.

- Equities: With markets in the midst of delivering double-digit returns, equities can look a bit expensive and risky.
    - The lack of significant allocation shifts suggests they are holding steady.
- Fixed Income: Falling rates have featured prominently in portfolio strategy for over a decade.
    - Institutions are happy to hold the hand they've been dealt and appear to want to moderate overall risk exposures.
- Alternatives: Investment plans for this asset class show slightly more movement, which reflects how far afield institutional investors are willing to go for yield replacements.
    - Those looking to adjust alternative allocations say they will increase allocations to private debt, infrastructure and real estate.

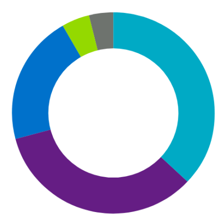
Portfolio allocations locked in for the long term

2019



39.1% Fixed Income
36.5% Equities
17.5% Alternatives
5.1% Cash
1.7% Other

2020



38.7% Fixed Income
35.8% Equities
18.7% Alternatives
5.1% Cash
1.7% Other

Institutions are not projecting any significant shifts, with allocations within one or two percentage points of 2019 projections.

3

Asset allocations remain in a holding pattern

Equities	Increase	No Change	Decrease	Do Not Invest
Emerging Market Equities	29%	42%	16%	12%
European Equities	25%	41%	28%	6%
Asia-Pacific Equities	22%	49%	18%	11%
US Equities	16%	43%	35%	6%

Fixed Income	Increase	No Change	Decrease	Do Not Invest
Investment Grade Corporate Debt	29%	44%	22%	5%
Government-Related (Sovereign Debt, Treasury)	27%	40%	29%	4%
Emerging Market Debt	24%	37%	15%	24%
High Yield Corporate Debt	22%	41%	23%	13%
Securitized Debt (Mortgage-Backed Bonds, etc.)	21%	47%	15%	17%
Green Bonds	15%	22%	1%	61%

Alternatives	Increase	No Change	Decrease	Do Not Invest
Private Debt	37%	32%	7%	23%
Infrastructure	32%	38%	7%	22%
Real Estate/REITs	29%	46%	11%	13%
Private Equity	28%	39%	12%	21%
Hedge Fund Strategies	17%	35%	17%	32%
Commodities	10%	40%	9%	41%

Cash	Increase	No Change	Decrease	Do Not Invest
Cash	18%	61%	17%	3%

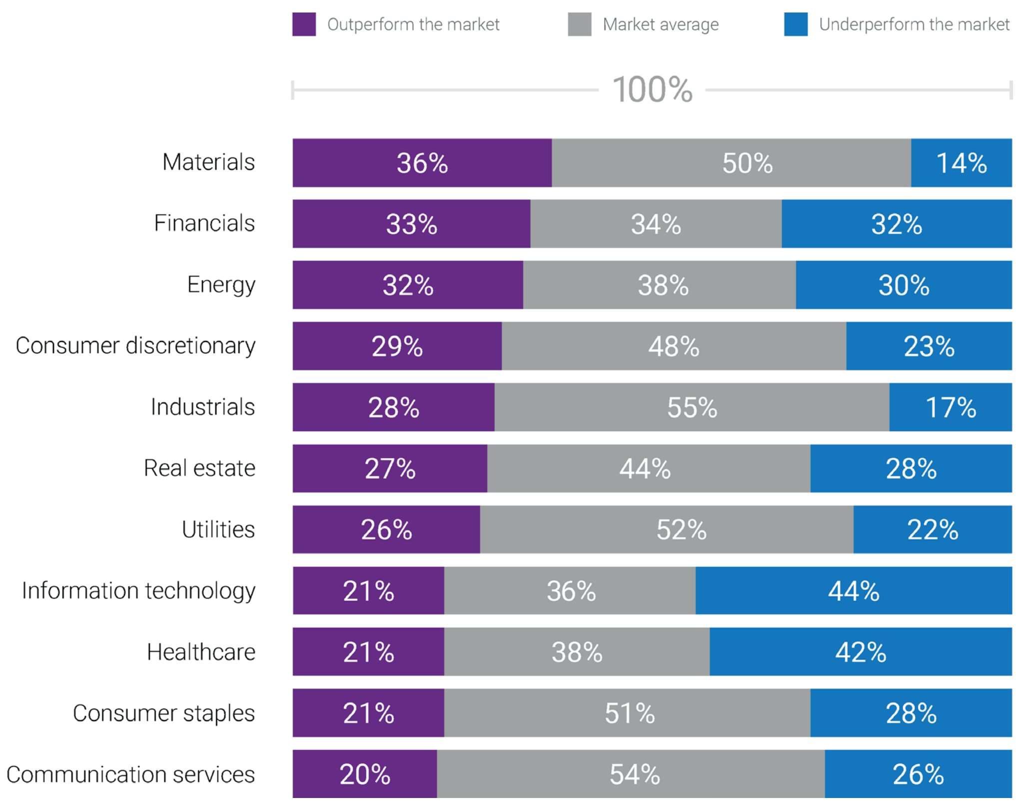
Rows may not add to 100% due to rounding.

4

Sector preferences reveal limited hope for growth

- Sector calls reflect the same muted performance outlook – institutions express no distinct sector preferences for 2020.
- Institutional investors expect market performance from most sectors with split projections for outperformance and underperformance.
- Machine learning and quantum computing present long-term growth trends in sectors where institutions do see potential for outperformance:
    - Healthcare – it's likely they see long-term growth potential in aging demographics
    - Information technology – the development of artificial intelligence

Many believe sector performance reveals conflicting viewpoints



Low rates, slow growth and a range of other factors simply add up to a big "meh" for market performance.

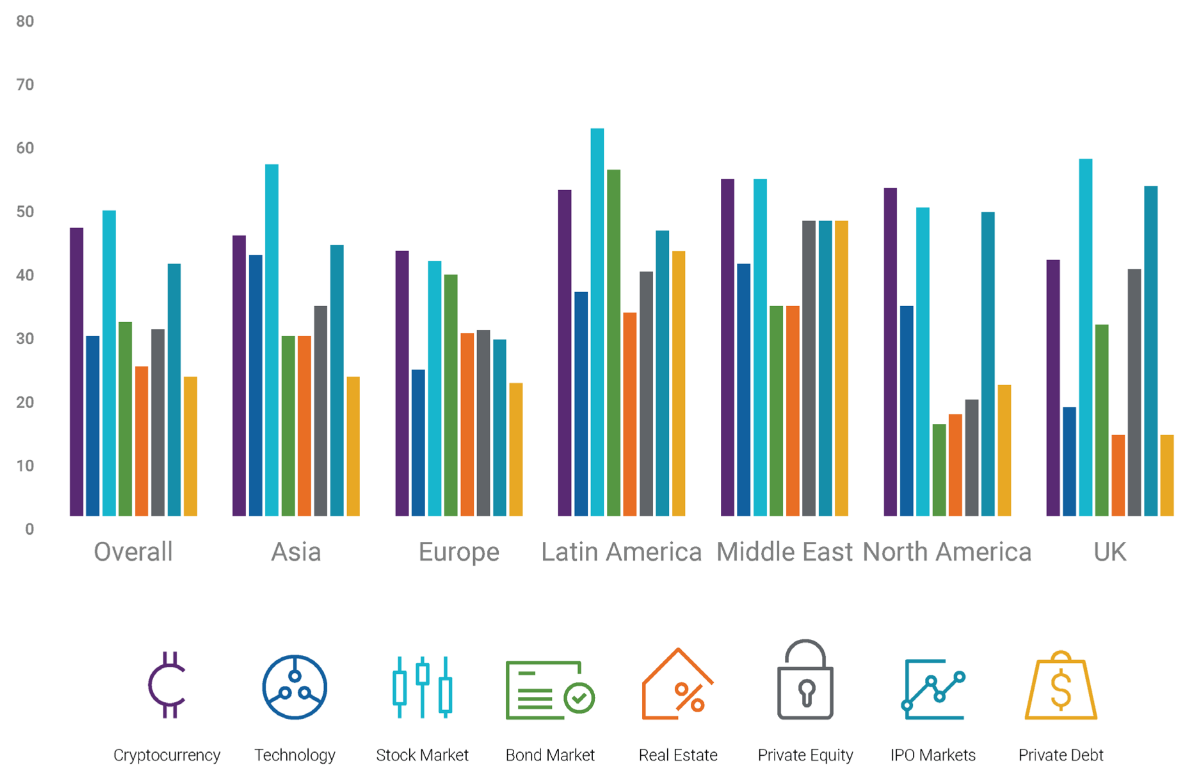
5

Markets are due for a correction, but which market … and when?

2019 was a stand-out year for stocks, especially the S&P 500 and the EuroStoxx which both reached the rarified air of 24% returns as of November 15.

- Almost half (48%) of institutions believe that equities are due for a correction in 2020.
- 46% believe cryptocurrencies are due for a correction.
  - Crypto has been a leading candidate for correction in our last three surveys and the asset has weathered numerous corrections only to bounce back time and again.
- Four in ten also see a correction in the wings for the IPO market.

Institutional investors see the potential for bubbles across a number of assets



It seems that institutional thinking lends itself to Newtonian physics. Investors believe that what goes up will inevitably come down.

6

Politics are the elephant in the room

Politics are the elephant in the room, from impeachment in the US, to Brexit in the UK, instability in Bolivia, and a rising tide of populism globally. Institutions are actively preparing portfolios for political risk.

- 64% project that the US presidential election cycle will result in market volatility.
- 54% believe impeachment proceedings will have a destabilizing effect on the markets.
- 52% think the market will respond favorably to a new US president.
- 54% see an unfavorable reaction should the Democrats win both houses of Congress.
- 73% believe trade disputes will have a negative impact on performance.

Top 5 strategies for managing political risk

Scenario analysis	48%
Have capital buffers/reserves in place	47%
Be more nimble and agile	31%
Prioritize risks based on some clear criteria	25%
Create signposts that track risks (and show how they are changing)	22%

Many events produced volatile short-term reactions, but few have delivered lasting impact to investors. In 2020, institutional investors will be watching the US presidential election carefully.

7

Central banks, interest rates and the viability of negative yields

Even after a decade of ultra-low rates, institutions are constantly challenged in their search for yield. The pressure to deliver is so great that three-quarters of those surveyed worry that institutional investors have taken on too much risk in pursuit of yield.

- More than half of institutions (56%) expect an increase in the volume of negative yielding bonds in 2020.
- One-quarter of those surveyed say they have already invested in some of the $17 trillion in negative yielding bonds that have been issued worldwide.
- More than half (54%) worry that banks do not have the tools they need at their disposal.

Top 5 challenges central banks face in implementing policy

Lack of tools at their disposal	54%
Increased expectations	36%
Lack of independence	35%
Lack of global coordination	34%
Gauging market reaction	29%

The many challenges facing central banks add up to a general insecurity about what could happen next.

Going private to get better results

Challenged to get what they need from traditional assets, institutional investors have turned to private markets.

- Institutions believe private assets are better suited than traditional assets for two critical portfolio functions: delivering diversification (62%) and generating more attractive returns (61%).
- 79% of institutions invest in private equity and 77% invest in private debt.
- 86% said they were worried that there may be too much money chasing too few deals when it comes to private investments, including 48% who are “very concerned.”
- Seven in ten are eyeing liquidity risk as a potential challenge.
- Institutions believe the returns of private assets (71%) are worth the liquidity tradeoff, and the majority (63%) say they are worth the higher fee.

Top 5 choices for private investment

Private Equity	
Growth capital	49%
Infrastructure	47%
Funds of funds	46%
Venture capital	45%
Co-investment	44%

Private Debt	
Direct lending	54%
Infrastructure	47%
Co-investment	36%
Distressed debt	36%
Mezzanine	33%

Despite potential challenges ahead, institutional investors don’t see private assets as a temporary solution. Nearly seven in ten (68%) say private investment will play a more permanent role in portfolios going forward.

9

ESG gains greater adoption as motivations gain clarity

Environmental, Social and Governance investing is being more widely adopted as 64% of institutions report they implement some form of ESG in their portfolios. Even though institutions have generally been on the leading edge of the practice, this represents a 10% increase over 2017 when 40% did not implement ESG.

- 57% of institutions say they do ESG to align their assets to organizational values.
- More than half (54%) of institutions believe there is alpha to be found in ESG.
- Almost four in ten (37%) implement ESG as a way of managing headline risk.
- One-third (33%) of those surveyed implement ESG as a way of influencing corporate behavior.
- 57% of institutions say they are more likely to vote in favor of ESG-related proxy issues in 2020.

It's not all about the numbers for all investors. A significant number of institutions (28%) say they implement ESG in order to help make the world a better place.

10

Institutions worry about how individual investors will react

Institutions see risk on the horizon for 2020. They plan for it by managing expectations, shifting assets, and relying on a long-term plan. Those responding to our survey worry that individual investors are not prepared to weather the same risks.

- Three-quarters of institutions believe recession worries could drive individuals to liquidate assets prematurely.
- Nearly eight in ten (78%) say individuals do not understand their own risk tolerance.
- 77% of institutions say individual investors have unrealistic return expectations.
- Investors across the globe expected returns of 10.7% above inflation in 2019, while 77% preferred safety over investment performance.
    - Overly optimistic expectations and extreme caution on risk is a combination that can lead to bad decisions.

When it comes down to it, the vast majority of institutional investors (78%) believe individuals are simply too focused on short-term results.

Winning the waiting game

Institutional investors have lots to worry about in 2020. But it appears they have the situation well in hand. They know politics could make markets more volatile. They know interest rates could make their hunt for yield even harder. They know global growth is likely to remain slow. But they also know it will take time, and they are patiently waiting out the market to see which trends will actually play out in the year ahead.

1. Institutions see volatility as a predictable outcome for markets in 2020.
2. With volatility rising, uncertain markets call for active management.
3. Even though they see challenges on the horizon, institutions aren't planning significant allocation shifts.
4. In most cases, institutions express no distinct sector preferences for 2020.
5. 2019 was a stand-out year for stocks, but institutions believe that what goes up will inevitably come down. The question is when.
6. There has been no shortage of political intrigue for markets to react to in the recent years, and institutions are preparing portfolios for political risk.
7. Institutional investors worry their peers have taken on too much risk in pursuit of yield and are concerned about the ability of central banks to manage through a new crisis.
8. Challenged to get what they need from traditional assets, institutional investors have turned to private markets.
9. Environmental, Social and Governance investing is being more widely adopted as 64% of institutions report they implement some form of ESG in their portfolios.
10. Institutions see risk on the horizon for 2020 and plan for it, but worry individual investors are not prepared to weather the same risks.

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Unlike passive investments, there are no indexes that an active investment attempts to track or replicate. Thus, the ability of an active investment to achieve its objectives will depend on the effectiveness of the investment manager.

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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An index fund is a type of mutual fund with a portfolio constructed to match or track the components of a financial market index.

A yield curve shows the relationship among bond yields across the maturity spectrum.

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