What Individuals, Institutional Investors, and Advisors Are Thinking Worldwide

Insight on investor attitudes toward risk, markets, and investing

CONTENT

NATIXIS GLOBAL ASSET MANAGEMENT INVESTOR INSIGHT SURVEYS

In 2012, Natixis Global Asset Management (NGAM) undertook three comprehensive studies of attitudes toward investing.

Among them, NGAM surveyed 5,319 individual investors in 14 countries for their views of risk, volatility and market performance, followed by a similar global poll of 482 institutional investors. Earlier, NGAM collected the views of 300 financial advisors in the United States and United Kingdom.

The surveys were sponsored by Natixis' Durable Portfolio Construction Research Center, which gathers insight into perceptions of investing, risk and the markets, connecting it with best practices from industry leaders. Through the center, Natixis looks to provide a springboard for conversations about new portfolio construction strategies.

The survey of individual investors was conducted online in June 2012. The respondents were based in the U.S., U.K., Australia, South Africa and 10 additional nations in Asia, continental Europe, South America and the Middle East. The survey of institutional investors was carried out in June and July 2012. The median asset level managed by the institutional respondents was approximately $23 billion. The survey covered the U.S., U.K. and 11 other nations in continental Europe, Asia and the Middle East. Most surveys were conducted online; in some nations, they were administered by telephone.

In March 2012, an online survey captured the views of financial advisors at firms that manage a combined $670 billion in assets. The survey was undertaken after a panel of financial advisors qualified and received an e-mail invitation from the survey firm.

None of the participants was informed that the surveys were sponsored by NGAM.

Executive summary:
Investors open up about risk, volatility and uncertain markets

Investing has become more complex, interconnected and volatile. In the last few years, we have experienced great market highs and lows; extreme daily shifts from gains to losses; massive ripple effects when a single country's economy expands or another's debt rises. We have experienced the biggest economic downturn since the 1930s and, afterwards, a fragile, uncertain recovery.

At the same time, the world is in the midst of seismic demographic shifts. The proportion of global population over age 60 is expected to double by 2050. The tumultuous market has led to historically low household savings rates in the United States, Italy, Japan and elsewhere, threatening the ability of hundreds of millions to meet their financial needs in old age.

To understand the implications of these changes, Natixis Global Asset Management sponsored a series of surveys in 2012 focusing on distinct sets of respondents – institutions, individuals and financial advisors. Our goal was to understand how these distinct types of investors cope with volatility and risk, what they expect from markets and whether they expect success in the future.

In combination, the surveys show striking similarities – and a few key differences – among these groups. Individuals, institutions and advisors fear an outside event will overwhelm their investment plans. They all want to repair the financial harm endured in the past few years, avoid repeating their mistakes, and constructively try innovative approaches to investing. At the same time, many are reluctant to commit fully to those new ideas.

In our survey, while investors want better results, they also want their investments to be safe. Their desire to keep their investments secure is understandable, especially on an emotional level. It could, however, lead to new mistakes that prevent many of them, especially individual investors, from recognizing new forms of risk or opportunities to better diversify their holdings.

▶ 1 in 5 people are very concerned about outliving their assets in retirement.

Our three surveys found:

- Individual investors are in deep conflict about whether to pursue returns or keep their investments safe; 80% of U.S. financial advisors say most of their clients aren't sure which direction to follow.
- Many individuals are sticking with conservative investment strategies that might have been suitable in the deepest days of the recession, from 2007 to 2009. As markets rise, however fitfully, investors' current behavior may not position them to meet financial needs as they age. In fact, only 25% of individuals worldwide believe they'll have steady income when they retire.
- Institutions believe the period of market hypervolatility isn't over. Eighty percent of institutional investors in our survey believe acute market ups and downs are simply facts of investing life. In this environment, most institutions are seeking to control risk. While that could produce more stable portfolios, 65% of institutions say they accept the notion that reducing risk will produce lower returns.
- Investors think it is time to shake up their investing plans: 69% of individuals would appreciate another new style of investing, while 64% of institutions say static 60/40 portfolios aren't the best way to pursue return and manage investment risk.
- Alternative investments could be part of the investing future for many investors. Fifty-one percent of individual investors would own alternatives if their advisors recommended them, and 63% of institutions believe portfolios ought to include alternatives to outperform the market. Alternative investments are those not classified as a traditional asset class such as stocks, bonds and cash.

Our research shows that individuals, financial advisors and institutions want a better way to cope with investing and economic changes. Given the findings outlined below, the challenge over the next few years is not only to recognize the potential for volatility and risk, but also to build portfolios that are responsive and durable.

Market volatility: Accepted by institutions, feared by individual investors

Investors large and small have endured market extremes in the past dozen years.

Day to day, markets have undergone tremendous swings; the Standard & Poor's 500 Index, for example, experienced more daily gains or losses exceeding 3% in the past few years than it did in the previous 50 years. Furthermore, equity markets have undergone historic shifts from bull to bear markets, and back again. Most major indexes throughout the world shed more than half their value from 2007 to 2009. While a few have nearly recovered their losses, markets from Milan and Madrid to Hong Kong and Tokyo remain far below peak levels.

Our research shows that a large majority of institutional investors have become accustomed to these abrupt changes in the markets: 81% of institutions worldwide expect the volatility experienced so far in the 2000s to be a permanent feature of the investing landscape. To them, it could be considered typical, even normal. Individual investors agree with them that volatility is here to stay.

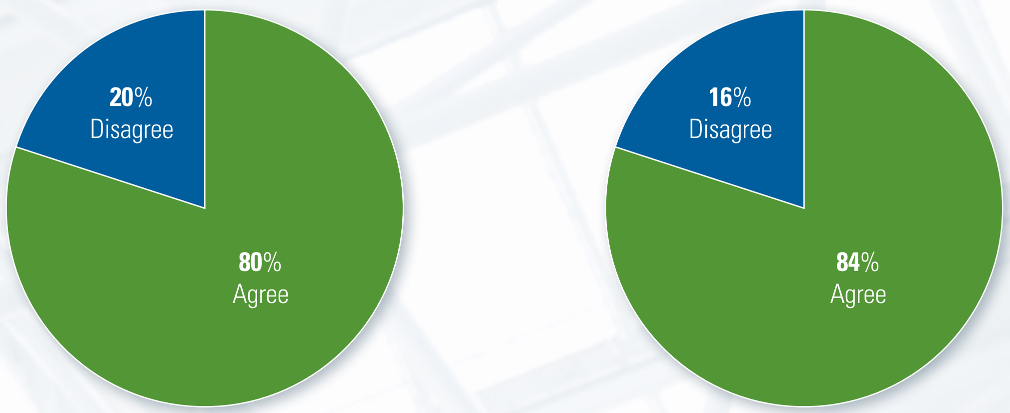
▶ Still on the sidelines...

57% of U.S. investors (49% global) say they don't plan on changing cash allocations.

However, we find that professional investors differ from individuals in one key respect: Most are much more optimistic about their ability to manage volatility now and in the future.

Across the 13 countries we surveyed, 84% of institutions say that volatility creates opportunity for investors, such as the chance to identify and trade mispriced securities while others are caught up in reaction to events. While 81% of institutions admit it's difficult to rein in the effects of volatility on their portfolios, only 32% report that they can't effectively control portfolio risk because of unexpected market movements.

INSTITUTIONAL INVESTORS SAY STOCK MARKET VOLATILITY IS HERE TO STAY



Market volatility is the new norm...
8 in 10 (80%) institutional investors agree that stock market volatility is the new normal for institutional investors.

...but volatility, like a crisis, provides opportunity
84% of institutional investors believe volatility creates investment opportunities.

Institutional investors in our survey have access to tools and data that individuals and many advisors don't have. For this reason, institutional managers are quite confident in their ability to harness market volatility: 89% believe their organizations are average or above average in managing risk during periods of volatility; 83% say they're effective in protecting their portfolios from dramatic swings in value.

Their conviction is shared by financial advisors. Though 43% of U.S. advisors say it's a major challenge to deliver strong performance in volatile markets, 89% believe their clients' investment portfolios are designed to manage volatility properly. In other words, while the job is difficult, they are certain they're up to the challenge.

Individual investors are far less assured, with 71% of those surveyed saying volatility has damaged their confidence in the markets. More than half (52%) say market volatility undermines their ability to reach their investing goals and 51% have lower expectations for future returns.

With personal wealth at stake, it's not surprising that individuals feel the sting of their losses more sharply than do professional investors. But they aren't without options. Financial advisors increasingly have access to sophisticated risk management tools. These analytical devices can demystify volatility, so advisors can help clients better understand the sources of risk in their portfolios, as many institutions routinely are able to do. Together with extra encouragement from their advisors and a plan that shows the virtue of remaining invested in the market, these tools can help keep individual investors from taking actions that could be counterproductive in the long run.

▶ ...but very concerned about outliving assets.

1 in 5 global investors are very concerned about outliving assets in retirement.

FIGHTING THE LAST BATTLE: SEEKING SAFETY AFTER MARKET LOSSES

Even if the pace of volatility has slowed compared with the darkest days of the 2008–2009 financial and economic collapse, the markets still have the potential for great upheaval. Markets continue to demand vigilance, not complacency.

So it's no surprise that many investors – both institutions and individuals – are reacting so conservatively. In some cases, they're choosing courses of action that, on the surface, seem safe but could carry an unexpected amount of risk.

Globally, 26% of institutional investors tell us they intend to increase holdings of cash-like investments; it's one of their biggest priorities in the coming year. Among individual investors, 57% say they don't plan to change their cash allocations. Seventy-six percent of Australians and 62% of British respondents don't intend to move their cash.

Simply stated, the goal of a sizable number of investors is simply to not lose money now. However, with the typical cash instruments earning record low rates, these investors have the potential to fall behind inflation. In other words, they'll lose the money they think they're protecting.

Investors and advisors need to reexamine their strategies and ensure they are equipped for future markets, not merely reacting to past events.

Market swings influence investors, threaten financial goals

Based on their responses to our survey, investors seem to be having debates with themselves about how to invest. Should they be aggressive and seek bigger gains? Should they stay conservative and put their money in safer assets? And, no matter what direction they choose, what risks are involved?

Those questions reflect a tension held by investors after steep losses and a halting economic recovery. Even as they nurse their financial wounds, investors realize they have to take care of major long-term financial needs, such as retirement or meeting pension obligations.

Across the globe, only one individual investor in four is highly confident in having a steady retirement income. Sixty-five percent of individuals are concerned about meeting their retirement savings goals; 51% worry they'll run out of assets in old age.

What are they doing to ensure they'll meet their needs? The picture is mixed.

Two-thirds of individuals (67%) say they have mixed feelings, that they can't decide whether to invest to obtain return or to preserve capital. That view is confirmed by advisors, 80% of whom say most of their clients are torn between pursuing gains and keeping assets safe. Institutions are clearer about their priorities. Growing capital in the long term is one their organization's top investment objectives, according to 62% of respondents. The second-ranked objective, preserving capital, is named by 37%.

Individual investors in our survey may be tentative because they're looking backward – back at the losses they endured three or more years ago – rather than looking ahead.

- 65% of individuals say they will take on only minimal investment risks, even if that means sacrificing returns. Only 6% of investors globally strongly agree they can tolerate more risk now than a few years ago.

▶ 80% of advisors say most of their clients are torn between gains and safety.

- 61% would select safety over performance, if forced to make a choice.
- 56% say they're afraid of losing money because of market volatility, so they don't invest or save as much as they otherwise would.
- Only 41% say they're eager to take on more risk to make up for past losses, and an even lower proportion (28%) claim they regularly focus on finding the highest return over preserving their investment assets.
- 75% of financial advisors put a higher priority on preserving capital than generating returns.

Industry data show these attitudes in practice. The Standard & Poor's 500 Index rose for three consecutive calendar years and gained 13% in the first nine months of 2012. Nevertheless, investors withdrew $83 billion from stock mutual funds in the first three quarters of 2012, according to the Investment Company Institute.

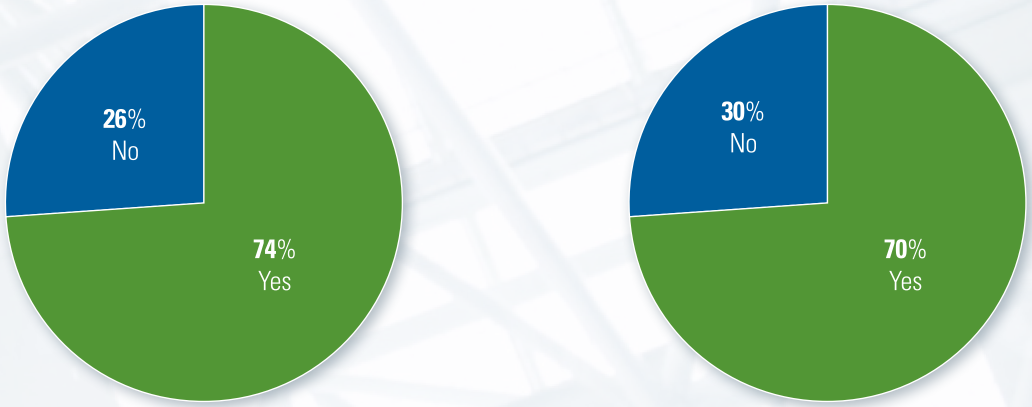
That type of defensive behavior might have helped investors through the market downturn. But deploying the same strategy as markets recover may prevent them from attaining the gains needed to meet their retirement goals.

Markets don't stand still. Conditions are constantly changing. Advisors can and should play a critical role in helping investors realize what is different.

INSTITUTIONAL INVESTORS ARE NOW MORE CONFIDENT ABOUT RISK MANAGEMENT

Has your institution changed its risk management approach compared to the approach it took five years ago?

Do you feel more confident that your risk management is the right one for today's volatile markets?



FROM CAPITAL ALLOCATION TO RISK ALLOCATION

Extreme markets have put investors on alert.

Sixty-two percent of individual investors worldwide say they pay more attention to risk than ever.

Meanwhile, institutions say they are devoting more resources to portfolio risk management. To them, putting together a diverse portfolio involves more than capital allocation – that is, the mix of assets their money is invested in. More and more, it's also about risk allocation and knowing where risk is embedded in their portfolios.

Seventy-five percent of institutions say they've changed their approach to portfolio risk management in the last five years, stepping up their use of risk budgeting and allocations to non-correlated assets, for example. In Asia, 81% of institutions have altered their risk management strategy. To avoid putting too many eggs in the same basket, 79% of institutions worldwide say they consider which investments are designed specially to produce low correlation to broader markets.

Consequently, 74% of institutions are more confident about risk management than they were five years before. That certainty is tempered by a concern about the effect on performance, as 65% of institutions believe that reducing risk means they'll have to accept lower returns.

This approach may help investors to develop better strategies to manage volatility and risk.

Usefulness of traditional asset allocation plans questioned

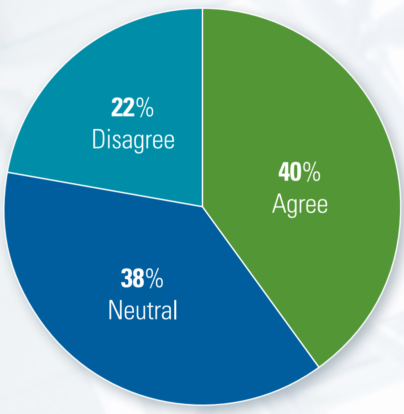
Institutions, advisors and individuals are all receptive to new approaches to investing. Traditional investing styles – such as placing 60% of assets in stocks and 40% in bonds – don't fully capture the complexity of the markets and should be replaced, they say.

Institutional investors have been innovators in asset allocation and portfolio construction. So it's not surprising that 64% of institutions say static 60/40 portfolios aren't the best way to pursue return and manage investment risk.

Likewise, 49% of advisors say they're not convinced the 60/40 strategy is relevant today. In response to a separate query, 40% of advisors agree that the conventional portfolio structure isn't the best way to balance return and risk for most investors; just 22% believe the 60/40 distribution is the best approach.

Research shows investors are open to a more dynamic investment strategy.

RETHINK OF TRADITIONAL 60/40 APPROACH UNDER WAY



Only 22% of financial advisors believe that a traditional 60/40 portfolio is the best way to pursue returns and manage risk.

▶ 69% of individual investors surveyed say they would welcome new methods of investing.

After all, 69% of individual investors surveyed say they would welcome new methods of investing. And, given their fears of market volatility and desire for stability, average investors might be open to portfolio construction techniques that put a priority on managing portfolio risk.

To be sure, the 60/40 strategy can, in certain market environments, deliver returns that investors desire. But it often does so with high volatility, giving investors a bumpier ride than many are comfortable with.

▶ Given their fears of market volatility, average investors may want to consider portfolio construction techniques that put a priority on managing risk.

Consider making alternatives part of the investment mix for individual investors

Alternative investments can be a potential source of risk protection and diversification for investors at all levels. Indeed, 69% of institutional investors say it's essential to invest in alternative strategies so they can diversify risk and 63% believe alternatives are needed in a portfolio to outperform the broad market.

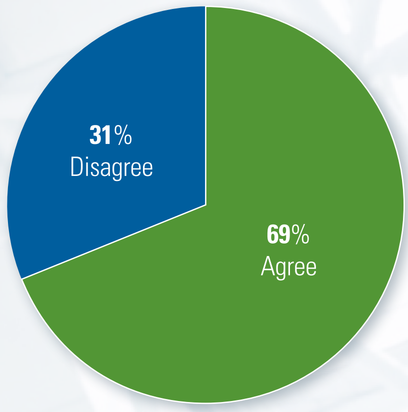
Alternative investments can include hedging or shorting, long or short stakes in commodities, currencies or real estate that can help portfolios overcome the ups and downs of market volatility.

Industry experts believe alternatives could become an important part of more portfolios; one industry estimate suggests that alternative funds could grow from 2.8% of mutual fund assets in 2011 to 16% within 10 years. Even with such apparent momentum, there's a good deal of skepticism about alternatives among individual investors. Many investors in our survey acknowledge they don't know much about these asset categories – and what they do know makes them leery.

Almost half of individual investors (46%) believe that alternatives are inherently riskier than traditional assets, like stocks and bonds, and 40% agree that alternatives are appropriate only for wealthier investors or institutions. Seventy percent of individuals say they invest only in assets they believe they understand. For them, alternatives don't make the list.

For their part, U.S. advisors want to make alternatives a bigger part of clients' holdings. About half (49%) say they already employ alternative strategies on behalf of at least some clients, though mainly those investors with $1 million or more in investable assets. Large majorities of advisors say they're willing to extend the use of alternative strategies to clients with fewer assets. That includes 64% of advisors who work with mass-market investors who have less than $300,000 to invest.

ALTERNATIVES VITAL TO RISK MANAGEMENT

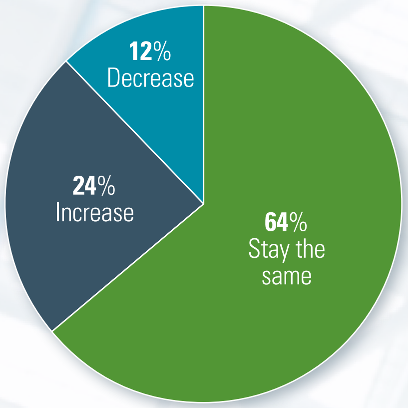


A majority of institutional investors say alternatives are vital in order to spread out risk.

While institutional investors recognize the importance of alternatives, 47% of investors worldwide acknowledge they've never discussed alternative investments with an advisor.

Investors would benefit from learning that, while alternatives are better known for taking higher risks to pursue returns, many are designed to seek returns that are more modest, stick to specific volatility targets and lower portfolio risk. In fact, investors are open to persuasion; 51% say they would use alternatives if their advisors recommended them.

INSTITUTIONS COMFORTABLE WITH ALTERNATIVES



If they had to do it all over again, nearly all institutional investors would either maintain (64%) or increase (24%) their current allocations to alternative assets.

Institutional investors have had the most experience with alternative investments and are more convinced of their value.

Looking back at the last few years, 85% of institutions that use alternatives are pleased with the performance of these assets.

Twenty-four percent of those institutions say that, in hindsight, they would have increased their allocations to alternatives. That's double the 12% of institutions that would decrease their allocations, while 64% say they would have kept the same allocation.

Conclusion: Building durable portfolios

Not all volatility, nor all risk, is negative. As the institutional investors we surveyed say, volatility creates opportunity. To achieve any return, one has to take some risk.

After years of financial and economic turmoil, the chance exists to change the thinking about assembling investment portfolios. Since the 2008–2009 global financial collapse, traditional investing practices have been put to the test. Market volatility has challenged long-standing notions about what it means to diversify one's portfolio and how to manage risk.

Ideally, diversification has meant cutting risk by combining dissimilar assets that in theory don't move up or down at the same time, or at the same pace, protecting investors from dramatic changes in value of any holding. The theory works best when performance relationships between different types of assets remain constant. In crises, that often doesn't happen.

Natixis Global Asset Management has pioneered the concept of **Durable Portfolio Construction**.® Based on years of research, this approach allows for the smarter use of traditional assets. It incorporates alternative assets into the investment mix, since the returns of alternatives are less likely to highly correlate to those of traditional assets. But Durable Portfolio Construction goes beyond asset allocation. It puts risk first, using risk management techniques to minimize the impact of extreme market movements on a portfolio. This helps generate sufficient returns in both neutral or favorable times, and it holds the potential to minimize portfolio losses when markets turn south.

Investors, advisors and institutions say they want a better way to cope with the changes that have occurred in the markets in the last few years. They are looking for investment techniques that work more often, even in times of great financial or economic stress. Durable Portfolio Construction could provide the answer they are looking for.

NATIXIS
GLOBAL ASSET MANAGEMENT

642289
CI19B-0313