



NATIXIS PORTFOLIO CLARITY®

Global Portfolio Barometer

Research and insights from the Portfolio Research & Consulting Group at Natixis Investment Managers

Natixis Investment Managers' annual Global Portfolio Barometer offers insights into model portfolios and asset allocation decisions from across the world. The report reviews a global sample of 421 "moderate risk" or "balanced" model portfolios from seven different locations: France, Germany, Italy, Latin America, Spain, the UK and the USA. The data excluding Spain covers portfolios analysed by the Portfolio Research & Consulting Group in the six months ending December 2018. Spanish portfolio data is derived from VDOS data¹. Statistics in this report are based on simulated returns for the model portfolios over the twelve months ending December 2018. These statistics are therefore representative, rather than actual historical figures.

REVIEW OF 2018

This report highlights the key differences found between countries in typical asset allocation models and seeks to explain the key drivers in performance differentials.

Key Findings

- All regions suffered negative performances in 2018, a marked contrast to 2017 when all regions enjoyed positive performance.
- Equities drove poor performance, contributing to around two-thirds of portfolio losses on average.
- Multi-asset funds added to losses, and provided little diversification to portfolios on average.
- Losses were not mitigated by fixed income or alternative strategies, which offered barely positive contributions at best.
- Volatility returned to markets and portfolio risk levels jumped up to more typical levels from the extraordinarily low levels reached in 2017.

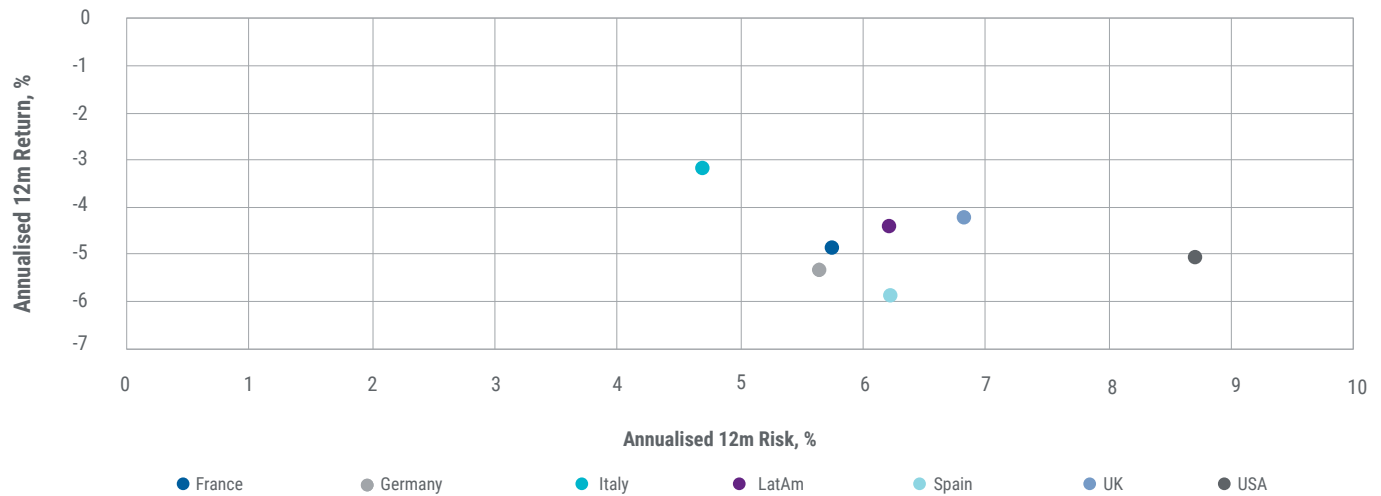
¹ Please refer to the methodology on page 8.



Section 1: Which region performed the best in 2018?

We have compared the performances of our moderate risk peer groups across seven different regions as shown in **Chart 1**. We report performances in the portfolio base currency for each region.

CHART 1: Moderate risk peer group average performances by region – 1 January 2018 – 31 December 2018, gross of adviser fees in portfolio base currency

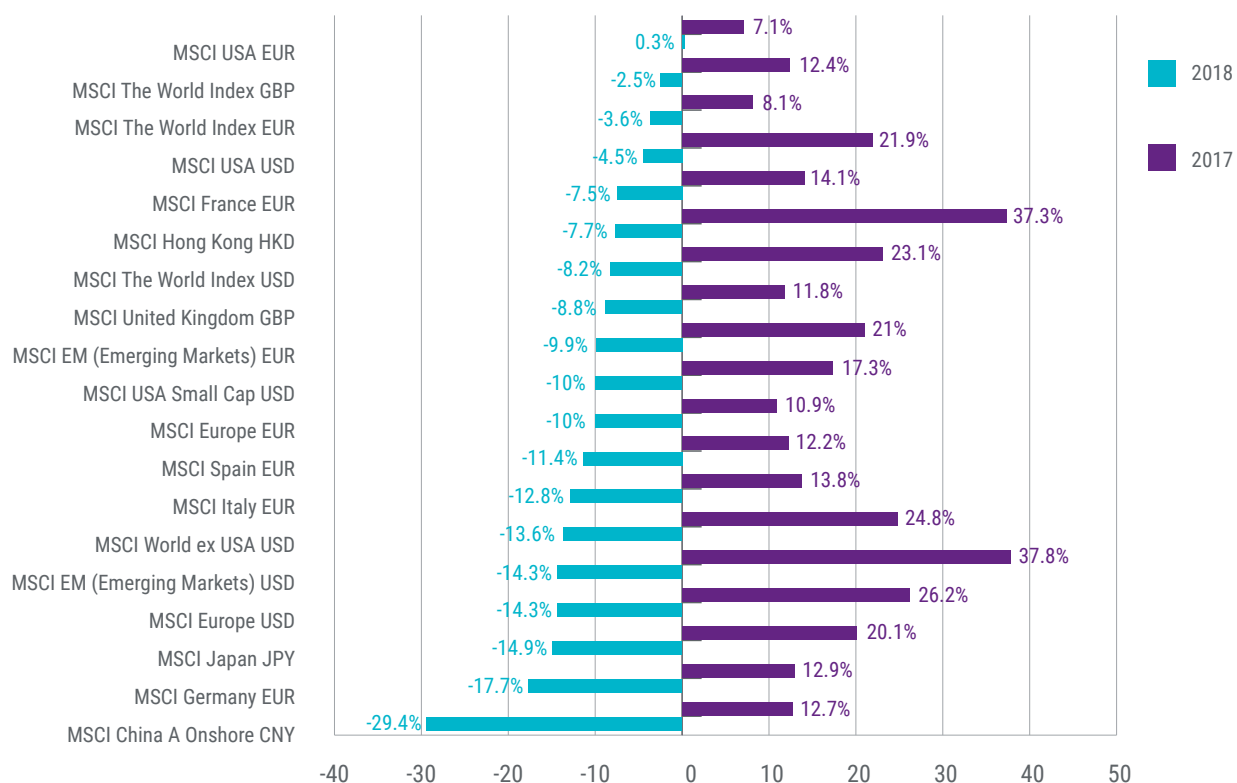


Source: Natixis Portfolio Research & Consulting Group (PRCG), VDOS. Past performance is no guarantee of future results.

Advisers in all regions suffered negative portfolio performances in 2018, which was unsurprising as equity markets fell across the board, and fixed income suffered losses or muted performance at best. In fact, just 2% of moderate portfolios we reviewed had positive performances in 2018. This was in marked contrast to 2017 where precisely the opposite happened; Chart 2 compares equity market performances between 2017 and 2018.

The best performing – i.e. least negative – region was Italy, with an estimated average loss of 3.2% for the average adviser portfolio, before adviser fees. This was followed by LatAm, with a loss of around 4.4%. The worst performer was Spain with an estimated loss of 5.9%.

CHART 2: Comparison of equity market performances in 2017 and 2018, in currency indicated



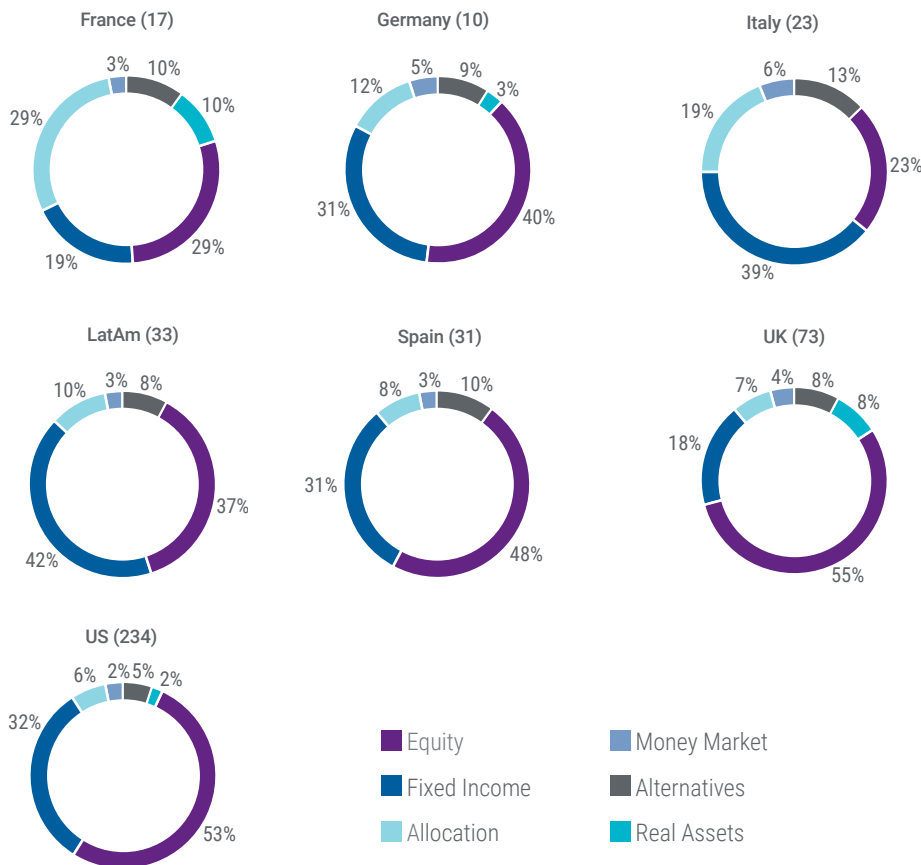
Source: Natixis Portfolio Research & Consulting Group (PRCG), Morningstar.

Portfolio risk levels also rose substantially in 2018 from the remarkably low levels in 2017, which is unsurprising given the marked increase in equity market volatility. However, this increase only brings them back to the level of 2016, so the 2017 period is the anomaly, not 2018.

Section 2: Global asset allocations²

Chart 3 shows the average allocations across regions, by asset class, for moderate risk model portfolios.

CHART 3: Average allocations across global portfolios – moderate risk (number in brackets refers to number of portfolios)



Source: Natixis Portfolio Research & Consulting Group (PRCG), VDOS.

As seen in previous Global Barometers, there is a huge disparity in the way that investors in different regions allocate to different asset classes to construct moderate risk model portfolios. Advisers in the UK and USA are the most bullish on equities, with weights in portfolios over 50%, whereas Italians allocate just 20%. On the other hand, Italy and LatAm allocate around 40% to fixed income, whereas in the UK and France it is below 20%.

The big change in portfolio construction following the 2008 financial crisis has been the shift away from traditional equity and fixed income investments towards multi-asset (shown as allocation in the charts) and alternative investments, in an attempt to provide diversification. This trend is most pronounced in France with 30% now invested in multi-asset funds and 10% in alternatives, and surprisingly least so in the USA with just over 10% between them. Real assets, such as commodities, property and private equity remain scarce in adviser portfolios, perhaps due to their illiquidity, with the UK really the only region allocating to property funds, and almost nobody except Germany (and Switzerland, which is not in our sample) investing in commodities.

² Asset classes are based on Morningstar categories. Real assets represents the sum of commodities, property and miscellaneous.

These differences indicate that asset allocation in adviser portfolios is at least partly a cultural phenomenon, meaning that clients with similar risk tolerances would get completely different portfolios depending on where they live.

Changes since 2017

We have also seen some interesting changes in portfolios since the end of 2017.

- **In the US**, broad strategic allocations changed little from the end of 2017, although there were some changes at the sub allocation level:

- In equities, advisors increased exposure to US Large Caps which ended the year at about 73% of total equities and up from 70% at the end of 2017. Exposure to EM recovered in the fourth quarter to finish the year in line with 2017. International Developed finished the year at 11% of equities, down from about 14% last year.

- In fixed income, advisors juggled duration, safety and yield. Portfolios ended the year with the largest allocation to Curve since 2013 but at the same time duration spreads versus the Bloomberg Barclays Global Aggregate index were at their widest since 2013. With credit spreads looking expensive for most of the year, advisors looked to shorter duration and higher quality to anchor their fixed income.

- Alternatives remain less of a focus in portfolios despite the increased levels of volatility. Weights remain in line with 2017 levels but there has been a shift from managed futures to the more transparent performance of option writing strategies. Exposure to minimum volatility strategies also increased nominally.

- **French** advisers have reduced their allocation to 'patrimonial' (multi-asset) funds on the back of poor performance throughout 2018. This was epitomised by the fall of many of the highly visible patrimonial funds, which experienced unprecedented outflows. Advisers have since been looking for true diversification away from traditional fixed income and equities, turning to absolute return fixed income strategies.

- **In Germany**, with the anticipated end of Quantitative Easing, investors are considering shifting the fixed income mix

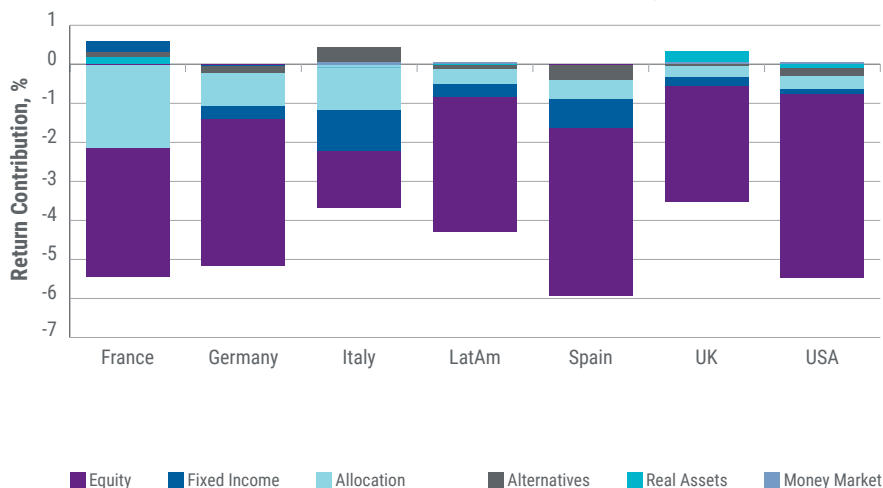
in their portfolios, by increasing allocations to emerging markets or high-yield. Alternative strategies have seen strong demand in 2018, especially absolute return bond funds, in an effort to generate returns in a low rate environment. Exposure to alternatives is now close to that of multi-asset funds.

- **In Italy**, for the first time in several years we are seeing a large shift back into fixed income, in particular European fixed income, while investors are reducing positions in multi-asset funds. Italian government bonds (BTPs) are also appearing back in portfolios. The universe of attractive investments for European and Italian investors is shrinking due to market conditions, mainly hedging costs and flat curves. Equity allocation doubled from 6% to 12% and allocation funds increased by almost 5%. Corporate credit and high yield in particular has been less appealing for some investors as the spreads have tightened and allocations to short-term treasuries have increased substantially. Although the decrease is significant, it is in line with what we are hearing from investment professionals as well as the market environment. With falling yields and the reversal of the downward trend in interest rates, it is not surprising that investors are looking for other areas to allocate capital.
- **In Spain**, portfolio adjustments during the year followed performances over previous months – we believe that this is because of less consensus over the market outlook among investors. Past performance and higher uncertainty could also explain increasing divergence between what investors have done (increased US equities) and what they said they were going to do (increase Europe and EM equities). In moderate portfolios, the main change in 2018 was a decrease in higher risk fixed income and conservative multi-asset funds. In general, concerns about higher risk fixed income have clearly increased, especially for the lower-rated corporate credit.
- **In Latin America**, aversion to equity risk was stronger than fear of rising rates as we saw an overall shift from equity to fixed income, with increases across the board to Global, EM and US fixed income categories encouraged by their relatively appealing yields. In their equity allocation, advisors shifted from global equity to direct US equity exposure where growth is still being favoured over value.
- Finally **in the UK**, the only allocation change we noted was a small reallocation from multi-strategy alternatives to other asset classes, which is perhaps more related to the well-publicised travails of one of the major managers in this space. Perhaps advisers here are waiting for clarity on the tortuous Brexit process before deciding on any changes.

Section 3: What drove 2018 returns?

With all regional portfolio performances down in 2018, are there any common trends across different regions? Chart 4 shows the performance contribution for each region, by asset class.

CHART 4: 2018 moderate risk peer group return contributions by asset class



Source: Natixis PRCG, VDOS. Past performance is no guarantee of future results.

Equity performance drove portfolio returns

In 2018, equities were the largest contributor to negative returns in all regions, costing around 3-5% on average, except Italy where it was just 1.5% due mainly to their low equity allocations. Multi-asset funds were the second largest detractor, especially in France where they are the most popular, costing around 0.5%-2% depending on region. The impact of other asset classes was minor with a few exceptions. In Italy, fixed income was a major detractor costing 1%, offset somewhat by alternatives, and in the UK property funds were a positive contributor relative to their modest allocation.

Diversification didn't mitigate losses

In a year where equities fell heavily, it was notable that fixed income allocations did not help advisers, contributing negatively to portfolios in all regions except France, where even there it was marginal at best. Whilst fixed income markets did begin to contribute positively to returns towards the end of the year, it was a case of too little, too late, as the magnitude of the losses from equities was too great. In Europe, it has been particularly difficult to generate returns from fixed income with benchmark yields low or negative, and USD-based fixed income suffering hedging costs in excess of 3% due to the interest rate differential between the Federal Reserve and ECB.

It was a similar story with alternative strategies, which whilst relatively uncorrelated to equities (more on this later), could not deliver the returns to compensate for equity losses. Most broad strategies were negative in 2018, with only "other alternative" strategies – predominantly global macro – positively contributing in some regions.

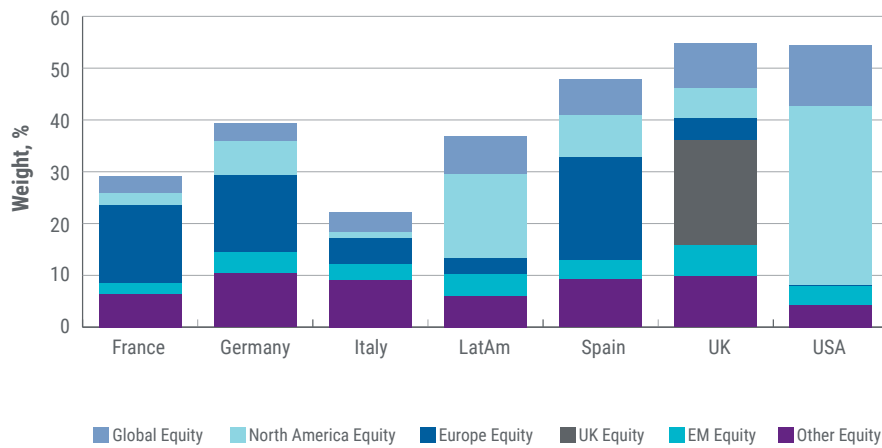
Equity market downs...and downs

As shown in Chart 2, there were big difference in performance between different equity markets in 2018, with US equities falling around 5%, global equities around 8% in USD terms, Europe around 10%, Japan and Emerging Markets (in USD) around 15% and China nearly 30%. However, the chart shows performances in local markets, whereas advisers will receive the performance in their domestic currency, i.e. after the impact of currency moves. Thus, a US investor investing in European equities would have experienced a loss of 14% in USD terms, worse than that of a European investor in EUR terms.

A European investor investing in US equities would have experienced a slightly positive return of 0.3% in EUR terms, much better than an US investor who would have lost 5%. The moves in currencies helped European investors but punished US investors. Currency moves had a smaller impact on performance in 2018 than in 2017, but they remain an often-overlooked area of risk for advisers.

It is clear that how different regional advisers allocate their equity allocation is therefore just as important as the performance of individual equity markets. Chart 5 shows the variation in equity allocation by broad region, and Chart 6 the resulting contributions to average portfolio performance. Advisers in France, Germany and Spain allocate a large proportion of their equity exposure to broad European markets, and rather less to global and US equities. With European equities underperforming US equities by 10% and global equities by 5% in EUR terms, this caused European equities to be their largest detractor to performance.

CHART 5: Allocation to equity markets, by region

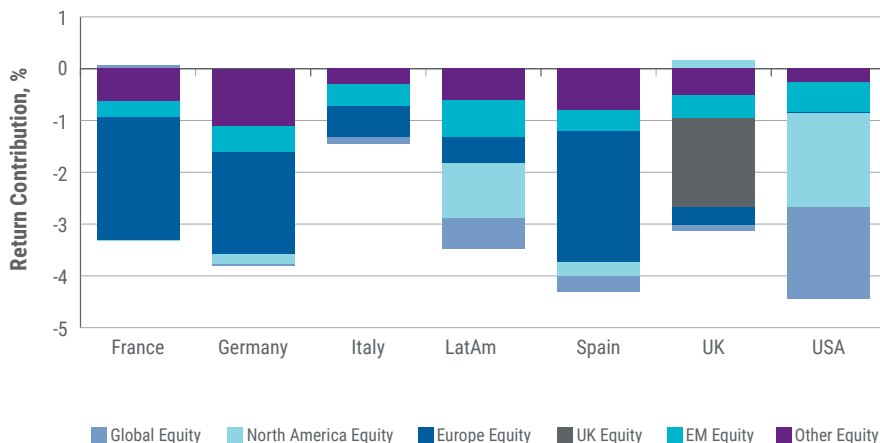


Source: Natixis PRCG, VDOS. Past performance is no guarantee of future results.

For US investors, their largest equity allocation to US equities was one of the least bad markets in 2018. However, their second largest allocation to global equities (ex US) did much worse at -14%, and thus the performance impact of global equities was about the same as that of US equities despite its much lower weight, and these two together meant that US investors suffered the most from falling equity markets in 2018.

Finally, Italian investors were rewarded in 2018 for their relative conservatism, with their lower equity allocation costing them far less in performance than other regions.

CHART 6: Equity contribution to portfolio performance, by region



Source: Natixis PRCG, VDOS. Past performance is no guarantee of future results.

Multi-asset funds: help or hindrance?

Many investors over the past few years have shifted allocations away from traditional equity and fixed income assets in to multi-asset funds, also known as allocation or patrimonial funds. The promise of such funds is that professional managers will be able to pick the best opportunities across all asset classes and as a result provide a source of diversification whilst hopefully complementing advisers’ own portfolios. How did this pan out in 2018?

Table 1 shows the average correlations of different asset classes to adviser portfolios. High correlations, indicating low diversification potential, are shown in purple, and low correlations and high diversification potential are shown in blue.

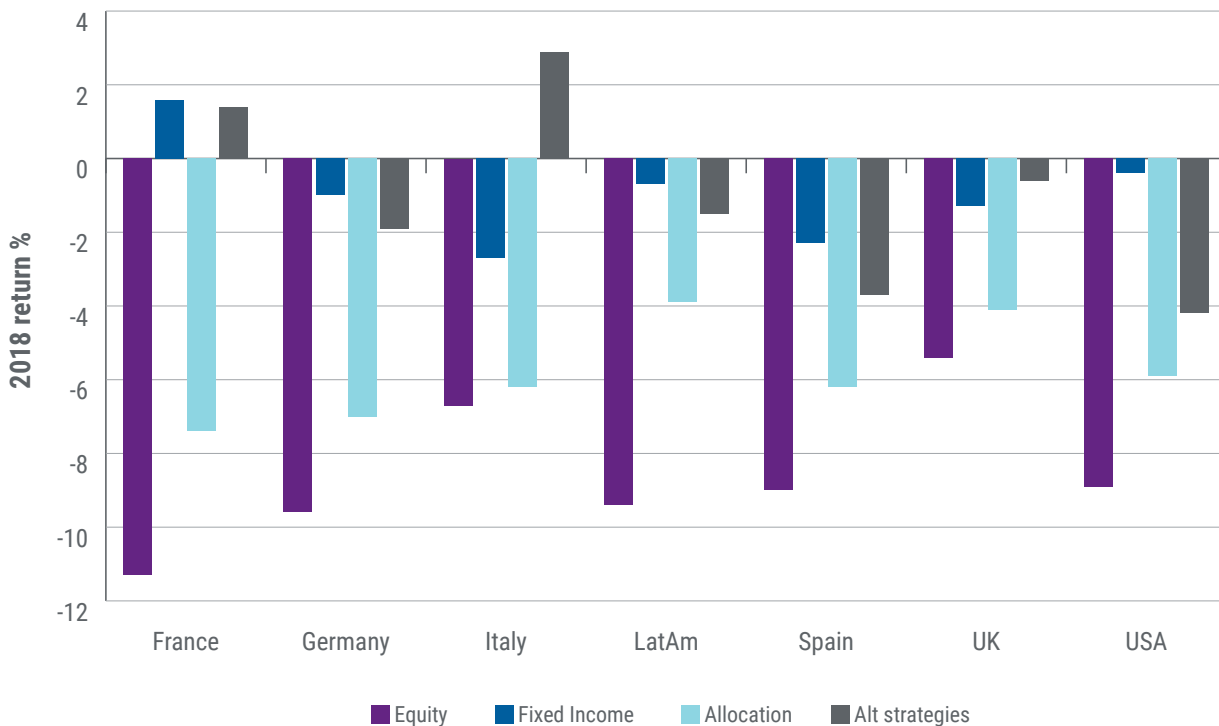
TABLE 1: average correlations to portfolio of different asset classes, by region

	Equity	Fixed Income	Allocation	Alt strategies	Real assets	Money Market
France	0.87	0.57	0.86	0.56	-0.39	-0.14
Germany	0.97	0.11	0.88	0.46	0.02	-0.03
Italy	0.90	0.45	0.80	0.60	-0.34	0.02
LatAm	0.96	0.42	0.87	0.24	0.32	-0.24
UK	0.98	0.13	0.83	0.15	0.40	-0.31

Source: Natixis PRCG. Past performance is no guarantee of future results.

It's clear that allocation funds, on average, are not providing much diversification given that they have high average correlations to portfolios, on par with equities in fact. So have they provided returns instead? This is shown in chart 7.

CHART 7: average 2018 performances of different asset classes within actual portfolios, by region



Source: Natixis PRCG, VDOS. Past performance is no guarantee of future results.

Chart 7 compares the average returns in adviser portfolios for different asset classes. Allocation funds on average performed a little, but not much, better than equities. And therefore, with high correlations, returns only a little better than equities, advisers in France and Italy which carry the most exposure to these funds suffered significant performance costs.

In a year like 2018, it would have been great to have an investment that mitigated losses from equities and provided diversification to portfolios. Allocation funds were not this investment. This is not to say that all such funds are the same, but in our opinion advisers should be careful when using these funds. There are some excellent funds available but many simply do not provide the benefits that advisers often expect.

Is diversification still a good idea?

With the failure of non-equity asset classes to mitigate portfolio losses, does this change our view on diversification? Absolutely not.

Many advisors sought diversification through multi-asset funds, which didn't work in 2018 as we have shown. However, many of these funds simply replicate what the advisers are doing themselves, and as a result have very high correlations to adviser portfolios, as seen in Table 1. Of course, there are some fantastic multi-asset funds available, but investors need to check whether those that they invest in are truly diversifying their portfolios, or just ballast where they are paying management fees for what they could do themselves. In fact, we have seen many advisers reducing allocation to these funds in 2018 in recognition of this fact.

Alternative strategies were another disappointing area in 2018. There are many different strategies in alternatives, and advisers need to be aware of the behaviour of these strategies, which provide the most diversification, and when they work best. For example, equity long/short strategies can provide diversification to equity allocations, but being in reality more long than short, they will generally follow the direction of equity markets. Long/short managers that can take net short positions can make money in equity market downturns – can yours do this? In previous research we have shown that the most diversifying strategies are market neutral, managed futures (in trending markets), global macro and long volatility. Many of these strategies did perform positively in 2018, but investors owned them either too little to make a difference, or not at all.

The final consideration is the relationship between diversification, risk and returns in adviser portfolios. When we compute the diversification benefit³ of all the portfolios in our sample, we find a strong negative correlation with portfolio risk, and a moderate positive correlation with returns. That is to say that the most diversified portfolios had lower risk and higher returns than the least diversified portfolios. Advisers with truly diversified portfolios fared much better than those with only pseudo diversification.

³ We define diversification benefit = 1-(actual portfolio risk)/(undiversified portfolio risk)

Final thoughts

In our 2017 Global Barometer we observed “with the very strong results in both equities and fixed income in 2017, we are increasingly hearing from investors that they do not know where to allocate capital for 2018, and as a result are increasingly outsourcing these decisions to multi-asset managers.” Multi-asset managers, with negative returns in 2018, clearly found it just as hard as other investors to navigate the more volatile markets, and we’re seeing signs that advisers are reducing their allocation to these funds again. But where should they put their money instead?

Whilst we hold no macro views of our own, we regularly survey our key global clients to understand the consensus views in the markets. Here is our summary of what we are hearing from our biggest investors on their 2019 outlook⁴:

- Compared to 2018 where views across investors were remarkably consistent (positive in equities, high yield fixed income, emerging markets and alternatives; negative in investment grade fixed income), there is a striking lack of consensus in 2019.
- **In equities**, investors remain slightly positive overall but with much less conviction than in 2018. Europe and emerging markets are seen as better value despite disappointing in 2018. Many investors still prefer US equities as a momentum play. In sectors there is much uncertainty on how to play the late cycle, but investors remain positive on ESG.
- **In fixed income**, investors are broadly positive on emerging markets, inflation and ESG and negative on European governments, but there is no consensus on investment grade, high yield or US governments.
- Investors remain broadly positive on liquid and illiquid **alternatives**, although with lower return expectations. However, the decline in return expectations is lower than for traditional asset classes making alternatives comparatively attractive. Some investors are expressing concerns over high private equity valuations.
- Finally, with higher uncertainty over the geopolitical, economic and monetary outlook, investors retain their view that volatility will be higher with more frequent spikes.

⁴ Source Natixis PRCG.

Methodology

All figures, unless otherwise stated, are derived from detailed analysis conducted by the Portfolio Research & Consulting Group of 421 moderate risk model portfolios received in the last six months of 2018 across seven different locations worldwide: France, Germany, Italy, Latin America (including US-Offshore), Spain, the UK and the USA. Peer group allocations shown are the averages calculated across all the models in the sample for each region. The performance data covers 1 Jan-31 Dec 2018 unless otherwise stated. Except for Spain, the Moderate Model Portfolios data is based on model portfolios that have been analysed by the Portfolio Research & Consulting Group and have been designated as moderate risk by investment professionals. The Portfolio Research & Consulting Group collects portfolio data and aggregates it in accordance with the peer group portfolio category that is assigned to an individual portfolio by the investment professionals. The categorization of individual portfolios is not determined by Natixis Investment Managers, as Natixis' role is solely as an aggregator of the pre-categorized portfolios.

Data for Spain is derived from VDOS data. Our sample includes all moderate risk allocation portfolios having fund weights 70-100% of total assets, with these weights rebalanced to 100%. Statistics based on weight, returns and return contributions are derived from holdings of portfolios extant in Q3 2018 (the latest data available) and simulated over the period 1 Jan-31 Dec 2018.

Please note that risk attributes of portfolios will change over time due to movements in the capital markets. Portfolio allocations provided to Natixis are static in nature and subsequent changes in an investment professional's portfolio allocations may not be reflected in the current data.

ABOUT THE PORTFOLIO RESEARCH & CONSULTING GROUP

Natixis Portfolio Clarity® is the portfolio consulting service of Natixis Investment Managers. Specialized consultants provide objective portfolio analysis to investment professionals who seek a deeper level of insight, using sophisticated analytical tools to identify and quantify sources of risk and return.



Matthew Riley

Head of Research, Portfolio Research & Consulting Group within Dynamic Solutions for Natixis Investment Managers

Matthew has over 20 years' experience in the investment management industry, and previously specialised as a risk consultant at Falcon Money Management where he was responsible for risk management, investment process and analytic reporting. Matthew also worked as an Investment Director at Aida Capital, the Fund of Hedge Funds arm of Standard Life Investments where he created portfolio construction, statistical analysis and risk management tools.

Prior to that he spent five years at Union Bancaire Privée where he managed fund of hedge fund portfolios for institutional and high net worth clients. He has a master's degree in Chemical Engineering from Pembroke College, Cambridge University.



James Beaumont

International Head of Portfolio Research & Consulting Group within Dynamic Solutions for Natixis Investment Managers

In this UK based position, James Beaumont manages the Portfolio Research & Consulting Group (PRCG) within Dynamic Solutions. A team of 16 based in London and Paris, it offers a wide range of risk management & portfolio construction analysis and thought leadership to clients across Europe, MENA and Asia. The group is also growing its Solutions capabilities and is the investment advisor to the successful Selectiz range of risk based portfolios.

Mr Beaumont started the team and its offerings in 2013 and now oversees a team of 7 Consultants and 9 Analysts, all experienced and highly qualified professionals that provide detailed portfolio analysis to help advisers improve the way they create and manage client portfolios. The team is independent and focuses its analysis on client's risk exposures to help improve diversification with a goal of achieving better returns with lower overall volatility.

Over the last 5 years the team has analyzed thousands of portfolios across multiple countries and worked with the full range of clients including sovereign wealth funds, insurance companies, private banks, wealth managers and IFAs.

James Beaumont is a Qualified Accountant with over 20 years financial services experience. He was previously at Standard Life Investments, where he was a Senior Investment Analyst in SLI's Fund Solutions team. Prior to that, he held roles as a Fund of Hedge Funds Portfolio Manager at Thames River Capital LLP and as a Partner at Eden Rock Capital Management.



Marina Gross

Executive Vice President, Portfolio Research & Consulting Group for Natixis Investment Managers

Marina Gross joined the firm in 2003 and is Executive Vice President of the Portfolio Research and Consulting Group. She and her group are responsible for a full range of portfolio construction-related analyses. She conducts extensive research on asset allocation tools, techniques, methodologies and protocol fostering unique ways to approach portfolio design. She provides highly customized analytics and consultation to clients designed to inform, validate and advance their decision-making around asset allocation

Ms. Gross has over 20 years of investment industry experience and was previously at Merrill Lynch in Fundamental Equity Research followed by Equity Capital Markets. She received her BSBA from Boston University.

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⁵ Cerulli Quantitative Update: Global Markets 2018 ranked Natixis Investment Managers as the 16th largest asset manager in the world based on assets under management as of December 31, 2017.

⁶ Net asset value as of September 30, 2018. Assets under management ("AUM"), as reported, may include notional assets, assets serviced, gross assets and other types of non-regulatory AUM.

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