NATIXIS
GLOBAL ASSET MANAGEMENT

INVESTOR INSIGHTS SERIES

2016 IN FOCUS

The investment outlook for institutional investors

EXECUTIVE SUMMARY

Institutional investors are concerned about generating returns and navigating a low-yield environment as they make plans for 2016. As a result, nearly two-thirds (64%) of the 660 decision makers interviewed for our 2015 Global Survey of Institutional Investors[1] say alpha is becoming harder to obtain as markets become more efficient. In response, these investors plan to increase allocations to equities and alternative investments[2] in hopes of generating better risk-adjusted returns.

Looking at the year ahead, public and private pension managers, insurers, sovereign wealth funds, foundations, endowments and central bankers share a consistent view on markets, risk and the steps they will need to take in order to meet long-term return objectives:

- Picks for 2016: Projecting asset class performance for the year ahead, institutional investors predict an up year for stocks and alternative investments. On the other hand, they believe monetary policy and interest rates across the globe will suppress fixed-income returns. Institutions will look to adjust portfolio allocations accordingly.

- Market challenges: These same decision makers foresee a bumpy road ahead for their asset class picks. Volatility, macroeconomic conditions and geopolitical events all present challenges. Institutions see it as the type of market that will favor active investment management.

- Portfolio strategy: Meeting return objectives in this environment will mean challenging conventional thoughts on how to source investment management expertise and will require a hard look at fixed-income strategy. For many, this will need to be executed within the framework of new regulatory standards for risk and liquidity, which could inhibit their ability to respond.

Successful implementation of portfolio strategy in 2016 will require walking a tightrope between risk, return and yield. If they are to meet their primary objective of achieving their return targets while staying within their risk budgets, institutions will likely seek added help from outside specialists in their execution of investment plans.

1 Natixis Global Asset Management, Global Survey of Institutional Investors conducted by CoreData Research, October 2015. Survey included 660 institutional investors in 29 countries.
2 An alternative is an investment that is not one of the three traditional asset types (stocks, bonds and cash). Alternative investments include hedge funds, managed futures, real estate, commodities and derivatives contracts. Alternative investments involve specific risks that may be greater than those associated with traditional investments, and there is no assurance that any investment will meet its performance objectives or that losses will be avoided.

SECTION ONE

Clear expectations on asset class performance

If their projections for top-performing asset classes in 2016 are correct, institutional investors will be well positioned to address their number one investment concern in today's market: generating returns.

High hopes for equities

Across the board, institutional investors believe equities are poised to outperform in the next 12 months. More than four in ten respondents (42%) believe global equities are most likely to be among the top performers, followed by U.S. equities (33%), emerging equities (25%) and domestic equities in their home countries (15%). Beyond the traditional equity classes, 20% of respondents say private equity investments will be among the best in class for 2016.

"The institutional outlook for equities may not just be optimism for stocks so much as a commentary on the state of the bond markets," says Natixis Global Asset Management chief market strategist David Lafferty. "Interest rates are low globally and negative in a third of European bond markets. These investors would rather tie themselves to corporate growth in stock than to sovereign stagnation in bonds."

OUTLOOK ON THE BEST- AND WORST-PERFORMING ASSET CLASSES FOR 2016
Institutions see equities as best performers for 2016

Best performers	Worst performers
Global equities – 42%	Commodities – 36%
U.S. equities – 33%	Emerging market fixed-income – 32%
Emerging market equities – 25%	Global fixed-income – 25%
Private equity – 20%	Domestic fixed-income – 21%
Hedge funds – 16%	Natural resources – 21%

Commodities, fixed-income to falter

If an optimistic market outlook represents the upside for stocks, then restrictive monetary policy across the globe may be the root cause for overwhelming pessimism on the fixed-income side of the equation. With the U.S. dollar continuing to strengthen against other global currencies, institutional decision makers project that commodities, such as precious metals, are likely to underperform other investments, with 36% placing the class within their three worst performers and another 21% citing natural resources, including energy and timber.

Whether it is low to negative interest rates in Europe or the prospect of an uptick in rates in the U.S., central bank policies across the globe are also a likely reason for institutions to tick the box for a range of fixed-income classes to sit on the list of worst performers. Emerging market bonds (32%), global bonds (25%) and domestic bonds (21%) round out the list of worst performers.

Allocation preferences follow picks

Institutional allocation plans follow their views on asset class performance. Private equity appears to get the most attention as 50% of respondents say they will increase allocations to this alternative, while 37% will maintain their current allocations. Equities also get considerable attention within institutional allocation plans for the year ahead, with 48% saying they will increase and another 37% saying they will maintain allocations here.

The demand for non-correlated returns comes across loud and clear in the next two asset class choices: 46% say they will increase investments in private debt, while 41% will increase hedge fund allocations. Focus on private debt is no surprise given that current interest rates have 42% of institutions saying they will decrease allocations to traditional bond strategies.

ALLOCATION CHANGES FOR 2016

Asset class	Decrease	Increase	Maintain
Equities	14%	48%	37%
Fixed-income	42%	16%	42%
Private equity	12%	50%	37%
Private debt	7%	46%	47%
Hedge funds	14%	41%	45%

While their perceptions and strategies are clear, institutional investors know that the markets may present significant roadblocks to fulfilling their expectations on investment performance.

SECTION TWO

Will markets cooperate with institutional expectations?

If institutions are to deliver on their primary investment objective of achieving the highest possible risk-adjusted return, they will need to address their second objective: effectively managing volatility in returns. Given that they are looking for equities to be the top performers, they are entering 2016 with eyes wide open to the possible risks.

More than four in ten of our respondents (42%) say they believe market volatility will be the number one risk to investment performance in 2016. After a year in which we saw 56 days with 1% movement in the S&P 500 between January 1 and October 31, it should be no surprise that this weighs on the minds of investors. But volatility is not the only fact that could derail plans, as slow economic growth (40%), monetary policy (39%) and geopolitical risk (37%) round out institutions' top risk concerns.

Sources of volatility reminders of recent events

Following a year in which the horrors of terrorism have led news coverage, investors see geopolitical events as the top cause of volatility (54%). With the terror attacks in Cairo, Beirut, Paris and Mali; the Syrian refugee crisis; the start of a polarized U.S. presidential election cycle – there are many potential political triggers that could send markets on another rollercoaster ride.

TOP CAUSES OF VOLATILITY	
Geopolitical concerns	54%
China market woes	49%
International monetary policy divergence	47%
Interest rate change	46%

China market woes (49%) also factor into potential causes of volatility in the minds of the decision makers we spoke with. As evidenced by the volatile reaction to its disparate efforts at financial stimulus, China has considerable sway over markets around the globe. When it falters, the world takes note. But China is not alone. The long-term effects of economic stimulus in other countries could also spur volatility.

Institutional investors also believe international monetary policy (47%) and interest rate changes (46%) are key challenges as they consider potential sources of volatility. After nearly a decade without an increase in interest rates, the mere anticipation of a quarter-point increase can put markets in turmoil. Imagine the potential fervor that will be seen when rates actually do go up.

It will be up to investment teams to find a way to manage these risks at the portfolio level. According to our study, two-thirds of respondents say these conditions favor active management.

SECTION THREE

Actively managing the portfolio

The search for better diversification and attractive returns could take institutional investors off the beaten path in the year ahead. Where they have traditionally relied on internal expertise to manage investments, institutions turn to external managers to augment their own capabilities. This is particularly true when investments are illiquid, difficult to access or difficult to accurately assess.

Respondents report the use of external managers across a range of asset classes. Most frequently, they cite real estate (53%). Given the size and scale of these hard assets, an external manager may be better positioned to source and evaluate potential investments – and better prepared to manage a portfolio of properties.

Outsourcing for greater efficiency

We also see institutional investors reporting that they turn to external managers for expertise in emerging market equities. With opportunities located in far-flung locations across the developing world, it may be more efficient to tap external resources for their expertise in identifying and evaluating investments. In essence, this allows institutions to participate in key growth opportunities without having to add staff or increase expenses, making them more efficient in the pursuit of returns.

TOP ASSET CLASSES WHERE INSTITUTIONS OUTSOURCE MANAGEMENT	
Real estate	53%
Emerging market equities	49%
Private equity	45%
Private debt	44%
Emerging market fixed-income	41%

We find institutions relying on external managers for private equities (45%) and private debt (44%). Here, too are examples of tapping into outside expertise and participating in parts of the capital markets with greater efficiency. Specialists in these alternative asset classes may be able to provide considerable value.

Alternatives a case of function over form

Knowing that institutions expect to increase allocations to a range of alternative investments, it is interesting to note how they plan to apply these strategies within their portfolios. Private equity, private debt and hedge funds are all mentioned as places where a number of institutions plan to increase allocations in the year ahead. Equities are also favored for an increase, but their purpose in the portfolio is clear – return generation.

We see a clear opinion favoring the use of alternatives: 54% of those we surveyed say traditional assets are too highly correlated to provide distinct sources of return, while 56% say they believe their alternative holdings will perform better in 2016 than in 2015.

Institutions say they look to alternatives to fit a range of portfolio functions. Enhanced diversification (64%), enhanced alpha (50%) and risk mitigation (49%) rank as their top three portfolio applications. It appears that their preferences are selected with these goals in mind.

Anticipating rate changes

After nine years without a rate increase and two years of public speculation about a quarter-point increase, any movement by the U.S. Federal Reserve will be the most widely telegraphed financial decision many investors ever see. In advance of any rate decision, institutions report they will implement a wide range of strategies to help decrease interest rate sensitivity within their portfolios.

Most commonly, our respondents say they will shorten bond durations (65%) in an effort to decrease exposure to interest rate movements. Second, they plan to reduce exposure to fixed-income altogether (49%), and their third most commonly used strategy is the implementation of alternative investments (47%).

WHY INSTITUTIONS IMPLEMENT ALTERNATIVE INVESTMENTS	
Diversification	64%
Alpha generation	50%
Risk mitigation	49%
Access to new investment opportunities	37%
High risk-adjusted returns	32%

In this time of uncertainty, it is likely that institutional interest in real estate may be an indication of their need to generate stable income over the long term, as 34% of respondents say they are planning on increasing their allocations to commodities such as real estate.

Regulatory challenges ahead

Regulatory pressure should be felt to a greater degree by institutional investors in 2016. With Solvency II taking effect on January 1, 2016, European institutions will need to examine investment selections within new liquidity frameworks. U.S. institutions are likely to feel similar pressures as more measures under the Dodd-Frank law are implemented. As a result, 80% of those we spoke to say it will be challenging to comply with these new regulations.

In the end these factors will all weigh heavily on the minds of institutional decision makers as they look to balance the need to meet short-term performance goals while fulfilling long-term liabilities.

CONCLUSION

More insight needed

Institutional investors are facing the uncertainty of a new year with optimism: They see opportunities to generate returns from growing equity markets around the world; they express confidence in their ability to manage interest rate sensitivity within their portfolios; and they see opportunities to enhance overall diversification with the use of alternative investments.

Their investment outlook is only half of the picture. There are many external regulatory and internal policy issues converging to shape investment decisions in the year ahead. Our full survey report will provide a more complete picture of the institutional mindset for 2016. It will look beyond immediate market considerations and examine the use of active and passive investment strategies, the role of ESG strategies (environmental, social and governance), and the need for greater innovation in the management of liabilities.

Each of these factors plays a significant role in determining how institutions will invest, not just in 2016 but also for decades to come. We see it as our role to help bring these issues to the surface and initiate a healthy debate of the right course forward.

PROGRAM OVERVIEW

About the Durable Portfolio Construction Research Center

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. Through the Durable Portfolio Construction Research Center, Natixis Global Asset Management 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

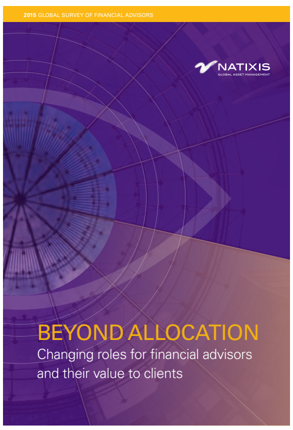
Our annual research program offers insights into the perceptions and motivations of individuals, institutions and financial advisors around the globe and looks at financial, economic and public policy factors that shape retirement globally with:

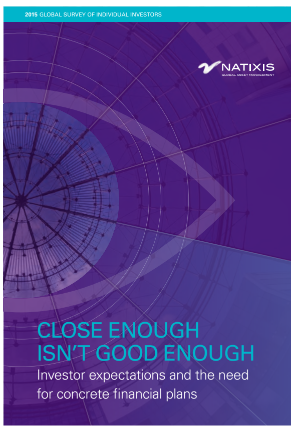
- **Global Survey of Individual Investors**
  Reaches out to 7,000 investors in 17 countries.
- **Global Survey of Financial Advisors**
  Reaches out to 2,400 advisors, consultants and decision-makers in 14 countries.
- **Global Survey of Institutional Investors**
  Reaches out to more than 600 investors, consultants and decision-makers in 29 countries.
- **Natixis Global Retirement Index**
  Provides insight into the environment for retirees in 150 countries based on 20 economic, regulatory and health factors.

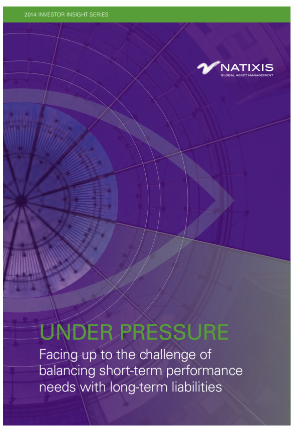
The end result is a comprehensive look into the minds of investors – and the challenges they face as they pursue long-term investment goals.

Helping to build more durable portfolios

Natixis Global Asset Management is committed to helping advisors build better portfolios that stand up to the challenges of modern markets. To learn more about our **Durable Portfolio Construction**® philosophy, visit durableportfolios.com.







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