CORE DATA research

CoreData's Quarterly Equities Sentiment Report

Q3 2023

www.coredataresearch.com

October 2023

About the study

CoreData's Equities Sentiment Report is a quarterly gauge of US institutional investor sentiment on global equity markets.

The objective is to create a benchmark to analyze how sophisticated investors are reacting to shifting market conditions and impactful events. As a robust timeseries develops, investor outlook will be plotted against market returns to understand the relationship between sentiment and performance.

The findings reflect the opinions of 100 asset managers and asset owners based in the US in September 2023.

Executive Summary

Greater consensus emerges re the path of inflation and rates

77% of asset owners and managers anticipate that rates and inflation will stay elevated in the next 12 months, reflecting an increase of over ten percentage points from the previous quarter. The prevailing drivers of the equity outlook are the economy and interest rates, while inflation slips down in investors' reckoning as concerns of spiraling inflation evaporate.

Cash is truly king; income-generating assets rise in importance

As investors assess the risk-adjusted returns environment for the next 12 months, steady and reliable income is the clear winner. The threat of rising defaults isn't dissuading interest in private credit, as it moves into the top 4 asset classes along with cash, FI and equities. Many investors are moving to take risk off the table to capture attractive risk-free yields; about 4 in 10 report creating a tactical allocation or increasing their strategic allocation to these assets.

High risk-free yields put risk assets and managers under pressure

4 in 10 asset owners and managers say they have raised their hurdle rates for risk assets, putting greater pressure on managers to meet elevated expectations. And many have already begun parting ways with underperforming active managers/strategies (38%), with assets expected to flow into better-performing strategies or more conservative allocations. More than two in five (44%) report slowing new investments into risk assets while 30% are actively trimming these allocations.

The outlook for Chinese equities collapses

Significant headwinds such as the simmering real estate crisis and sluggish consumption have pushed many investors into the bearish camp over the last three months. Nearly 8 in 10 are now bearish on the market, compared to 4 in 10 just 3 months ago. China's slowdown will continue to have major knock-on effects in an increasingly fractious global economy.

The wind comes out of big tech's sails

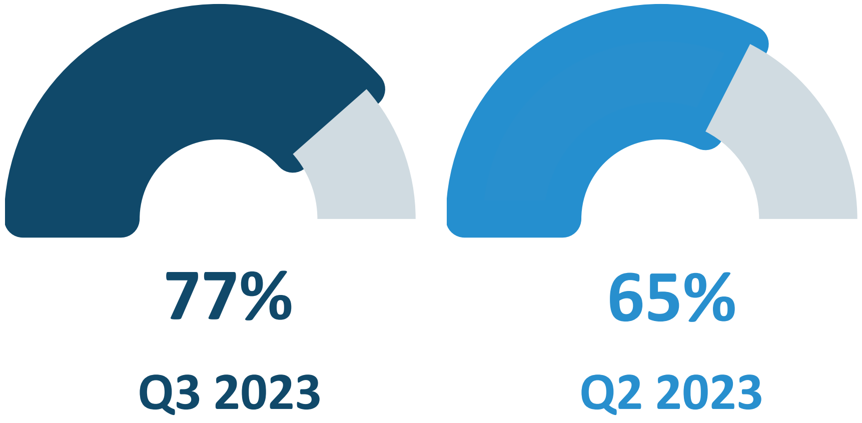
Investor sentiment around mega caps fell markedly as expected performance for this cohort is now on par with other size categories. 71% now believe the technology sector is overvalued, compared to 55% 3 months ago. The lack of conviction around size factor performance will likely result in diminished returns as investors lean into diversified exposures.

1 Adjusting to a high-rate regime

Vast majority now expect elevated inflation and rates for the year ahead

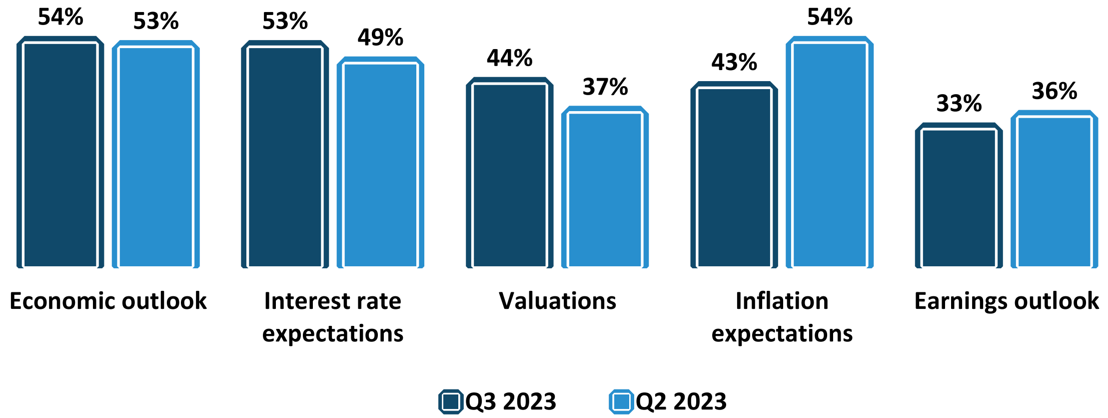
- As more economic data points to a “soft landing” in the US, holdouts are joining a growing chorus who anticipate that rates and inflation will remain high throughout much of 2024. Some institutional investors believe that central bankers have shifted their focus from reducing inflation to insulating valuations.
- Investors have de-prioritized inflation among their list of primary equity outlook drivers, demonstrating increased confidence that central banks have done enough to keep it from spiraling higher. Valuations (44%) rise in importance as fears of a tech bubble increase.
- Unsurprisingly, bears more often point to valuations as a top outlook driver, whereas bulls attach greater importance to the earnings outlook and interest rate expectations.

Inflation and rates will remain elevated for the next 12 months.



%Agree (Strongly agree + Agree)

Biggest drivers of 3-month equities outlook



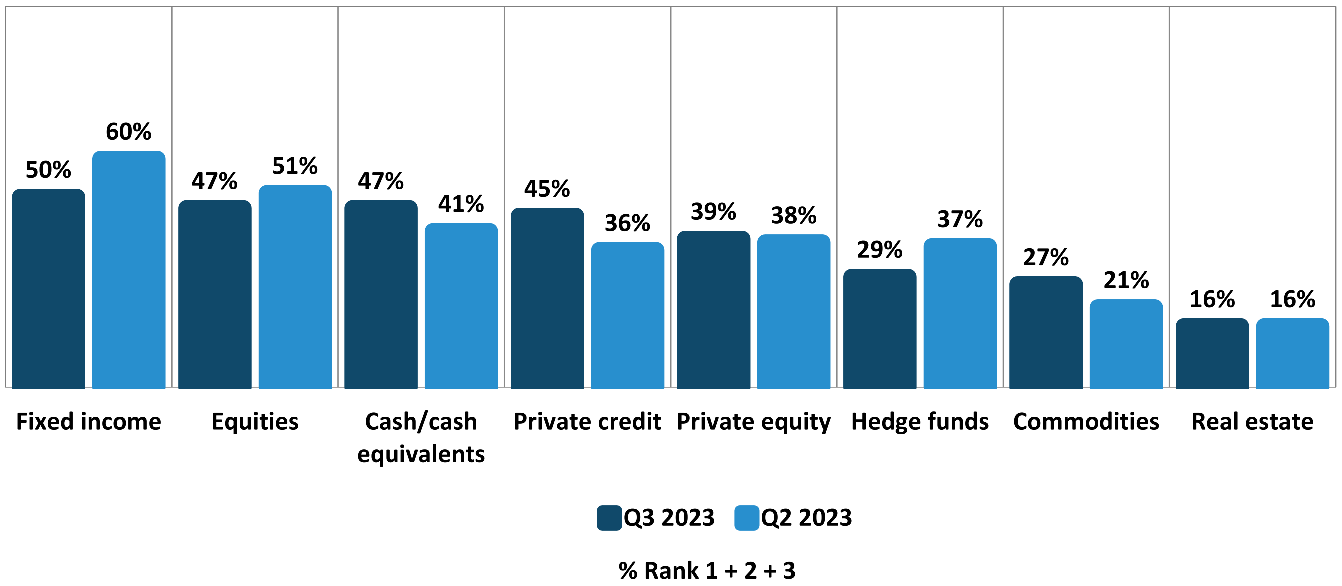
% Multiple answers allowed

Q6. What is driving your outlook on equities for the next 3 months? Select up to three.

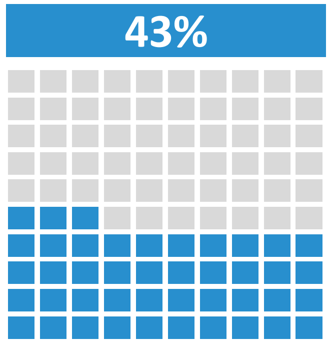
Income-generating assets rise in importance as many investors dial back risk

- As asset owners and managers assess the risk-adjusted returns environment for the next 12 months, steady and reliable income is the clear winner. Despite rising yields' impact on bond prices, public fixed income remains the top asset class, although it is not the runaway leader it was in Q2. Increasing concerns around valuations likely weighed on equities, as the asset class landed at the same level as cash. Institutional investors appear undeterred by the threat of rising defaults, as private credit leapfrogged PE and HF in the rankings.
- Many investors are moving to take risk off the table to capture attractive risk-free yields; about 4 in 10 report creating a tactical allocation or increasing their strategic allocation to these assets.

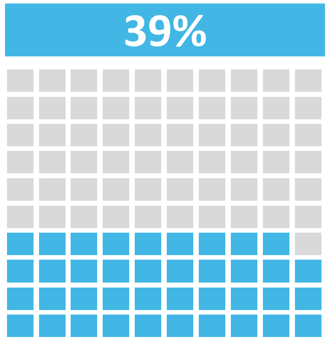
Top asset classes for risk-adjusted returns over the next 12 months



"Our new strategic plan is shifting toward a more yield-centric portfolio by way of public/private credit, the proceeds are almost entirely derived from our US equity bucket... We're cognizant that cash is having its moment and leaning into a bit more tactical cash on hand." - *Large US Pension*



We have increased our strategic allocation to government bonds and/or cash-like investments



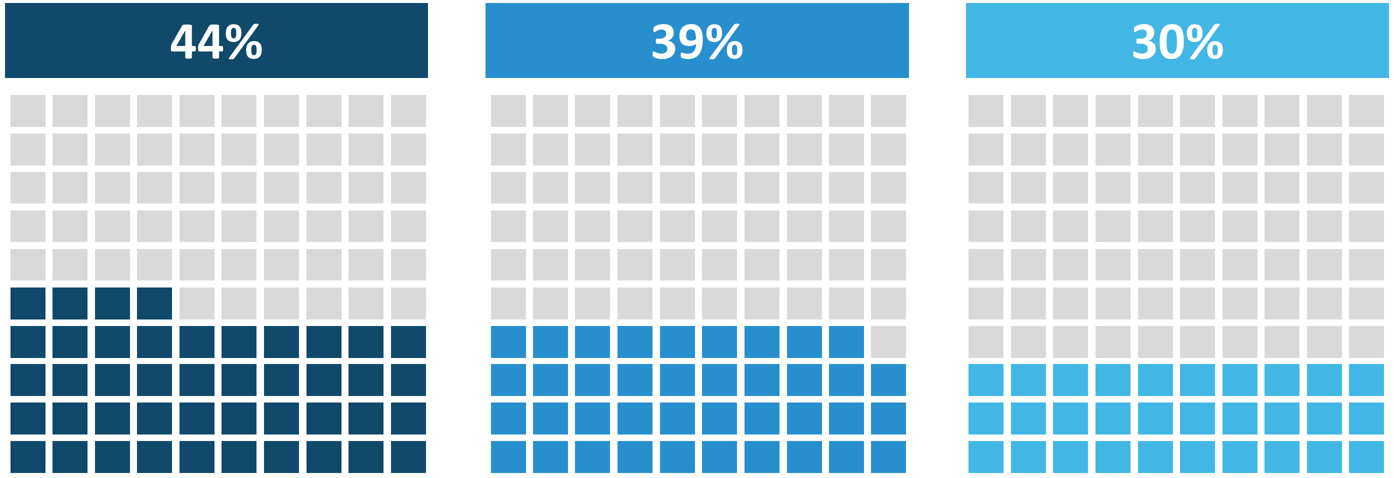
We have created a tactical allocation to increase exposure to government bonds and/or cash-like investments

Q11. Please rank the following asset classes in order of the best opportunities for risk-adjusted returns over the next 12 months.

Q13. How have relatively high risk-free returns changed how your organization views risk and return across asset classes? Select all that apply.

Higher risk-free returns force a re-think and put risk assets under greater scrutiny

- Investors are re-evaluating their strategy and exposures when it comes to risk assets. More than two in five (44%) report that they are slowing new investments while 30% are actively trimming allocations. On the other hand, the majority of asset managers and owners appear reluctant to change course with long-term plans despite being presented with a fundamentally new market regime.
- Perhaps most importantly on a go-forward basis, 4 in 10 say they have raised their hurdle rates for risk assets, putting greater pressure on managers to meet elevated expectations.



We are slowing new investment in risk assets | **We have raised our hurdle rates for risk assets** | **We are trimming our exposure to risk assets**

> "This is the most critical aspect for asset owner success over the next 10 years. There is a generational opportunity to effectively de-risk given how elevated nominal risk-free yields have become… this environment paves the way to minimize dispersion around an expected hurdle rate.
> *- Large US Pension*

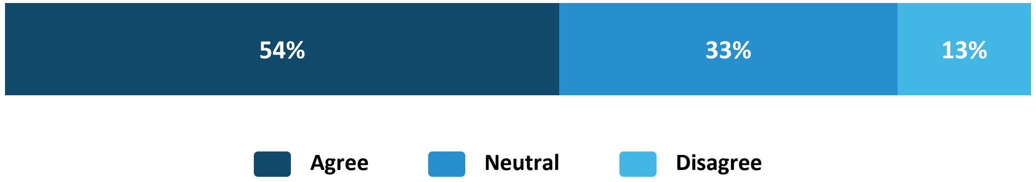
Q13. How have relatively high risk-free returns changed how your organization views risk and return across asset classes? Select all that apply.

Nearly 4 in 10 are parting ways with underperforming active managers/strategies

- A significant number of asset owners and managers (38%) report consolidating their active lineup as serial underperformers run out of time to turn results around, with assets likely flowing into better-performing strategies or more conservative allocations.
- However, about half signal optimism about actively managed equity performance over the next 12 months amid a low growth environment, demonstrating a vote of confidence for trusted managers.

My organization is offboarding active strategies/managers that have failed to perform over the last few years.

We expect our actively managed equity strategies will deliver strong outperformance in the next 12 months.



% Agree (Strongly agree + Agree)
% Disagree (Strongly disagree + Disagree)

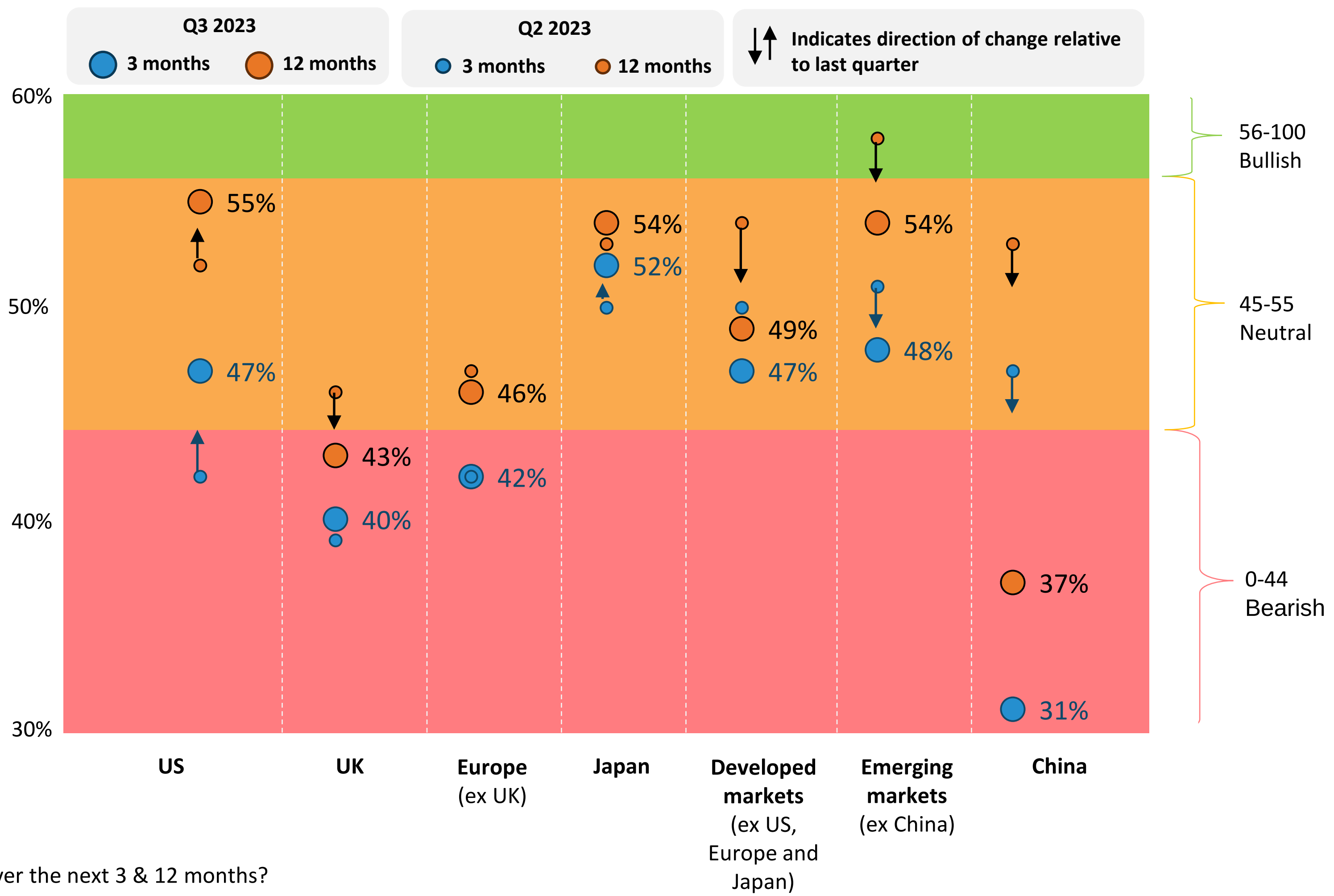
"There has been a definitive uptick in operational or performance blow-ups that have shaken confidence… Over the last 12 months, we have terminated nearly 10 managers across our public markets program which are no longer considered high conviction selections from a business enterprise or investment acumen POV. This is in stark contrast to only 5 terminations over the 9 years prior."
- Large US Pension

China slides into bearish territory as US, Japan and EM are relative bright spots

- The ESI aggregates the views of 100 asset managers and asset owners into a single score, indicating the strength of the market for the year.
- Investors view the US, Japan and Emerging Markets (ex China) as the most likely to generate positive 12-month returns in an increasingly fractious global economic recovery.
- China is the clear outlier as it falls into bearish territory; geopolitical tensions, sluggish consumption and a teetering real estate market point to trouble in the months and years ahead as some investors worry about "Japanification."
- The UK, Europe and other developed markets face an uncertain path as China's slowdown and high rates and inflation reverberate across global markets.

> "We've begun a de-risking campaign across our EM exposures… equal parts concerns over China, the manager's organizational challenges, and an inability to add value over a market cycle."
> *- Large US Pension*

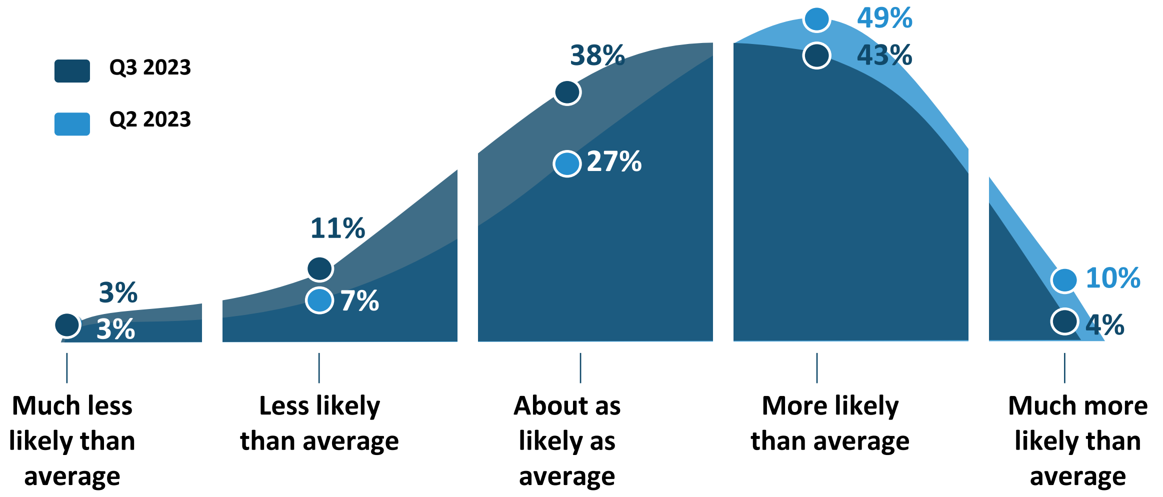
Equities Sentiment Index Scores



Q5 & Q5a. Are you bullish or bearish on the following equity markets over the next 3 & 12 months?

Tail risk concerns ease slightly, but fears remain high

- While it's no longer a majority indicating that a catastrophic market event is more likely than average in the short-term, it's still a meaningful number at roughly half (47%). Worries are likely to increase in next quarter's poll as conflict in the Middle East brings an already fraught geopolitical environment to the brink.
- The range of responses is trending toward a normal distribution, which could indicate some complacency creeping into investors' minds as they grow accustomed to operating in a highly uncertain environment.



"Given the robustness of the market's snapback over 1H23, the short memory effect seemingly kicked in for asset owners, creating the illusion of safety. I would argue that tail risk is the highest it's been since the outset of Covid-19 lockdowns. The amalgam of valuations, bank failures, dwindling liquidity, cycle high rates, structural inflation, and determined central banks is a recipe for air pockets of sudden volatility to emerge."
- Large US Pension

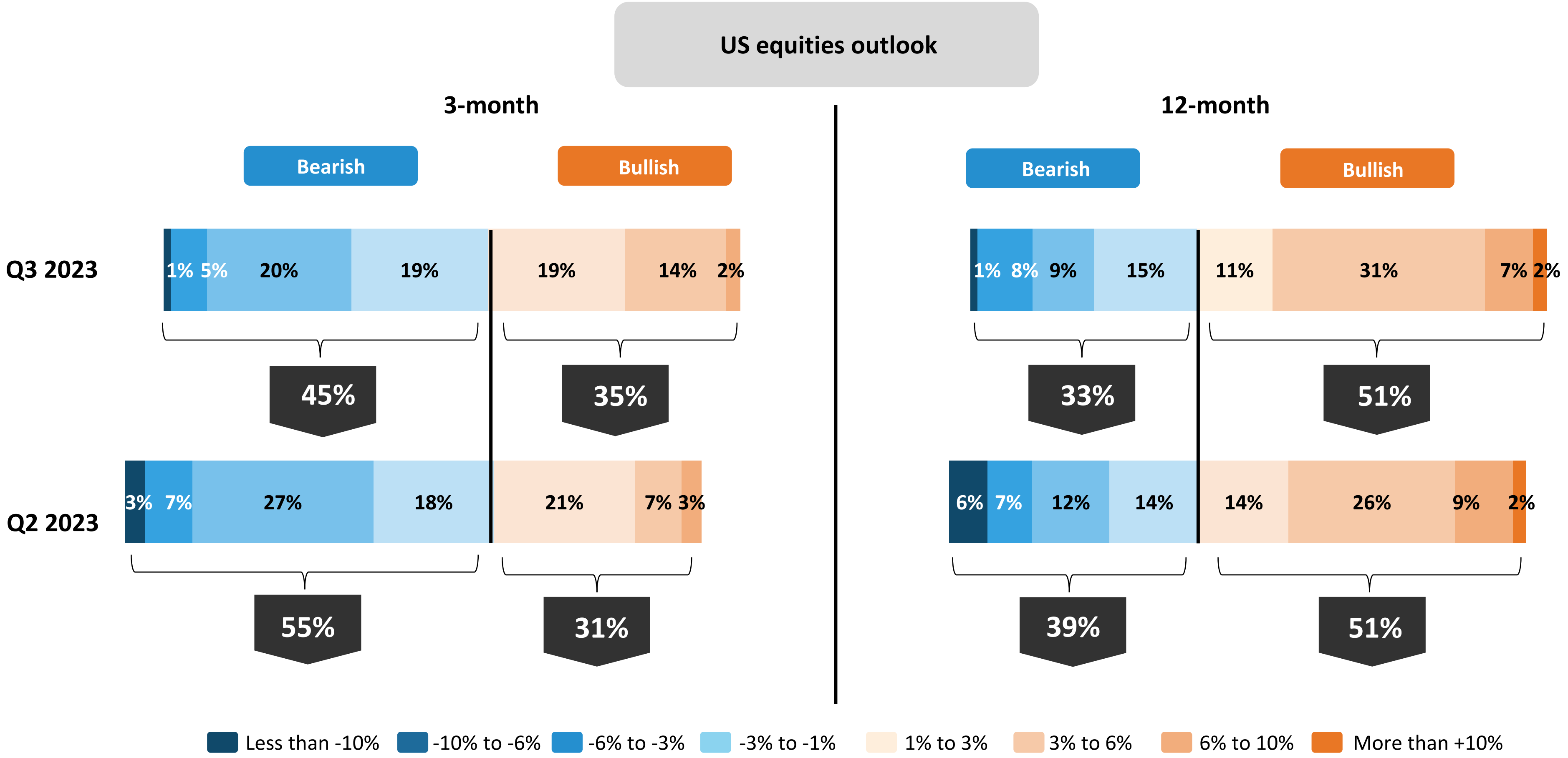
Q10. Do you think current market conditions/trends put the likelihood of a left tail risk event occurring in the next 3 months at a higher or lower than average probability?

2

US Equities Outlook

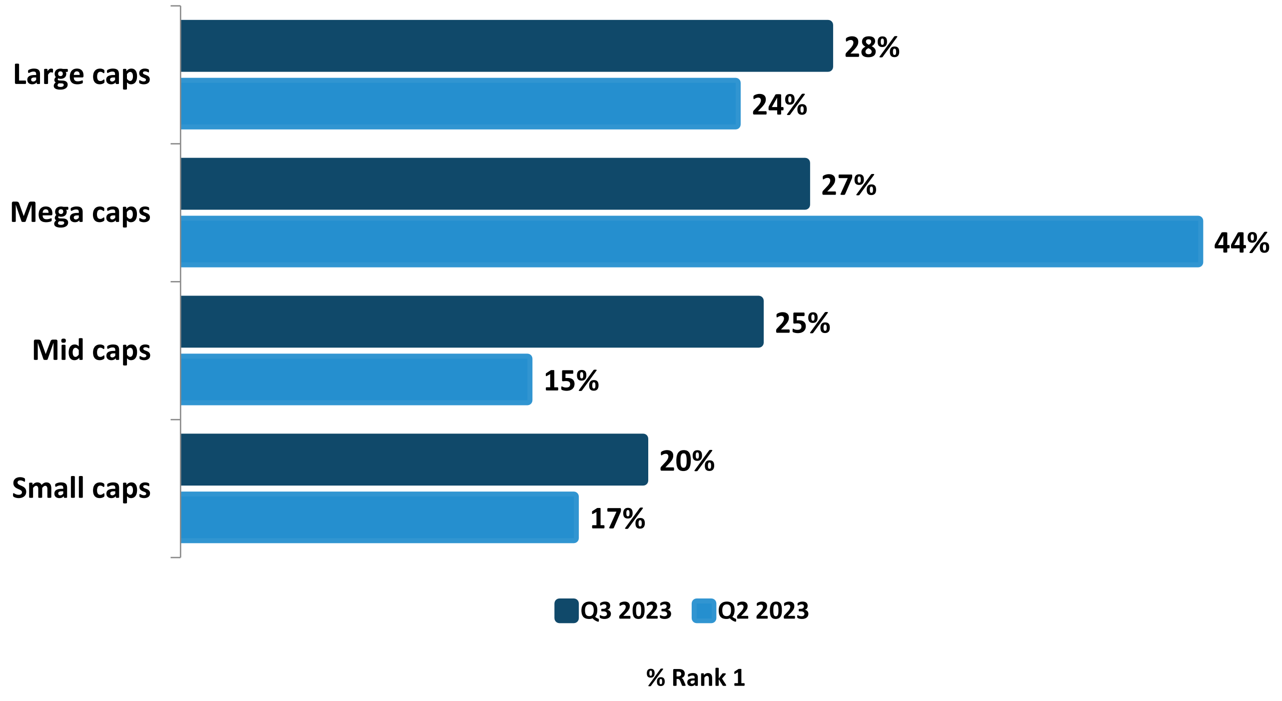
Outlook for US equities improves marginally as bearishness ebbs in both time horizons from last quarter

- Stronger-than-expected economic readings have moved some investors out of the bearish camp but have done little to change investor sentiment broadly. Consistent with last quarter, more are bearish than bullish on 3-month returns, and half are bullish on 1-year returns. Among the 12-month bulls, very few are expecting meaningful real returns as most (42%) expect the market to print just 1% - 6%.



Expectations for mega caps sink after run-up in value

- Large caps drift to the top in terms of the size category that will deliver the largest expected returns over the next 3 months as the air comes out of mega caps. Meanwhile, mid caps and small caps see slight increases as investors signal no consensus on the returns landscape for the months ahead.

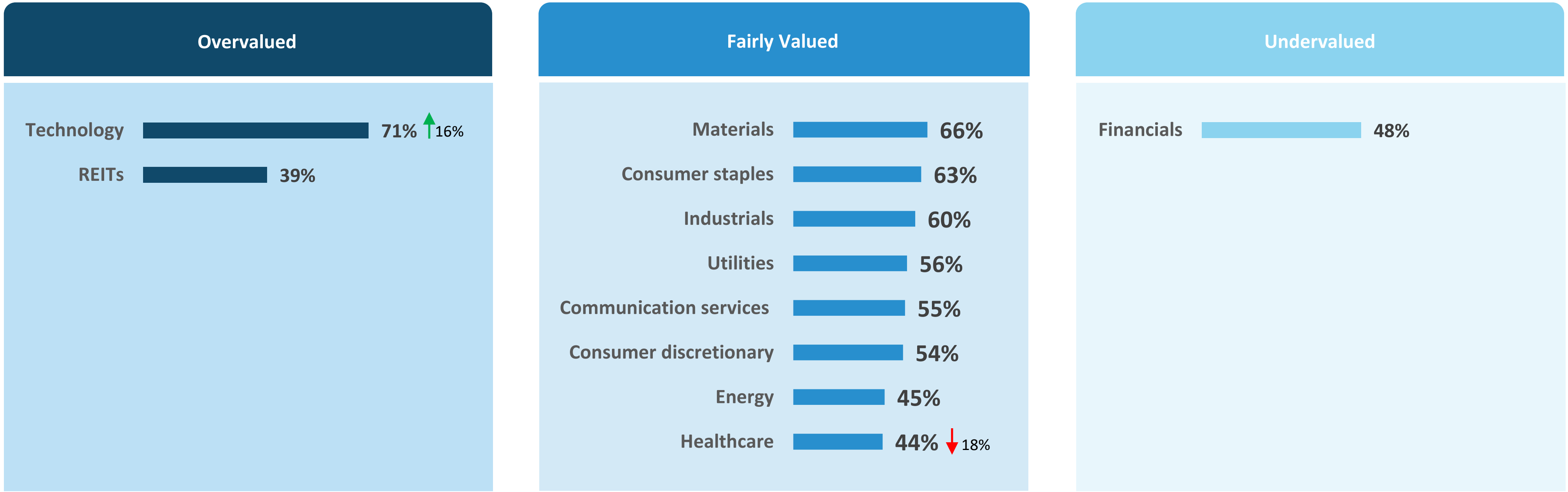


"There is an extraordinary amount of uncertainty as it pertains to market leadership go-forward… I would posit you'll see relatively uninspiring results generated from most asset owners given the lack of conviction one way or the other. The potential for closet-benchmarking becomes real as no one is willing to lean into any particular risk expression or take a flyer on compelling value and/or secular thematics."
- Large US Pension

Q9. Please rank the following US equity categories in terms of expected returns from highest to lowest on a percentage basis over the next 3 months.

More investors turn on tech as 7 in 10 say the sector is overvalued

- Concerns about a tech bubble have grown substantially, with 71% now saying the sector is overvalued compared to 55% three months ago.
- For the second consecutive quarter, REITs, energy, and financials have no majority view as there is significant uncertainty/dispersion within these sectors.
- While a majority viewed healthcare as fairly valued last quarter, just 44% share the same sentiment in the current period. More investors believe healthcare is undervalued (34%) than overvalued (22%) suggesting that we could soon see greater inflows from value investors, particularly if the economy begins signaling weakness.



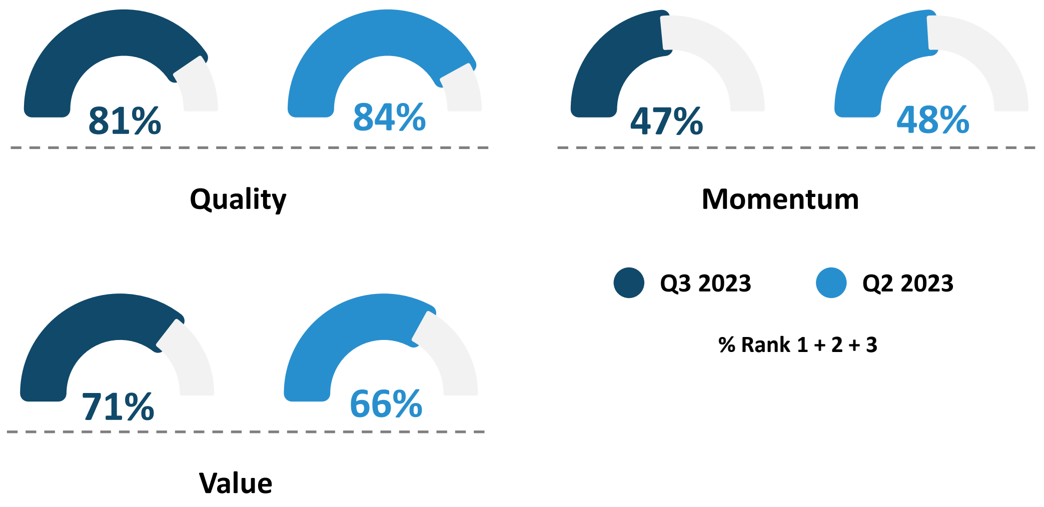
Q7. Do you think the following US equity market sectors are fairly valued?

Note- changes of greater than 10% from previous quarter are indicated by an arrow.

Quality expected to be the top driver of outperformance, with value closely following

- Given the uncertain outlook on equities, investors continue to look to quality as the key style factor for outperformance in the short-term. This style factor is especially top of mind for asset owners, as nine in ten (89%) chose quality in their top factors, compared to 73% of asset managers. Value gains a bit of traction over the last quarter, moving up to 71% from 66%.

Top style factors for outperformance over the next 3 months



"Maintaining an active high quality beta expression is on the top of our list, even more so than value… if left uncontrolled, simply legging into cheap stocks will bring a lot of uncompensated factor "baggage" with it (low quality, high volatility, high beta, etc.). These uneconomic exposures can seriously hinder excess returns, particularly at the precipice of a recessionary environment."
- Large US Pension

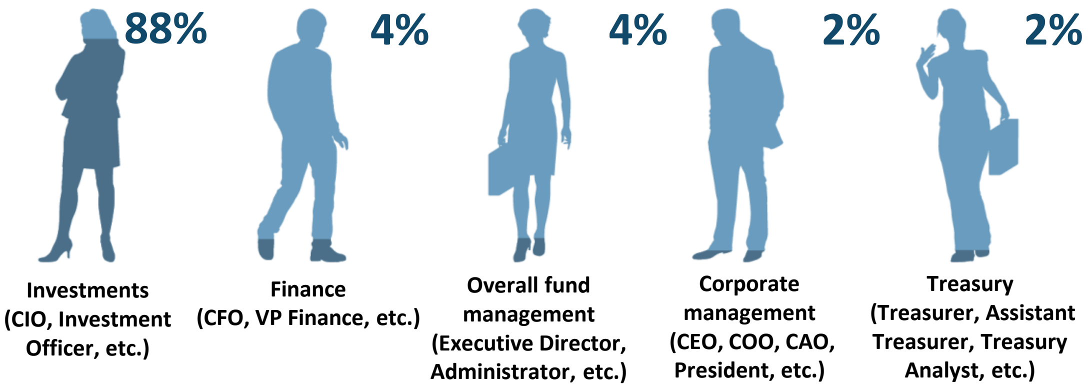
Q8. Please select and rank up to three style factors that you believe will generate outperformance over the next 3 months.

3

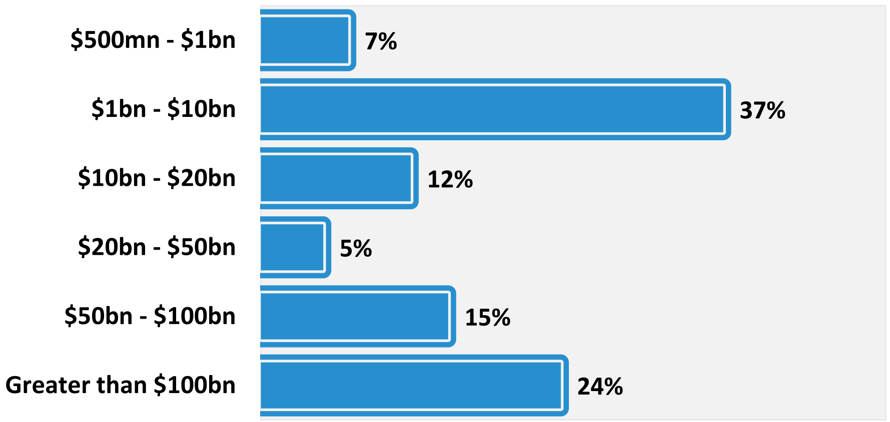
Appendix

Sample demographics

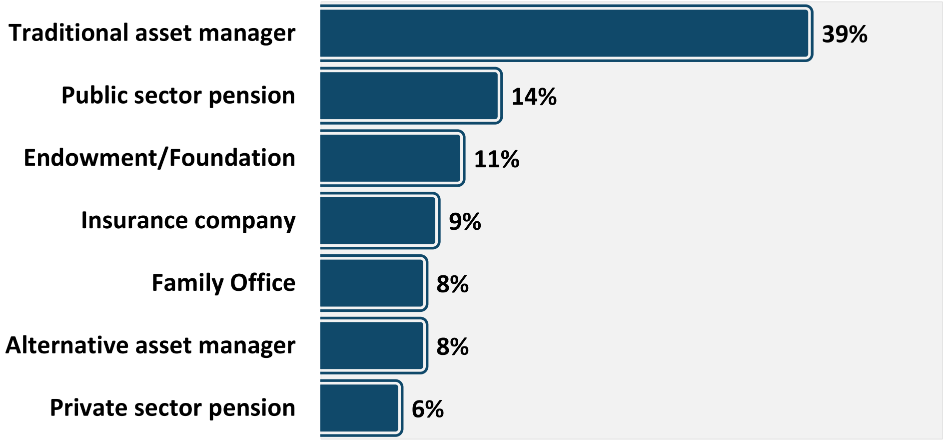
What is your primary function at your organization?



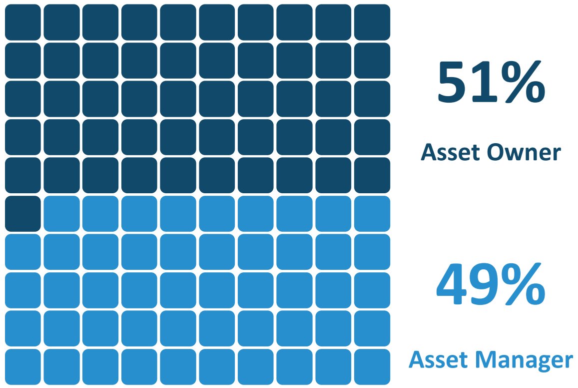
What is the AUM of your organization?



Which of the following best describes your organization and primary investment portfolio?



Asset Owner vs Asset Manager



About us

Coredata Research

CoreData Research is a global specialist financial services research and strategy consultancy, founded in 2002 and headquartered in Australia, with operations in Sydney, Perth, London, Boston and Manila.

It provides clients with bespoke and syndicated research services through a variety of data collection strategies and methodologies, along with consulting and research, database hosting and outsourcing services.

CoreData provides both business-to-business and business to consumer research, while the group's offering includes market intelligence, guidance on strategic positioning, methods for developing new business, advice on operational marketing and other consulting services.

CORE DATA research