ADDEPAR

Coming Out of Pandemic Mode

We recently introduced our Addepar Investor Sentiment Index (ISI) (methodology found here), which uses portfolio-level transaction data to gauge investor sentiment. We analyze the investment data on our platform to gain insight into how ultra-high-net-worth (U/HNW) investors are making adjustments at the portfolio, sector and stock levels. Additionally, we conduct client interviews to supplement the data and analysis presented in our research notes. For privacy reasons, we never disclose identities.

Elevated trading activity witnessed throughout the pandemic subsided to historically low levels in July. Net, gross and sector-level scores were all subdued. This month's key highlights include:

- Investors were very modestly bearish in July, although they briefly turned bullish when markets sold off in the 3rd week of the month.
- Gross activity, a measure of volume, hit its lowest historical level since we started tracking the index. Gross activity shows seasonality effects with troughs in the summer months and peaks in December.
- Sector sentiment was also mild, consistent with the aggregated sentiment measures.
- Of notable exception was the technology sector, where sentiment in Salesforce, Texas Instruments and Apple led to a relatively bullish read.
- China's crackdown on technology companies sent the Hang Seng steeply lower while investor sentiment was neutral with average volumes indicating disagreement on the market's direction.

Investors navigate July's market crosscurrents

The S&P 500 returned 2.3% in July, the 6th consecutive month of gains. The first two weeks of the month started with a rally and then sharply sold off on July 19th as apprehension grew over the rapidly spreading Delta coronavirus variant and its quickly increasing risk to domestic and international economies. The sell-off subsequently reversed and the S&P 500 climbed to its all-time high on July 26th before drifting lower in the final trading days of the month. Disappointing quarterly

results from giant growth stocks such as Amazon, together with China's escalating crackdown on technology companies, fueled the sell-off.

The bond market reflected the continuing deceleration in longer-term growth expectations. Over the course of the month, yields in 10-year Treasuries fell from 1.45% to 1.24% (yields fall when prices rise), the biggest drop since March 2020, the start of the epidemic.

Broadly, sectors showed positive returns with the exception of energy and financial services. Oil prices fell both on news of the agreement between OPEC and its trading partners to boost supply and expectations that demand for oil will moderate due to slowing growth. This drove a sell-off of 8.3% in the sector. Financial services returned –.4% as Treasury yields fell.

In July, the ISI was a very modest –1.9, the fourth straight month of bearish reads. In scrutinizing weekly ISI data, investors were bearish during three of the five weeks of the month. Consistent with their historical behavior, investors took the opportunity to buy U.S. equities during the sharp mid-month dip before returning to their bearish stance.

Figure 1: Weekly Addepar Investor Sentiment Index (4wma)
December 30, 2020–August 3, 2021
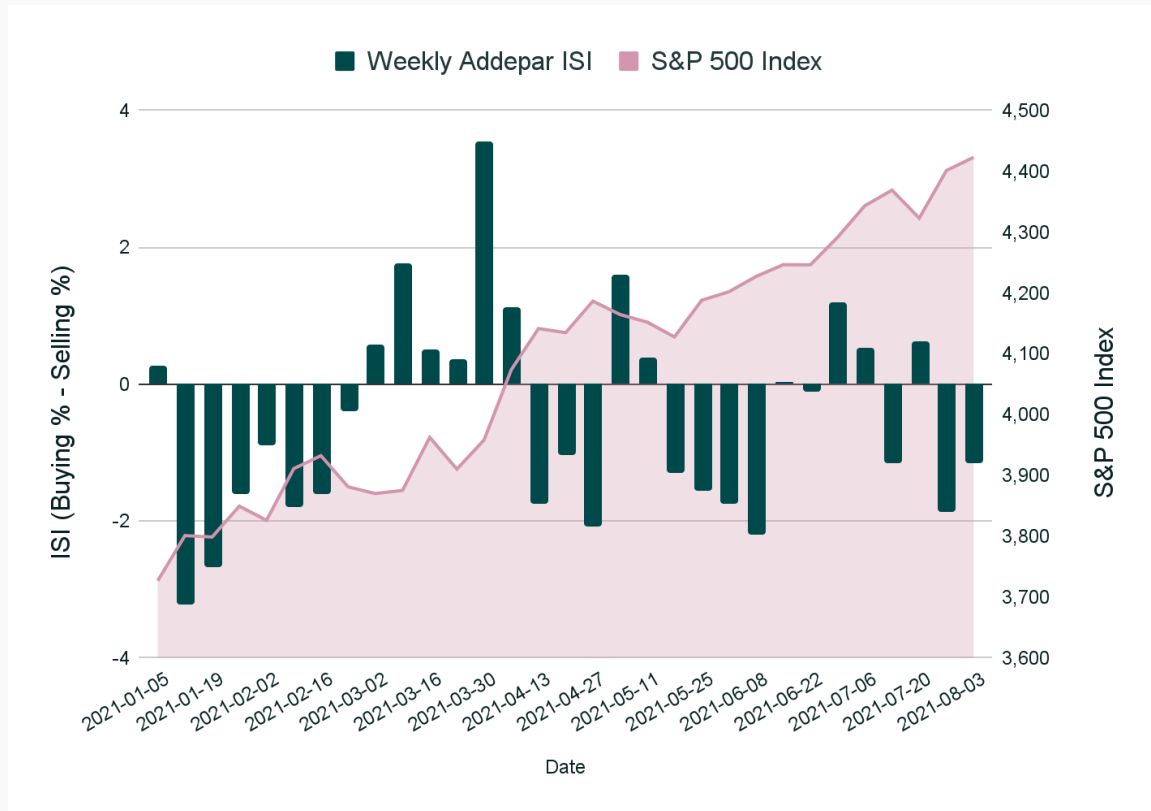
Gross activity reverts to pre-covid levels

After being elevated throughout the pandemic, volumes and gross trading activity have come down (below even) pre-covid levels. Gross activity (% of portfolios buying plus % of portfolios selling) has continued to decline since the start of the pandemic. In fact, July's print of 23.4 was the lowest since we have been tracking the index.

Trading volumes for the S&P 500 have also declined since the start of the pandemic. While trading volumes and gross activity show some historical correlation (.4, -.5), this has increased to .8 since the start of 2020 largely due to the unique set of circumstances in March of last year that drove volumes, volatility and gross activity to highs not seen since the financial crisis of 2008.

Figure 2: Gross Activity and S&P 500 Trading Volumes
January 2019–July 2021
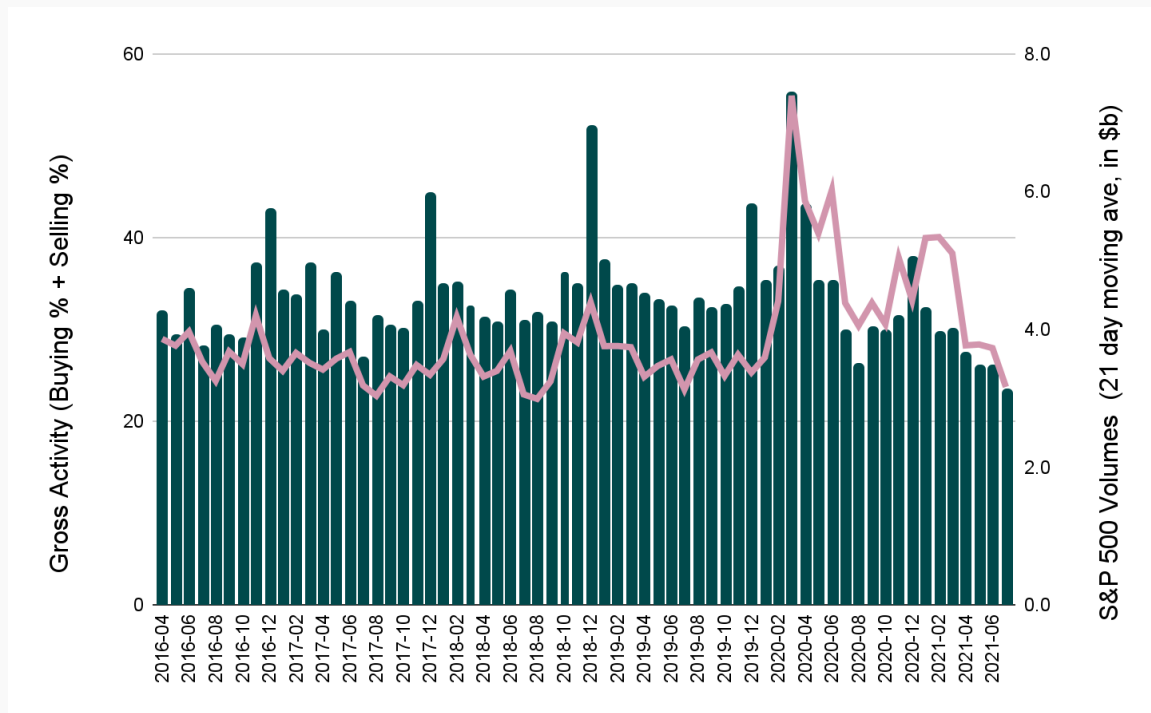
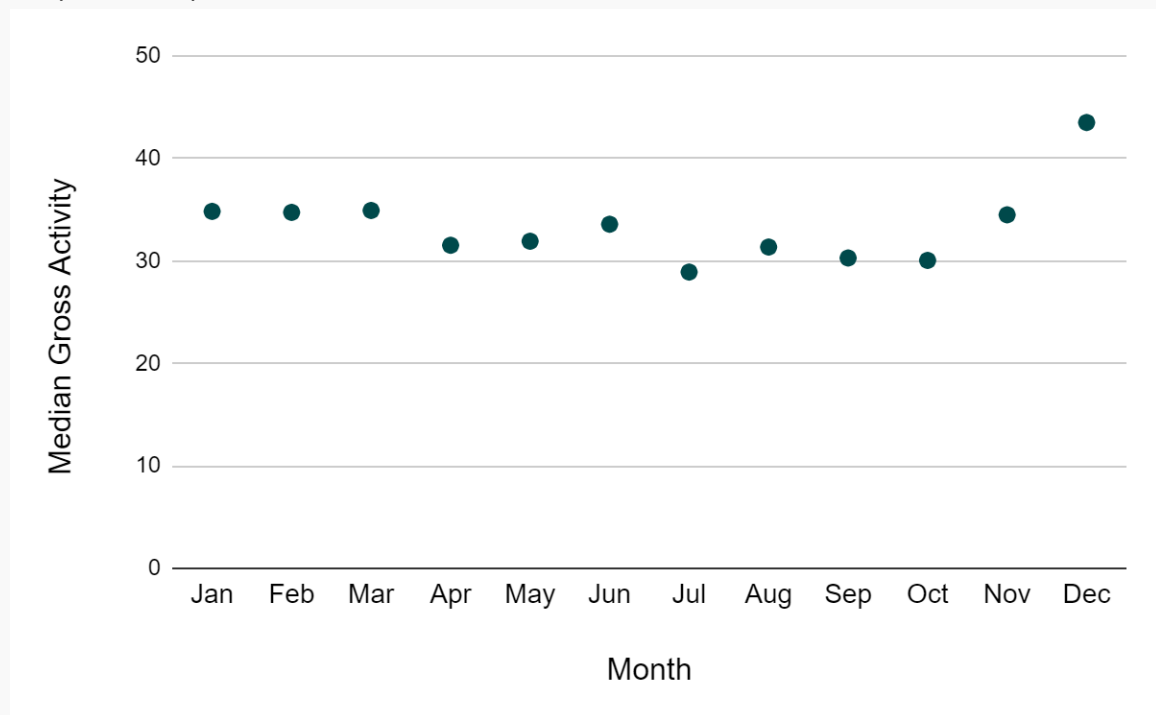Source: Addepar

Gone fishing?

One may also observe in figure 2 that the local troughs in gross activity appear to be in the summer months, particularly in July and August. This may lead one to ask whether seasonality impacts gross activity scores.

Figure 3 shows median gross trading activity by month. Historically, July is the least active month, with a median gross activity score of 28.9. This July in particular had the lowest July read to date. A CIO of a family office from the northeast region of the U.S. remarked "No one took a proper summer vacation last year and this year everyone is making up for it."

Meanwhile, December stands out as the most active month, with a median gross trading activity of 43.5, which can be attributed to reinvestment of dividends back into funds.

Figure 3: Seasonality in Gross Activity
May 2016–July 2021

Source: Addepar

Investors disagree on china

In July, the Hang Seng index sold off 11% of its market value, reflecting investor anxiety over how the technology sector will fare under increased Chinese regulatory activity related to data security, online education and online gaming.

Investor sentiment in emerging and frontier markets (which includes China) had a robust positive read in July. In fact, investors have been bullish every month this year except for June. However, sentiment for Chinese equities was neutral with average volumes indicating disagreement on the market's direction.

Due to variations in the magnitude of sentiment scores across geographies, we normalize values using z-scores (a statistical measure of how strong sentiment is in each geography relative to its historical mean) in figure 4.

An independent RIA client from the southwest explained, "Long-term prospects in China and the region remain sound. We believe the aggregate market oversold on the online education news and therefore it's now a buying opportunity."

Figure 4: Sentiment Z-Scores by Geography
July 2021
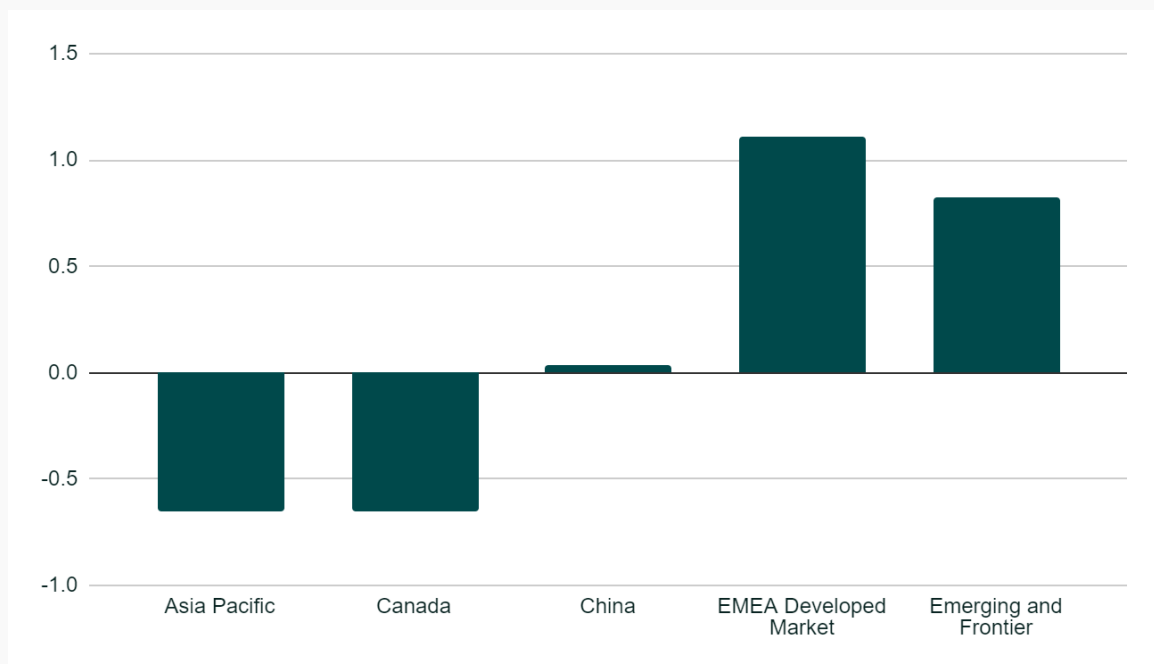
Source: Addepar

Quiet at the sector level

Figure 5 shows sector-level sentiment and historical z-scores. In July, sector rotations were generally quite muted and consistent with aggregate net and gross sentiment. Investors modestly rotated out of industrials and consumer defensive and into consumer cyclical and technology.

Of note, the technology sector, which tends to have negative sentiment, turned moderately bullish. Texas Instruments, Salesforce and Apple were significant contributors on robust quarterly results. Intriguingly, however, Amazon's disappointing quarterly results did not impact investors' bullish sentiment.

Figure 5: Sector Sentiment

July 2021

Sector	Sentiment	Z-Score
Consumer Cyclical	1.0	0.3
Technology	0.9	1.4
Energy	0.7	0.3
Communication Services	0.4	0.0
Materials	0.5	0.4
Utilities	0.2	0.3
Healthcare	0.3	0.1
Real Estate	0.2	0.0
Financial Services	-0.8	-0.3
Consumer Defensive	-0.9	-0.5
Industrials	-1.3	-0.6
Bullish/Bearish		
Relative to own history:		
Strong -		
Moderate -		
Strong +		
Moderate +		

Source: Addepar

To further put the technology sector sentiment into perspective, figure 6 shows a box plot of monthly sector sentiment. A box plot is a statistical chart often used to get a visual sense of the dispersion in a data set. End points of the lines represent

the 5th and 95th percentiles, while edges of the boxes represent the 25th and 75th percentiles.

One can observe that for all sectors with the exception of technology, zero lies between the lower quartile and the upper quartile. This would indicate that biases are most pronounced for the technology sector[1] and clearly negative.

Figure 6: Distributions of Sector Sentiment
May 2016–July 2021
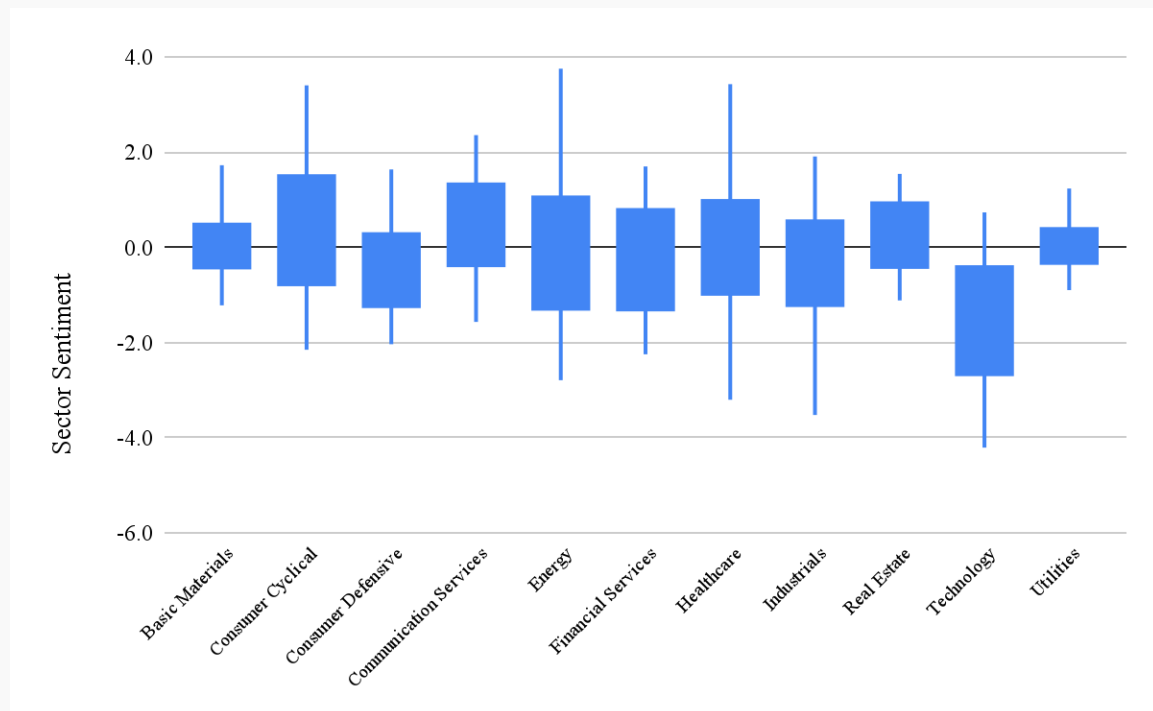
Source: Addepar

Additionally, the differences in the range from the 75th percentile to the 25th percentile in figure 6 are not consistent. In fact, some are quite small, such as utilities, while others are rather large, such as consumer cyclical.

As one may suspect, this illustrates many investors' general propensity to allocate relative to sector weights in the market and make over/under alpha allocation decisions relative to these weights. Figure 7 shows a scatter plot of sector weights vs the upper–lower quartile for each sector. A best fit line excluding energy and technology is included, although it's not statistically significant.

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[1] See January 2021 Research Note for additional coverage of technology

With the exception of technology and energy, one can see a loose linear relationship between weights and dispersion. Technology has the largest weight, although it does not have dispersion that's higher than smaller sectors. We'll explore more about the dynamics in the technology sector when discussing figure 8, below.

Energy also stands out as it has a small market weight but high dispersion. This is due to the outsized impact of energy prices on the sector, which we have explored in previous research notes.

Figure 7: Sector Weights vs. 75th–25th Percentile
May 2016–July 2021
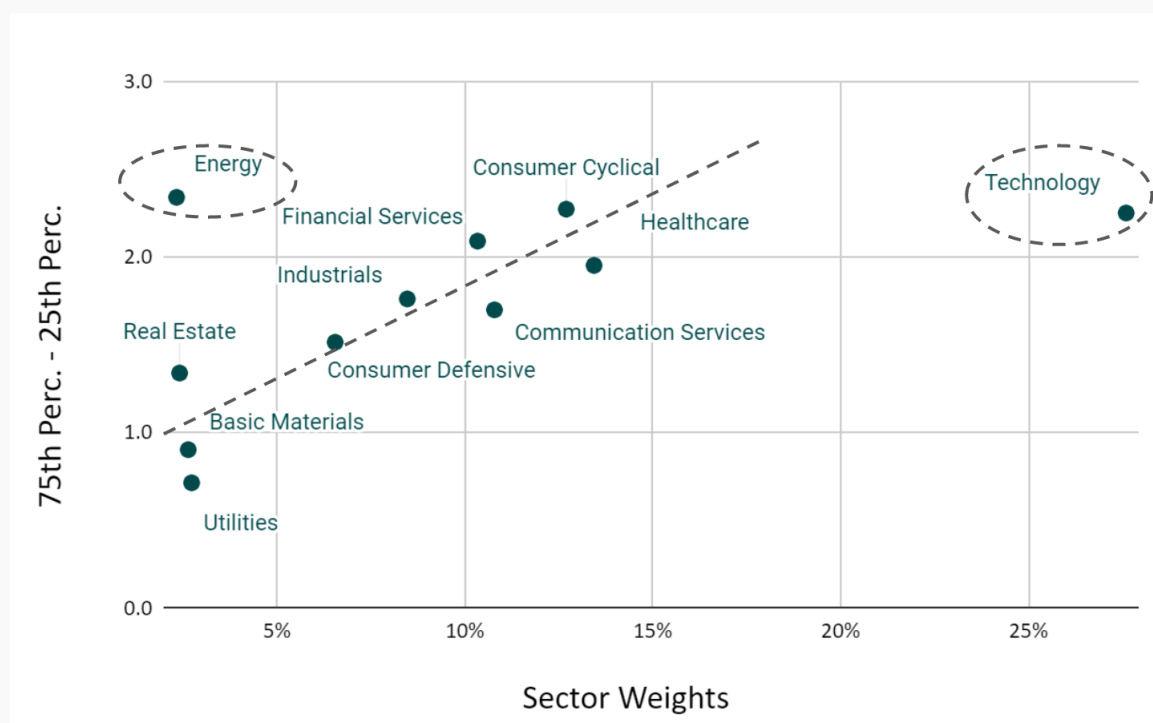
Source: Addepar

In figure 8, we look at the top 10 most-traded stocks in the technology ISI data set. Because investors often invest on a market cap–weighted basis, we also include these figures to evaluate the relative importance of each stock. In a particularly concentrated industry such as technology, Apple and Microsoft share more than half of the total sector market cap, and therefore sentiment in these two stocks drives much of the overall sector-level sentiment.

Figure 8: Top Ten Technology Stocks by Market Capitalization
August 2020–July 2021

Top 10 Traded Stock	Average ISI Previous Year	July, 2021 ISI	Percentage Market Cap
Apple	-0.7	0.3	26%
Microsoft	0.1	0.1	20%
NVIDIA	0.1	-0.1	4%
Intel	-0.4	-0.3	3%
Adobe	0.4	0.2	3%
Cisco	-0.2	0.0	2%
Qualcomm	0.2	0.2	2%
Oracle	-0.2	-0.5	2%
Salesforce	0.3	0.5	2%
IBM	0.0	-0.3	1%

Source: Addepar

Stay tuned

We will continue to develop analytics that provide additional value to our clients through the aggregated and anonymized investment data on our platform. We'll also keep posting the monthly ISI index, our key observations and periodic research notes on our website.

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