ADDEPAR

RESEARCH NOTE / FEBRUARY 2021

Entering bubble territory?

We recently introduced our Addepar Investor Sentiment Index (ISI) (methodology found here), which uses portfolio-level transaction data to gauge investor sentiment. Much has been written lately on the topic of market bubbles and in this note, we apply our analytical toolkit to provide insight into how ultra-high-net-worth (U/HNW) investors are positioning at the portfolio, sector and stock level.

As of January 2021, investors turn bearish on the market. The negative sentiment can be attributed to fewer investors buying into what many consider a frothy market while selling remains consistent with historical levels.

In February, investors positioned for improved growth and reflation. The highlights are:

- Moving out of the larger sectors including technology, healthcare and communications.
- Bullish on energy, basic materials and industrials, which is consistent with the pricing in of reflation and increasing real economic growth expectations as the U.S. makes progress on vaccinations and adds a new round of fiscal stimulus.
- Increasingly bullish on consumer cyclicals, with Tesla joining Amazon as a favorite.

A record number of stocks have had their price triple in value since the beginning of 2020. With few exceptions (most notably Tesla), U/HNW investors have not chased these “frothy” stocks.

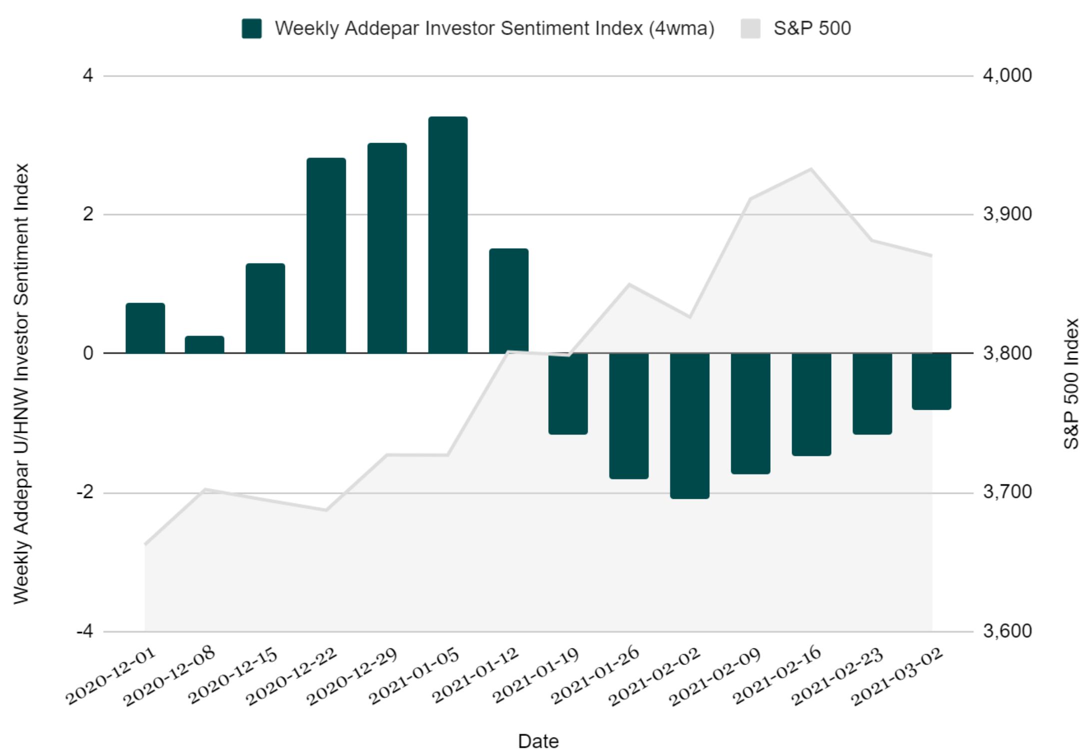
Sentiment turns and has stayed bearish in the new year

In these unprecedented times of massive fiscal and monetary stimulus, a steepening yield curve and inflationary risk, it's challenging for investors to make sense of market pricing using traditional methodologies. Discussions of market bubbles have been in the news lately, so in this month's note we apply the ISI analytical toolkit to provide additional insight into how U/HNW investors are revisiting their positions at the portfolio, sector and stock level.

Figure 1 shows the 4-week moving average (4wma) of the Addepar ISI computed on a weekly frequency for the previous year. After a period of bullish sentiment ending the week of January 12, 2021, U/HNW investors turned bearish and remained so through the end of February. The negative ISI can be attributed to fewer investors buying into this market while the level of selling remains consistent with historical levels. Client conversations corroborate the picture with concerns over high valuations and the impact of rising treasury yields.

Figure 1: Weekly Addepar Investor Sentiment Index (4wma)

December 1, 2020–March 2, 2021



Source: Addepar, Morningstar

Portfolio shifts reflect a changing macro environment

Are U/HNW investors broadly staying away from the market or searching for opportunities within selected sectors? To gain additional insight, we dive a little deeper and apply sentiment at the sector level.

Figure 2 shows February sector sentiment rank-ordered sectors by their weight in the S&P 500 and sector performance from March 31, 2020 through February 28, 2021. We chose this time period because it approximately represents the return since the bottom of the pandemic sell-off. Additionally, we included each sector's ISI z-score (which measures the relative strength of each sector's sentiment relative to its history).

One may recall in January, investors became more bullish on the laggard sectors, which have continued to catch up to the broader market. In February, sentiment is less clearly tied to performance. We see the sentiment is largely split amongst the lower-performing sectors, with healthcare having the most negative sentiment of all the sectors across February, a neutral reading for utilities (the worst-performing sector), and moderately bullish performance in consumer defensive and real estate sectors. A similar picture emerges from the higher-performing sectors, with bearish readings for communication services and technology, and bullish readings for consumer cyclical and industrials.

Putting on a macro lens, it's interesting to see that investors are moderately to strongly bullish on energy, basic materials and industrials, which is consistent with the pricing in of reflation and increasing real economy growth expectations as the U.S. makes progress on vaccinations and distributes the latest round of fiscal stimulus. With the exception of the consumer cyclical sector, sentiment in February is negative in the larger sectors and neutral to positive in the smaller sectors.

We also note that sentiment appears to be moderately shifting into sectors that have been in long-term secular decline. With the exception of the consumer cyclical sector (which we will cover in more detail below), U/HNW investors are more bullish on sectors that have become a smaller proportion of the market over the last 10 years. We will continue to monitor and update you if this trend persists.

Figure 2: Sector Sentiment and Sector Returns

Sector	Index Weight	10-Year Change in Index Weight	Sentiment	Apr. 2020 - Feb. 2021 Sector Return	Z-score
Technology	28%	9%	-1.3	64%	0.1
Healthcare	13%	2%	-1.5	29%	-0.8
Consumer Cyclical	13%	4%	2.7	64%	1.4
Communication Services	11%	7%	-0.7	56%	-0.7
Financial Services	10%	-6%	0.0	58%	0.2
Industrials	8%	-3%	1.2	56%	0.9
Consumer Defensive	7%	-4%	0.2	19%	0.6
Utilities	3%	0%	0.0	8%	-0.1
Basic Materials	3%	-1%	0.7	66%	0.8
Real Estate	2%	0%	0.8	24%	0.7
Energy	2%	-8%	0.7	70%	0.4

Bullish/Bearish
Relative to own history:

Strong -
Moderate -
Strong +
Moderate +

*In gray, return is below median
** Index is S&P 500

Source: Addepar Analysis

As per the January Research Note, the consumer cyclicals sector has been bullish due to Amazon and become even more bullish with Tesla now included in the S&P 500 index. In a subsequent section, we'll look further into all of the stocks that have skyrocketed over the past year.

Of note, healthcare has turned relatively bearish. Below, we show how this doesn't necessarily represent a broad-based shift in how the sector is viewed, but rather has been mostly driven by investors' changing perspectives on a single healthcare stock.

Regeneron drives negative sentiment in healthcare

In figure 3, we look at the top 15 most-traded healthcare stocks in the 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. As we scan down the list of stocks, we see a mixed picture of bullish and bearish sentiment. Mostly, sentiment is modest in absolute terms. But sentiment for Regeneron is almost three times larger in magnitude than the rest.

Figure 3: 15 Most-Traded Healthcare Stocks

February 2021

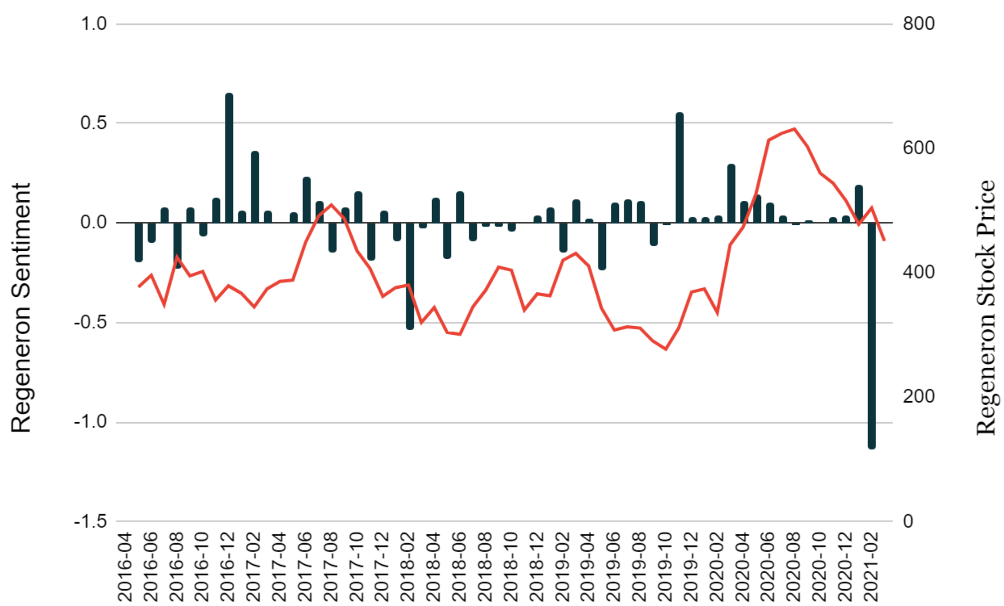
Top 15 most traded	% of Market Cap	February Sentiment
Regeneron	1%	-1.1
Pfizer	3%	-0.4
Eli Lilly	2%	-0.3
J&J	6%	-0.3
Bristol Myers	2%	-0.3
Abbvie	2%	-0.2
Amgen	2%	-0.2
CVS	1%	-0.1
Abbot Laboratories	3%	-0.1
Medtronic	2%	0.1
Gilead Sciences	1%	0.2
United Healthcare	5%	0.2
Thermo Fisher Scientific	2%	0.2
Zoetics	1%	0.3
Danaher	2%	0.4

Source: Addepar Analysis

In charting the time series for Regeneron's sentiment (figure 4), we see that it has been thinly traded up until February 2021. Meanwhile, the stock price peaked in September 2020 on news of its successful antibody cocktail drug trials and has continued to slide since.

Figure 4: Monthly Regeneron Sentiment vs. Equity Price

April 2016–February 2021



Source: Addepar Analysis

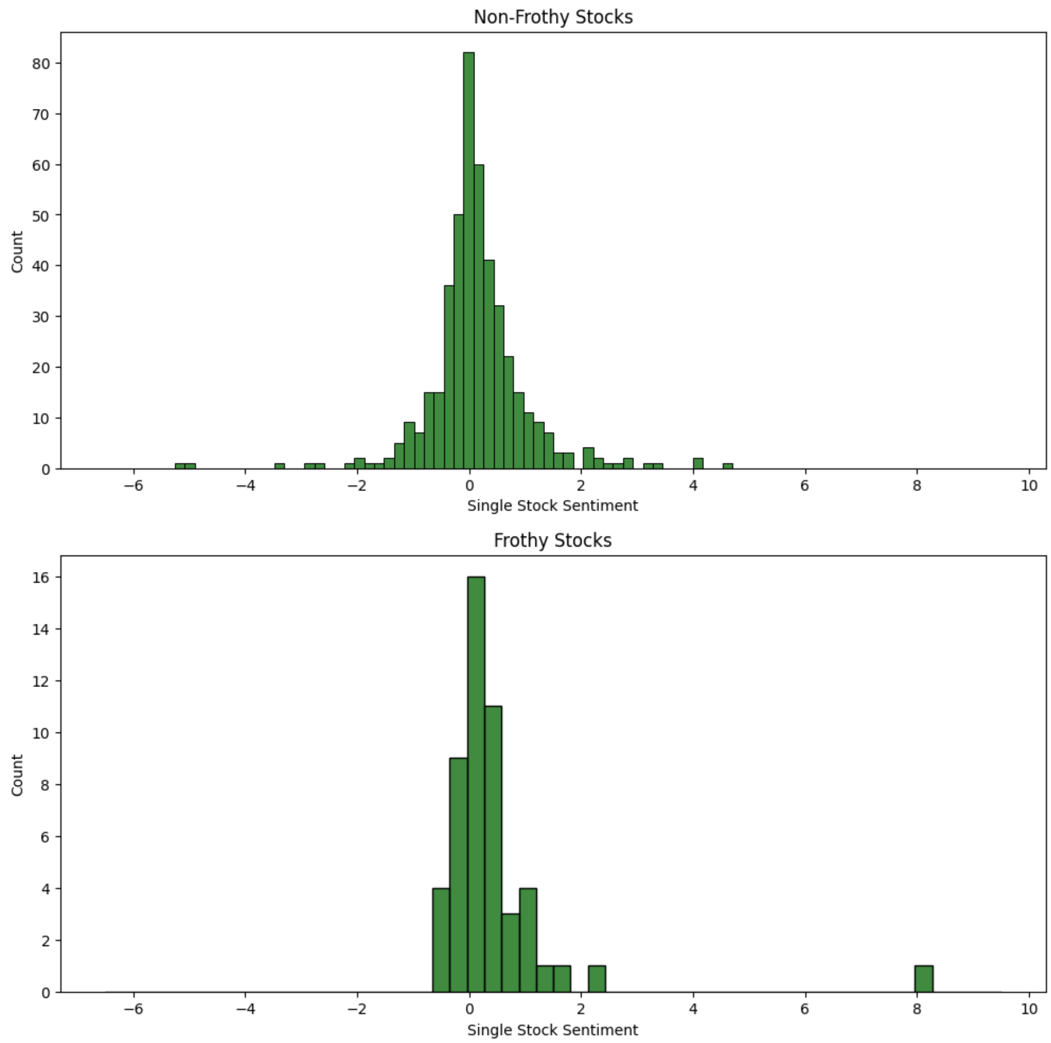
U/HNW investors have not chased "frothy" stocks

As we described earlier, sentiment in the consumer cyclical sector, while already high, has increased in February due to Tesla's popularity. Intriguingly, Tesla's stock has skyrocketed over the past year, as have others. In this context, we decided to put a finer point on U/HNW investor sentiment regarding "frothy" stocks. More precisely we ask if, as is the case for Tesla, are U/HNW investors participating in the run-up of these stocks?

Roughly, we defined an S&P 500 stock as "frothy" if its price tripled from trough to peak in the period from 2020–present. Over this time frame, we have identified 51 such stocks (including Tesla). In figure 5, we then compare sentiment for these stocks and the remaining stocks in the S&P 500. In figure 5, we see the histograms of stock sentiment for frothy and non-frothy stocks during the time of their run-up. Interestingly, both sets center around 0 with median sentiment being .17 and .1 for the respective sets. From these histograms, we see that U/HNW investors are not systematically contributing to the run-up in frothy stocks. However, in the bottom chart (right side) Tesla, to some degree Nvidia and to a lesser extent Paypal stand apart—where a significant portion of investors bet on these stocks, which were in fact the three largest stocks by current market cap in the analysis. Almost 11% of investors bought Tesla during this time frame, with less than 3% selling!

Also of note, in looking at sentiment for frothy stocks over the past few months, only Tesla stands out as having significantly bullish sentiment. The rest are relatively neutral at this stage.

Figure 5: Frothy and Non-Frothy S&P 500 Stock Sentiment Histogram



Source: Addepar Analysis

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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