ADDEPAR

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Investors Bet on Consumers and the Real Economy

We recently introduced our Addepar Investor Sentiment Index (ISI) (methodology found here), which uses portfolio-level transaction data to gauge investor sentiment. With mounting concerns over rising stock values and renewed inflation, 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.

Our primary ISI indicator turned bearish in April. At the sector level, investors continued to position their portfolios for improving consumer spending and a recovery of the real economy. This month's highlights are:

- After an incredible 10% jump in retail sales in March, investors showed bullish sentiment in the consumer cyclical and consumer defensive sectors.

- Despite broad-based optimism for consumer cyclicals, U/HNW investors turned bearish on Home Depot, which traded sideways in April after a 35% run-up in March.

- Investors are also betting on growth in the real economy as indicated by the positive sentiment in key cyclical sectors including industrials, energy, real estate and basic materials. However, financial services and technology sentiment were negative.

- Investors have historically traded the financial services sector based on changes in long-term treasury rates. Coming out of the pandemic, this relationship appears to have broken down. Despite rates beginning to rise, investors have remained bearish on the sector.

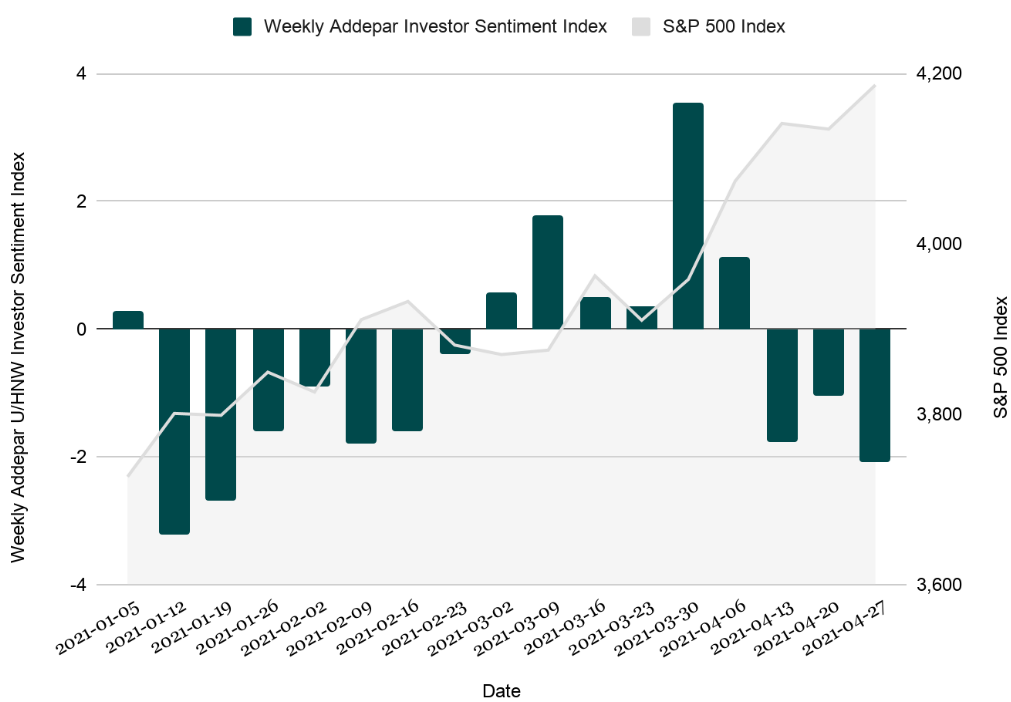
Investor sentiment turns bearish in April

In April, equities continued their rally to historic highs against a backdrop of continued commitment by the Federal Open Markets Committee (FOMC) to keep interest rates low and maintain current levels of bond purchases. Fiscal stimulus continues to work its way through the economy. Because of concern that the recovery is "uneven and far from complete[1]," the central bank has maintained its dovish policy despite acknowledging mounting risks of inflation and asset price bubbles. Meanwhile, news articles abound in which economists and investors express concerns over increasing signs of these risks (CPI surprise to the upside and cryptocurrency come to mind).

Despite the strong positive news on the economy, market sentiment is shifting. Headline investor sentiment flipped from positive in March to negative in April (figure 1). Declining aggregate buying activity and increasing selling activity caused successive weekly negative reads in the last three weeks of April. By comparison, equity fund flows data also recorded inflows in March and outflows in April[2].

Figure 1: Weekly Addepar Investor Sentiment Index

December 30, 2020–April 27, 2021



Source: Addepar, S&P Global

[1] Fed Chairman Jerome Powell

[2] Morningstar U.S. Fund Flows

Fueled by the latest round of stimulus checks, retail sales gained more than 10% in March. Investors and economists predict additional gains as consumers return to their pre-pandemic activities. In April, investors continued to position themselves for improved consumer spending. The consumer cyclical and consumer defensive sectors persisted in providing strong bullish reads on our sector ISIs.

Investors bet on further improvement in economic growth with positive sentiment in the cyclical sectors including industrials, energy, real estate and basic materials. Meanwhile, financial services and technology sentiment were negative. While technology sector sentiment is potentially explained by the susceptibility of the sector to rising rates, it's intriguing to see bearish sentiment in financial services, which often does well in an environment of rising growth and interest rates. We'll look further into how investors and the sector respond to long-term rate increases below.

Overall, sector level sentiment was generally muted—with the consumer defensive sector showing the only moderately high z-score for the month.

Figure 2: Sector Sentiment
April 2021

Sector	Index Weight	April, 2021 Sentiment	Z-score
Consumer Cyclical	13%	1.7	0.8
Industrials	8%	1.1	0.8
Consumer Defensive	7%	1.0	1.2
Energy	2%	0.8	0.4
Real Estate	2%	0.7	0.5
Basic Materials	3%	0.6	0.6
Healthcare	13%	0.3	0.2
Communication Services	11%	0.2	-0.2
Utilities	3%	0.0	0.0
Financial Services	10%	-0.8	-0.3
Technology	28%	-0.8	0.3

Bullish/Bearish
Relative to own history:

Strong -
Moderate -
Strong +
Moderate +

Source: Addepar

Amazon and Tesla remain post-pandemic top-buy picks within the consumer cyclicals sector (figure 3). Despite broad-based optimism for this sector, investors turned bearish on Home Depot in April, which after a 35% run-up in March, traded sideways in April. For the most part, share-price appreciation over the previous year is approximately in line with the broader S&P 500 index (45%) with the exception of Tesla. After a 333% rally and looming semiconductor shortage risk in the supply chain, investors still continued to buy this stock in April.

Figure 3: 10 Most-Traded Stocks in Consumer Cyclicals
April 2021

Stock	Sentiment	Share Price Appreciation	Market Cap. % of Total
Amazon	1.6	40%	36%
Tesla Motors	0.5	333%	12%
Home Depot	-0.4	51%	8%
TJX Companies	0.3	46%	2%
Alibaba	0.3	16%	13%
Nike	0.3	54%	5%
Marriott	0.1	66%	1%
Starbucks	0.1	52%	3%
eBay	0.1	43%	1%
Hilton	0.1	72%	1%

Source: Addepar

Given that share prices in the technology sector have appreciated significantly more than the broader market, one might suspect that valuations are rich and rather susceptible to rising rates. Though negative, technology sector sentiment has actually been increasing recently from -3.2 in December to -.8 in April.

Apple, the heavyweight by market cap, now has a slightly negative sentiment score, while Accenture has replaced it as the top contributor to the overall bearish view (figure 4). Nvidia, whose stock has more than doubled since the start of the pandemic, also continues to be consistently popular with U/HNW investors.

Figure 4: 10 Most-Traded Stocks in Technology Sector
April 2021

Stock	Sentiment	Share Price Appreciation	Market Cap. % of Total
Accenture	-1.0	60%	1%
Microsoft	0.8	42%	14%
Broadcom	0.6	78%	1%
Gartner	-0.6	67%	0%
NvidiA	0.5	110%	3%
ServiceNow	0.5	44%	1%
Adobe Systems	0.4	46%	2%
Cisco Systems	-0.3	25%	2%
Apple	-0.3	83%	16%
Oracle	-0.2	46%	2%

Source: Addepar

In reviewing recent sentiment data, we've been more surprised to see financial services sentiment neutral to bearish in recent months. Given the sector's strong linkage to interest rates and in the context of long-term interest rates rising to levels not seen since January of 2020 (i.e. before the pandemic), one may have expected to see some bullish sentiment in recent readings. Below, we explore the financial services sector sentiment in further depth to gain some perspective on recent sentiment readings.

Treasury yields lead sentiment prior to the pandemic

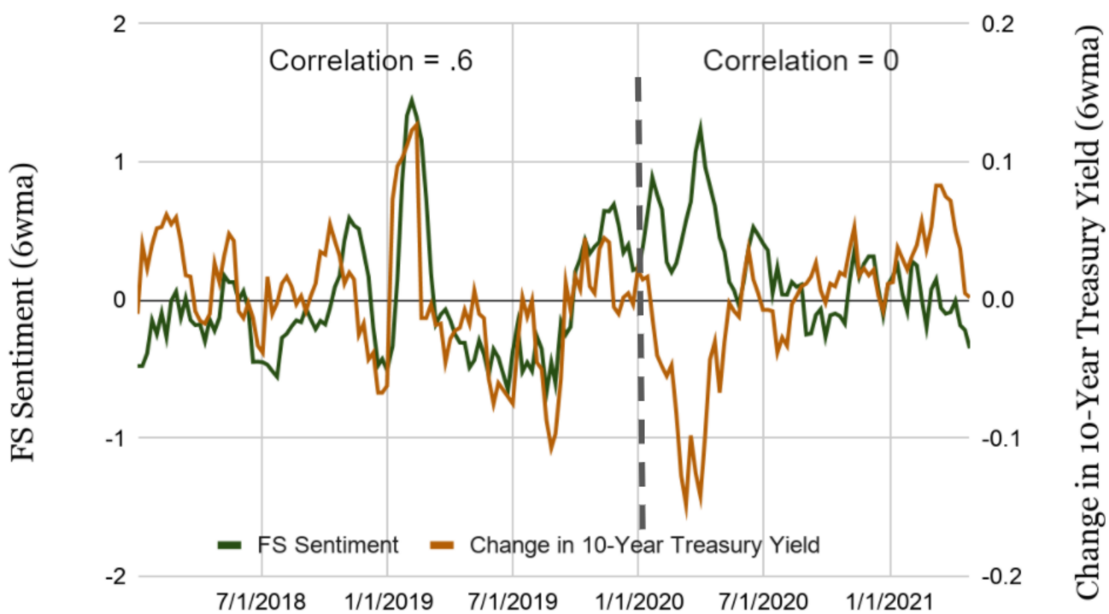
The financial services sector, particularly in banking, takes in deposits that pay short-term rates while lending out the capital and earning longer-term rates. In doing so, the profitability (net interest margin) of banks and other providers is directly influenced by the spread of long and short-term rates. When long-term rates rise, the spread between the rate a bank charges its customers and the fed funds rate increases, which drives net interest margin higher. See figures 6 and 7 of the Appendix for further analysis of the relationship between the financial services sector and interest rates.

Figure 5 shows the weekly financial services sector sentiment and changes in the 10-year treasury yield computed on a 6-week moving average basis. From the period of January 2018 through December 2019, the two series have a correlation of .57. Also as one can see from the graph, yields modestly lead sentiment by approximately two weeks. On a lagged basis, correlations rise to .7. This lag suggests that investor sentiment responds to changes in the yield.

In 2020 (after the start of the pandemic), the relationship breaks down. Financial services sentiment is largely bullish during the March 2020 market sell-off similar to the broader Investor Sentiment Index. Subsequently, there's no correlation between the two time series that we can measure.

A number of reasons could explain the shift in investor behavior. One explanation might be that loan creation relative to rising cash deposits is decreasing, which reduces profitability. Alternatively, investors may be concerned about future balance sheet losses (e.g. loan defaults) or simply don't believe that the rise in yields is sustainable. What is clear is that the investment paradigm in this sector has changed.

Figure 5: Financial Services Sentiment and Treasury Yields
Jan 1, 2018–April 30, 2021



Source: Addepar, Federal Reserve Bank of S.T. Louis

Stay tuned

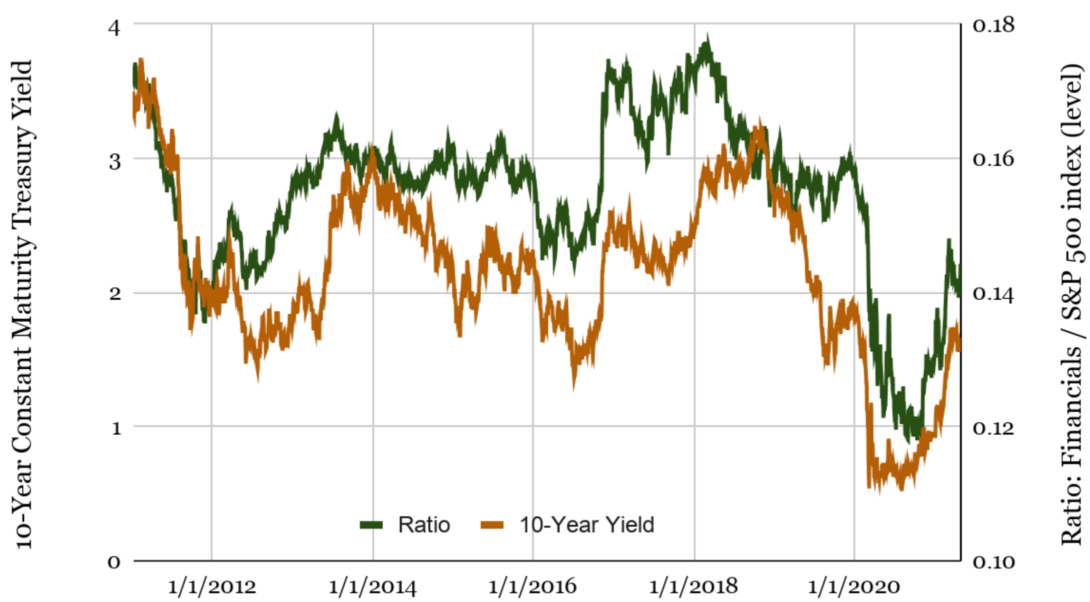
We will continue to develop analytics that provide additional value to our clients through the aggregated and anonymized investment data on our platform. We'll also keep posting the monthly ISI index, our key observations and periodic research notes on our website.

Appendix

Figure 6 shows a crude illustration of the connection between long-term rates and the sector. On the right hand axis, we plot the time series for the ratio of the financials sector index and the S&P 500 index. This ratio of indices dampens the effect of the market beta. On the left-hand axis, we plot the time series for the 10-year bond yield. One can see that there's a visible correlation between the two time series.

Figure 6: Treasury Yields and Financial Services Sector Time Series

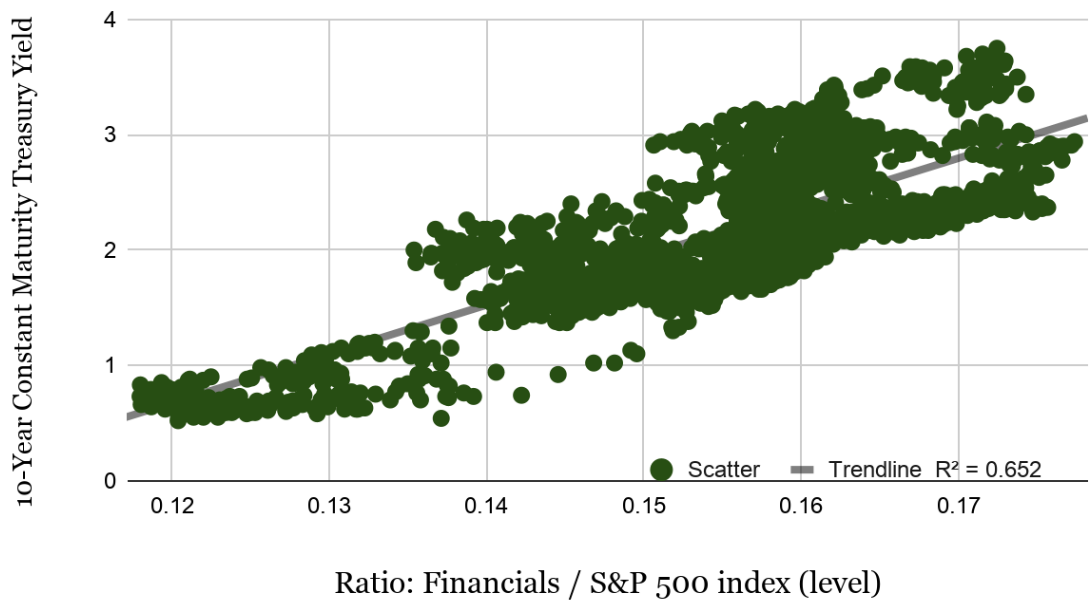
Jan 1, 2011–April 30, 2021



Source: Addepar, Morningstar, S&P Global, Federal Reserve Bank of S.T. Louis

In fact, in converting these time series into a scatter plot (figure 7) and running a simple regression analysis, we see an R^2 = .65, which suggests a strong link. We now dive deeper and explore if the connection to yield levels is also visible with investor sentiment.

Figure 7: Treasury Yields and Financial Services Sector Scatter Plot
Jan 1, 2011–April 30, 2021



Source: Addepar, Morningstar, S&P Global, Federal Reserve Bank of S.T. Louis

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