

Investor Sentiment Index in the Year of the Pandemic

Executive Summary

We recently introduced our Addepar ISI (methodology found [here](#)), which uses portfolio-level transaction data to gauge investor sentiment. As this year's global pandemic has brought major shifts in the financial industry, the ISI has proven to be a valuable tool to capture investor behavior in the U/HNW segment.

During the major market sell-off between February 19 and March 23rd, ultra-high-net-worth (U/HNW) investors were generally bullish and added equity exposure. Overall trading activity also rose rapidly, coinciding with a spike in market volatility.

But investor optimism waned just as markets bottomed, and investors turned bearish on equities from April through October of 2020 (7 consecutive months), the longest "risk-off" period since we've been tracking the index. Clients report that this is due to cash accumulations and portfolio rebalancing.

In 2020 sector-level dispersion also reached its highest level in two decades, and U/HNW investors made significant shifts in their sector allocations. Key shifts included:

- Investors turned bullish on the technology sector at the beginning of the March rally, although they sold off moderately as valuations increased and portfolios became increasingly overweight in the sector.
- Consumer Cyclical became popular early in the pandemic. Starting March 3, the sector ISI turned very positive. While it tapered off in May, it again became positive on August 25 through the year-end as the reality of a longer-than-expected pandemic set in.
- Though allocations to energy have generally been small, investors continued to shift out of energy from April through the end of 2020.

- Investors timed the financials sector well and have remained bullish through the major rallies of this year.

Risk-off in uncertain times

The ISI data set starts in April 2016, which roughly tracks the last four years of the longest growth cycle in U.S. market history. During this time, the ISI showed investors behaving largely as contrarians to U.S. equity market movements. When U.S. equity markets go up, the ISI has generally been negative, indicating a net reduction in investor equity holdings. Conversely, the index is positive when markets decline.

The year 2020 has been consistent with this general pattern of behavior. Even as market volatility increased in February and March, we saw positive sentiment readings of the ISI. As the pandemic set in, starting in April, we saw the longest “risk-off” period since we’ve been tracking the index. In fact, the ISI showed negative sentiment seven months in a row, April through October 2020 (see figure 1).

Despite the massive government stimulus, the subsequent rally in markets, and ultra-low bond yields, U/HNW investors continued to pull capital out of equities from April through October of 2020. While generally consistent with the historically contrarian behavior of this investor group, clients report that this is due to accumulations of cash, shifts in strategy to increasing allocations to private markets, and portfolio rebalancing.

Although markets continued to rally, the November ISI was the first positive read since the start of the pandemic, potentially signalling a thematic shift to risk-on sentiment.

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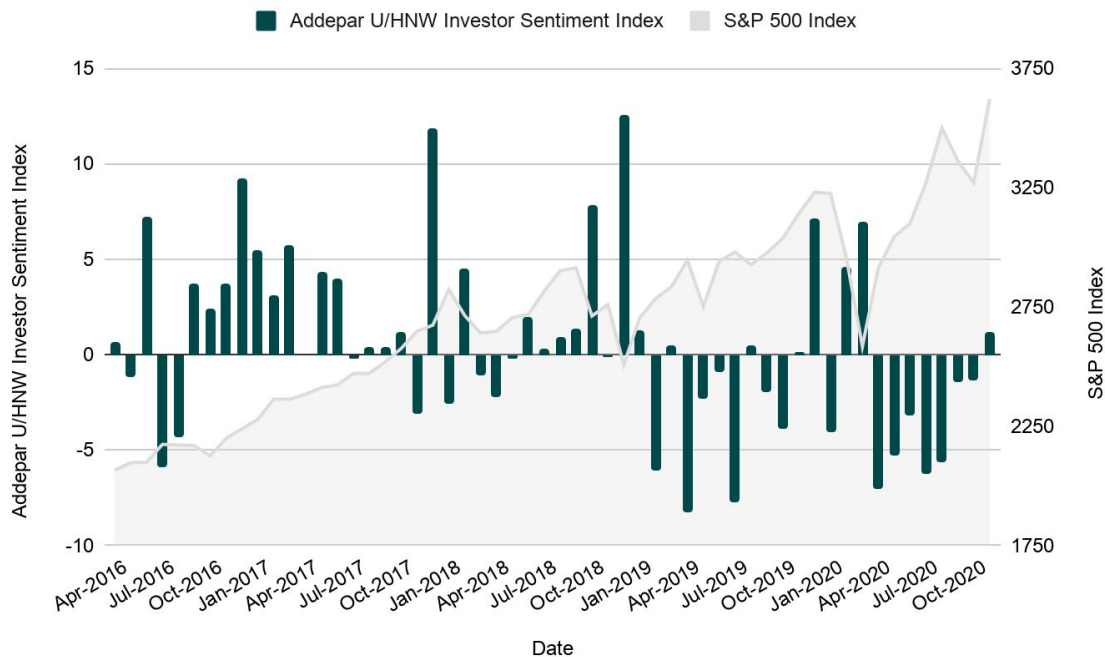
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Figure 1: Addepar U/HNW Investor Sentiment Index and the S&P 500 Index

April 2016–November 2020



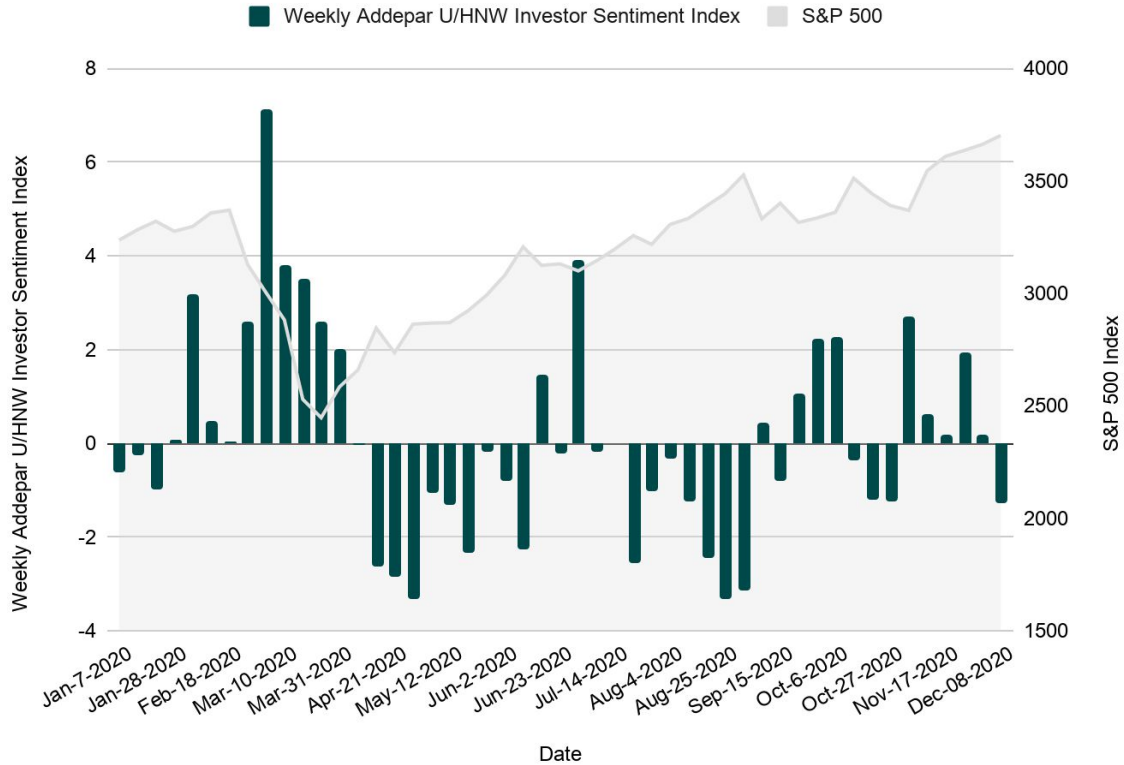
Source: Addepar, Morningstar

To reflect the rapidly changing market conditions we take a higher frequency look at investor behavior this year. Figure 2 shows the Addepar Investor Sentiment Index computed on a weekly frequency for 2020 through December 1. U/HNW investors on the platform were consistent buyers throughout the sell-off in late March. The strongly positive ISI read is particularly interesting because it occurred during an extreme sell-off. Often in large drawdown scenarios flows will show stop-loss selling and highly leveraged market participants getting margin calls— all leading to considerable selling pressure. The ISI saw extremely elevated selling activity during this time, although it was more than fully offset by the buying activity, leaving net positioning positive.

As the market recovery took hold in late April, the bullish sentiment quickly turned bearish for 10 consecutive weeks. We saw a brief reversal of sentiment in June, but investors soon turned bearish again for an additional 11 weeks, potentially as additional fiscal stimulus seemed less likely and expectations for the duration of the pandemic increased. In September, vaccine trials made headlines, generating positive investor sentiment in November. The locally large positive read in the first week of November coincided with the presidential election, perhaps a small window into investor views of the election outcome on markets and the economy. In fact,

the daily data shows that sentiment was negative on Nov. 2nd while subsequently positive on the 3rd and the rest of the days that week.

Figure 2: Year-to-Date Weekly Addepar Investor Sentiment Index
January 1–December 8, 2020



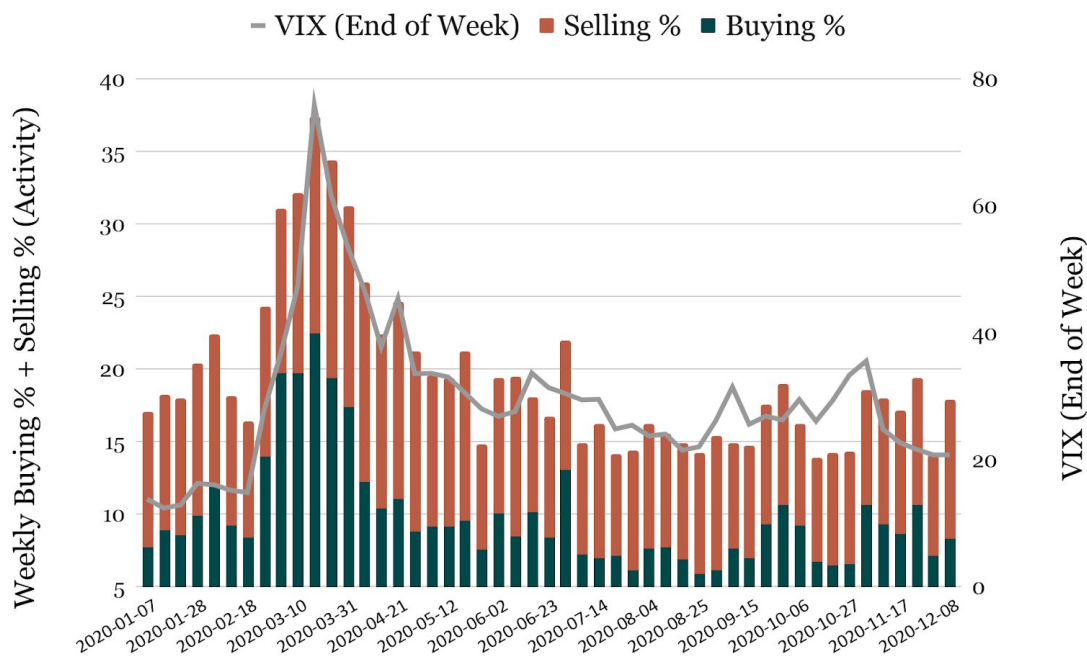
Source: Addepar, Morningstar

Portfolio trading activity and volatility hit record peaks

While the aggregate investor sentiment was bullish during the 34% drawdown, we saw that trading activity had simultaneously spiked and investors disagreed significantly on the market’s direction. Gross trading activity (% of portfolios buying plus % of portfolios selling) peaked at the same time as volatility at levels we have not seen since the start of the financial crisis (Figure 3). Subsequently, both indices shifted back to pre-pandemic levels.

Figure 3: Year-To-Date Investor Activity and the VIX

January 1–December 8, 2020



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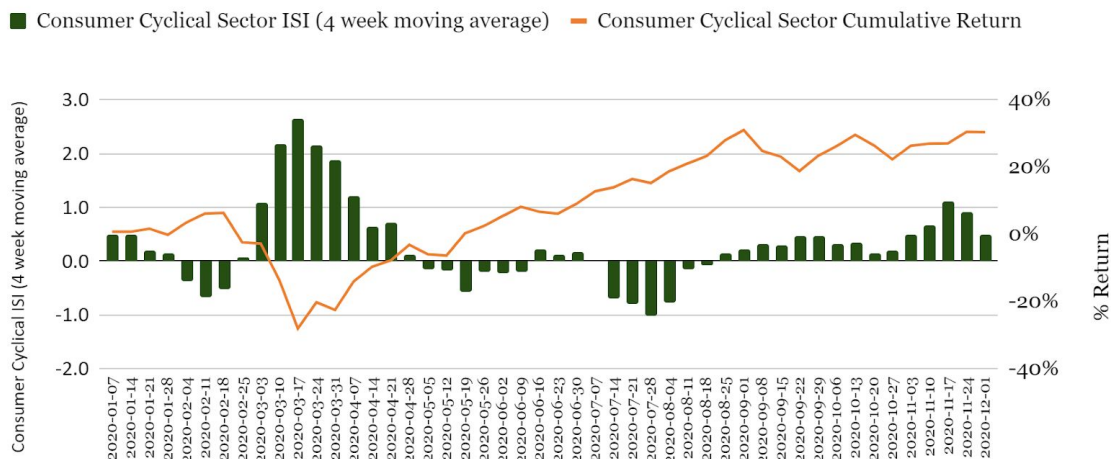
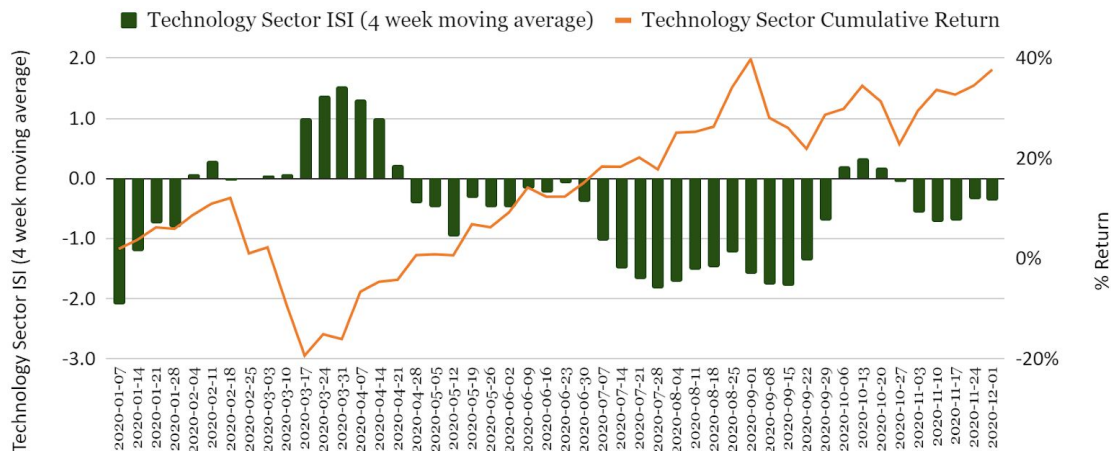
Insight into sector-level sentiment

Dispersion across sectors has been the highest in two decades (see appendix). In this context, we now dive into sentiment for the top-two and bottom-two performing sectors. Following the March market sell-off, investors were bullish in the technology sector through April 21 (Figure 4). Subsequently, the technology sector ISI was largely bearish through the end of the year. One may ask whether rising valuations and subsequent overexposure to this sector, both in the public and private markets, may be leading investors to bring their allocations back into balance. The pre-IPO market has been particularly strong this year, although due to lack of liquidity in these markets, many investors have used public equity markets for allocation adjustments.

By the start of March, consumer cyclicals went from being neutral to very bullish in the ISI. Potentially through their own experiences, investors foresaw the importance of companies such as Amazon during the pandemic. While overall sentiment remained modestly neutral through the end of the summer, consumer cyclicals sentiment turned positive, perhaps signalling a belief in long-term changes to consumer behavior.

Figure 4: Top 2 Performing Sectors vs. Sector ISI

January 1–December 1, 2020



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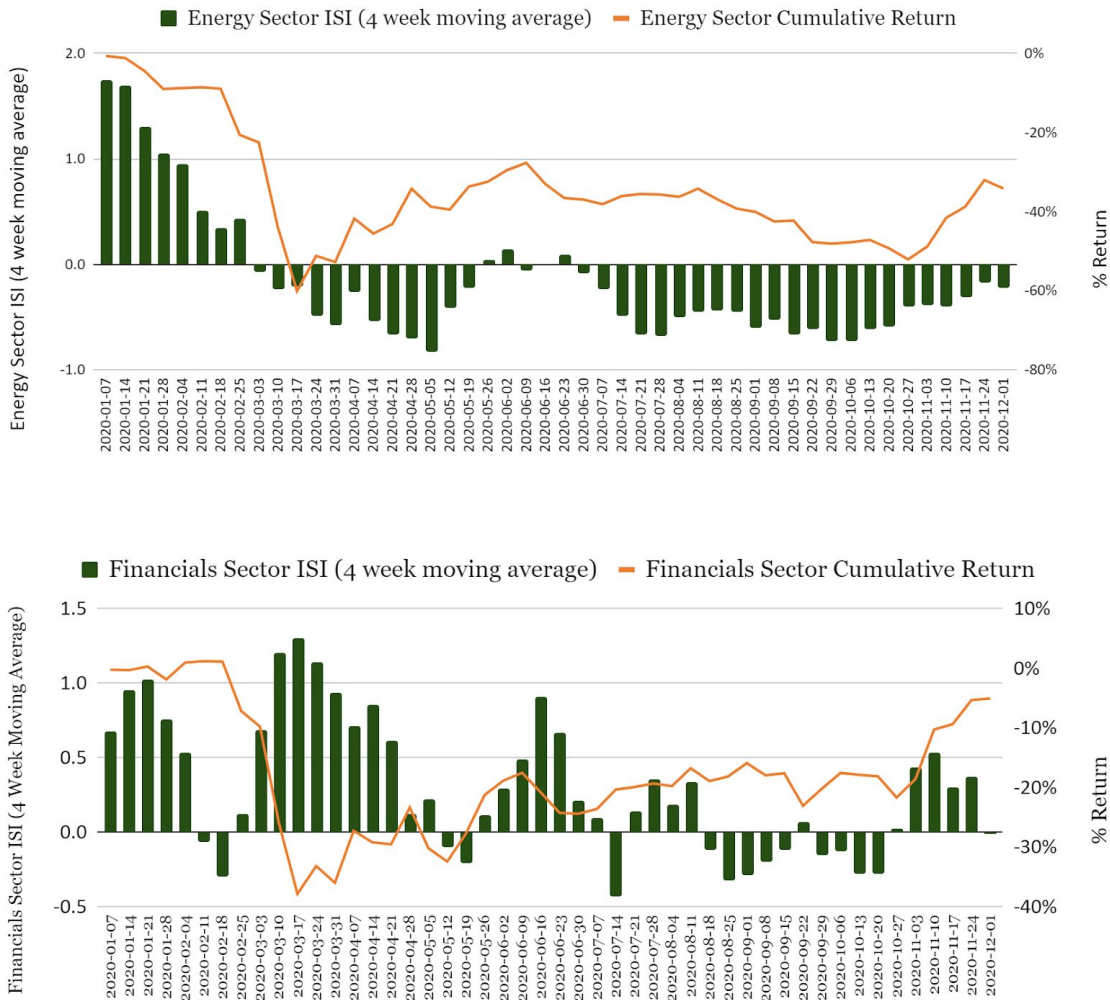
As shown in Figure 5, the energy sector ISI was bullish at the beginning of 2020. By the end of the March sell-off, sentiment for energy had turned bearish. Even though for many investors (and the S&P 500), the allocation to the energy sector was small, as energy prices crashed and it became clear that medium-term demand was stunted, investors continued to reduce their allocations through the end of the year.

Sentiment for the financials sector has been most intriguing in that the ISI remained bullish through the market sell-off and the rally that immediately followed. The sector

traded sideways from the end of August through November, and during this time the ISI for financials was modestly negative. As the rally picked up again in November, technology sector sentiment also turned bullish.

Figure 5: Bottom 2 Performing Sectors vs Sector ISI

January 1–December 1, 2020



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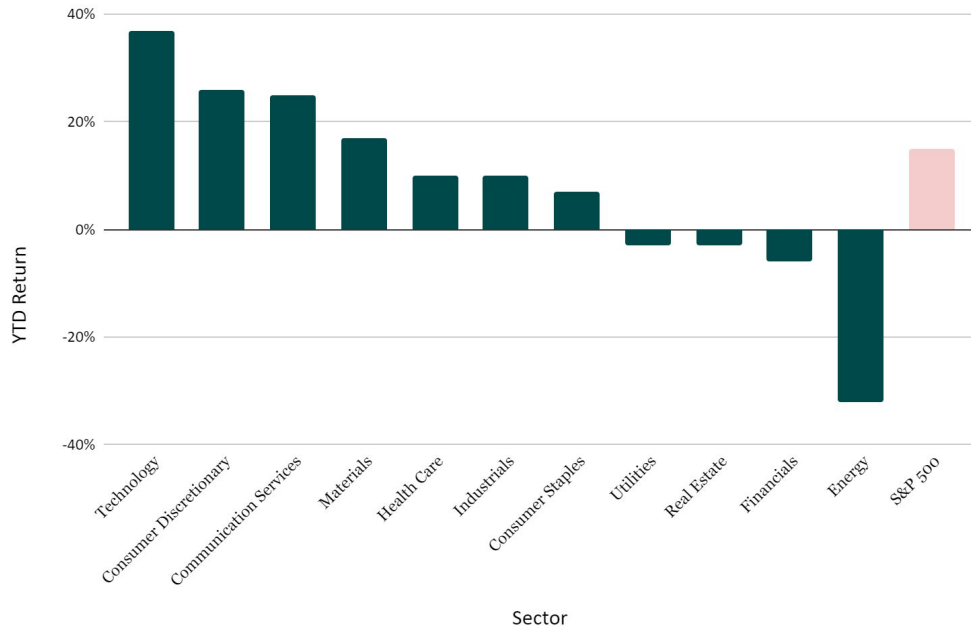
Stay tuned

Looking forward, 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 continue to post the monthly ISI index, our key observations and periodic research notes on our website.

Appendix

Figure 6: S&P 500 and Sector Year-To-Date Returns

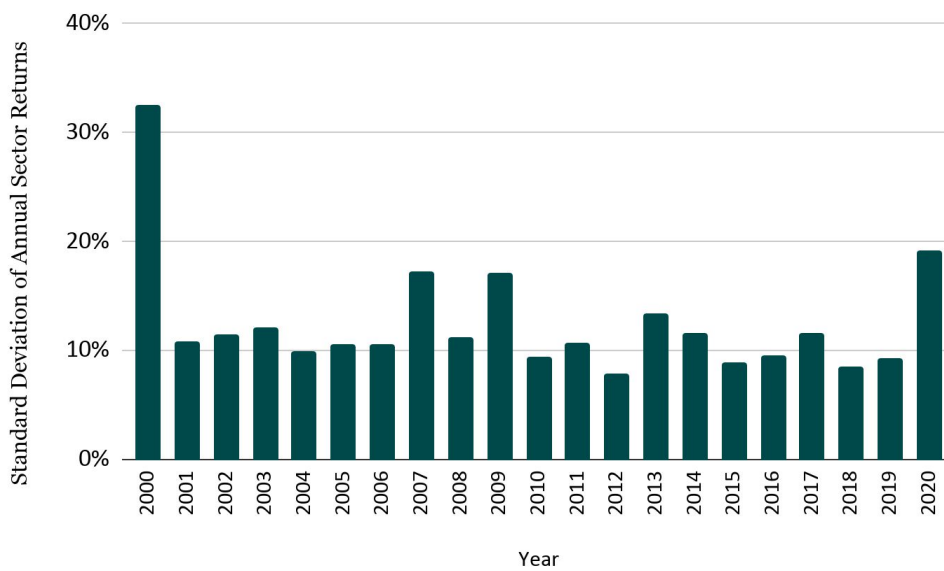
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Figure 7: Standard Deviation of Annual Sector Returns

2000–2020



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