RESEARCH NOTE | JANUARY 2022

Dan Golosovker
Head of Research Analytics
dan.golosovker@addepar.com

Panic Sell-off?

The Addepar Investor Sentiment Index (ISI) research note is uniquely designed to provide transparency into the investment behavior of the wealthiest tier of investors. Leveraging Addepar's network of RIAs and family offices, we analyze the investment data on our platform to gain insight into how ultra-high-net-worth (U/HNW) investors are making portfolio adjustments, effectively capturing their views on the economy and markets. Additionally, where relevant, we conduct client interviews to supplement the data analysis presented in our research notes. To ensure privacy, we never disclose identities.

Summary:

U/HNW investors generally follow the maxim "buy low, sell high." However, during periods of extreme (20%+) market drawdowns, such as occurred in the last quarter of 2018 and March of 2020, some investors abandoned this strategy by cutting their exposure to equities.

In January, markets haven't sold off to the historical tipping point and panic selling hasn't ensued. Rather, sentiment was solidly bullish in aggregate, as well as at the sector level. This month's key highlights include:

- Technology sentiment peaked at the highest level we've recorded. Today is no exception to the historical trend—investors are typically only bullish on this sector following significant drawdowns.
- Investors remain bullish on financial services, which continues to track the path of long-term Treasury rates.
- Historically high oil prices are driving bullish sentiment in the energy sector.

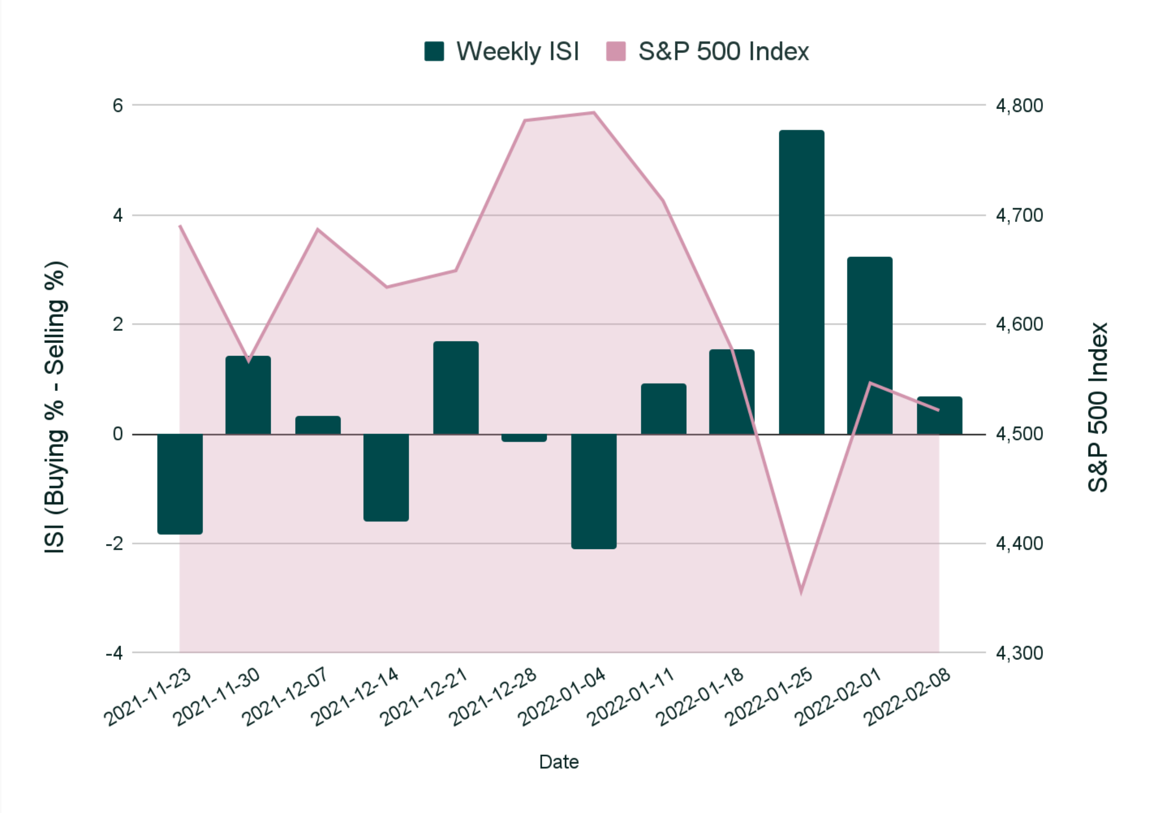
It takes a drawdown of approximately 20% to trigger U/HNW investor selling

In response to high inflation and the prospect of quickly tightening monetary policy, U.S. equity markets experienced a sharp drawdown rivaling some of the largest of the past decade. 10-year Treasury rates continued to ascend—now approaching 2%—reaching levels not seen since prior to the pandemic. Meanwhile, oil prices surged on strong demand and supply disruption concerns due to geopolitical tensions.

Figure 1 shows sentiment at the weekly level. The percentage of investors buying U.S. equities continued to increase until the bottom-of-the-market sell-off in January, and has since retreated to more neutral levels.

Figure 1: Weekly Addepar Investor Sentiment Index

November 23, 2021–February 8, 2022



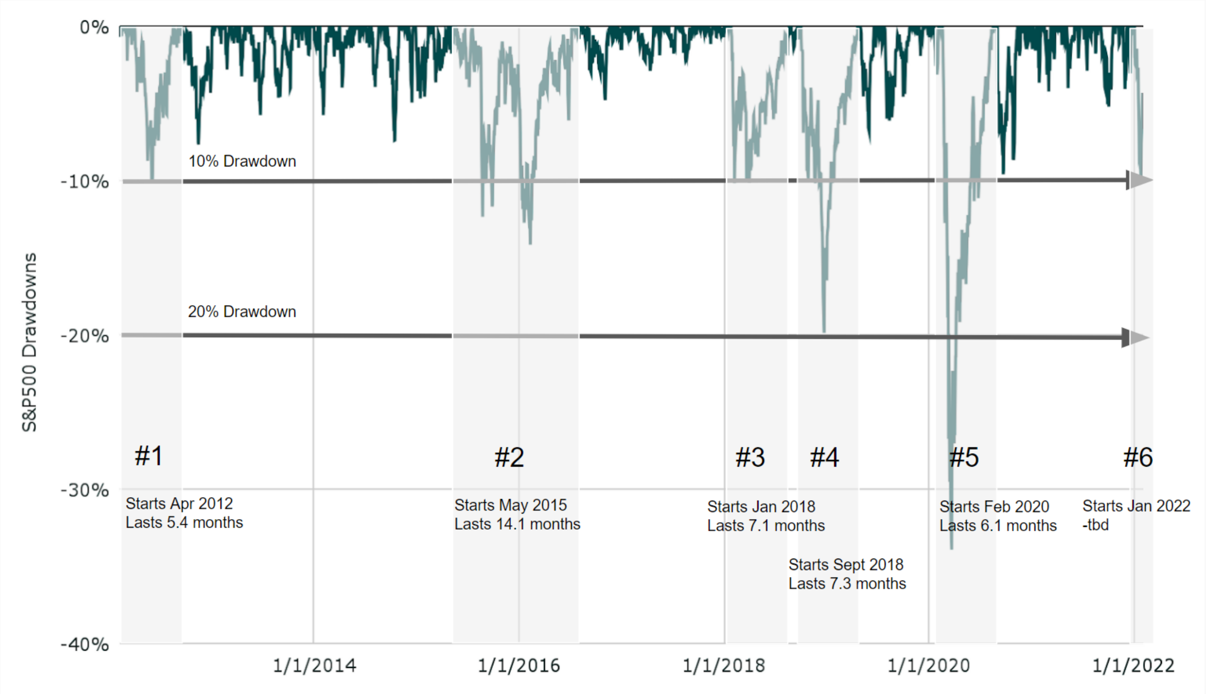
Source: Addepar, S&P Global

Drawdowns of 10% or more (our simple definition of a significant drawdown) are somewhat infrequent, having occurred six times over the last decade (figure 2). Although relatively infrequent, these sell-offs have a significant impact because they generally have lasted approximately six to seven months from peak to peak. This is both a long time in and of itself and is roughly one-third of the total time of the past decade!

Putting these radical events into the context of history and how investors have reacted to them is a useful tool in providing additional perspective to investors processing today's circumstances. In this note, we look back on investor sentiment during the recent drawdowns.

Figure 2: S&P 500 Drawdowns Over Past 10 Years

February 2012–February 2022

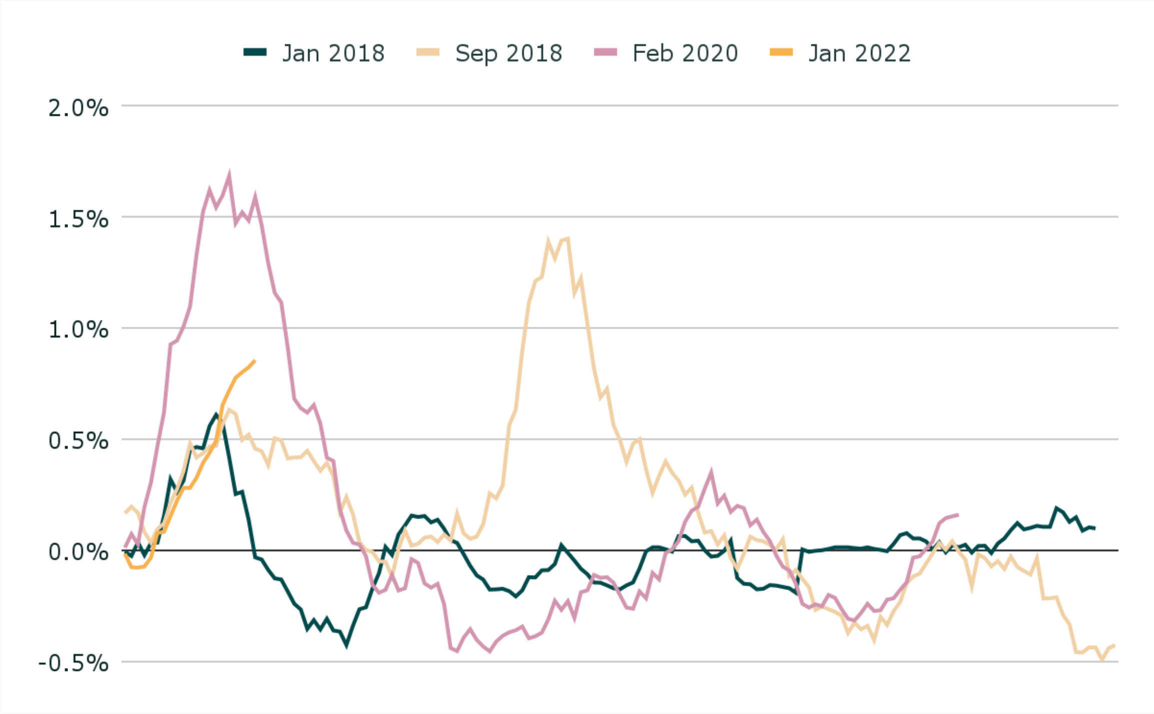


Source: Federal Reserve Bank of St. Louis

On average, most investors follow the maxim "buy low, sell high" even during extreme market drawdowns. By adding exposure when markets are selling off and reducing exposure as markets rise, U/HNW investors gain an advantage.

Figure 3 shows daily sentiment over the last four drawdowns, the periods over which we've tracked the index. As we've documented previously, an increased number of investors tend to enter the market and purchase equities for purposes of rebalancing and speculation as markets sell off. Intriguingly, this relationship also holds during periods of extreme drawdowns. Sentiment appears to also become increasingly strong as markets go through more significant corrections. During the September 2018 correction and February 2020 sell-offs, sentiment rose to levels that are four to five standard deviations above the average (approximately neutral or zero). During the less severe January 2018 drawdown and the one we're currently experiencing, sentiment has increased to approximately two standard deviations above the mean.

Figure 3: Daily ISI (10-Day Moving Average) During Last 4 Drawdowns



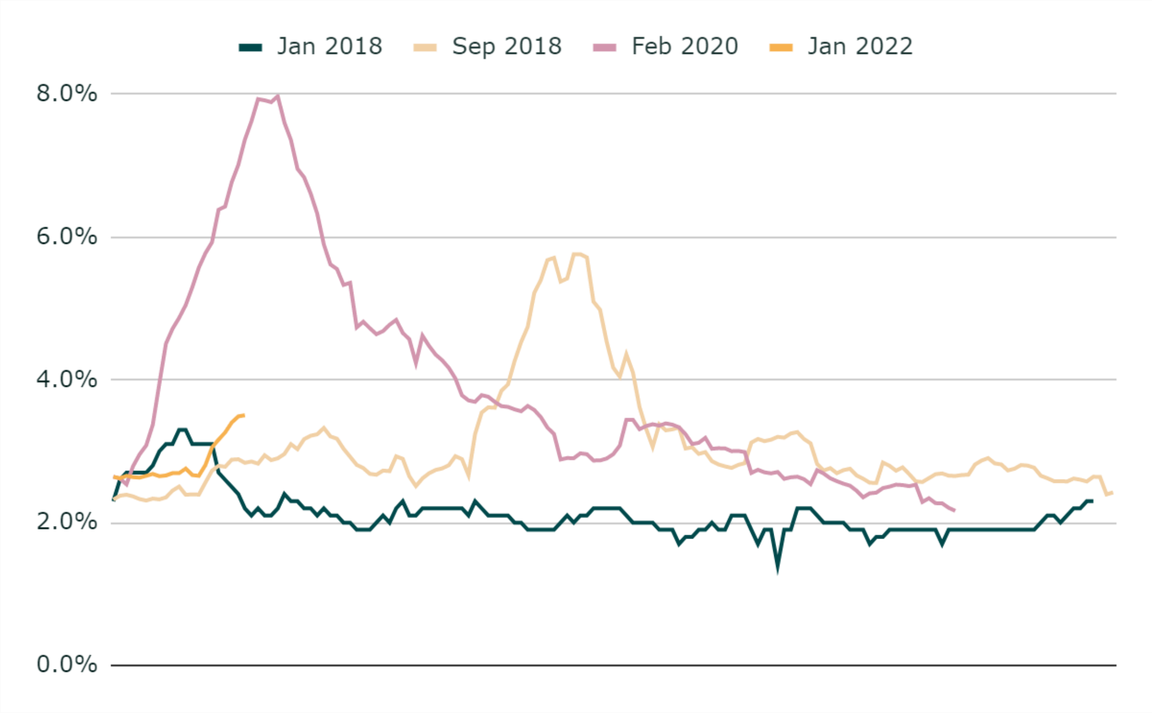
Source: Addepar

A significant percentage of investors—although not the majority—get spooked during periods of significant market stress (20% drawdowns). By reducing exposure during these events, these investors negatively impact their portfolios by missing out on potential upside moves when markets rebound.

Gross activity—the percentage of investors trading at any point in time—is on average 2.7% with a 1% standard deviation. During the September 2018 correction and February 2020 sell-offs, activity surged to 6% and 8% respectively. Given net sentiment is generally low, a little less than half of this activity is attributable to selling behavior. This pattern is not particularly visible during the two smaller drawdowns in our sample, indicating that it takes a really big drawdown of approximately 20% to drive some investors to sell.

In the February 2020 drawdown, markets sold off very quickly while in the September 2018 drawdown, after an initial sell-off of about 10%, the market remained within a narrow band before resuming its sell-off to the 20% range later in the quarter. It's interesting to see that selling activity does not actually spike until a drawdown transitions to 10%-20% territory.

Figure 4: Daily Gross Activity (10-Day Moving Average) During Last 4 Drawdowns



Source: Addepar

If investor behavior is consistent with history, one would expect that the majority of investors will continue to remain on balance buyers during the current drawdown. However, should markets start to sell-off significantly below current levels, we should then expect to see a significant proportion of investors start to take risk off the table.

Technology sentiment hits a historic high

At the sector level, investor sentiment is broadly positive (figure 6). Technology, financial services, and energy show high sentiment relative to history. Technology sentiment, in particular, is surprising because rates are rising and the high-growth sector is traditionally sensitive to discount rates that are rising along with Treasury rates.

Figure 6: Sector Sentiment and Performance
January 2022

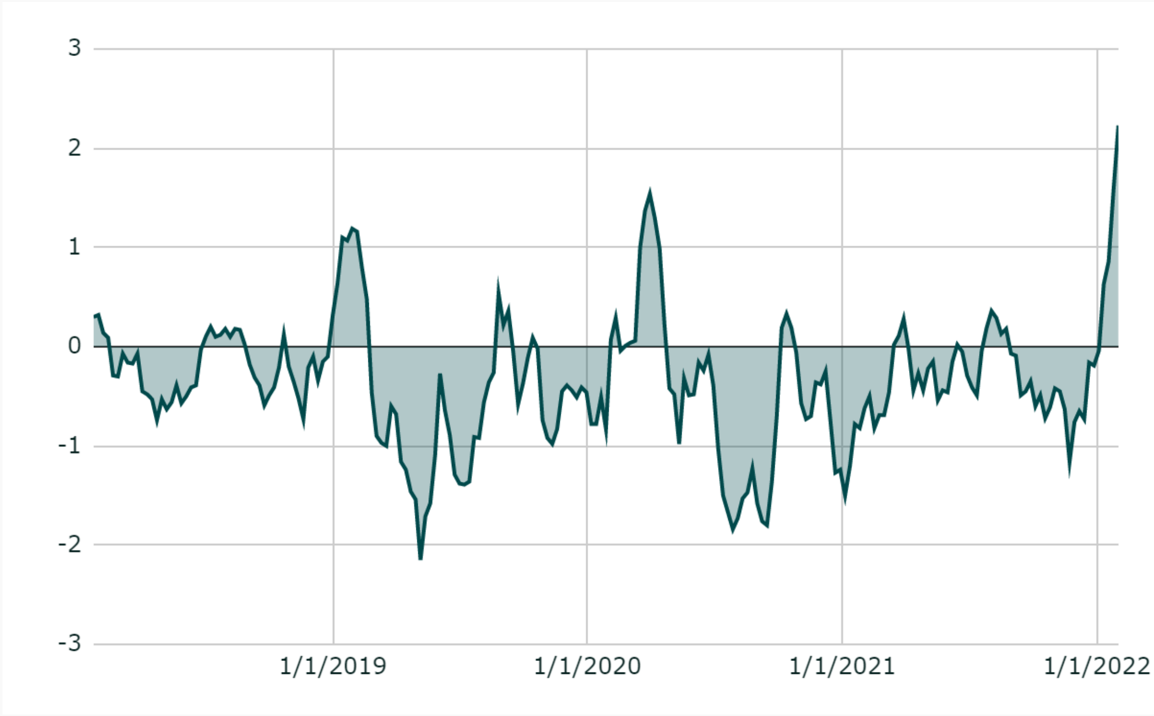
Sector	Sentiment	Performance
Technology	2.2	-6.9%
Financial services	1.5	0.1%
Industrials	1.1	-4.7%
Communication services	1.1	-6.2%
Energy	1.0	19.1%
Healthcare	1.0	-6.8%
Consumer defensive	0.7	-1.4%
Real estate	0.6	-8.5%
Materials	0.4	-6.8%
Consumer cyclical	0.4	-9.7%
Utilities	0.3	-3.3%

Bullish/Bearish		
Relative to own history:		
Strong -		
Moderate -		
Strong +		
Moderate +		

Source: Addepar, Refinitiv

As figure 7 shows, technology sector sentiment is, at this time, the highest we've seen since we started tracking sentiment at the sector level. Prior to this, technology sentiment generally remained bearish except during or right after the September 2018 and March 2020 drawdowns. While today's drawdown has yet to reach the lows of the previous drawdowns, sentiment is peaking at record levels.

Figure 7: Technology Sector Sentiment (4-Week Moving Average)
January 23, 2018–February 1, 202,

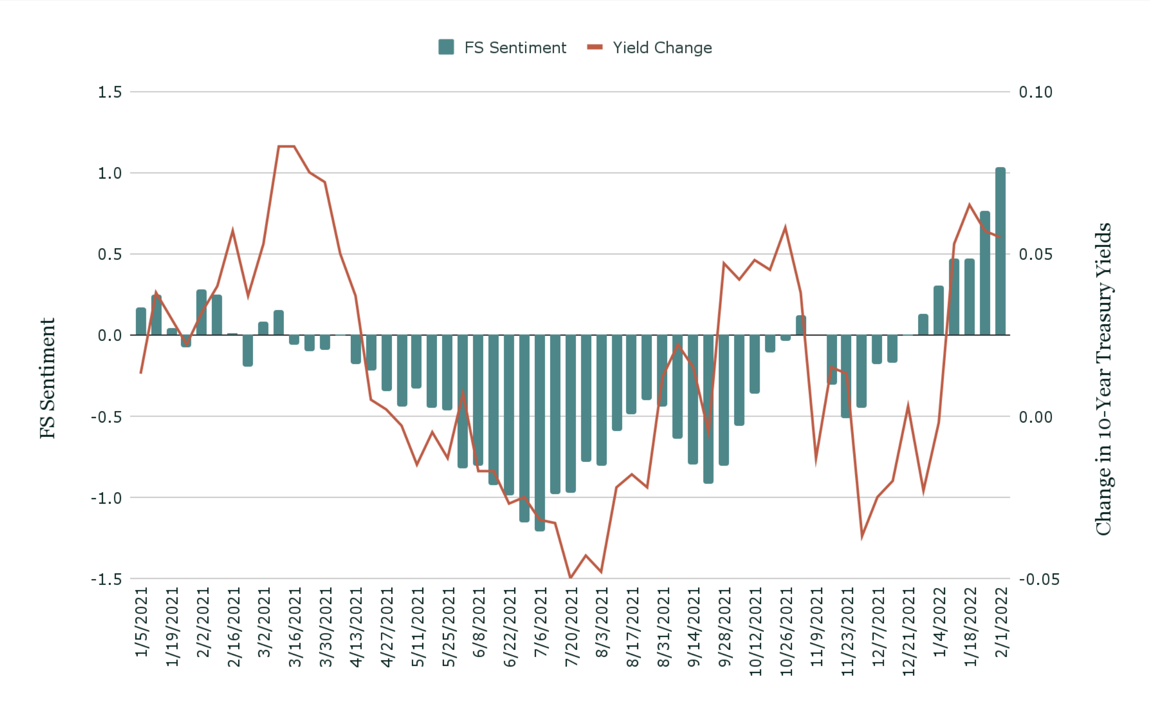


Source: Addepar

While most sectors sold off, financial services, and energy rallied. Financial services sentiment continues to track 10-year Treasury rates (.6 correlation), which have been rising and are now at levels last seen prior to the pandemic.

Figure 8: Financial Services Sentiment vs. 10-Year Treasury Yields (6-Week Moving Average)

January 1, 2021–February 1, 2022

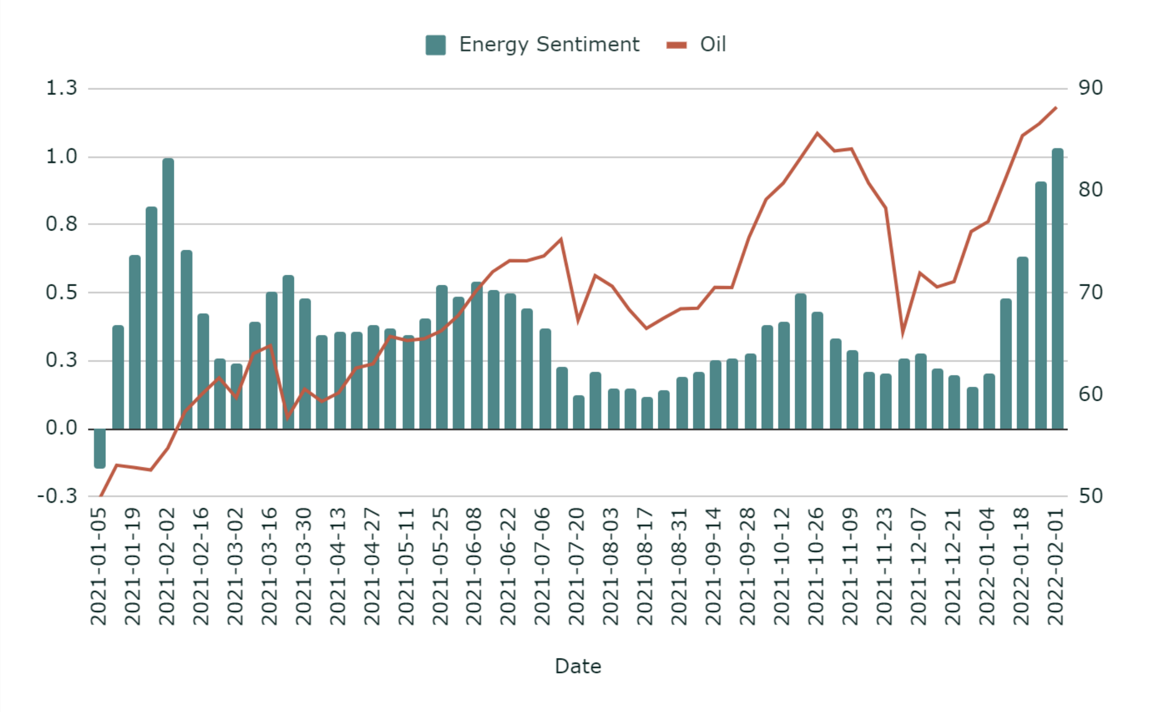


Source: Addepar, Federal Reserve Bank of St. Louis

Similarly, sentiment in energy continues to closely track oil prices. Both oil prices and sentiment are at recent historical highs. With high demand and supply constraints exacerbated by geopolitical risks, we may see continued high sentiment in this sector for some time.

Figure 9: Energy Sentiment vs. Oil (4-Week Moving Average)

January 1, 2021–February 1, 2022



Source: Addepar, Federal Reserve Bank of St. Louis

Stay tuned

We'll 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.

Notice and disclaimers

The Information may not be used to create derivative works or to verify or correct other data or information without prior written permission from Addepar. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other Addepar data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information.

Addepar makes no express or implied warranties or representations with respect to the information (or the results to be obtained, but rather the use thereof), and to the maximum extent permitted by applicable law, Addepar expressly disclaims all implied warranties (including, without limitation, any implied warranties of originality, accuracy, timeliness, non-infringement, completeness, merchantability and fitness for a particular purpose) with respect to any of the information.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

Addepar does not recommend, endorse, approve or otherwise express any opinion regarding any issuer, securities, financial products or instruments or trading strategies, and Addepar's research products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Addepar, Investment Sentiment Index and other Addepar brands and product names are the trademarks, service marks or registered marks of Addepar or its subsidiaries in the United States and other jurisdictions.