NATIXIS
GLOBAL ASSET MANAGEMENT

2013 Global Survey of Institutional Investors

Confident but Cautious: Insights on Risk, Investing and Alternatives

Plan for the best, and prepare – as well as you can, at least – for the worst. That's a common sentiment among the world's institutional investors, according to this year's Global Survey of Institutional Investors by Natixis Global Asset Management (NGAM). While most are comfortable with their overall risk management approach, they also understand that it's impossible to plan for every contingency, and are resigned to the fact that something is coming in the not-too-distant future that could put their strategies to the ultimate test.

One of the key lessons learned from the crisis is that risk management strategies need to be dynamic and flexible, and most investors have made significant changes to their approaches over the last several years. Despite these efforts, however, many of the more than 500 investors surveyed aren't sure how their portfolios will stand up to severe market fluctuations or to rising inflation – and all have concerns about generating returns in a low-yield environment. More importantly, they're not sure what else they can do on the risk management front to safeguard their assets.

Demand for new portfolio-building strategies

As a result, many are on the hunt for new asset allocation and portfolio construction strategies. Five years after the crisis turned traditional investing principles upside down, most tell us that the old rules of investing have been broken, and nearly as many say it's time to embrace new techniques that will help them strive for that elusive balance between growth and preservation.

Confident in meeting liabilities, concern for individuals

In terms of meeting future liabilities, virtually all investors surveyed are confident that their institutions will meet their obligations – but not without some bumps in the road over the next few years.

Notably, though, this forward-looking confidence does not extend to individual investors saving for retirement, as most investors believe the average citizen in their home country will fall short of what they'll need for assets. Considering the source – many respondents manage assets for private and public pension plans – this is a powerful message that should influence reform-related discussions with retirement policymakers around the world.

Equities rule the roost

On the investing front, expectations are high for equities, with institutional investors displaying a particular fondness for global stocks and a decreased appetite for bonds and gold. Alternatives[1] are in favor as well, with many investors increasingly turning to these investments to help diversify portfolio risk, as determined by standard deviation. Most plan to bump up their exposure to alternatives in 2013, and believe these investments will perform well.

RISK

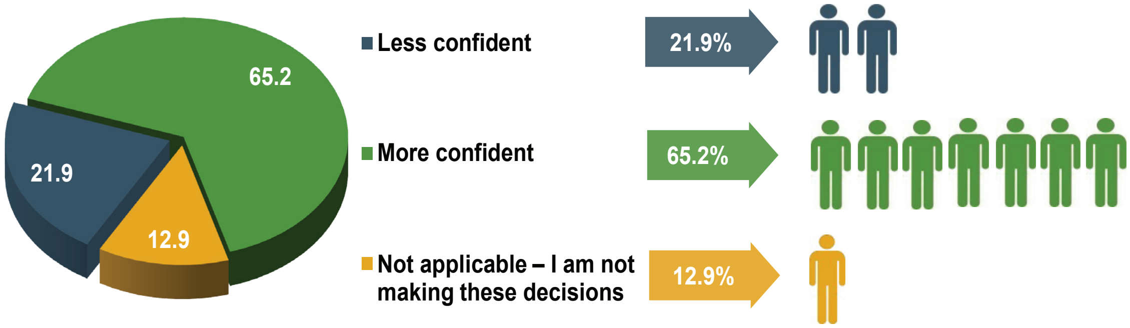
In a better place, but what's lurking around the corner?

Many institutions have conducted thorough analyses of their own risk management strategies and processes over the last five years, with seven in ten reporting that they have made changes – in many cases, significant changes – to their overall framework.

More recently, a smaller percentage (21%) have instituted similar changes in the last 12 months, which suggests investors feel their previous adjustments have been effective. A point supporting this theory is that 65% say they are more confident in their risk approach than they were a year ago, including 85% of U.S. investors who say their overall confidence level is up. The decrease in activity over the past year could also be due in part to stabilized market conditions around the globe.

1 **Alternatives** is an investment that is not one of the three traditional asset types (stocks, bonds and cash). Most alternative investment assets are held by institutional investors or accredited, high-net-worth individuals because of their complex nature, limited regulations and relative lack of liquidity. Alternative investments include hedge funds, managed futures, real estate, commodities and derivatives contracts.

FIGURE 1: COMPARED WITH ONE YEAR AGO, ARE YOU MORE OR LESS CONFIDENT YOUR RISK MANAGEMENT APPROACH IS RIGHT FOR MARKET CONDITIONS?



Source: CoreData/Natixis Global Asset Management, 2013

Currency hedging[1] (67%), risk budgeting[2] (62%) and increased allocations to non-correlated assets[3] (59%) are among the more popular strategies being used to manage risk, but investors fear that factors beyond their control could wreak havoc on even the best-laid plans.

A significant majority (83%) say that mitigating the impact of market volatility in the next few years will be difficult, including 42% who say it will be a significant challenge. And inflationary concerns are on the rise, with 64% agreeing that inflation will present formidable challenges should it spike up in the next three years.

Adding to these hurdles, using currency hedging to manage risk entails exposure to ongoing volatility in currency markets. This can lead to difficulty in appropriately pricing certain hedging instruments. Additionally, more than half of the investors (53%) who have implemented risk budgeting expect difficulty adhering to their discipline in the next three years due to increased volatility.

When it comes to risk management, institutional investors have shown the courage to change things within their purview, and have reached a certain level of acceptance with external risks that are beyond their control. While they feel they have done all they can to prepare for the unpredictable, they aren't sure where to turn next to supplement the changes they've already made.

ASSET ALLOCATION

Wanted: New, more modern approaches

Institutional investors are continually enhancing their asset allocation strategies to keep pace with changing markets, improved information and portfolio tools and more diverse asset class choices.

Consider the path they've traveled to this point. In a span of just two decades, investors have gone from being focused on the naïve premise of diversification as owning lots of different investments to the style-box approach of owning lots of asset classes. The idea then became owning different asset classes with low correlations (a statistical measure of how asset classes move in relation to each other) and then owning lots of asset classes with low correlations within specific risk parameters.

1 **Currency hedging** is the act of entering into a financial contract in order to protect against unexpected, expected or anticipated changes in currency exchange rates. It is used by financial investors and businesses to eliminate risks they encounter when conducting business internationally.

2 **Risk budgeting** is the process of analyzing, allocating and deciding whether resources should be allocated to each asset class (or even single asset) towards the goal of shareholder wealth maximization.

3 **Non-correlated assets** are assets that tend to change in value independent of the core financial markets such as stocks and bonds. Alternative investments such as real property, precious metals , and private equity ventures are examples of assets used in a non-correlated investment strategy to counter the price movements of a traditional investment portfolio.

Today, most investors agree that we're currently in between stages in the evolution of asset allocation, and they're asking for help. More than half (58%), for instance, say the old rules of investing are no longer effective, six in ten say traditional approaches to portfolio construction are outdated, and 57% believe traditional assets are too closely correlated to offer distinctive sources of return.

Institutions also tell us they're finding it difficult to execute current strategies. A large majority (70%) say setting strategic asset allocation is challenging – including an above-average concentration of sovereign wealth funds – and even more (74%) have difficulty taking tactical advantage of market movements.

The next phase in this ongoing evolution of asset allocation needs to target these tactical concerns so investors can build stronger, all-weather portfolios that can better withstand the inevitable business, financial and market cycles.

LIABILITIES

We'll meet our future obligations, but individuals saving for retirement are in trouble

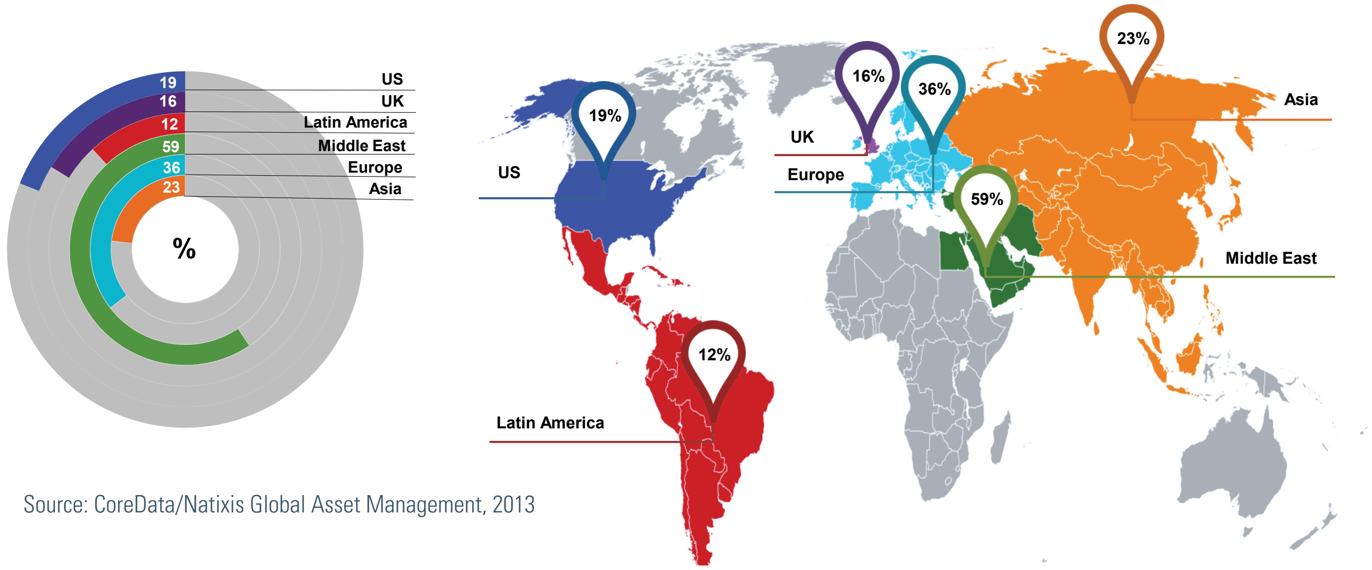
Regardless of country or region, the three legs of the retirement savings stool generally consist of private pensions, government benefits and individual savings. According to these investors, the first and second legs are pretty sturdy, but the third leg – individual savings – is showing major signs of weakness.

While an overwhelming majority (89%) believe they'll meet their own future obligations, seven in ten (70%) say the average citizen in their home nation won't have enough assets in retirement. In light of the fact that many of these investors manage retirement assets every day, this is an important message that should resonate with both individuals and retirement policymakers to help drive better savings behaviors.

Regional outlook

The state of retirement savings is particularly dire in Latin America, the United Kingdom and the United States. The U.K. has a high concentration of underfunded portfolios, and in the U.S., a recent Senate study pegged the retirement savings deficit at $6.6 trillion, or nearly $57,000 per household.[1] Even investors in the Middle East, home to many of the world's wealthiest sovereign wealth funds, have concerns, with 41% believing the average citizen will come up short.

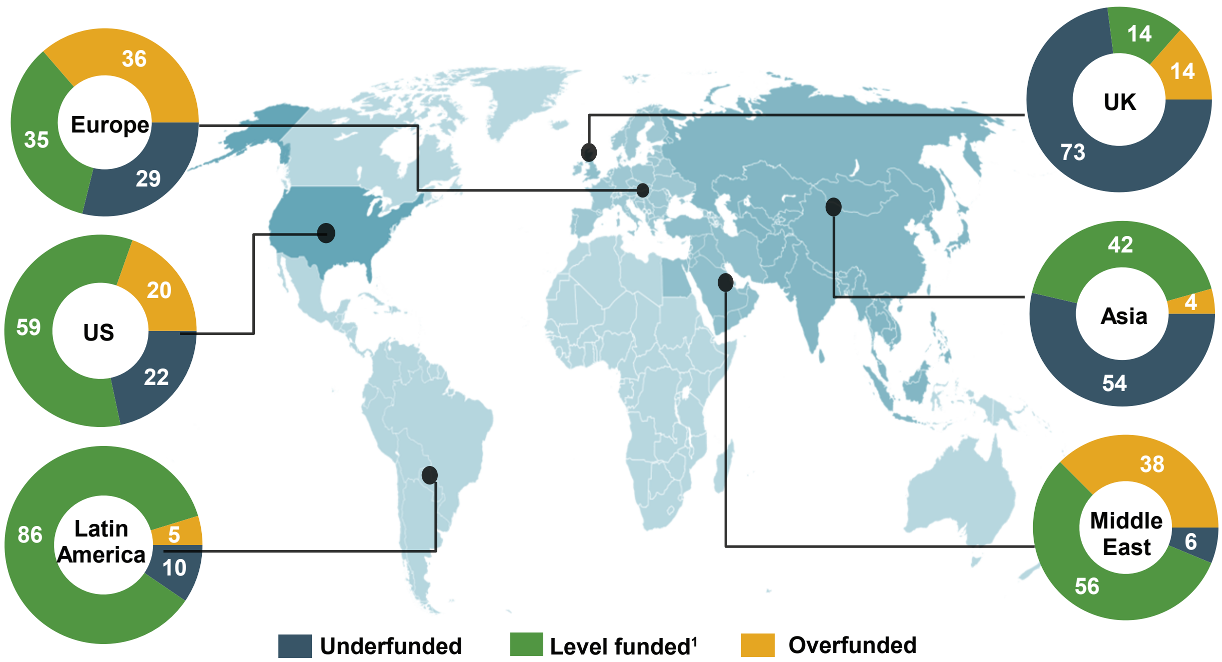
FIGURE 2: DO YOU BELIEVE THE AVERAGE PERSON IN YOUR COUNTRY WILL HAVE ENOUGH ASSETS INCLUDING PERSONAL SAVINGS AND GOVERNMENT BENEFITS TO MEET THEIR FINANCIAL OBLIGATIONS WHEN THEY RETIRE? (INSTITUTION RESPONSE BY REGION)



Source: CoreData/Natixis Global Asset Management, 2013

1 U.S. Senate Committee on Health, Education, Labor & Pensions

FIGURE 3: OF THE PORTFOLIOS YOUR INSTITUTION MANAGES, WHAT BEST DESCRIBES THE FUNDING LEVEL OF THE MAJORITY OF THE PORTFOLIOS? (BY REGION)



Source: CoreData/Natixis Global Asset Management, 2013

Country highlights

At the country level, investors in Qatar, the Netherlands and Germany have a sunnier view on individual retirement savings than do their counterparts in Peru, Italy and Spain. Qatar is home to one of the world's largest sovereign wealth funds, and assets will only climb as the state moves closer to becoming the world's largest exporter of liquefied natural gas. The Netherlands and Germany, on the other hand, both provide strong social safety nets to their citizens, including above-average healthcare benefits. This stands in stark contrast to Peru, where a fragmented and underfunded medical system drains valuable resources from retirees. The main challenges for Italy and Spain are demographic in nature, as both nations have rapidly aging populations and decreasing worker-to-retiree ratios, meaning fewer workers to support retirees in the years ahead. Many of these challenges were identified in NGAM's 2013 Global Retirement Index.

Asset liability management

Despite widespread concern about funding liabilities over the next few years, just over half (54%) of investors say they are incorporating asset liability management[2] into their overall portfolio strategies, with investors in Asia (59%), Europe (57%) and the U.K. (54%) among the top practitioners. Only 13% and 25%, respectively, of U.S. and Middle East investors have adopted similar strategies. Nearly seven out of ten insurance companies use asset liability management compared to just 26% of sovereign wealth funds and 32% of private pension funds.

MARKET OUTLOOK

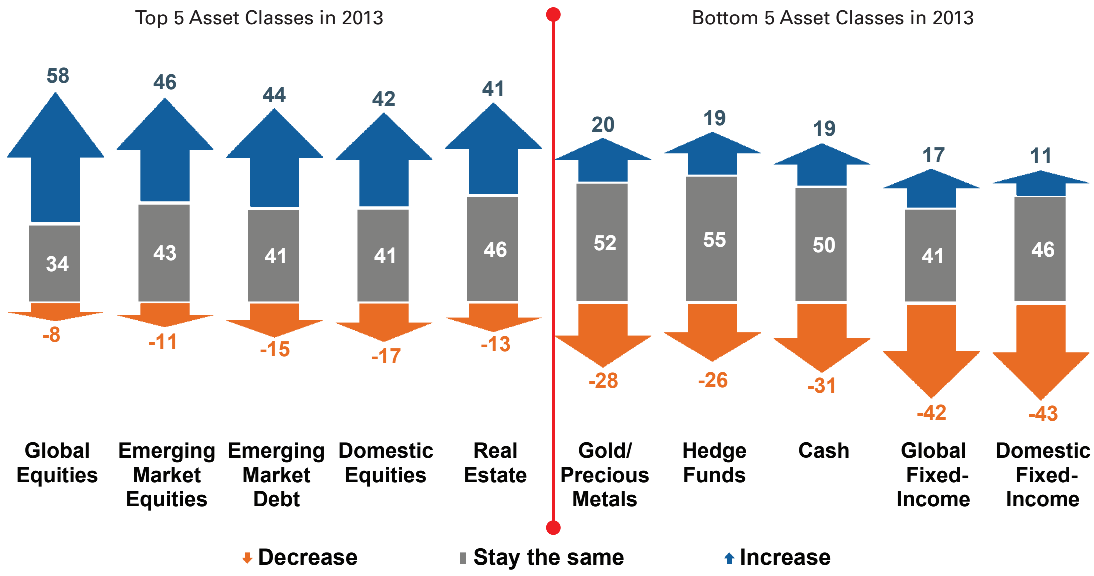
Investors expect global equities to perform best in 2013; bonds, gold falling out of favor

Institutional investors need to meet both short and long-term objectives, and it's clear that they view stocks – particularly those that are global in nature – as the best way to achieve that balance. Asked to project which asset classes will perform best this year, the most popular choice was global equities (27%), followed by domestic stocks (19%) and emerging market equities (15%).

1 **Level funded** means that institutions are on pace to meet anticipated obligations. Overfunded means that institutions believe they have more than enough assets to meet their future obligations and those underfunded are behind on the assets they need to pay projected obligations.

2 **Asset liability management** is a technique companies employ in coordinating the management of assets and liabilities so that an adequate return may be earned.

FIGURE 4: IN 2013, WILL YOU INCREASE, DECREASE OR KEEP THE SAME ALLOCATION FOR THE FOLLOWING?



Source: CoreData/Natixis Global Asset Management, 2013

As a result, more than half (57%) say they will increase their global equity allocations, 48% plan to add more home-grown stocks to their portfolios and 40% anticipate an increase to their emerging-market equity positions.

On the fixed-income side, lower yields in bond markets around the world have made for far less appealing risk/reward scenarios. Only 11% and 17%, respectively, plan to add to their domestic and global bond allocations in 2013. Instead, many investors plan to look to emerging markets for opportunities, as 42% expect to increase their emerging market debt exposure. The group is also bearish on gold and cash, with only one in five investors planning to add to their allocations.

ALTERNATIVES

Investors adding more to their portfolios, anticipating improved performance

Institutional investors have a significant comfort level with these investments, with a large majority (84%) reporting that they own them and nearly three in four (74%) agreeing that alternatives are essential in helping to diversify portfolio risk.

Accordingly, 61% plan to add to their alternative holdings, or to other assets that don't correlate with the broader market, over the next year, with the following areas most appealing among respondents:

Category	% Who Plan to Increase
Real Estate	41%
Private Equity	36%
Macro/Absolute Return Strategies	35%
Infrastructure	30%
Alternative Mutual Funds	28%
Commodities	21%
Hedge Funds	19%

Source: CoreData/Natixis Global Asset Management, 2013

The move to real estate is a notable trend, with 41% of investors saying they plan to increase their exposure in 2013 alone. German investors are particularly bullish, with nearly two-thirds (66%) saying they will add to their real estate holdings. Conversely, only one in five U.S. investors expects a real estate increase. Looking out further, respondents in every country – except for the U.K. and Spain – plan to increase their real estate allocations over the next three years.

Overall, respondents are optimistic on how their alternative investments will perform in 2013, with 71% predicting better year-over-year performance.

MACRO ISSUES

Most downplay the effect economic and political events have on their investing strategy

The ongoing European financial struggle – which has engulfed Greece, Spain, Italy and, more recently, Cyprus – is still the most pressing international issue on the minds of institutional investors. Yet, most investors say these events – as well as other global and domestic economic factors – aren't weighing on their investment decision-making as much as they did just a year ago.

Worldwide, a substantial majority (64%) claim that their home government's financial situation does not significantly affect their investment decisions, and 57% say the same about other nations' finances. Most also say geopolitical risk, global fiscal imbalances and tax policy and regulatory changes have little to no bearing on how they invest.

CONCLUSION

Durable Portfolio Construction®: Incorporating lessons from the world's institutional investors

The Natixis Global Asset Management (NGAM) Global Survey of Institutional Investors is an important measure of what these investors, who oversee assets totaling approximately $11.5 billion, think about the financial markets, how to generate the returns needed to meet their liabilities and how to protect the assets with which they are entrusted.

By helping us better understand the challenges they're facing every day, we also find lessons that are relevant not only for other institutional investors but also for individuals seeking to manage their personal portfolios and the advisors who guide them.

Our key takeaway from this year's survey: Institutional investors are more confident than in the past, but at the same time acknowledge that they need to manage risk more effectively and consider new means of constructing and managing portfolios.

The old road map for investing no longer guides these decision-makers, and the new one is being drawn through the millions of decisions made daily. Institutional investors need more tactical help with portfolio construction and asset allocation so they can build stronger, more durable portfolios. Durable Portfolio Construction, a concept pioneered by NGAM that puts managing risk, managing volatility and enhancing diversification at the center of portfolio construction, can help them make more efficient, effective allocation decisions.

This unique approach, which is grounded in years of research and empirical observation, employs a comprehensive set of strategies that include the smarter use of traditional assets, the addition of alternative investments and – most importantly – putting risk first when designing a portfolio.

Survey background

500+ senior decision makers

189 private pension funds
35 insurance companies
97 institutional consultants
109 public pension funds
18 foundations/endowments
43 sovereign wealth funds
11 fund of funds companies

Representing 19 countries in six regions

Asia: Hong Kong, Japan, Singapore, Taiwan
Europe: France, Germany, Italy, Netherlands, Spain, Sweden, Switzerland
Latin America: Colombia, Mexico, Peru
Middle East: Kuwait, Qatar, UAE (including Dubai)
United Kingdom
United States

One-on-one phone interviews (Jan/Feb 2013)

Approx. 30 minutes
$100 compensation or charitable donation

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