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Investor Sentiment Research Note | October 2022

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Bearish Trends Largely Continue

This Addepar Investor Sentiment Index (ISI) research note is 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 anonymized 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. To ensure privacy, we never disclose identities.

Takeaways

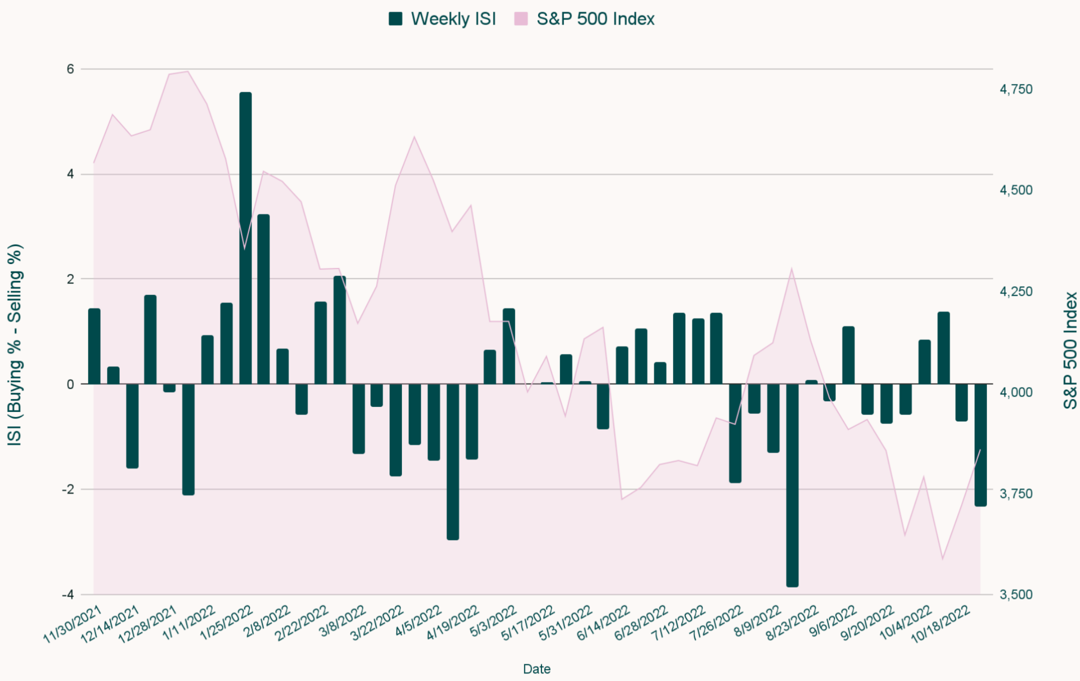
- Since the market peak in August, sentiment has been bearish on average.
- Healthcare sentiment is a notable exception, at its highest level since the onset of the pandemic.
- Financial services is quite bearish relative to the sector's performance and direction of long-term interest rates, potentially indicating investor concern over credit demand and profitability.

U.S. equities peaked in August and subsequently sold off, continuing the drawdown that began at the start of this year. In September and October, investor sentiment was on-net bearish, with five of the eight weeks showing negative sentiment.

Figure 1

Weekly ISI vs. S&P 500

November 30, 2021–August 2, 2022



Source: Addepar

Figure 2 below outlines sector-level sentiment. **Sentiment in healthcare stocks increased to a very high level in October while sentiment in financial services stocks became the most bearish of all sectors.**

These sentiment values are based on flows from individual equity positions without "looking through" into fund instruments. The sentiment values are shown as "z-scores," which are measures of how unusual values are relative to past history.[1]

[1] Z-scores (or "standard scores") are defined as $z = (x - \mu) / \sigma$, where μ is the mean and σ is the standard deviation of the population. In this case, we calculate the mean of quarterly flows (i.e., Buys–Sells) from Q1 2016 to Q1 2022. Similarly, the standard deviation is calculated based on quarterly flows over the same timeframe. For reference, a z-score with a magnitude larger than -1 or 1 has a probability of ~16%. A z-score with a magnitude larger than -2 or 2 has a probability of ~4%.

Historically when growth slows, some portfolio managers tilt portfolios to traditionally defensive sectors such as consumer defensive, utilities and healthcare. Currently one may observe the relative outperformance of healthcare within the defensive grouping. This sector is also second only to energy among all sectors.

Figure 2

Sector Sentiment (4-week average) and Performance

September 1, 2022–October 31, 2022

Sector	Oct.	Sept.	Perf. (Sept-Oct)
Healthcare	2.4	0.5	6.9%
Technology	1.4	-0.6	-5.1%
Industrials	1.0	0.1	2.0%
Consumer Defensive	0.5	1.6	0.3%
Energy	0.5	-0.2	13.4%
Materials	0.4	0.3	-1.2%
Consumer Cyclical	0.3	0.1	-7.8%
Real Estate	-0.2	0.0	-11.4%
Utilities	-0.7	1.6	-9.5%
Communication Services	-0.8	-1.1	-12.0%
Financial Services	-1.9	0.1	3.3%
Bullish/Bearish			
Relative to own history:			
Strong -			
Moderate -			
Moderate +			
Strong +			

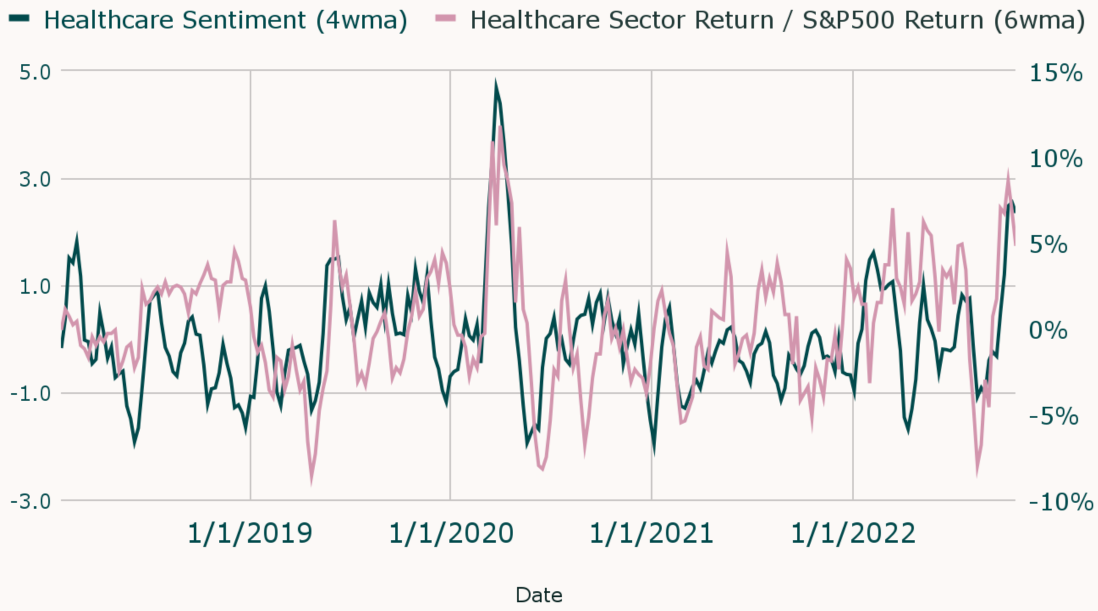
Source: Addepar, Refinitiv

Figure 3 shows healthcare sentiment relative to sector performance in excess of market returns over a longer time horizon. Sentiment in healthcare is peaking at levels not seen since the onset of the pandemic. As the chart indicates, healthcare sentiment is moderately sensitive to the sector's performance with a correlation of .45. Periods of time when investor sentiment significantly diverges from the market sentiment can be important, although this doesn't appear to be the case at this time.

Figure 3

Healthcare Sentiment vs. Sector Performance

January 1, 2018–October 31, 2022

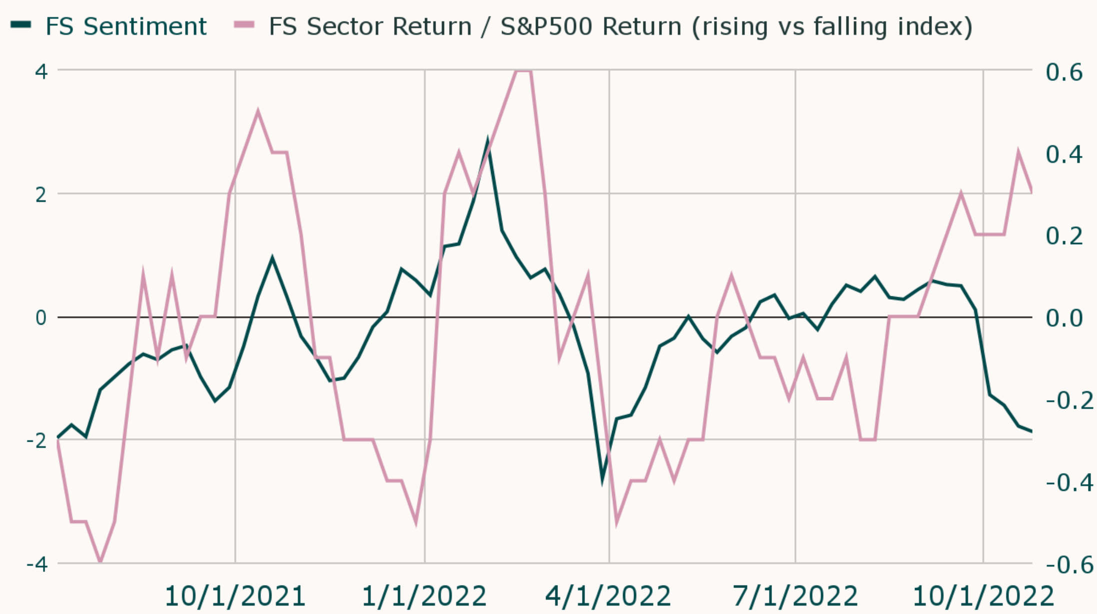


Somewhat more surprising is the bearish read on financial services sentiment relative to the market. At this stage, these are moving in different directions. Also as discussed in previous research notes, sector performance generally tracks long-term Treasury rates, which are also increasing right now. One potential explanation is that investors are focused on the spread of long-term rates to short-term rates, which is currently negative— impacting loan profitability. Alternatively, investors may be lowering expectations regarding future growth and credit demand.

Figure 4

Financial Services Sentiment vs. Sector Performance

January 1, 2021–October 31, 2022



Conclusion

In this research note, we've expanded our coverage of net sentiment and sectors to fund categories. 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.

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