Portfolio Performance Research Note | June 2022

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Impact of the Drawdown

Takeaways

The Fed's pandemic-era easy money policies coupled with government stimulus helped to boost all asset prices. Now Fed tightening is causing the opposite effect with equities and fixed income falling in unison with historic lows in the second quarter. Portfolios experienced major drawdowns on par with the pandemic era retrenchment from March of 2020. Key performance benchmarking highlights include:

- In the second quarter, asset classes generally had negative performance. Public market asset classes underperformed private markets.
- Asset class volatility is now rising to levels similar to when the Fed last tightened in 2016, although they haven't yet reached the levels of the 2008 financial crisis or the pandemic.
- On a risk-adjusted basis, fixed income underperformed all asset classes.
- Within equities, energy and utility sectors performed best while consumer cyclicals and communication services underperformed.
- Private equity continues to do well, while hedge funds have experienced particularly poor performance on average, in part due to high correlation with public equities.
- The largest portfolios outperformed in alternatives while underperforming in equities relative to other portfolio types. Outperformance in alternatives has been due to larger allocations to private equity over hedge funds and better security selection.

Introduction

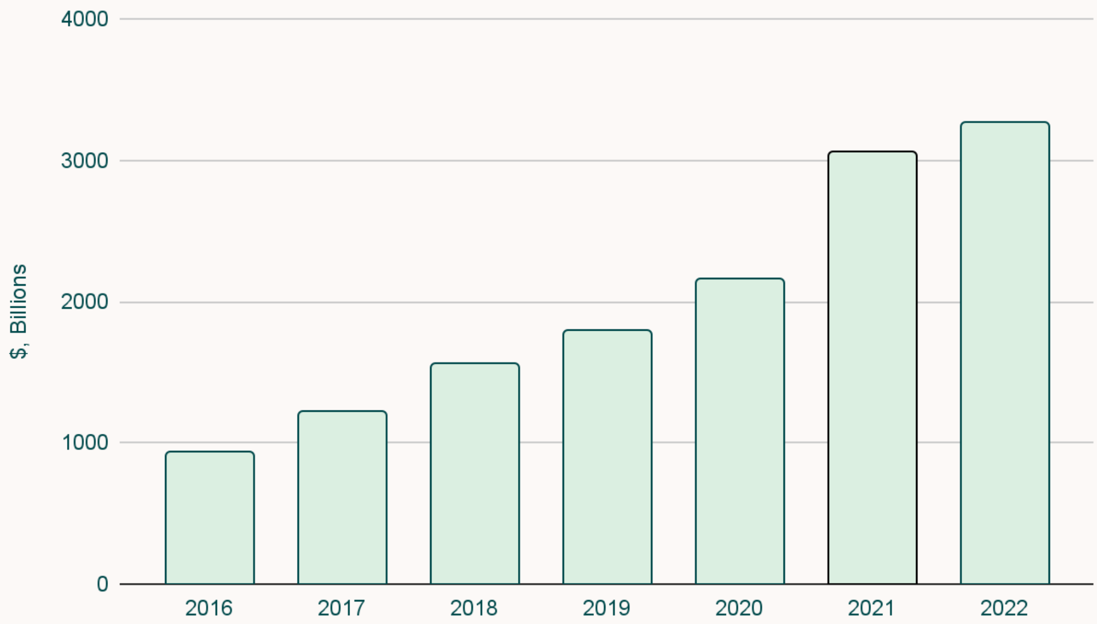
Addepar is a leading wealth management platform. When the company was founded in 2009, one of the most pressing challenges in financial services was a lack of transparency. Addepar was built with the mission of unlocking the power of informed data-driven investing and advice. In keeping with that mission, we established Addepar Research to carry out research on investment organizations—their governance, management, operations and decision-making—leveraging the power of the Addepar network to improve collective performance.

The platform natively supports all ownable asset categories, with a particular focus on alternative asset classes such as hedge funds and private equity. In this analysis, we focus on assets of independent registered investment advisors (RIAs) and single family offices (SFOs). This subset of the assets represents over 175,000 portfolios with more than $3 trillion in assets (see Exhibit 1).

Exhibit 1

RIA and SFO Assets Reported on Addepar USD

$, Billions[1,2]



The unique breadth and depth of the dataset generated by the Addepar platform offers transparency into the investment themes and trends of sophisticated high-net-worth (HNW) investors. Particularly for investors with a significant allocation to less-traditional investments, we hope to provide a relevant point of comparison that complements other benchmarking analyses.

[1] All analyses shown in the report exclude individual investments that exceed $1 billion in value along with very small and very large portfolios. This avoids introducing significant skew into the results.
[2] All values displayed are as of the end of Q2 in each year.

The goal of this particular report is to provide transparency into portfolio performance across the platform. We'll also regularly publish companion pieces that focus on asset allocation.

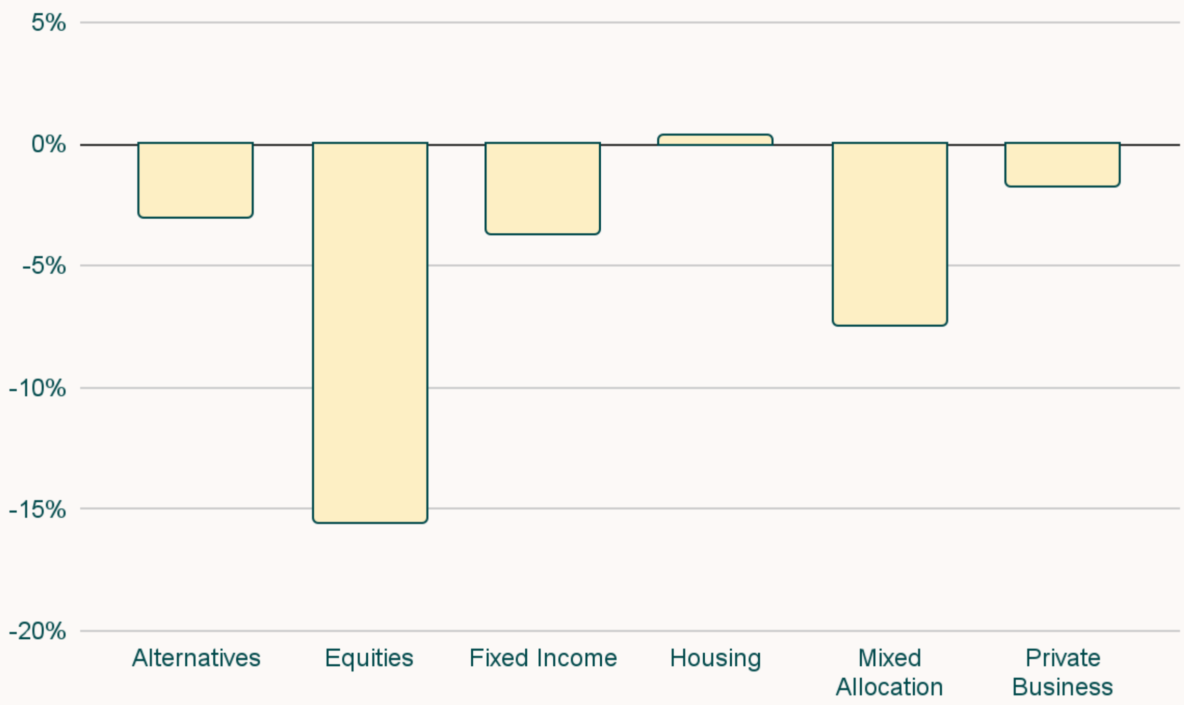
Performance

We start by examining the average performance by asset class (see Exhibit 2) for the previous quarter.

Exhibit 2

Aggregate Performance by Asset Class

Percent, Q2 2022

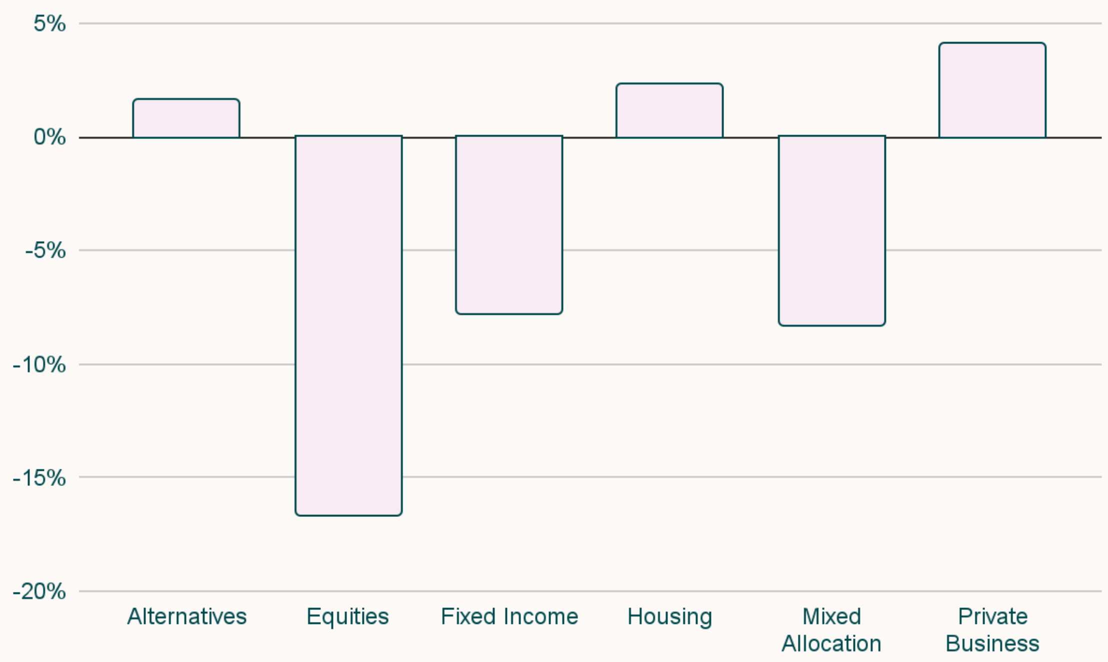


In the second quarter, asset classes generally had negative performance. Equities, the largest asset class, performed the worst and returned an average -15.5% while housing returned 0.3%. The broad-based negative performance was due to rapidly increasing discount rates, which reduced the present value of future cash flows.

Exhibit 3

Aggregate Performance by Asset Class

Percent, Q3 2021–Q2 2022



The second quarter's performance contributed to public market asset classes having negative returns for the previous year and private assets retaining positive performance. Many private assets are currently lagging and negative returns may become apparent in the months and quarters to come[3].

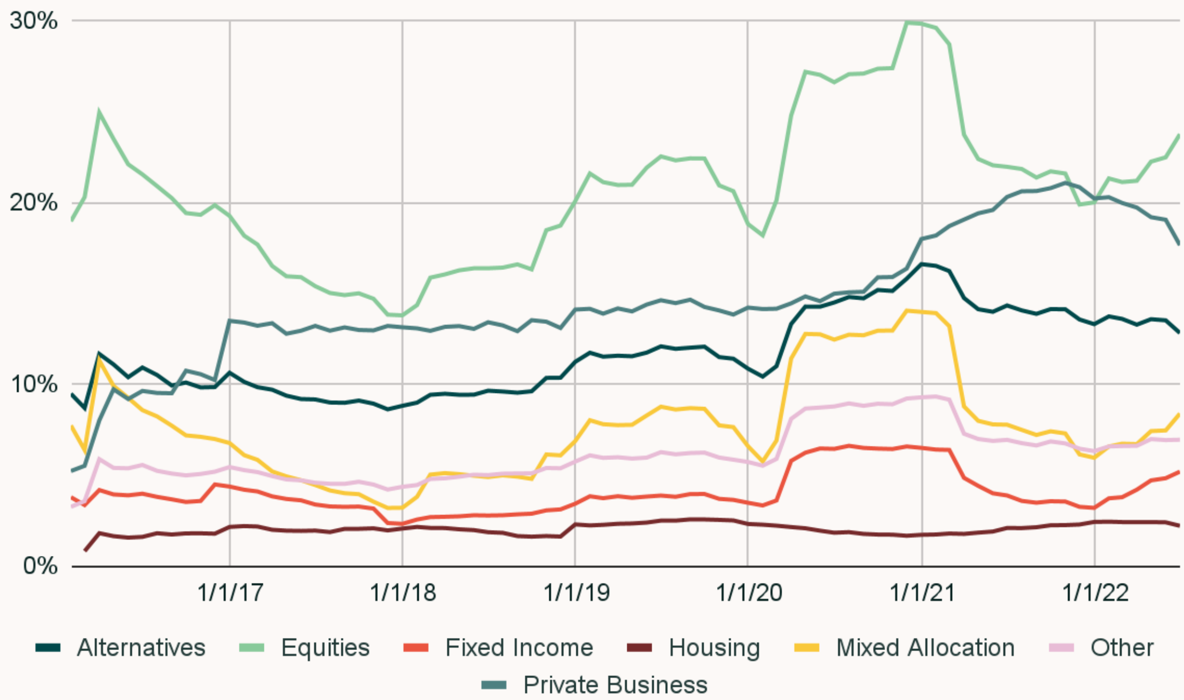
Asset class risk (measured as the monthly standard deviation of returns annualized) increased moderately over the course of the quarter. Volatilities are now at similar levels to the Fed's most recent rate hikes which began in early 2016[4].

[3] See our Private Equity Benchmarking ARB for more details.
[4] See the appendix for long-term market volatilities.

Exhibit 4

Rolling 12-Month Volatility by Asset Class

Percent, Jan. 2017–June 2022

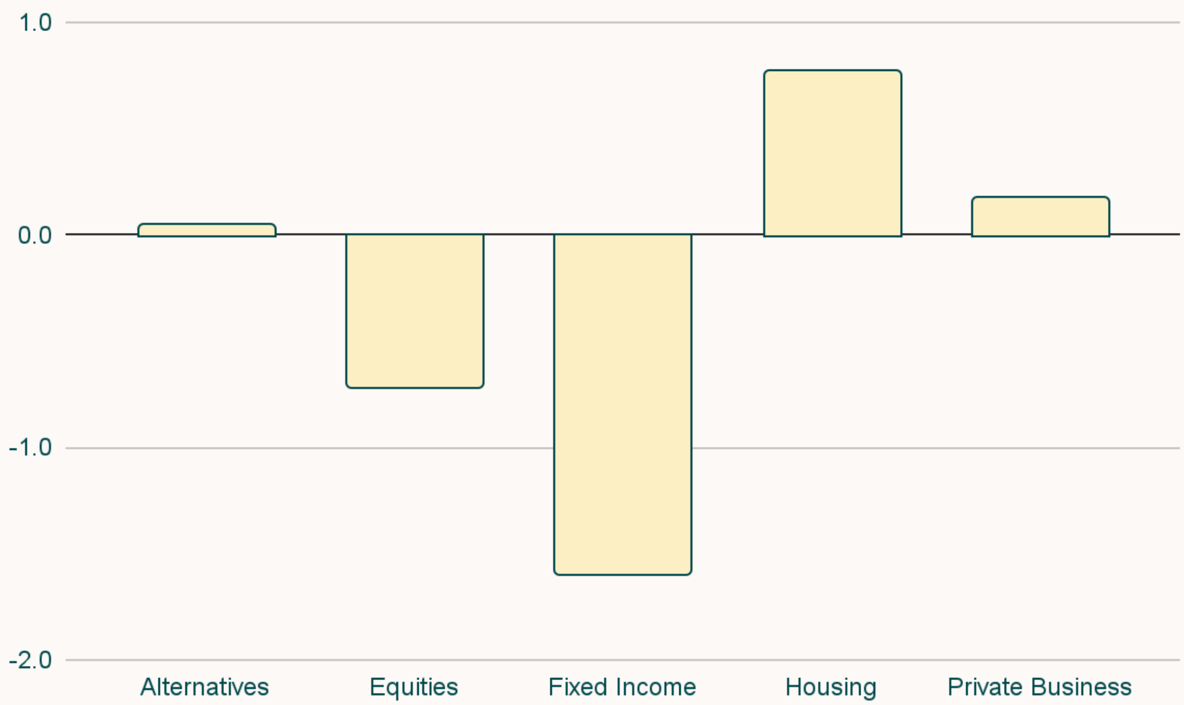


On a risk-adjusted basis, fixed income underperformed equities. Rising inflation and increasing expectations for monetary tightening have disproportionately weighed on this asset class.

Exhibit 5

Sharpe Ratio by Asset Class

Percent, Q3 2021–Q2 2022



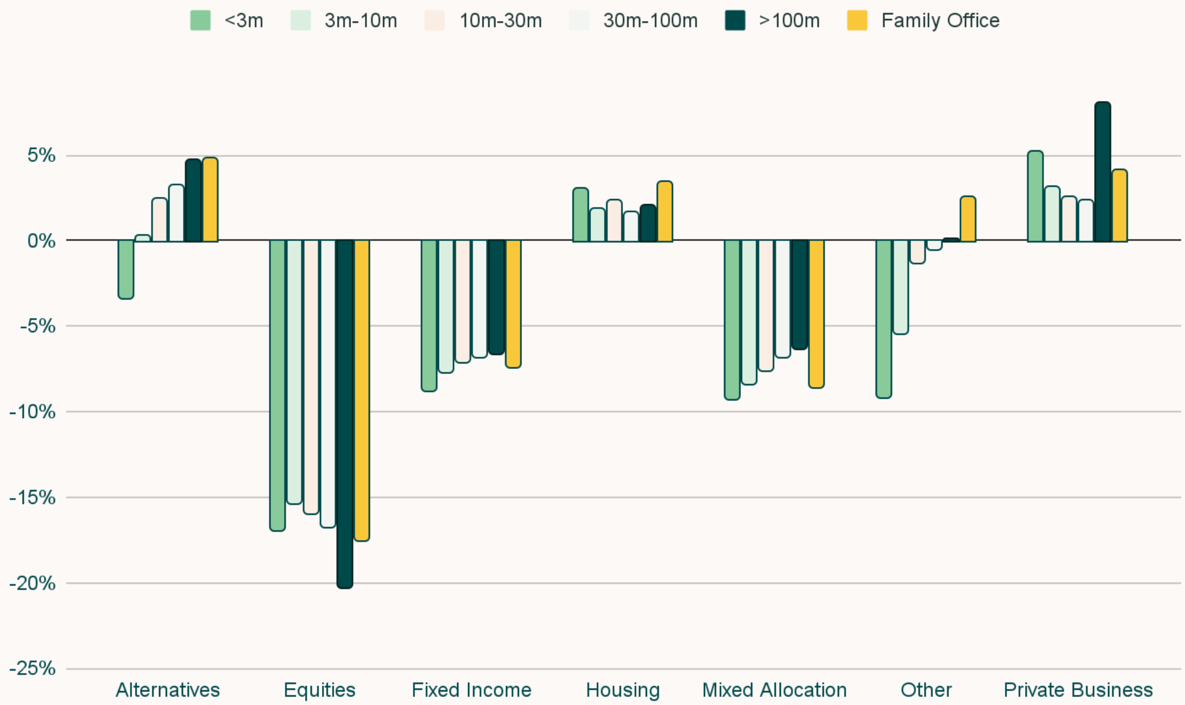
Performance by portfolio type

Over the past year, different classes of investors experienced a range of asset-class performance. The largest portfolios outperformed in alternatives but underperformed in equities.

Exhibit 6

Performance by Portfolio Size/Type

Percent, Q3 2021–Q2 2022

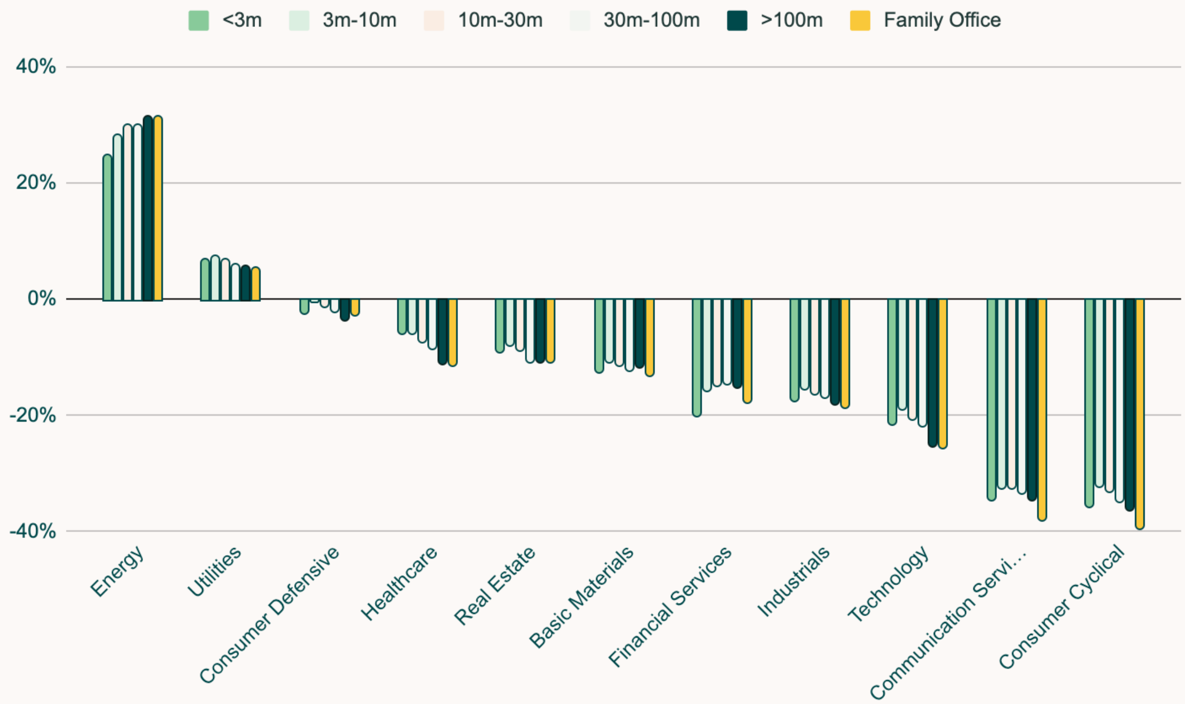


The past year has also seen rising energy prices buoyed the energy sector while sectors with more growth-oriented stocks such as consumer cyclicals, communications and technology underperformed. Due to the longer cash flow duration of growth stocks, these were more heavily impacted by rising discount rates.

Exhibit 7

Equity Returns by Sector and Wealth

Percent, Q3 2021–Q2 2022

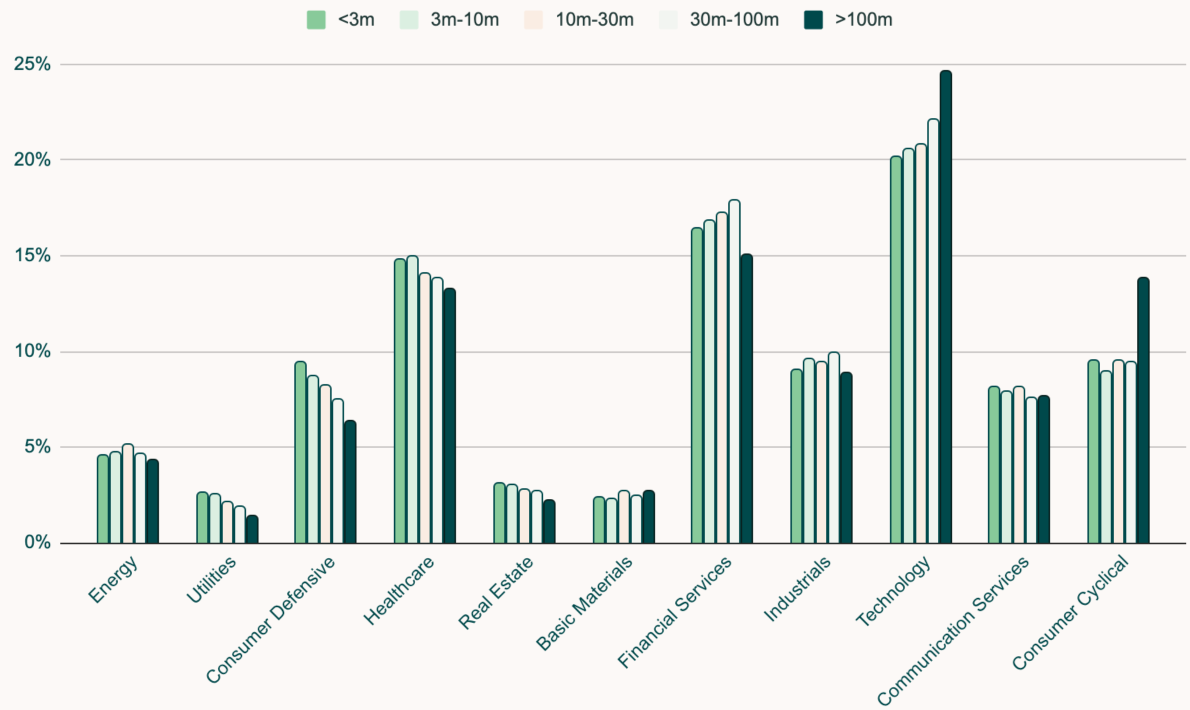


One contributing factor to the largest portfolios underperforming in equities is sector allocations. Larger portfolios had smaller equity allocations toward those sectors that performed the best (energy, utilities, consumer defensive, healthcare), and higher allocations toward the worst-performing sectors (technology, consumer cyclical) compared to smaller portfolios.

Exhibit 8

Relative Equity Allocations by Wealth

% of Equity Holdings, Q2 2022



Alternatives Performance

As shown in Exhibit 9, despite drawdowns in public markets, investors earned robust returns from their private capital funds though negative performance from their hedge fund investments. The largest portfolios had the highest performance relative to the other portfolio categories everywhere except hedge funds. Because the largest portfolios allocate more to PE over hedge funds (see our Asset Allocation research note) and because they outperform within the PE sub-asset class, these portfolios generally outperformed at the aggregate alternatives asset-class level.

Exhibit 9

Returns in Alternatives by Wealth

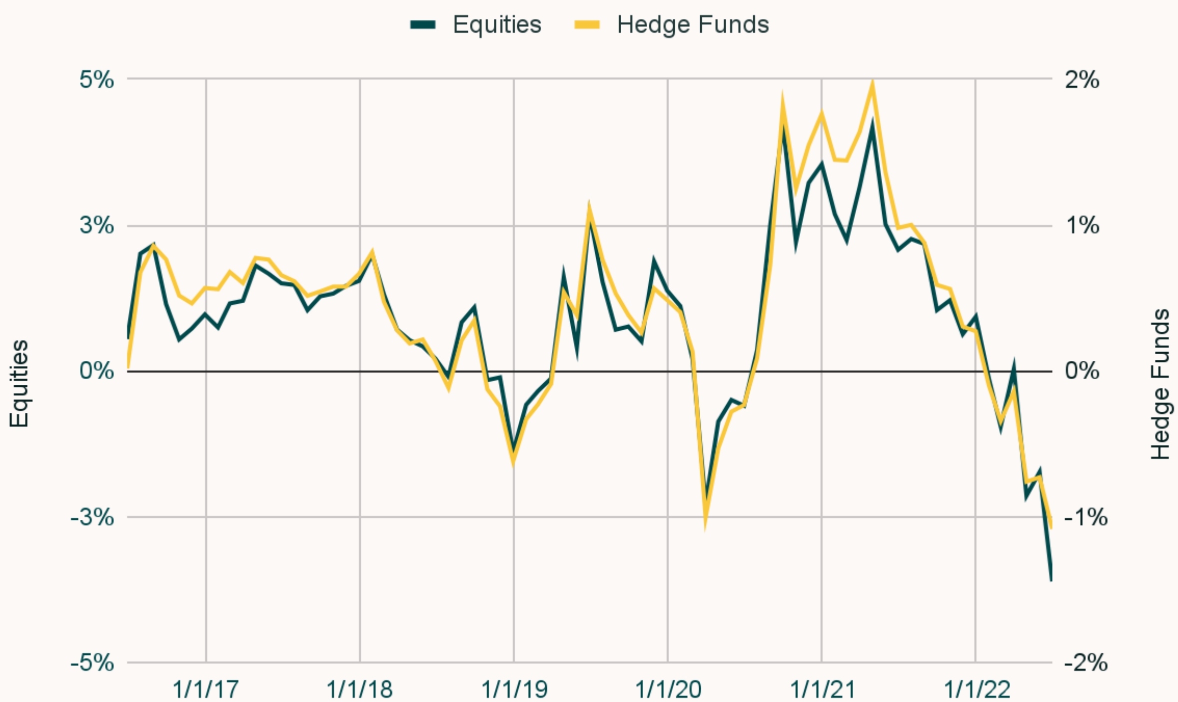
Percent, Q3 2021–Q2 2022

To better understand hedge fund performance, we looked into whether we could identify beta exposures using factor analysis. Exhibit 10 shows 6-month rolling returns of hedge funds and equity asset-class returns. A regression yields an R^2 of .95 suggesting that, in aggregate, hedge funds are providing an equity-like return stream. While the aggregate picture may suggest that investors are essentially buying equities through their hedge funds investments, we note that there is significant dispersion across managers, and top decile fund managers are significantly less correlated to equities. We will delve deeply into hedge funds performance and their relationship to betas in our forthcoming Factor Modeling research piece.

Exhibit 10

Equity and Hedge Funds Returns

6-month Rolling Average



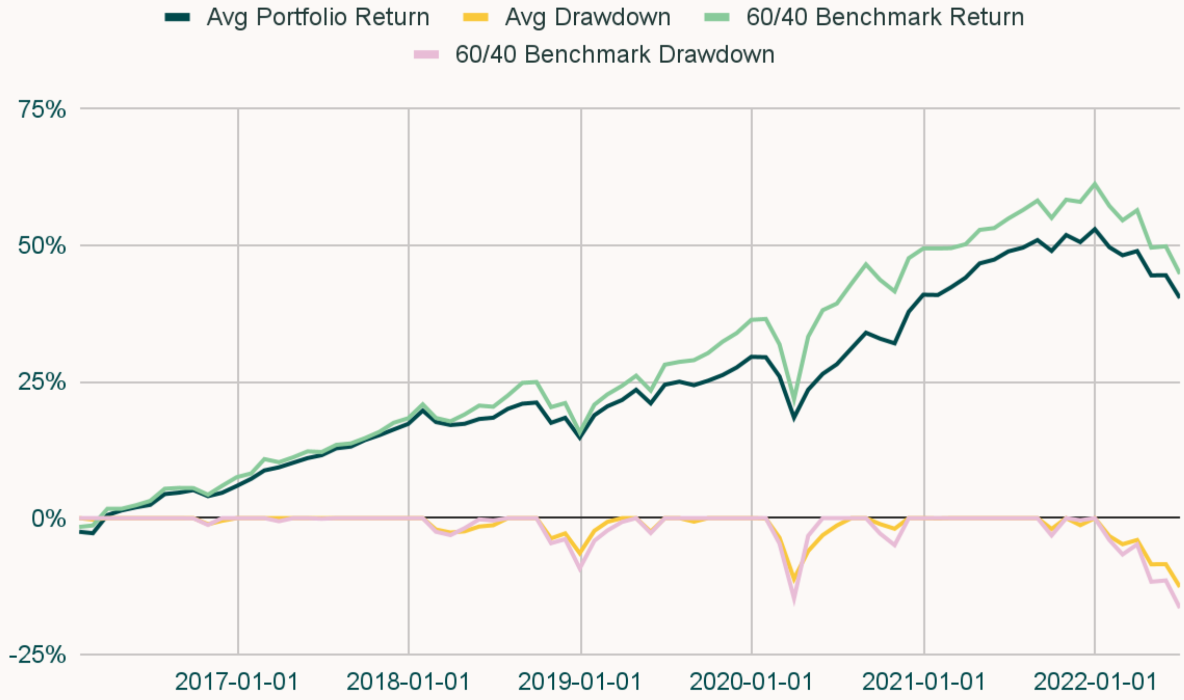
Cumulative Performance

Performance peaked at the end of 2021 which has subsequently turned into the most significant drawdown in recent memory. The current level of inflation in the developed world is unprecedented since the 1980s and will continue to require great portfolio management skills to navigate well.

Exhibit 14

Cumulative Performance

Percent, Q3 2021–Q2 2022



Conclusion

We've provided a range of views and transparency into the performance of portfolios on the Addepar platform. As we mentioned, we'll be publishing updates to these views on a quarterly basis. And also as noted, you're invited to also see our companion piece on Q2 2022 portfolio positioning.

Please email **research@addepar.com** if you have any thoughts or suggestions on how this publication can be improved.

Appendix

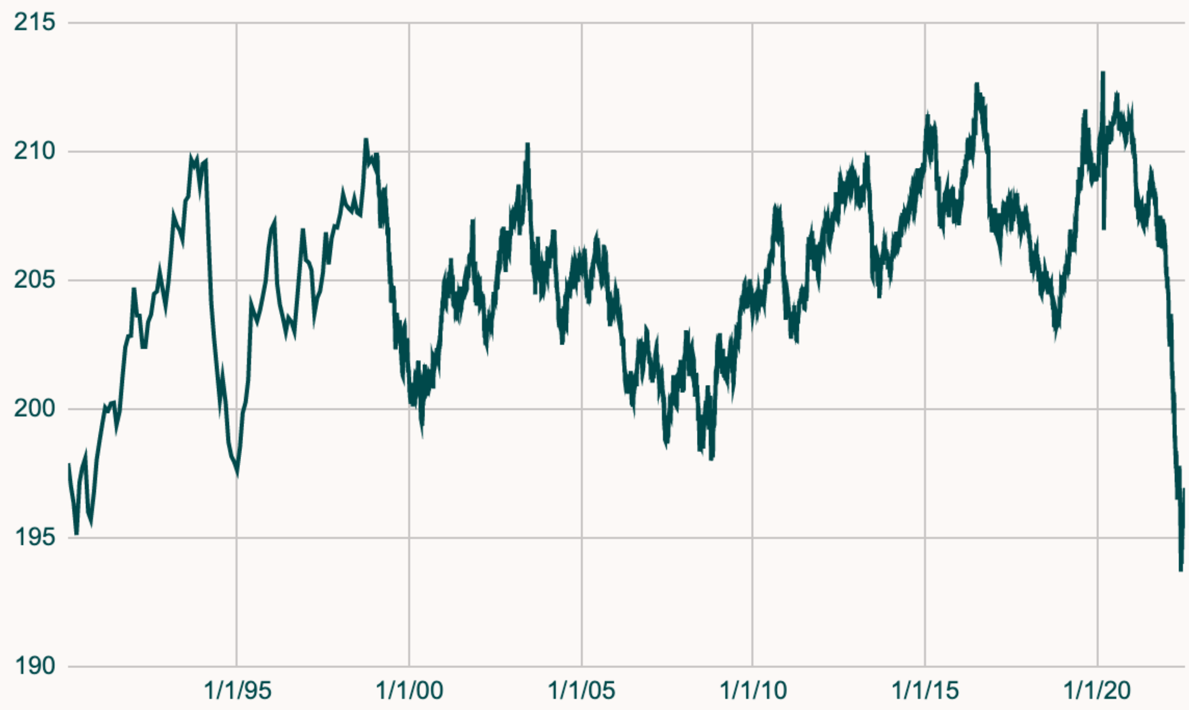
Asset Classifications

Asset class	Sub-asset class
Cash	Cash Cash equivalents
Fixed income	U.S. Treasuries and Agencies U.S. TIPS U.S. investment-grade credit U.S. high yield U.S. bank loans International developed markets Emerging markets Opportunistic Other fixed income Unknown fixed income U.S. municipals/tax exempt
Equities	U.S. equities Global equities Developed markets–Americas Developed markets–EMEA Developed markets–Asia Pacific Emerging & frontier markets Other equities Concentrated equity positions Unknown equities
Mixed allocation	Asset allocation vehicles Held-away accounts
Alternatives	Hedge funds Concentrated alts positions Private equity & venture Real estate funds Other alts Unknown alts
Private business	Direct private companies
Direct real estate	Direct real estate
Other	Collectibles Direct loans Unknown Liability

Exhibit A

Bloomberg Agg. Bond Index

Prices, 1990 - 2022 Q2

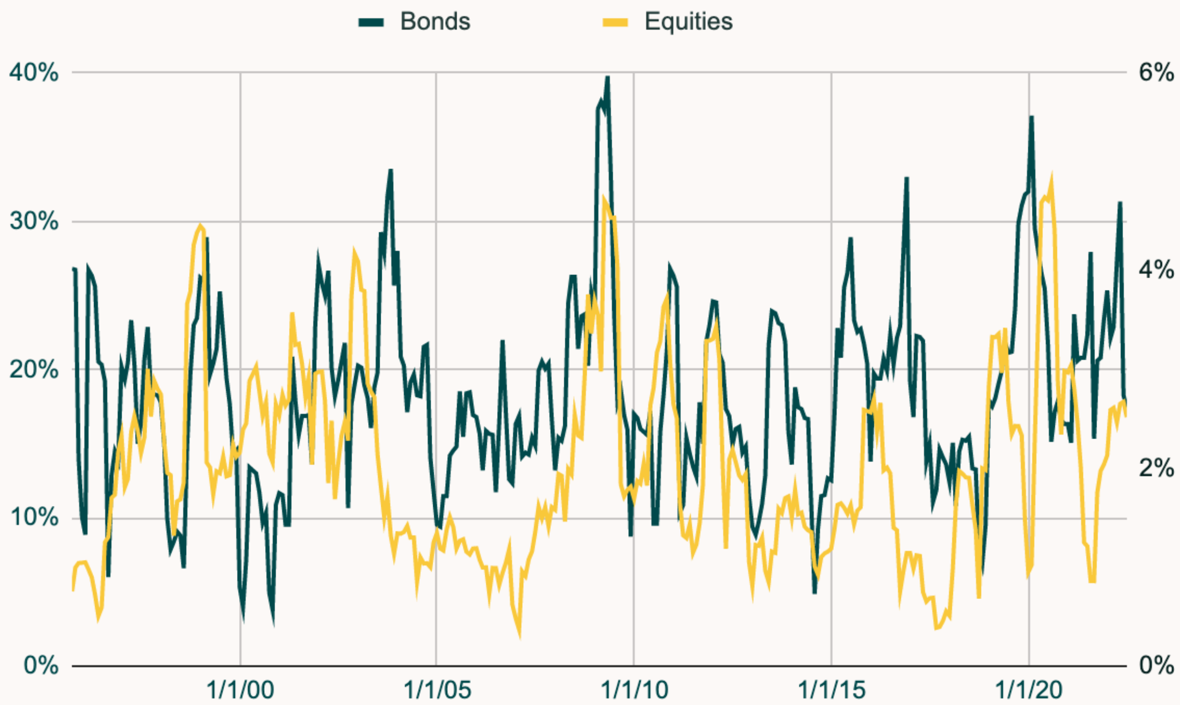


Source: Thomson Reuters

Exhibit B

Volatility of equity, bond indices

6-month Rolling Average



Source: Thomson Reuters

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