ENVESTNET

Envestnet **ACT**

(Advisor & Consumer Trends)

No One Could Predict How Advisors And Their Clients Would React To The Recent Market Sell Off

August 2020

Early on, the COVID-19 pandemic had a sharp impact on the stock and bond markets, and, in turn, advisor and investor decision making. The following analysis includes key insights related to how advisors and their clients specifically reacted to the sudden market sell-off when the pandemic first hit the United States. In past sell-offs, advisors were largely reactionary, with a short-term focus. This time was different.

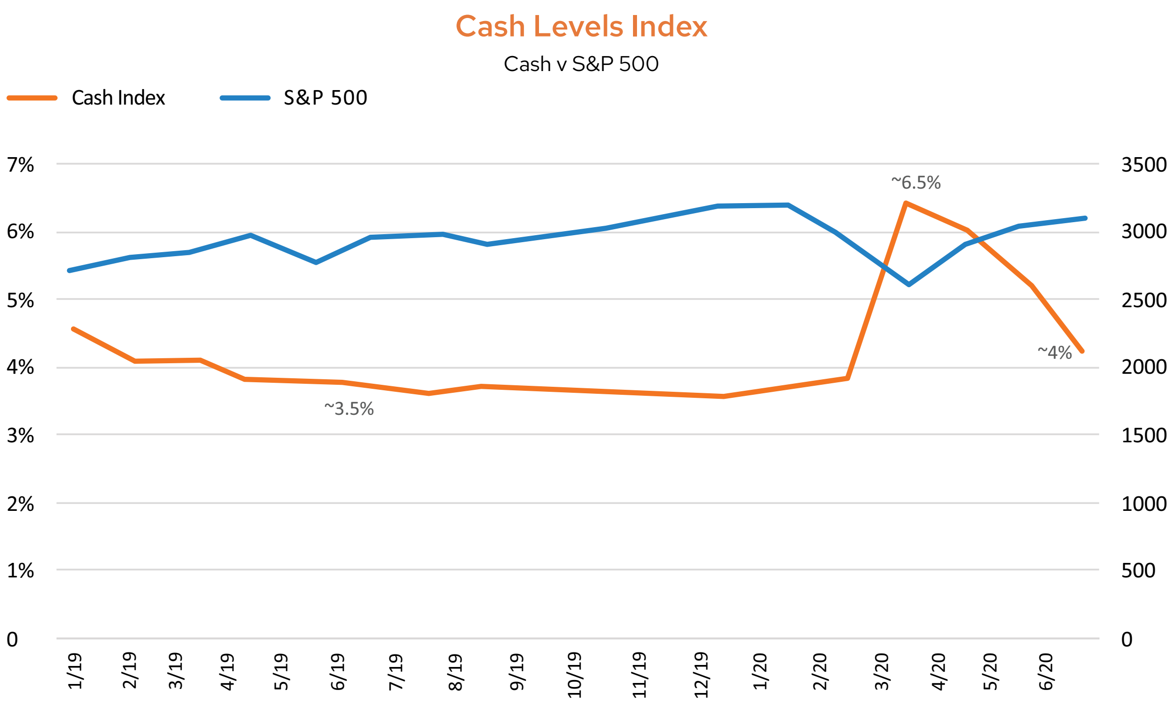
The bottom line:

- **Market volatility led to an increase in cash.**
- **Risk adjustments peaked in March and remain elevated.**
- **Flows into fixed income funds outpaced equities.**
- **Crisis activity increased dramatically, both in rebalancing and shifting from active to passive.**
- **Discretionary spending dipped and has not returned to previous levels.**

In recent weeks, the markets have rebounded. However, economic uncertainty persists, the timeline for a vaccine is unclear, and a second stimulus package remains uncertain in Congress. It's impossible to predict if current behavior will persist or what trends will emerge moving forward.

As we navigate unpredictable market volatility, we'll continue to monitor behavior and share key findings.

How did advisors and their clients respond to increased market volatility?

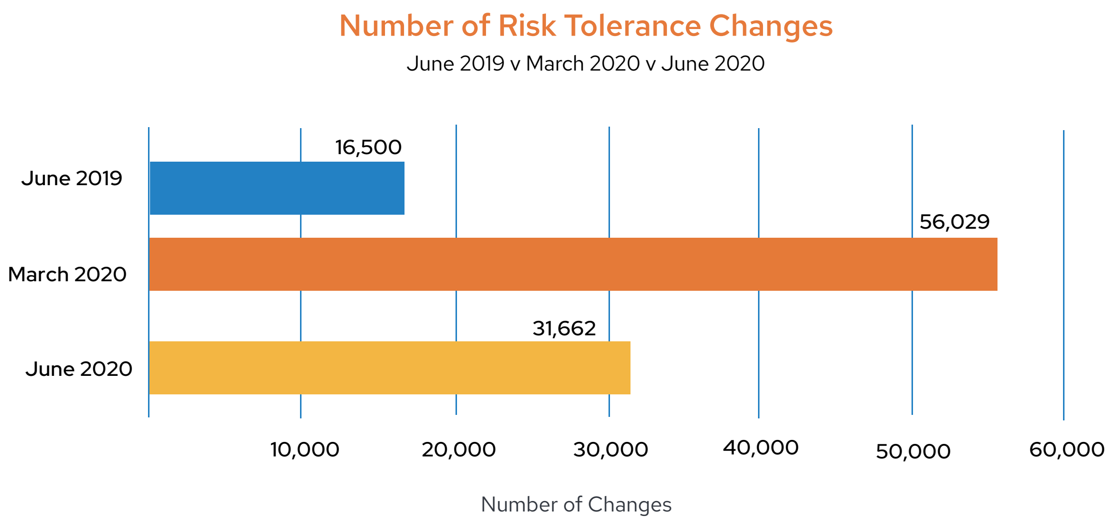


Notes: The Cash Levels Index is the sum of cash and equivalents as a percentage of total assets for the RIA.

Cash became the logical safe haven. Allocations to cash doubled at the height of the crisis in March 2020, to almost 6.5 percent of total allocations. Cash levels remain elevated compared to June 2019, but are nowhere near the highs we saw in March and April 2020.

- Cash rose sharply at the onset of the pandemic, but declined soon after, likely related in part to the stimulus package and a strong outlook for a potential vaccine.
- Cash allocations stabilized in June 2020, but remain slightly above the 2019 average.
- Investors didn't panic and continued to contribute and withdraw at observed long-term rates.

How did advisors react to increased volatility and talk to clients about the risk and return dynamics in the new market environment?



Notes: These figures represent service requests to change clients' model portfolios/investments, target allocation, or manager selection. The objective is to change an account's investments or risk tolerance.

The number of client risk tolerance changes is a proxy for how advisors and clients engaged around risk conversations. **Platform data suggests that advisors either rebalanced back to the original allocation or adjusted target allocations to control for investment policy thresholds.**

- At the early onset of the pandemic (March 2020), we saw an increase in changes to less risky assets overall, indicating a general preference towards risk aversion.
- The number of risk adjustments peaked in March, at an almost 3x increase in advisor-led changes (compared to June 2019).
- Since this peak, we continue to see a slightly elevated trend in changes at almost 2x the average relative to the same time last year (June 2019).

How did advisors and their clients put their money to work?

Asset Class	June 2019	March 2020	June 2020
Equity	$311,986,521	$780,691,902	$(682,934,315)
Fixed Income	$1,993,038,944	$(12,173,308,626)	$4,900,490,629

As advisors remain risk averse, there have been significant net flows into fixed income funds and ETFs over other equity-based investment styles. The strong use of fixed income funds suggests that while yields have been depressed, advisors use of fixed income funds was more constructive after heightened rebalancing and product swapping in March.

- Year-over-year flows into intermediate bond funds have increased dramatically. In fact, net inflows into intermediate bond funds and ETFs are 2.5x higher than June 2019.
- Advisors are using municipal bonds for greater tax efficiency.
- Throughout the month of June 2020, advisors rebalanced portfolios with net outflows coming from individual fixed income (and equity) instruments into equivalent mutual funds and ETFs.
- There have been substantial outflows from Large Cap Value equities, as it significantly lags the performance of Large Cap Growth equities. Year to date, the greatest net inflows are into Large Cap Core equities.

Did advisors take advantage of mispriced securities or index portfolios with the assumption that markets would stabilize?

Rebalancing	2019 Monthly Average	March Monthly Average	March vs. 2019	June Monthly Average	June vs. 2019
ETF to ETF	4,760	29,811	526%	9,182	93%
MF to MF	6,558	33,708	414%	11,384	74%

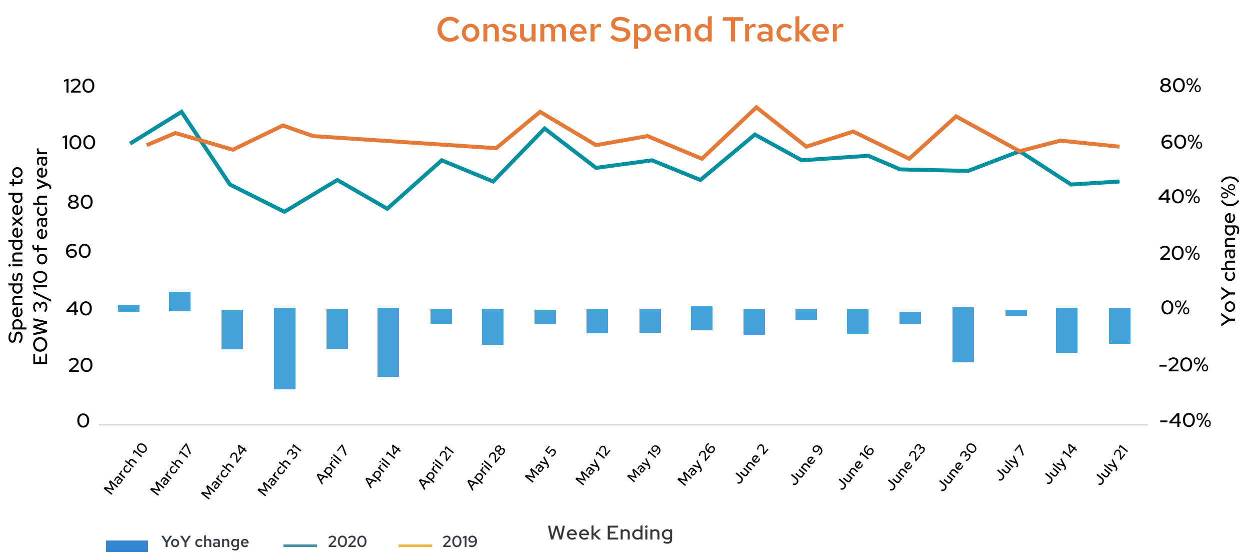
Active/Passive	2019 Monthly Average	March Monthly Average	March vs. 2019	June Monthly Average	March vs. 2019
MF to ETF	2,559	16,106	529%	3,396	33%
ETF to MF	2,181	8,309	281%	3,476	59%

Notes: These figures represent the trade volume as measured by the total number of buy-and-sell transactions in mutual funds and ETFs.

Faced with the choice to stay the course, reallocate back to original allocations, or change target allocations, platform data suggests that advisors opted for the latter two options.

- Advisors used the crisis to move their clients from active mutual funds to lower-cost, passive ETFs.
- There was, surprisingly, a significant increase in the number of trades moving from passive ETFs to active mutual funds, possibly signaling that advisors saw the sell-off as an opportunity for active managers to outperform during the eventual recovery.
- Passive to active activity is still 60% higher than average, suggesting that advisors may believe volatility still persists in the market that active managers may be able to exploit.

How did market volatility impact consumer spending?



Note: This includes spend on industry groups food & staples/retailing/communication/entertainment/travel and consumer services; it excludes committed expenses such as rent, mortgage, loan repayments.

Overall, discretionary spend in 2020 started to diverge from 2019 after 3/17. **After an initial dip, it began to trend upward throughout April, but remains lower overall than 2019 levels.**

- Spend on food and staples spiked the week ending 3/17, whereas most other spend declined heavily.
- Spend related to transportation (airlines, road, rail, etc.) and consumer services (restaurants, leisure, lodging, etc.) have been on an upward trend since their steep fall in March 2020. However, spend related to retail and media and entertainment has largely recovered and returned to pre-pandemic levels.
- Spend decreased 11% YoY during the week ending 7/21 in comparison to 19% for the week of 7/14.

Platform data also revealed that investors were largely loyal to their advisors during the peak of the crisis, demonstrating their desire for professional guidance in navigating volatility. It seems that now, more than ever, investors want seamless, timely guidance and support from someone they can trust.

As the financial services industry and client expectations continue to evolve and the impact of the pandemic continues to unfold, advisors will need to find ways to do more with less with a focus on improving the client experience.

In shifting from past behavior and using this sell-off as an opportunity to make adjustments in line with their clients' long-term goals, advisors are demonstrating their value as a true partner and essential advisor on the journey to financial wellness.

ENVESTNET

Don't miss the latest insights from the Envestnet team. Visit our blog for our perspective on the financial services industry and information about our platform and solutions. Visit Envestnet Institute to access on-demand resources from a variety of asset managers in one consolidated location, including webinars, articles, podcasts, and more. Follow us on social media for news and other updates.

Envestnet Blog

envestnet.blog

Envestnet Institute

envestnetinstitute.com

/Envestnet @ENVIntel /Envestnet @Envestnet @Envestnet

All data was provided by Envestnet Data & Analytics for the timeframe June 2019 through July 2020.

About Envestnet

Envestnet, Inc. (NYSE: ENV) is transforming the way financial advice and wellness are delivered. Our mission is to empower advisors and financial service providers with innovative technology, solutions, and intelligence to make financial wellness a reality for everyone. Over 103,000 advisors across more than 4,900 companies including 16 of the 20 largest U.S. banks, 46 of the 50 largest wealth management and brokerage firms, over 500 of the largest RIAs, and hundreds of FinTech companies, leverage the Envestnet platform to grow their businesses and client relationships.