ACTIVE MANAGEMENT SENTIMENT STUDY

Analyzing the attitudes and perceptions regarding active investment management among professional investors globally

KEY FINDINGS

- Active management resonates strongly with professional investors globally. Most indicate that active strategies will play an important role in their portfolios moving forward.
- There is strong demand for skilled active managers.[1] A large number of investment professionals expect continued market volatility, and many will rely on active management to navigate current market conditions.
- Professional investors believe risk management, investment selection and long-term conviction differentiate skilled active managers. Indeed, risk management remains a key asset manager selection criterion globally.
- Professional investors[2] believe that active management provides better downside risk management and potentially higher risk adjusted returns. This is especially important given concerns about future market volatility.
- Many professional investors say that investors are focusing too much on short-term returns despite the need to plan for long-term goals.

[1]MFS defines skilled active managers as those who show one or more of the following behaviors: demonstrating conviction through low portfolio turnover and high active share; adding value in volatile markets; integrating research and rewarding collaborative thinking.

[2]By professional investors, we mean retail advisors, institutional investors, and professional buyers/gatekeepers.

OVERVIEW

Despite strong returns over the past six years, global markets today present significant challenges for investors. Volatility is increasing, concerns about liquidity are growing, and investors are focused more on short-term information and market movements than on aligning their investment strategies with their long-term goals. At the same time, many investors need to better understand the role of active and passive investment strategies within their portfolios.

Changing and more volatile market conditions signal the need for active management, both for its ability to manage risk and its ability to broaden the investment opportunity set through changing market conditions.

In this context, MFS has sought to determine the views of professional investors globally on the following issues:

- Overall level of confidence in actively managed strategies or active managers
- Proportion of assets invested in actively managed strategies now and in five years
- Most important criteria in selection of actively managed strategies
- Willingness to pay for active managers who have the potential to outperform over the long term
- Current sentiment on global and economic conditions and the impact on investment decisions

94%

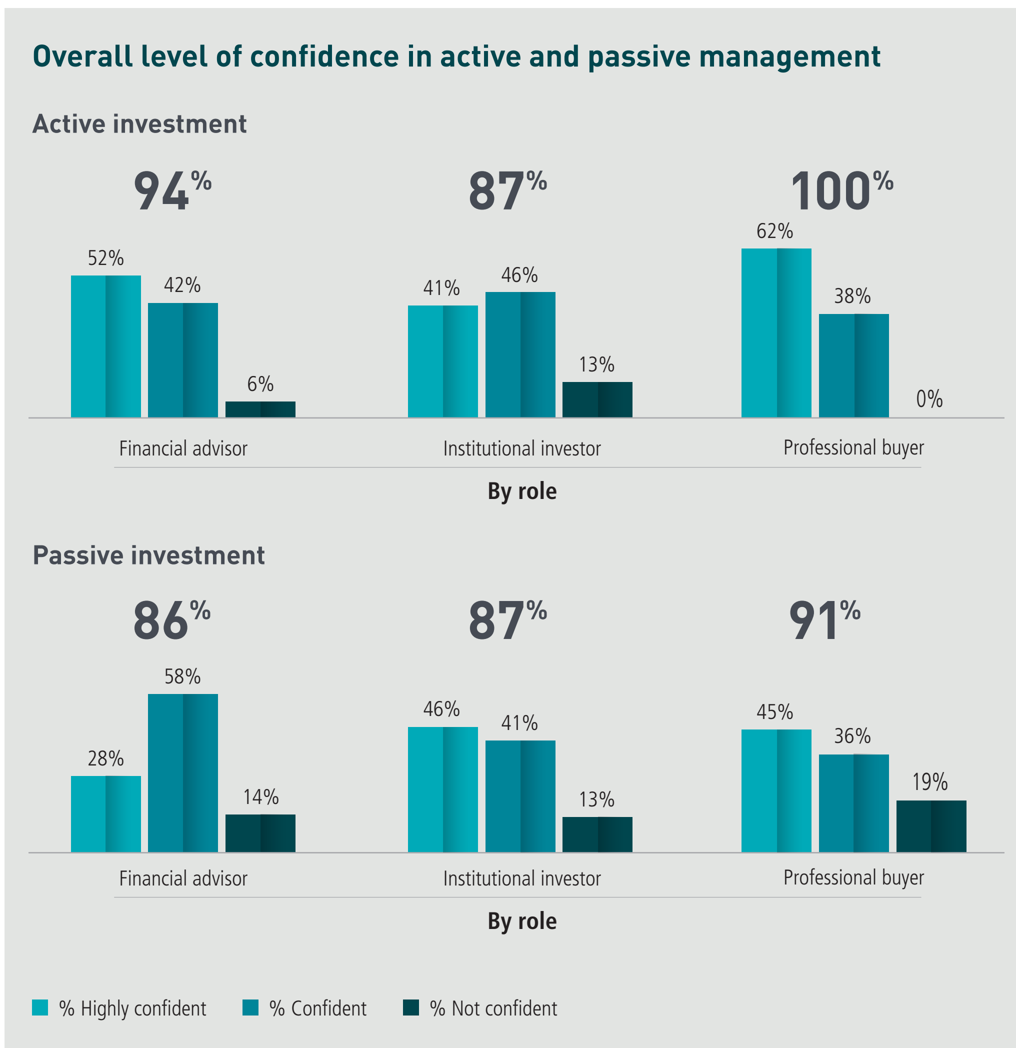
of professional investors are confident in active management, with half (52%) saying they are highly confident.

ACTIVE MANAGEMENT SENTIMENT IS STRONG

While strong market performance has driven more flows into passive funds and raised some questions about active's ability to outperform, active management continues to resonate positively with professional investors. In fact, more so than passive.

Indeed, an overwhelming 94% of professional investors are confident in active management, with half (52%) saying they are highly confident. In contrast, less than 39% of professional investors are highly confident in passive management. Clearly, while many investors have directed more assets to passive during the bull market, professional investors still place more trust in active.

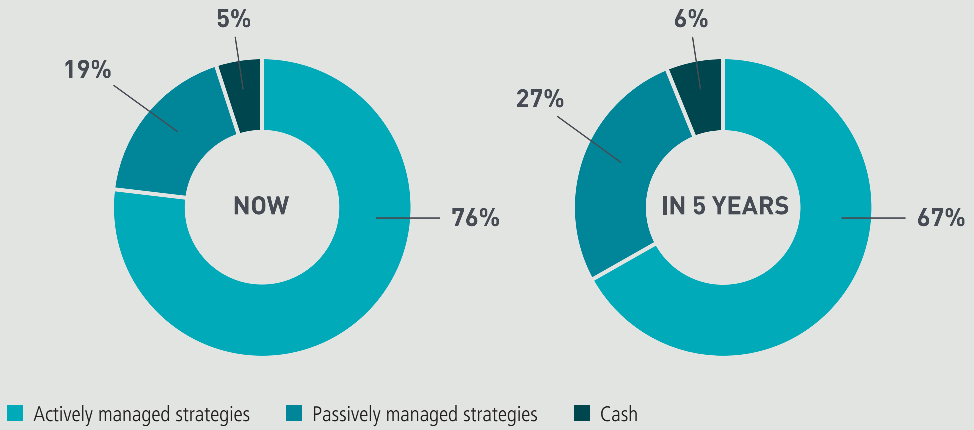
Professional buyers are the biggest advocates of active strategies, with every respondent saying they have at least a moderate degree of confidence in active strategies.



"We are committed to supporting active managers. We think there are market inefficiencies, [and] we think that active managers have a role to play."

– Institutional investor, Europe

Allocation: Active and passive management



Confidence in active management is perhaps best reflected in the extent to which professional investors around the world allocate to active strategies. On average, more than three quarters (76%) of total allocations are in actively managed strategies, 19% in passive and 5% cash. While passive management is likely to gain some share in the future, based on survey responses, active management will remain dominant for most professionals over the next five years.

As markets become increasingly complex, passive management will continue to have its place in investor portfolios, but active management will likely continue playing a pivotal role. In fact, 57% of investment professionals see active strategies playing an important role in their portfolios, and that is likely to increase as the market cycle enters a new, and perhaps uncertain, phase.

81%

of investment professionals assert an active risk management process is a key skilled active manager trait.

THE IMPORTANCE OF SKILL IN ACTIVE MANAGEMENT

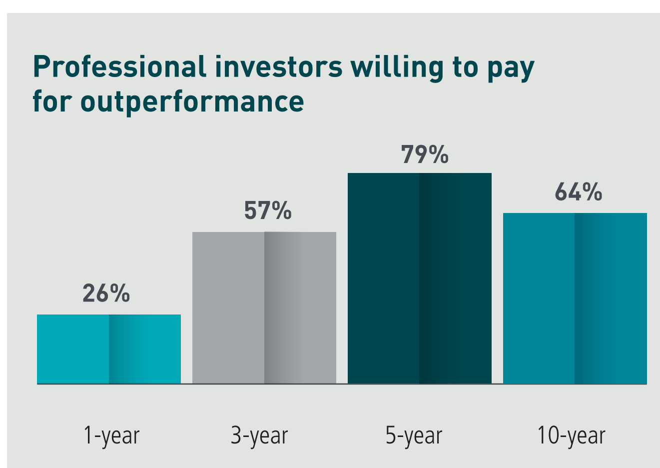
Skill is fundamental to the value proposition of active management. Where there is skill, there is the potential to outperform over market cycles.

There is no greater test of a manager's ability than volatile markets dominated by emotional decision making, herd behavior and misguided short-termism. Managers lacking the skills and confidence to navigate a turbulent market will be challenged to defend their approach whereas managers who can take advantage of market opportunities while reducing down-side risk will thrive.

Professional investors have a very clear idea of the manager attributes required to navigate today's complex and challenging markets. In fact, they've pointed to the traits below as the top three criteria for differentiating skilled active managers.

Managing risk is a crucial component of active management: Skilled active managers are more likely to steer through volatile market conditions and minimize downside risk by positioning for, rather than reacting to, market conditions. Active investment selection that generates alpha and drives outperformance also requires a considerable amount of expertise, skill and long-term conviction.

While cost is an important investment consideration, professional investors are willing to pay more for active managers with the potential to outperform over the long-term. Indeed, nearly two out of three investment professionals are willing to pay more for outperformance overall, and nearly 8 in 10 are willing to pay for outperformance over 5+ years.



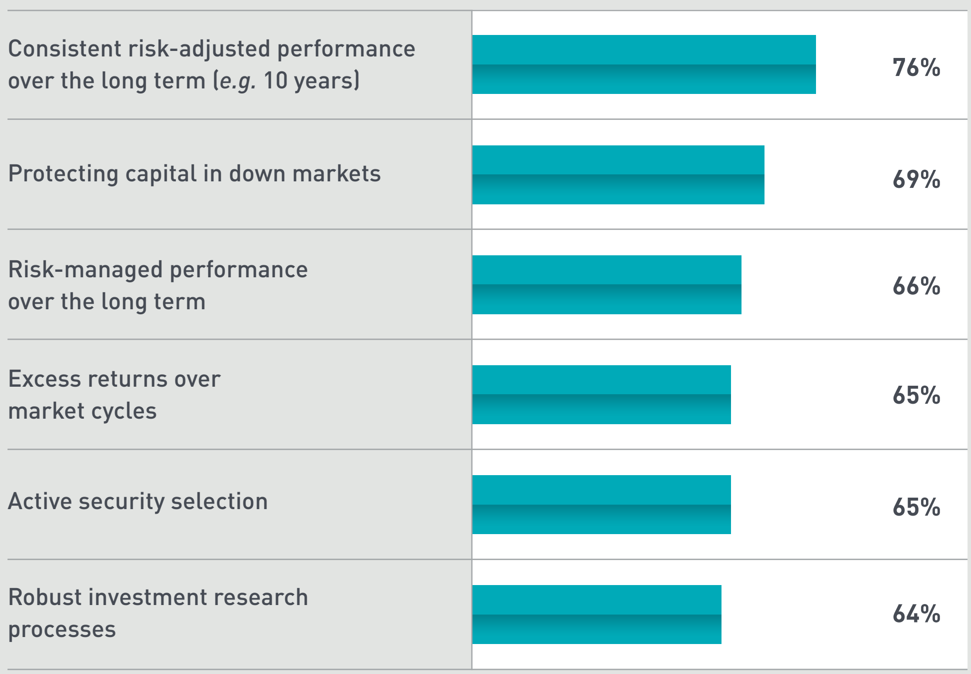
"A lot of firms say they are active managers, but in many instances they don't have the skill set. We'll still continue to use active, but we might get a lot more selective about the firms we use."

– Corporate pension manager, Asia

With market short-termism now a widespread phenomenon, skilled active managers who stay true to their long-term convictions and avoid over-reacting to short-term market movements may be able to arbitrage time and tap a broader opportunity set. The basis for an active manager's strong conviction is using robust research to develop insights, expressing them through a differentiated portfolio and giving those good ideas time to play out.

And this is exactly what professional investors want: potential outperformance offset against risk exposure, plus the ability to minimize losses when markets turn sour. In fact, three-quarters (76%) think consistent risk-adjusted performance over the long term is very important, while nearly seven in 10 (69%) see protecting capital in down markets as crucial and two-thirds (66%) attach great importance to risk-managed performance over the long term.

Critical active management attributes



All respondents
% Very important

38%

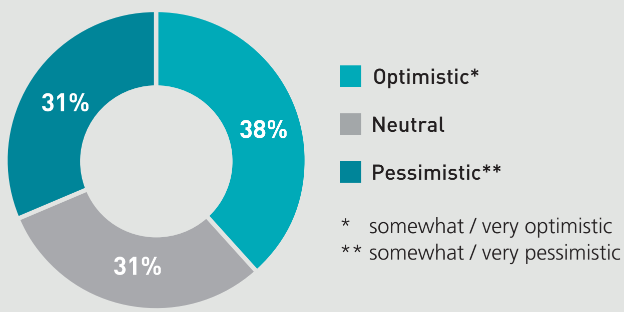
of investment professionals have an optimistic view on the global economy.

ACTIVE PROVIDES STRONGER RISK MANAGEMENT

Robust risk management is at the core of skilled investing. While the wounds of the global financial crisis may be starting to heal, investors shouldn't lose sight of the unpredictability inherent in the financial markets. Steadily rising stock markets in recent years have made the adoption of inexpensive passive approaches an attractive proposition. However, given that volatility — both upward and downward movements — is a normal part of market behavior, it is critical to have a strong focus on downside risk management. This is particularly important in light of the fact that 60% of professional investors believe market volatility is set to rise in the next year.

Patience may be a virtue but it is uncommon in today's markets: Sixty-eight percent of professional investors worldwide believe investors are too focused on short-term investment returns. And it is not uncommon for investors to fall prey to recency bias. Passive investments tend to perform well in certain market environments but it would be imprudent to assume recent performance is an indicator of future performance regardless of market dynamics.

Global economic outlook



On top of market concerns, less than 40% of investment professionals are optimistic about the global economic outlook.

Among those with a pessimistic view, 39% are very concerned about a major drop in stock or bond markets. [Note, between the survey field end date and 15 September 2015, the Dow Jones Industrial Average fell 1,704 points, or 9%].

Major economic concerns

All respondents
% Extremely / very important

SUMMARY

Changing and more volatile markets create a need for more investment expertise, not less, as investors try to navigate what could be challenging conditions. Through skilled active management, investors may have access to a broader opportunity set and the long-term conviction that may help them better achieve their own goals.

Regardless of market conditions, active management has a vital role at the core of investment portfolios. Investors will look to active managers for investment opportunities, even through volatile markets, and for the robust risk management that is so critical in market downturns.

That risk management cannot simply be an overlay or a compliance procedure, but instead, should be embedded in every corner of the investment process. To outperform, skilled active managers need to consider risk from multiple perspectives, including the individual security, portfolio and firm levels. For skilled active managers, outperformance is as much about minimizing losses in market downturns as it is about participating in market upswings.

Investors recognize this. And so regardless of product or market trends, they will continue turning to active management to both diversify and fortify their portfolios.

"The beauty of active management is being able to really talk about the ability to manage risk. If you are an index follower, you'll never be in the position to manage risk, because you can't actively navigate away from it."

– Professional buyer, North America

ABOUT THE SURVEY

MFS® Investment Managed partnered with CoreData Research, an independent third-party market research provider, to conduct this survey of financial advisors, institutional investors and professional buyers in North America, Latin America, Europe and the Asia-Pacific region.

The survey results include the views of 1,083 investment professionals (700 financial advisors, 258 institutional investors and 125 professional buyers), with data collected between 28 April and 1 June 2015.

To learn more about the importance of skill in active management, see:

"There's No Substitute for Skill."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THERE'S NO SUBSTITUTE FOR SKILL

The value of active management through market cycles

IN BRIEF

- As markets become more short-term focused, potentially more volatile and increasingly more complex, the skill of active managers may help investors navigate these conditions more effectively.
- We believe skilled active managers are those who can demonstrate conviction through high active share and long holding periods, add value in volatile markets and collaborate on investment decision making.
- Active managers with a higher degree of skill have shown the ability to outperform over time.

If a trend is a pattern of gradual change and skill is the ability to do something well, which is of greater value to investors? To manage growing investment challenges and continuously find opportunities through changing market conditions, we would argue for active skill over passively following market trends.

And yet as more assets have flowed into passive strategies, it seems that investors may have discounted the value that skilled active managers offer. Trends can be very enticing, particularly in continuously rising, monolithic markets. In all likelihood, however, passive investors who follow them haven't considered whether simply accepting what the market has to offer can actually help them accomplish their objectives without undue risk. As markets grow more difficult to navigate, investors will find they need access to more skill — not less.

THE POWER OF ACTIVE MANAGEMENT

Skill is at the very core of active management. It is the ability to exploit market inefficiencies, actively select securities, take on certain risks intentionally and create longer-term value than what can be achieved by simply following market trends. But that skill varies widely — a point we believe has gone unrecognized in recent claims that active managers in general cannot outperform their benchmarks. Many active managers have, in fact, outperformed over full market cycles. With requisite expertise, active managers can potentially add value when the markets are

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