



**INVESTMENT
PHILOSOPHY**



INVESTMENT PHILOSOPHY


A conceptual choice: at the core of efficient and disciplined asset management

Discovering and understanding our universe:
an approach which provides rich insights into
understanding the investment world and selecting
the best securities.

To illustrate this brochure, we have chosen satellite
images of our planet. They show the different
geographical regions where added value and wealth
are created due to their economic specialisation.

This is where the best companies are discovered and
thus the asset performances that the best portfolios
seek to capture.

In the following pages, we also pay tribute to some
of the exceptional minds that have inspired our
investment philosophy and methods.



INTRODUCTION

Which securities should be selected from amongst the nebula of financial investments? How should an asset portfolio be constructed so as to preserve capital and target a respectable return?

General knowledge of finance is not enough to be able to structure a strong portfolio. It takes cutting-edge expertise to discover, identify, analyse, choose and assemble the best securities in the investment universe.

The BCGE has been perfecting its investment philosophy for private and institutional clients for several years now. This brochure is the 6th extended edition. BCGE's unique investment philosophy focuses on quality and originality. It is based on the history of the financial markets and on an overview of the global economy. It includes the advances made in quantitative finance, but applies them with great care and is not guided by technocratic blindness which leads many investors down the road of heavy losses generated by concepts and products based solely on fragile assumptions.

The BCGE's investment philosophy is founded on eight key principles:

- 1.** Finance is an applied art and not only a quantitative technique.
- 2.** Performance is produced by the real economy and its companies.
- 3.** The key to good asset allocation is critical selection and defined exclusion criteria.
- 4.** The best assets are discovered thanks to open architecture.
- 5.** A high level of diversification increases return and reduces risk.
- 6.** A simple structure makes a portfolio more resilient.
- 7.** The investor determines his objectives, his time horizon and his risk tolerance.
- 8.** The investment philosophy determines portfolio performance not the size of the bank or the individual talent of its asset managers.



GALILEO GALILEI

(1564-1642)

“And yet, it does go round!”

Galileo, professor of mathematics at the University of Padua, believed that the laws of physics must be proved by experimental methods to enable scientific progress. To confirm the laws of physics, he built his own telescope in 1609, with which he observed the heavens in order to verify Copernicus' theories, which contradicted the geocentric world view of antiquity.





SUMMARY

FINANCE: AN APPLIED ART AND NOT JUST A QUANTITATIVE TECHNIQUE

- 8 Financial markets are by nature unpredictable in their fluctuations
 - 8 The markets are buffeted by mass psychology
 - 8 An unmanageable proliferation of assumptions is the substitute for explanations
 - 8 Methodical, realistic and consistent asset management
 - 9 Choose an investment philosophy and stick to it
 - 9 Opt for a secure execution model: the mandate
-

PERFORMANCE: BUILT ON THE REAL ECONOMY

- 12 What does the real economy teach us?
 - 13 Equities: the best-performing asset class
 - 14 Unlisted shares (private equity): a bonus to your portfolio
-

AN INVESTMENT PHILOSOPHY BASED ON EXCLUSION CRITERIA

- 15 Selection and prioritisation of the guiding principles
 - 15 The "laws" of certainty
 - 16 The empirical principles
 - 16 The realm of intuition
-

THE BEST SECURITIES ARE IDENTIFIED THROUGH OPEN ARCHITECTURE

- 20 Open architecture, its technical role and its ethical component
-

BROAD DIVERSIFICATION TO INCREASE RETURNS AND REDUCE RISK

- 21 Diversification of securities positions
 - 21 Diversification of investment styles
-

FOCUS ON SIMPLICITY AND AVOID FADS

- 24 It is better to remain true to one's principles than to succumb to trends
 - 24 Simplicity and consistency generate performance
 - 25 Good ethical and ecological behaviour of companies and institutions in a portfolio improves performance
-

A PHILOSOPHY FOR PRIVATE INVESTORS AND INSTITUTIONAL INVESTORS

- 27 Performance begins with capital preservation
 - 27 The objective of an investment: a factor which is often overlooked
 - 28 Reflection on risk: self-analysis is essential
-

THE INVESTMENT PHILOSOPHY DETERMINES LONG-TERM PERFORMANCE

- 32 Practical consequences of our investment philosophy
-



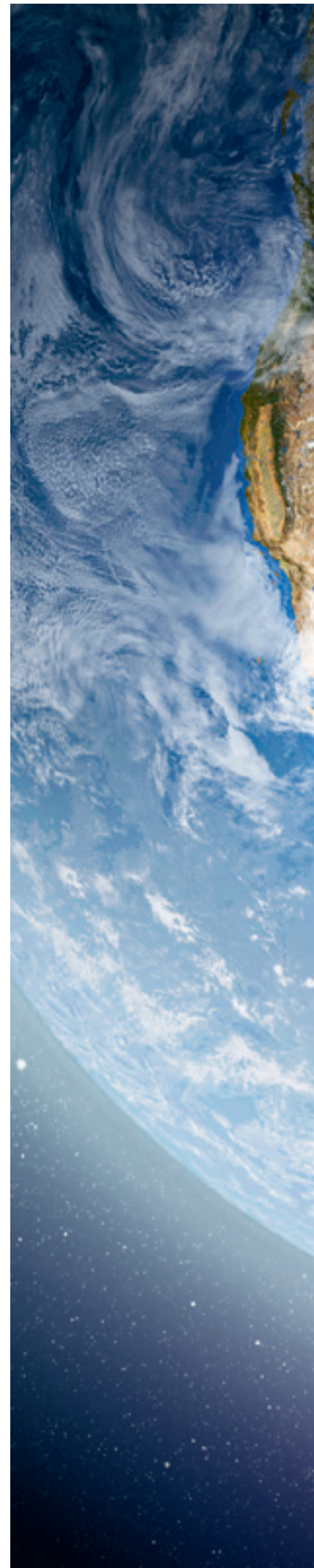
EDWIN HUBBLE

(1889-1953)

“Science is the one human activity that is truly progressive. The body of positive knowledge is transmitted from generation to generation.”

He was the first to explore the world of galaxies. By observing a shift towards the red end of the spectrum by several galaxies, he demonstrated that they were retreating from one another at a speed proportional to their distance (Hubble's law). This is commonly referred to as the expansion of the universe. He also established a system by which galaxies could be classified. This system is still used today.

The United States is the world's leading economic power. The country, which is almost the size of a continent, is attractive because of the dynamism of its leading technology companies or global multinationals that favour investment in research and development. Its place among the most competitive countries is proof of this. The economic market is vast and its access to a wide range of natural resources contributes to its growing energy autonomy.





FINANCE

AN APPLIED ART AND NOT JUST A QUANTITATIVE TECHNIQUE

Financial markets are by nature unpredictable in their fluctuations¹

Investors are often confused by the ups and downs of stock markets and their indices. The irregularity and unpredictability of performance leads to hesitant behaviour. The corrections, which take on very different dimensions and can never be predicted, lead to a loss of reference points for large and small investors alike. Some withdraw from the markets, while others opt for extremely costly hedging and defence strategies.

The markets are buffeted by mass psychology

Today, capital and equity markets are globalised. This means that “connected” providers (borrowers and issuers) and investors react and overreact to the slightest report or rumour from anywhere and on a large scale. This technical ability amplifies the old phenomena of price rallies and collective panic, thereby ensuring that speculative mass movements and herd behaviour influence day-to-day security prices substantially. Speculation naturally plays a recognised, useful role within the economic system, as it contributes to providing liquidity to the markets. The speculative energy and the attraction surrounding betting and gambling on the markets are factors to be taken into account. Furthermore, it is an increasing trend with modern tools such as online trading, automated trading² and a growing gambling culture³.

A serious investment philosophy must take advantage of these realities while remaining focused on the fundamental economic facts. Any investor in search of fantasy or a quick thrill can stop reading this brochure right now.

An unmanageable proliferation of assumptions is the substitute for explanations

The countless and often conflicting statements as well as a wide range of often inscrutable products leave the investor confused and sceptical. Be it articles in the financial press, prospectuses from the banking industry or the occasional academic paper, an unmanageable proliferation of assumptions abounds that cannot satisfy every investor’s need for clarification or an overall picture.

Understanding the markets and structuring one’s investments with an intelligent approach is a legitimate aspiration of the investor, whether private or institutional.

Methodical, realistic and consistent asset management

For obvious reasons, the management of a portfolio cannot be based on day-to-day opportunistic behaviour, nor on the volatile influence of equity market trends. BCGE’s investment philosophy is founded on a process that defines consistent and durable guidelines and principles of action. Portfolio management has to be methodical, realistic and consistent.

- **Methodical**, in the sense that it is performed using a structured and documented process⁴.
- **Realistic**, as the key issues at stake, such as protecting capital and maintaining the optimum level of liquidity, preclude speculative fantasy and impose a sceptical view of the investment markets.
- **Consistent**, because real results can only be obtained in the long term through a high level of discipline and a precise focus.

¹ Jean-Baptiste Alphonse Bachelier, Theory of speculation in the *Annales scientifiques de l’Ecole normale supérieure*, vol. I 3, no 17, 1900, pages 21 to 86.

² “As high-frequency trading comes to dominate daily activity in securities worldwide, regulators and traditional investors alike fear some of the interlopers may bring dangerous distortions”. Jeremy Grant, Up against a bandsaw, in *Financial Times*, 3 September 2010, page 7.

³ In 2009, the total volume of the global regulated betting markets amounted to USD 335 billion, of which casinos and lotteries accounted for a third. Online gambling. You bet, in *The Economist*, 10 July 2010, page 14.

⁴ Claims by wealthy private investors identified in a number of studies: “adoption of an institution-like investment approach that follows a structured process, looks for financial solutions rather than products to buy and takes an unemotional approach to investing”, Merrill Lynch, *World Wealth Report 2004*, CapGemini, page 14.

Choose an investment philosophy and stick to it

A key step in the management process of a portfolio is the choice of an investment philosophy. Today's asset management is a discipline that can be based on proven scientific knowledge, multiple empirical observations and numerous schools of thought expressed through schools or celebrities. Our level of knowledge has expanded greatly thanks to mathematical discoveries and the power of computer calculations. But many fundamental questions remain unanswered, as scientific progress raises more questions than it provides answers. Ensuring high performance without taking risks: the Holy Grail, or the Philosopher's Stone, is far from being discovered. And yet, we have to make daily decisions and navigate the markets by accepting many unknowns.

Choosing an investment philosophy means adopting a strategic framework built on a number of carefully selected assumptions. Some are scientifically proven and easily accepted. Others are more empirical in nature and require subjective selection and thus become investment approaches. An investment philosophy selects and prioritises the founding principles and rules for constructing and allocating a portfolio.

We have found that adopting our philosophy generates a common understanding, even intellectual complicity, between investors and asset managers. Our clients also expect that the execution of the mandate will be faithful to the guidelines defined and that the chosen course will be maintained over the long term.

Opt for a secure execution model: the mandate

The main objective of a classic and sustainable management approach, as advocated by our bank, is to protect capital as best as one can, regardless of the extent of market fluctuations. The philosophy summarised here serves as the framework for the strategic management of the portfolios entrusted to us. This is executed exclusively by means of discretionary mandate and centralised asset management. We believe that the responsibility for asset management cannot be shared between a client and his bank. The management responsibility lies solely with the bank, which relies on stable and rigorous operating processes certified by an independent body⁵. Any investor without sufficient infrastructure⁶ and time has very little chance of obtaining high-quality performance.

"It is much more natural to be afraid to consult than to decide." Memoirs, Cardinal de Retz

⁵ Therefore, all BCGE's Best of mandates have obtained GIPS (Global Investment Performance Standards) certification under the supervision of the CFA institute and are subject to an annual compliance audit by an independent auditor.

⁶ "Anyone without the time or skill to do the necessary research should keep out of the stock market", David Schwartz, stock market historian, Past signs point to dark future, in Financial Times, 27 July 2002, page 20.



PETER WARE HIGGS

(1929-)

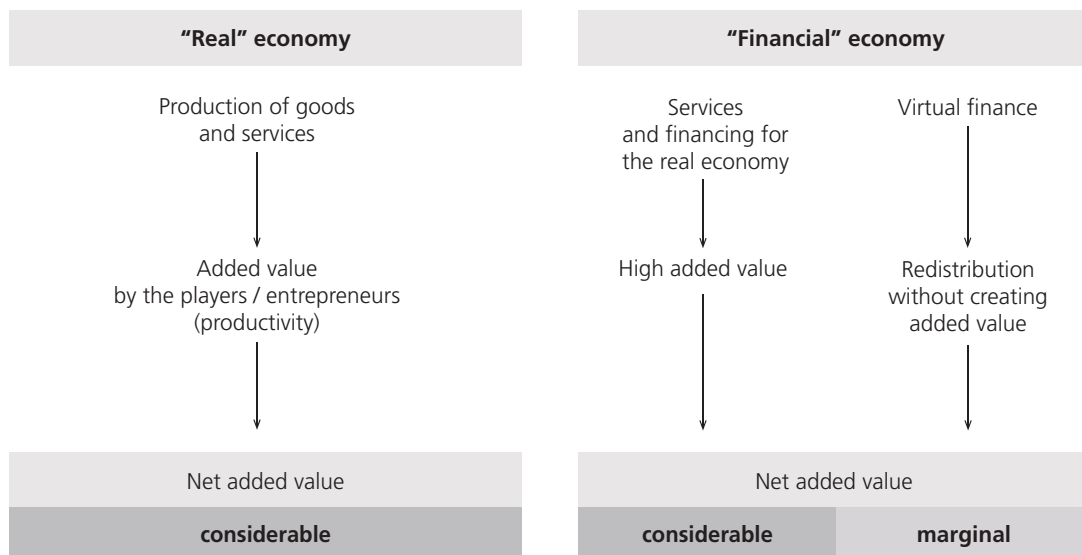
“It’s a question of understanding! Understanding the world!”

From the largest to the smallest, the Higgs boson is an elementary particle whose existence was first introduced in 1964 by Gerry Guralnik, C.R. Hagen and Tom Kibble; Robert Brout and François Englert (who called it the “massive scalar boson”) together with Peter Higgs. It explains the breaking of the unified electroweak interaction into two interactions by means of the Higgs mechanism. It also became known as the Higgs quantum field theory.





PERFORMANCE BUILT ON THE REAL ECONOMY



What does the real economy teach us?

Financial techniques, together with the institutions that implement them, have become powerful tools today⁷. The “financial” economy (stock exchange, financial markets) used to live in symbiosis with the so-called “real” economy, but now the latter is sometimes decisively influenced by it in the short term. There is no area of the real economy that is not temporarily influenced by the actions of the financial sector. Commodity prices, company values or the real estate market are all inter-connected with the financial world, whose speculative aspects have become globalised.

This new reality also affects the profession of asset management, although the fundamental rules remain in place. The fundamentals remain intact because the psychological behaviour pattern of the players does not change either. Furthermore,

however powerful the financial currents may be and however significant an impact they may have on asset valuations, it is not certain that their impact will be lasting. A return to the true economic value of the “attacked” assets ends up by imposing itself over the long term⁸. “The real economy influences markets, not the other way around.”⁹ We must therefore assimilate the sometimes irrational short-term behaviour of the markets and protect ourselves against it. Thus, the main focus of asset management must be to capture the added value created by the top players in the real economy. This requires a rigorous selection of the most productive and solid companies, whatever their size, whether listed or in private equity and wherever they are in the world. To create performance, we rely on the real economy, not the casino economy.¹⁰

⁷ “Without the very low key interest rates offered by the central banks, hedge funds would not have the firepower that [...] the central banks themselves criticise [...]” Pierre-Antoine Delhommais, *Et si les banquiers centraux partaient en vacances...*, in *Le Monde*, 23 July 2006, page 2.

⁸ “Indeed, it is only in the long term that stock market valuations accurately reflect economic fundamentals”, Professor Mickaël Mangot, in *Investir dans l'économie, pas en bourse, Guide opérationnel de gestion de fortune*, Blaise Goetschin, Constantino Cancela, page 4, Favre, 2017.

⁹ Remarks by Clive Granger, 2003 Nobel Prize in Economics, collected by T. Thöni, *Le Temps*, 18 August 2006.

¹⁰ “[...] the selection and weighting of investment categories should not be based on strategic optimisation, but on economic principles.” R. Banz, B. Eberle Hæring, T. Häfliger, *Indices Pictet LPP 2005. The new index family for Swiss pension funds*, November 2005.

**Equities:
the best performing asset class**

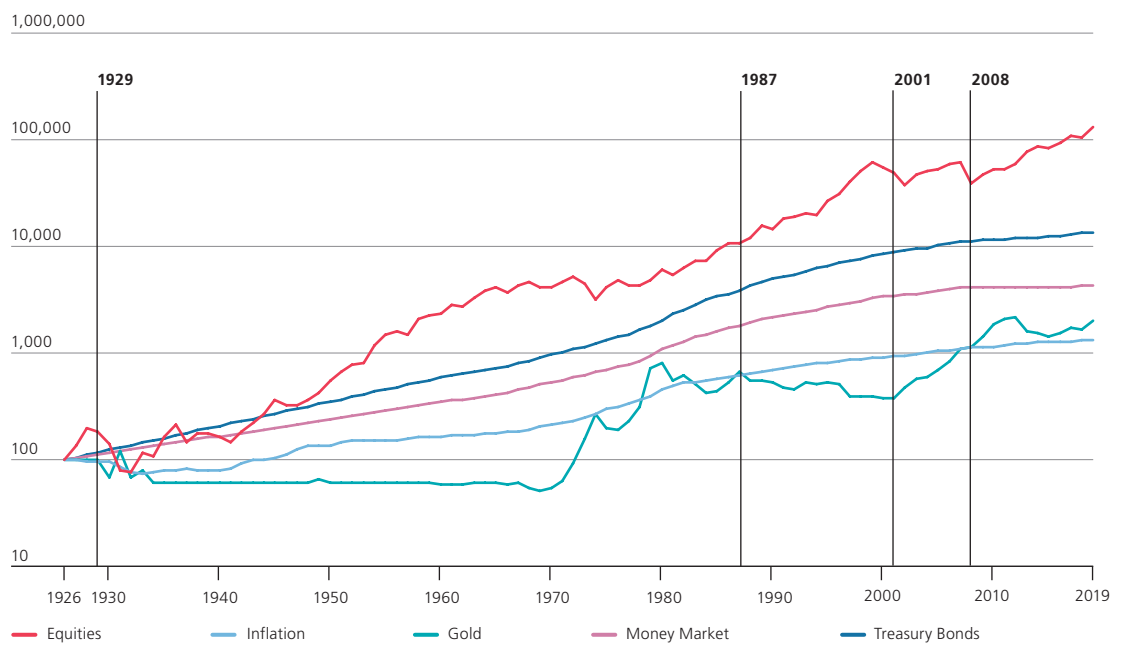
The huge productivity gains generated by new technologies and improved management methods and production processes are reflected in the value (shareholder value creation) of the world's leading companies.¹¹ We, therefore, favour shares in companies throughout the world (world equity through investment funds or through asset managers specialised in each geographical area or in specific industries).

Two arguments support this key approach:

- Productivity allows companies to create value through accumulated or distributed profits. This value is recognised sooner or later by the stock markets. This is the economic argument.
- On a historical basis, equities perform better than other asset classes as shown by the statistics in the graph.

On the other hand, we reject purely speculative financial strategies, such as those pursued by certain hedge funds, or "tactical" approaches to passive assets, such as commodities because the latter do not generate added value on their own. We check that the asset managers of the funds we select adhere to this active and fundamental approach. We ensure that they have an adequate primary research infrastructure to be able to select the best global companies, whatever their size, in their respective fields of expertise. Lastly, we ensure that the positions are constructed and maintained with the patience¹² necessary to harness the increase in intrinsic value of each company.

Comparison of returns for USD 100 invested on the US market, since 1926



Source: Datastream, national data

¹¹ "The stock market, after all, is supposed to mirror the economy, indeed, outperform it", Daniel Fisher, The great stock illusion, in Forbes Global, 2 July 2002, pages 65 to 66.

¹² "Patience is the greatest virtue for long-term success", Philippe Rey, in l'Agefi, 11-13 August 2006

**Unlisted equities (private equity):
a bonus to your portfolio**

For experienced investors, access to the world's best unlisted companies is also recommended through an asset class commonly referred to as private equity. This segment offers attractive returns provided that one turns to professional asset managers. These asset managers should be able to recruit the best companies and to build on their strong growth, whether organic or through acquisitions.

Private equity invests in equity (share capital or similar instruments) in unlisted companies. It is generally divided into 4 segments, each corresponding to a stage of development of the company: "Venture capital" refers to investment in newly created companies with high growth potential; "growth capital" refers to the financing of the development and expansion of growth

companies; "buyout" refers to transactions related to company takeovers in leveraged or unleveraged transactions; "distressed" refers to the acquisition of companies in difficulty, injection of financial resources and turnaround of companies in difficulty.

Depending on the investor's time horizon, the private equity allocation should be significant in an equity portfolio. By way of comparison, large Anglo-Saxon investors allocate between 10 and 30% of their portfolio to private equity. This is far from being the case in Europe, and particularly in Switzerland where pension funds allocate less than 2% to this segment. We prefer the Anglo-Saxon approach on this point, while recommending that each investor carefully examine this question with his banker when deciding on the allocation strategy. A professional portfolio, with this bonus in the form of private equity would then be truly global and almost perfect...

AN INVESTMENT PHILOSOPHY BASED ON EXCLUSION CRITERIA

Selection and prioritisation of the guiding principles

Managing a portfolio is much more complex than is commonly believed, because asset management is not an exact science. And like all human sciences, it is a field in which different schools of thought compete for ideas. In our view, asset management is an art, an applied art based on both proven scientific methods and conceptual choices. The management of a portfolio of financial assets is built using selected¹³ and prioritised guiding principles¹⁴. It is via this order of preference that each financial institution differentiates itself and characterises its management. This is our central philosophy behind the management of all entrusted portfolios, whether they are private or institutional assets. We identify three categories of principles: certain, quasi-mathematical and semi-certain principles (empirical conclusions available), and principles based on intuition (“moods” of the markets).

The “laws” of certainty

When prioritising the guiding principles and then taking them into account to construct the model portfolio, we clearly favour certain or indisputable laws, for example:

- The need to use open architecture rather than exclusively in-house products (page 20).
- The advantage of broad diversification (page 21).
- The need for a balanced strategic allocation
- The imperative of simplicity, which allows synthetic management, while high complication paralyses it¹⁵ (page 24).

Basic architecture of the investment doctrine

Certain principles

Well-balanced strategic allocation	✓ ✓
Very high diversification	✓ ✓
Open architecture	✓ ✓ ✓
Simplicity for greater portfolio resilience	✓
Risk budgeting	✓
Past performance is no guarantee of future performance	✓

Empirical principles

Focus on fundamental factors in financial analysis (analysis of the quality of the companies, in-depth knowledge of the real economy)	✓ ✓ ✓
Higher returns on equities in the long term	✓ ✓
Acknowledging the difficulty of generating a high performance without taking any risks	✓

Intuitive principles with no recognised validity

Short-term bets and favourites ¹⁶	×
Market timing	×
Hedging strategy with leverage and other derivatives	×

Factors of importance and weighting, from the most important (✓ ✓ ✓) to the least important (✓), or those that should be avoided (×)

¹³ “Defining and believing in a set of investing rules lies at the heart of successful investing”, Tim Hale, Smarter Investing, FT Prentice Hall, 2006, page 46.

¹⁴ The basic foundation of our approach is the optimisation of the portfolio in the light of modern concepts such as structural decorrelation. As most specialists agree on the fundamental rules of good asset management, the art lies in prioritising and weighting them so as to structure the portfolio with consistency and cohesion. Structural decorrelation differs from purely statistical decorrelation, whose main shortcoming is instability over time. It views the performance of a financial asset according to its very essence and reflects the fact its performance differs from that of other financial assets for intrinsic reasons: any two assets are structurally decorrelated because of their very nature and not on the basis of simple statistical considerations (pages 20 and 21).

¹⁵ “Conscious thinking can only focus on a limited number of elements.” Study from the University of Amsterdam, quoted by National Geographic, section: Psychology, July 2006.

¹⁶ In the large majority of cases, investing in commodities or metals, including gold, stems from irrational speculation. The chances of success are generally less than 50%.

The empirical principles

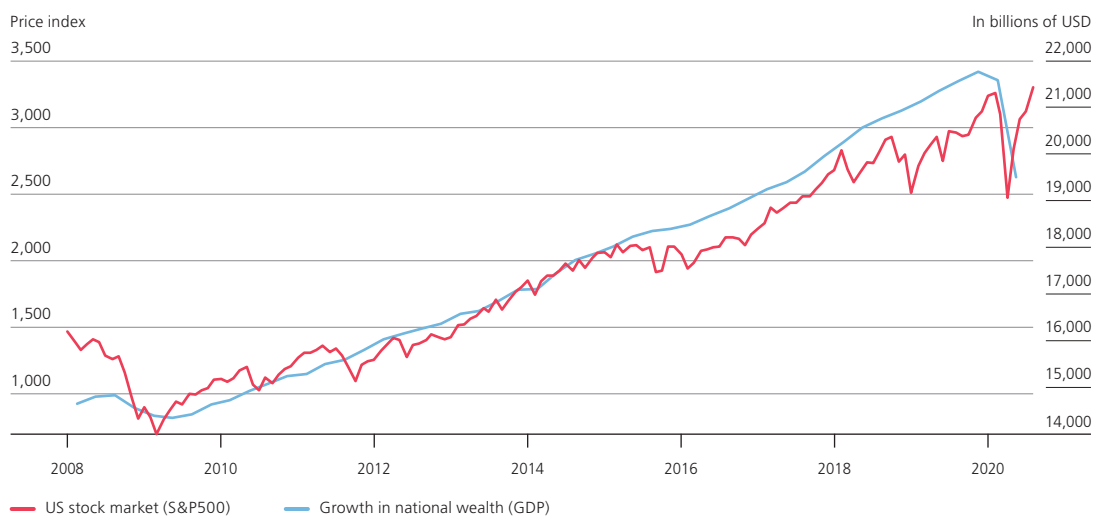
The second stage is to integrate the empirical or semi-certain principles into the model:

- Focus on fundamental factors in financial analysis (this analysis is published quarterly in the document “BCGE Group Investment Strategy” available on the bank’s website).
- Observe that equities perform better over the long term and that the best companies must be actively

selected through primary analysis of all their listed securities.

- Recognise the direct causal link between the quality of companies and institutions and the performance of their securities.
- Take into account the difficulty of outperforming indices without taking any risk. Expectations of return are always associated with risk.

Real economy and stock market: the US example



Source: BCGE Asset Management, Datastream

Even if the correlation is not perfect between the expected evolution of the economy (blue curve) and the actual evolution of stock prices (red curve, in this case the US market), a return to normal over a long cycle can be observed. This graph also highlights the importance of the investment horizon and the risk of stock market trends and unpredictable market timing. This is particularly true if we look at the period before 2000, just before the bursting of the internet bubble.

The realm of intuition

Lastly, we are sceptical when it comes to principles of portfolio organisation that stem from feeling, belief or act of faith.

The prevailing financial thinking arrogantly asserts that it is able to identify favourable entry and exit points for an investment in the stock market. This is a central myth in the universal culture of stock market speculation: market timing.

When an investment is made, it is not the circumstances and market moods of the moment that should dictate the decision. It is, as we have seen above, the investor's investment time horizon, i.e. the date estimated by the investor at which he is likely to want to convert his portfolio into cash (for use, investment or transmission of this wealth) that should serve as a reference point. Depending on whether the horizon is six months, three years or an indefinite period, the investment strategy will be very different. This factor, which is secondary to the investor's objectives, is of course much more decisive than short-term market fluctuations.

Typical investor questions: is it the right time to buy or sell this or that asset class? Will the market go up tomorrow or down this autumn? Science here easily proves that nobody knows anything.¹⁷

The best way to demonstrate the impossibility of seriously predicting the evolution of an asset over the short term is to examine the past, the history of the markets, and to verify whether a forecast has been scientifically proven, and therefore repeatedly reliable. If you look at the graph, you will see that from 1 January 1987 to 31 December 2019, i.e. for 33 years, you would have had to experience the 10 worst days to outperform with timing. It is immediately clear that such a forecast is impossible and therefore that advice claiming to guess the evolution of short-term assets is useless. Worse still, if you do not anticipate the 10 best days, you will massively underperform.

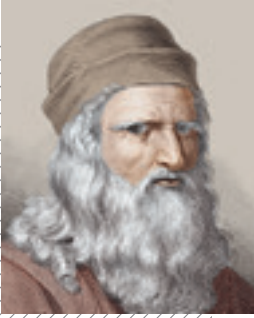
Superimposed on this three-storey architectural choice are quantitative controls and financial engineering, which ensure risk budgeting and quality control.

Impact of market timing on the performance of the Swiss Performance Index (SPI)



Source: BCGE Asset Management, Bloomberg

¹⁷ "In stock market matters, no one is master of the calendar. Even if there is something in the air, even when the fundamental conditions are in place, even when the technical indicators are flashing, it is never possible to set the date of a turnaround." Bruno Bertez, *L'Agéfi*, 11 July 2016.

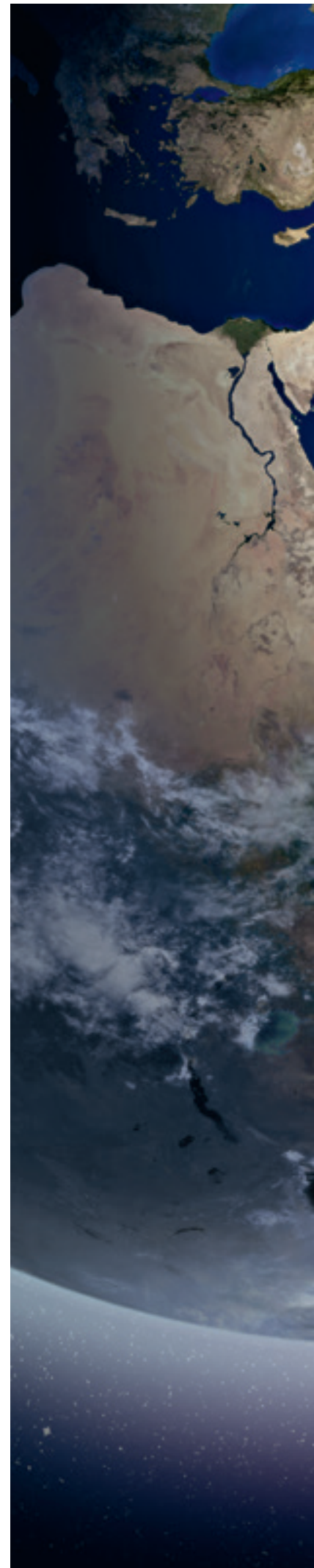


LEONARDO DA VINCI

(1452-1519)

“Simplicity is the ultimate sophistication.”

Painter, inventor, engineer, scientist, humanist, philosopher, a universal mind, who still fascinates five hundred years on. Spanning the period from the 15th to the 16th century, he illustrated and embodied the Renaissance, with its advances in the artistic field, but also in the sciences and, above all, in the scientific approach.





THE BEST SECURITIES ARE IDENTIFIED THROUGH OPEN ARCHITECTURE

Open architecture, its technical role and its ethical component

Once the strategic allocation has been made and the proportion of equities versus risk reducing-assets, such as fixed income assets (bonds) and liquid assets (money market investments) has been determined, the equity basket should be allocated accordingly. This involves a substantial amount of research and filtering work given the wide range of investment opportunities that exist¹⁸.

We have opted for open architecture. In other words, we entrust the selection of assets to the world's top experts using collective investment instruments. Exceptionally, our asset managers may, in a small proportion of cases, use internal instruments if they perform better than the competition over a long period of time¹⁹. The firms we select have the necessary infrastructure to carry out thorough and continuous financial analysis of each company and they are very familiar with the geographical and monetary zones in which they operate.

This approach gives our clients access to high-quality expertise on the various small and mid-cap equity markets in the US or the best large caps in Asia, for example.

Our role as an independent selector allows us to make choices based exclusively on the quality of the asset managers and parameters such as experience, track record, consistency of style, bottom-up analysis, etc.

In addition to the significant advantages of open architecture, we also check the consistency and compatibility of the styles of the various firms that will be brought together in a single fund of funds. The very opposite of an in-house, single-culture product range.

Open architecture substantially increases the expectations of success in security selection. It also constitutes a somewhat rare ethical commitment to independence and objectivity.

“There is no half truth.”

The Diary of a Country Priest, Georges Bernanos

¹⁸ The universe of investment funds to be filtered is considerable: tens of thousands of funds are accessible to European investors, according to the databases used by professionals.

¹⁹ This situation has occurred, for example, with Swiss equity funds.

BROAD DIVERSIFICATION TO INCREASE RETURNS AND REDUCE RISK

Diversification of securities positions

Although scientifically proven, risk reduction and performance enhancement through portfolio diversification are not always obtained to the desired extent in practice.

The attachment that some investors display to their home market (home country bias)²⁰, a lack of discipline in switching when a security is performing particularly well or, as another example, “instinctive” market timing transactions, lead to many portfolios having concentrated exposures to certain categories of risk.

The portfolio’s diversification rate can only be maximised via centralised management and the portfolio’s continual adjustment to the allocation grid. To this must be added the use of investment funds, as these are strong multipliers of diversification at an acceptable cost.

In applying the “certainty” principle of diversification, we are cautious about the categorical assertions made by some experts about the “laws” of correlation²¹. Quantitative finance which, in many situations, attempts to predict and advise on the future, bases its forecasts on the study of historical statistics. It is better than nothing. But it is therefore only statistical models that have made it possible to affirm that certain asset classes were or were not correlated, and this correlation was permanent. Furthermore, a strong correlation does not necessarily imply that there is a direct link.

In the field of space travel or meteorology, these approaches may have proven their worth. However, as an applied art and science with a strong human component, finances are much more difficult to represent in a model. A key problem is that “the relationship between different assets changes over time”²². It is a bit like changing the rules of the game halfway through the game. This weakens the alchemies of probability.

So, before we pay the price of diversification for different asset classes, we must ensure that it is really necessary and that the areas are not too strongly correlated over the long term. When relying on correlation principles, investors are primarily interested in decorrelation, which also suffers from relative asymmetry.

The strong decorrelation observed in bull market scenarios simply vanish when there is a massive downturn, at the very moment they are most needed.

We, therefore, try to optimise diversification at the overall strategic allocation level and to maximise it within each asset class. Rigorous management of this parameter offers opportunities to outperform the indices.

Diversification of investment styles

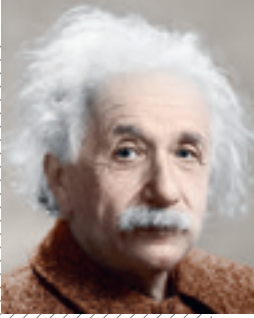
An open architecture asset management company seeks the best fund managers worldwide. Bringing together different visions and approaches solidifies the final mix of a portfolio²³.

²⁰ Some examples of “massive losses of national securities”: Swissair (2001, Suisse), UBS (2008, Suisse), GM (2009, USA), Lehman (2008, USA), BP (2010, Great Britain), etc. On this subject refer to J.K. Galbraith, A short history of financial euphoria, Penguin books, 1990.

²¹ See definition of structural decorrelation, note 14 on page 15.

²² “The problem is that the relationship between assets changes over time” (original version), E. Chancellor, Diversification, the diversification pitfall, in Breaking views, point of view considered on 17 April 2006, 17:03. Edward.Chancellor@breakingviews.com.

²³ On an empirical basis, evidence has shown that diversifying an investment fund portfolio based on the styles management practised by the fund managers provides an effective way of overcoming the problem of the instability of historical correlations. This is because it is easier to understand the risks linked to the sources of a fund manager’s performance once his management style has been identified. This fundamental qualitative work means that an investment fund portfolio can be constructed in the knowledge that the sources are complementary. The “systemic” crisis of 2008 exposed the quantitative optimisation weaknesses that some funds had adopted, refer to Quant Fund Assets Plunge After Strategies Underperform, Nomura Research says, in Bloomberg, 9 November 2010.



ALBERT EINSTEIN

(1879-1955)

“The creative personality must think and judge by himself, because the progress of society depends exclusively on his independence.”

The genius of the twentieth century, or even the millennium. The founder of modern-day physics. At the start of his scientific work, Einstein realised the shortcomings of Newtonian mechanics, and his special theory of relativity stemmed from an attempt to reconcile the laws of mechanics with those of the electromagnetic field. He dealt with the classical problems of statistical mechanics and the problems in which they were merged with the quantum theory which led to an explanation of the Brownian movement of molecules. He studied the thermal properties of light with a low radiation density and his observations laid the foundations for the photon theory of light. In 1905, he proved the famous $E=mc^2$ formula, resulting in the equivalence between mass and energy.

Asia is the most populous continent in the world and the most represented region in the G20; China is the leading regional economic power, while Singapore and Hong Kong dominate the ranking of the most competitive countries. The region is heterogeneous but has undeniable comparative advantages in the industrial and technological sectors. Asia also benefits from an abundant and skilled labour force that strengthens the region's competitiveness. The rapidly growing middle class positions the continent as a new centre of consumption.





FOCUS ON SIMPLICITY AND AVOID FADS

It is better to remain true to one's principles than to succumb to trends

The stock market is influenced by societal trends and number prediction. This is so-called "behavioural" finance. At regular intervals, new beliefs inundate specialised articles and recommendations. The end of inflation, uninterrupted growth, carry trade, guaranteed performance, not to mention the disillusion with hedge funds²⁴, exotic derivatives and certain structured products. So many tempting statements designed to entice private and institutional investors to make unnecessary purchases.

Reputable indices, which are actually intended to track and compare the performance of pension funds, are tolerating an ever-increasing proportion of alternative asset classes that are sometimes little known. Even commodities are banging on the door. It is only natural for the indices to adapt to the custom and practice of the markets they subserviently mirror.

The problem today is that they also serve as models of inspiration and, instead of being measuring instruments, they become management tools. This leads to a collective dynamic and herd instinct towards asset classes for which there is little historical data available and to which we have major reservations.

Hedge funds are giving even more cause for concern, as the concept covers a whole range of highly varied and even contradictory strategies. The action of "hedging", protecting against a risk, or conversely accentuating a performance component, is a perfectly sound and interesting operation, provided that it is carried out within a precise strategic allocation framework, with a targeted objective, within a defined time horizon. If you simply mix a wide variety of investment approaches in a "basket" under the pretext that these are trendy products from different financial boutiques, you are doing exactly the opposite.

Once short-term capital gains have been exhausted due to market inefficiency, quickly arbitrated in today's connected world, the pioneer investors of a hedge fund have already left and put the investor in their place, who will realise after a few years that the sherpas make the greatest effort and are paid the lowest wages by the roped party. Lastly, many products are not transparent. It is therefore difficult for non-specialists to detect the counterparty²⁵ and illiquidity risks attached to these products. This risk has fuelled some memorable bankruptcies.

Simplicity and consistency generate performance

Many financial products quickly become obsolete or unsuitable because they are badly conceived or poorly prescribed. A clear and comprehensible philosophy is thus essential against the avalanche of "packaged" solutions and strategies. This is demanding by definition, because it is ultra-selective, highly diversified and oriented towards a stable and long-term future.

If absolutely necessary, certain structured products can be implemented, but they remain subordinate to a constant and simple strategic approach. They can be useful, be it for neutralising a risk component or for increasing the return expectation on an equal risk basis.

Harnessing capital gains through a perfect balance between the equity component (a choice of some 1,000 companies worldwide), liquid assets and fixed income securities is already an exercise that demands a high degree of sophistication. Too many confusing asset classes without a track record undermine the need for simplicity and long-term performance. "Unnecessary laws weaken necessary laws", wrote Montesquieu: an ingenious portfolio manager...

The issue of protecting the portfolio against risks is also very complex. In practice, our fund managers who sense that a risk is emerging (a substantial fall or rise in a currency for example) retain the option to protect against this risk by taking a 6 to 12 month hedge position. That only involves a moderate cost of hedging.

²⁴ "Hedge funds show increasing signs that they're not invincible", Chris Hughes and A. Gangahar, in *Financial Times*, 13 July 2006, page 20.

²⁵ "Some of these instruments are threatened by a counterparty risk that should not be overlooked", J.-L. Ruiz, *Are ETFs appropriate instruments for portfolio management?*, in *Le Temps*, 17 May 2010, page 15.

If one accepts that the short-term probability is at best 50%, such a strategy is limited because nobody really knows whether the risk will materialise during the period in question or a few days after the protective hedge has been lifted. The risk would therefore have to be protected over the entire period, from day one through to the investment maturity date (if known). However, such an exercise is sterile, as it is far too costly and imperfect, since it is not conceivable to hedge all risks (default, interest rate, currency, equity, etc.). This observation explains why there has been so much disappointment in the field of structured products. It endorses a simpler form of asset management which tries to minimise upstream risks through the quality of its strategic allocation (natural hedge) and the degree of diversification. This streamlined approach constitutes a resilient system which, when all is said and done, can withstand the trials and tribulations that only the market has the secret to.

Good ethical and ecological behaviour of companies and institutions in a portfolio improves performance

Even if there is no scientific evidence that corporate shares and bonds with exemplary conduct in the areas of the environment (E), impact on society (S) and governance (G), perform better on the market, we still favour them. Our observations as a commercial bank have shown that better management of the relationship between the company and its stakeholders in many sectors reduces reputational incidents and sanctions in the long term. It also improves the motivation of employees or clients. The bank therefore strives to make the best possible choices, while remaining ideologically and politically neutral without unnecessarily discriminating against certain sectors or companies.

The dialogue with private and institutional investors is based on the following principles:

- **Investors determine their own selection criteria**

Faced with the multitude of requirements or restrictions that can be applied to a company in order to select or not select its shares in a portfolio, choices have to be made. These choices are primarily the responsibility of the investor client, who defines his priorities and imposes his requirements on the portfolio. It is then the responsibility of the asset manager appointed accordingly to make the appropriate selection.

- **ESG filtering aims for better financial performance**

The fields of application of the ESG approach are very diverse in nature and can range from impact investing to philanthropy, which by definition implies a lack of financial performance. For its part, our “Responsible Performance” approach encompasses the only investment methods that aim to improve financial performance through additional ESG filtering.

- **Promote rather than coerce and vote with your feet**

Shareholder activism has a rather mixed record. In any case companies in the field of ESG should focus their efforts on incentive rather than coercion and confrontation. If you disagree with the way a company is run, you should sell shares in it or simply not buy them: this is what we call “voting with one’s feet”. It is the best way to express your dissatisfaction with a listed company, whether for financial or ethical reasons.

- **Evaluate a company as a whole**

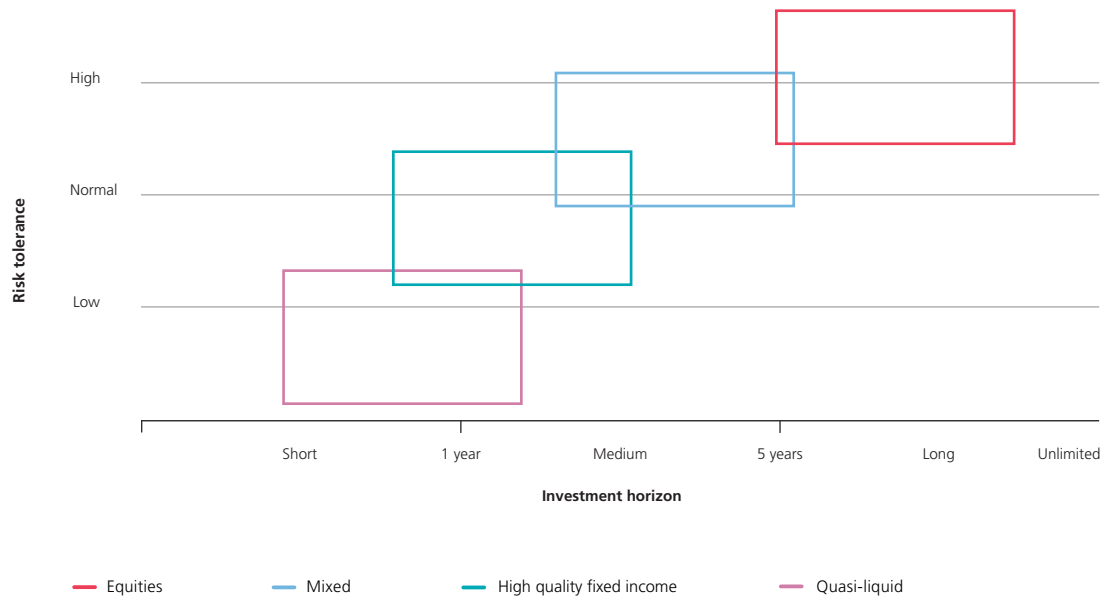
Active management consists of a strict selection of equities in a portfolio. It makes little sense to look at the financial aspect without looking at the corporate governance or strategy aspects. The expert analyst must make a recommendation to buy, hold or sell the security based on a multitude of criteria and in very different contexts depending on the company. Different filters and scoring models are used as a decision-making aid. It is an overall evaluation that is expected from the expert.

A PHILOSOPHY FOR PRIVATE INVESTORS AND INSTITUTIONAL INVESTORS

Phase 1: definition of the client profile

Investment horizon
Short
Medium
Long
Risk tolerance
Low
Normal
High
Personal objectives²⁶
History²⁷

Phase 2: selection of the general asset category



Source: BCGE Asset Management

²⁶ These are personal preferences (geographical choice or restrictions, aversion to certain assets, personal interests in certain assets, currencies, securities such as SRI or other criteria). They are taken into account when choosing the fund.

²⁷ Briefly ask the client/prospect to express their views on their experience as investors. This helps to define risk tolerance. The suitability of the investment horizon will also be checked.

Performance begins with capital preservation

The historical study of returns shows that capital must first be protected from multiple forms of erosion before it is able to generate an income. Capital is highly vulnerable to inflation, theft, spoliation, embargo, counterparty risk and the loss of value of its reference currency. Therefore, before worrying about profitability, it is necessary to ensure a capital conservation strategy.

The objective of an investment: a factor which is often overlooked

The doctrinal basis for asset management has been outlined in the previous pages. The challenge now is to adapt it to the specific needs of investors. Each asset or part of it ultimately serves a specific purpose. This may be to prepare for retirement, to build a reserve for future investment, to build up capital for one's heirs. The goals are innumerable. They determine the investment horizon, the time perspective that will ultimately enable these goals to be achieved. At the end of this period, the securities portfolio is either converted into cash, invested in physical assets or transferred to a new beneficiary. Several decisions regarding the investment strategy depend on this point in time.

Lastly, holders of an asset must also define the level of personal risk that they wish to take or can take in the event of a loss. This risk tolerance differs significantly from one individual or institution to another. It is therefore essential to check whether and to what extent the investor is prepared to take risks.

The investment strategy varies according to the goals that may be:

- to diversify one's assets;
- to invest in personal pension funds to ensure a "second active life";
- to invest in collection pension funds;
- to invest part of one's capital in search of higher returns;
- to plan for a succession.

We will try to be even more precise by taking into account the risk factor and choosing the following options:

- to preserve capital with minimum risk;
- to obtain a better performance with little risk;
- to improve performance by taking moderate risk;
- to obtain the best possible performance with increased risk.

Institutional investors define their investment objectives within a more restrictive framework than private investors, whether it be legal regulatory standards or internal standards. Our investment philosophy is suitable for all types of investors.

Reflection on risk: self-analysis is essential

1. It is necessary to consider one's tolerance (rational and emotional) to financial risk by focusing on two parameters:

- The time horizon for investing capital (how soon should I have this amount of cash available again for using or transferring)?
- The level of subjective risk tolerance (what possible loss can I accept on the invested capital)?

The review is conducted on a functional chart which generates risk profiles that will play a determining role in the choice of a management style.

Degree of tolerance to financial risks

Level of subjective risk tolerance	High	Risk/return balance	Favoured return	Favoured return
	Normal	Limited risk	Risk/return balance	Favoured return
	Low	High caution	Limited risk	Risk/return balance
		Short 1 year	Medium 5 years	Long Unlimited
		Investment horizon		

2. It is also necessary to determine the time horizon of the investment.

This choice will have a strong impact on the strategic allocation of the capital in question. It depends on many parameters:

- Is the capital linked to my person? Will I reinvest it or use it myself or will I pass it on (age, state of health, willingness to pass it on)?
- Will it be passed on in its current state or be transformed (modification of the allocation) or passed on to a foundation with an ideal objective (institutional approach)?

Some possible choices

Type of situations	Recommended horizon option	
<ul style="list-style-type: none"> • Older natural person • Known or fixed horizon: succession, transfer, investment in sight 	Short term	Up to 1 year
<ul style="list-style-type: none"> • Person within a few years of retirement • Willingness to give oneself a few years to invest 	Medium term	1 to 5 years
<ul style="list-style-type: none"> • Younger natural person 	Long term	5 years to 45 years
<ul style="list-style-type: none"> • Institutional (foundation, pension fund, etc.) 	Unlimited	Infinite

3. Lastly, define one's level of risk tolerance.

This is an eminently subjective question. In principle, as an economic player descended from Adam Smith, a person today cannot bear the prospect of a loss. Unless, in return for it, there is a probability of gain or a performance at least equal to or greater than the loss.

Here again, the reasoning is summarised by a function:

Definition of the level of subjective risk tolerance

Expected ROA	High > 500 bp + risk-free rate	Impossible	Very difficult	Very high performance Very unlikely
	Normal 200 to 500 bp + risk-free rate	Impossible	Theoretical balance of risk and return	Aggressive strategy insufficiently remunerated
	Low 0 to 100 bp + risk-free rate	Unproductive caution	Poor performance	Very poor performance
		Low 0% to 10%	Normal 10% to 25%	High > 25%
		Level of subjective risk tolerance		



JEAN DE LA FONTAINE

(1621-1695)

“Diversification is my motto”, wrote Jean de La Fontaine in *“Le Pâté d’Anguille”*.

Jean de La Fontaine is a French poet renowned for his fables and tales. The Fables by de La Fontaine, which include 3 collections and 240 short stories, were written by the author from 1668 to 1694. They are considered a masterpiece of French literature. In an era marked by censorship, the fabulist used animals to represent and criticise, often in a funny way, the great moral traits of human beings. The crow and the fox, the cricket and the ant. The lion and the rat, the wolf and the lamb are among the best known fables of Jean de La Fontaine.





THE INVESTMENT PHILOSOPHY DETERMINES LONG-TERM PERFORMANCE

Practical consequences of our investment philosophy

Annualised performance of benchmark indices in CHF
(31.12.2004 - 30.06.2020 monthly data)

Large asset class	Asset class (example)	Return history (CHF)	Comments
Liquid assets/Cash CHF	CHF/3 months 👍 Major currencies (USD, EUR, etc.) 👍 Cryptomoney (Bitcoin, Ether, etc.) 🚫🚫🚫	0.18%	<ul style="list-style-type: none"> Allocation defined by the portfolio's cash flow budget (disinvestment horizon) Stick to the most important currencies Ensure good diversification Currencies insufficiently regulated and supervised. High risk of collapse due to fraud
Fixed income	CH government bonds/short term 👍👍	0.63%	<ul style="list-style-type: none"> Low return Vulnerable to counterparty risk, especially corporate debt (foreign) Only the best ratings Risk/return ratio is structurally unfavourable The highest volatility in fixed income
	CH government bonds/long term 👍👍	4.22%	
	Foreign government bonds 👍👍	1.65%	
	Corporate/corporate debt/foreign 🚫	2.81%	
	Private debt 🚫		
	Swiss securitised real estate (investment funds) 👍👍	5.43%	<ul style="list-style-type: none"> Inversely correlated to rates (more than 95% in CHF over 15 years)
Equity securities	CH companies / Equity 👍👍👍	7.16%	<ul style="list-style-type: none"> The best universal returns Returns sufficient to absorb the cost of risk Strong short-term fluctuation if event (geopolitical)
	CH equity small & mid	9.10%	
	Europe equity	2.45%	
	US equity	7.14%	
	Emerging market equity	5.22%	
	Global equity	4.04%	
	Private Equity 👍👍	10.60%	<ul style="list-style-type: none"> Not very liquid, but very profitable if well managed Essential to complete an equity portfolio (approx. 10-20% of total allocation)
Hedge funds & Co	🚫	1.36%	<ul style="list-style-type: none"> Only a few investment concepts should be recommended to experienced investors
Others	Gold 🚫🚫	8.11%	<ul style="list-style-type: none"> Too volatile Not very liquid Not very profitable
	Raw materials 🚫🚫🚫	0.17%	
	Wine	NA	
	Art	NA	

Source: BCGE Asset Management 2020

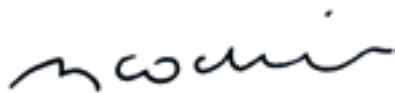
Our investment philosophy is a strategic choice

BCGE has taken a very clear and unique approach to investments. This approach inspires all the management operations conducted on behalf of its clients and for the bank itself. It is this method, which bears the hallmarks of classicism, caution and rigour, which also and, somewhat paradoxically, differentiates it in terms of strategy and innovation in today's world of asset management.

A host of market incidents have served to test this guiding principle in recent years. Its excellent resilience and the support of many of our investing clients have convinced us of the integrity of this choice. It is precisely its transparency and simplicity that attract the most demanding investors, weary of the "complicated-disappointing" duo.

Its components: independence and open architecture strengthen its credibility even further. It is firmly rooted in the real economy and not in virtual finance, making it a clear-cut, natural choice for a universally recognised bank which lives in harmony with business entrepreneurs. Its performance has lived up to its reputation for years now. It has even been awarded prestigious prizes, as in 2019.

Indeed, it is a bank's investment philosophy, and not its size, which determines the quality of the portfolio's performance. Our investment philosophy is a strategic choice that distinguishes and personalises our bank, making it a lasting benchmark in the sometimes arrogant and often confusing financial sector.



Blaise Goetschin
CEO

Contact

Communication department
communication@bcge.ch

All rights reserved: any translation, reproduction, representation or adaptation, in whole or in part, of this publication, by any process whatsoever, and all forms of recording are strictly prohibited without the express written permission of Banque Cantonale de Genève, except in the cases provided for by law.

Concept and realisation: alternative.ch

Printing: ATAR Roto Presse SA Geneva

Illustration credits: pages 2 and 18 © Biblioteca Comunale di Trento, page 10: by Bengt Nyman, the Creative Commons Attribution 2.0 Generic licence

 **myclimate**
neutral
Imprimé

myclimate.org/01-20-420342



