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Dear Clients,

At the beginning of the year, markets assumed that the U.S. Federal Reserve (Fed) would announce a total of six interest rate cuts in 2024. Things turned out differently. Persistent inflation thwarted the monetary authorities' plans, leading to the first rate cut not being made until September. Following the already promising previous year, many experts also assumed that there would be a significant correction on the stock market in 2024. This did not occur either. As of 10 December – the editorial deadline for this letter – we look back on an exceptionally gratifying stock market year.

Forecasts from analysts, stock market experts and gurus are notoriously not worth much. Although the Fed did not announce its long-awaited first interest rate cut until its meeting on 18 September, much later than originally planned, this did not faze stock markets. Dividend stocks embarked on a robust rally last year despite high interest rates, and we are pleased to report a very solid performance thanks to our investment philosophy, which is heavily focused on equities. In absolute terms, they are clearly above the long-term average. In comparison to the market capitalisation-weighted global market index MSCI World, which is greatly influenced by the American market, we lagged somewhat in 2024. This was partly because we gave a significantly lower weight to the American market, which accounts for over 70 percent of the MSCI World. In part, we are also more defensively exposed relative to the highly valued technology stocks, which themselves make up a third of the American market. Among our predominantly value-conservative stocks, ABB, Apple, Danone, Disney, DormaKaba, Holcim, IBM, Microsoft, Munich Re, 3M, Novartis, Procter & Gamble, SAP, Schneider Electric, Siemens and Swiss Re performed well. However, our international blue chips Bayer, Nestlé and Swatch were a major disappointment.

> "The discipline of not buying everything at any price, regardless of others' enthusiasm, is one of the most important qualities an investor can have."
>
> Howard Marks, American investor and co-founder of Oaktree

The breathtaking rally of the American stock market was characterised by a few technology stocks, particularly the so-called Magnificent Seven – Alphabet (Google), Apple, Amazon, Meta (Facebook), Microsoft, Nvidia and Tesla. Besides these rocket stocks, a large portion of the equities gained little or even fell. The situation was similar on the German stock market. The software giant SAP was largely responsible for the pleasing performance of the DAX. When the heavyweights of the stock markets excel and become even heavier, this means a tailwind for passive or index-oriented investors and a headwind for conservative and value-oriented asset managers such as "Hotz", who, for reasons of balanced risk diversification, tend to favour an equal weighting of equities. We know this from past experience: in boom times, we are more defensively

positioned with our value-conservative investment policy compared to risk-loving competitors. However, we feel comfortable with this because, firstly, we are clearly above the respective benchmarks over the long term and, secondly, our investments should also be robust for the next crisis, whose timing is not predictable.

> "There are people who don't know what they are saying – if they are lucky, they are called prophets."

Alexander Roda Roda, Austrian writer, satirist and publicist (1872 – 1945)

There was a stock market correction in August. The triggers were economic fears and temporarily disappointing employment figures in the United States, as well as a waning enthusiasm for the topic of artificial intelligence. For numerous Swiss clients whom we have been pleased to welcome over the past two years, this correction was a blessing. The temporary slump in global markets finally gave us the opportunity to make a countercyclical move and build up newly opened securities portfolios with Swiss Francs as the reference currency, in order to benefit from the subsequent market recovery. In the preceding long-lasting rally, this was denied to us, resulting in portfolios that we were able to open in 2023 being "underinvested" for a rather long time. In the euro-denominated portfolios, the summer correction was too weak to trigger countercyclical purchases. In hindsight, it would have been better, for once, to invest all the funds immediately upon opening the portfolios. But firstly, in hindsight, everything is always clear and simple, and secondly, we reject such a risky portfolio build-up purely for risk reasons. The "normal case" looks like this: as a rule, in the 6 to 18 months of the portfolio build-up phase, there are one or more corrections of at least 5 percent to make countercyclical purchases. These should be taken advantage of. We are therefore firmly convinced that our concept of a temporally staggered portfolio build-up will be the optimal approach in the future as well.

Forecasts from the pros: for the shredder!

After the storming of the Capitol in January 2021, it seemed more likely that ousted President Donald Trump would end up in prison rather than that he would be moving back into the White House as a convicted fraudster four years later. The controversial showman is celebrating a grand comeback on the political stage. It is difficult to assess what the election of the unpredictable egomaniac will mean for the global economy and financial markets. However, we can assume that there will be a revival of spectacle and uncertainty. Ahead of the elections, there was speculation about which sectors and stocks would benefit from a win by Kamala Harris or Donald Trump. Out of conviction, we steer clear of such speculation.

> "You should not forget: Donald Trump will be in office for four years. Most investors have a much longer investment horizon. It's not worth changing your investment strategy based on politics. Presidents come and go."

Kristina Hooper, Chief Strategist at the American investment manager Invesco, interview in the "NZZ am Sonntag", 17 November 2024

Let's not forget that after Donald Trump became president for the first time in 2016, a majority assumed that his policies would be good for oil, finance and pharmaceuticals, but bad for the technology sector. It turned out differently: during the following four years of his presidency, energy and finance significantly underperformed the overall market, while the technology sector performed well above average. After Joe Biden was elected president in 2020, most investors expected his administration would put an end to "dirty" energy. The opposite happened: during his term, energy was the outstanding sector. When Bill Clinton was inaugurated as president in 1992, he declared war on the pharma-

ceutical industry and threatened to drastically lower drug prices. Few would have thought back then that the healthcare sector would vastly outperform the overall market during the eight years of his presidency. Mark Dittli, editor of the online newspaper "The Market", refers to a study by Marko Papic, Global Chief Strategist at BCA Research, in his Big Picture article on 1 November 2024. It shows that there is no consistent pattern between the party of the election winner and future sector performance in stocks. According to a majority opinion, Donald Trump represents higher growth, higher deficits and higher debts, as well as higher tariffs and thus generally higher inflation. How much of this will become reality is completely open. What is likely certain is this: only Wall Street and the financial markets will be able to curb the megalomania of the would-be dictator. American elections are a spectacle; predictions based on them belong in the shredder.

> "I could stand in the middle of Fifth Avenue and shoot someone, and I wouldn't lose voters. That's kind of incredible."

Donald Trump, 47th President of the United States of America

To stick with the predictions: do you remember 19 July of last year? On that day there was a worldwide IT systems outage, which affected Microsoft's Windows version and, as a result, airlines, banks, hospitals and TV stations. Countless flights were cancelled or suffered huge delays. The "Falcon" software from the IT security company Crowdstrike, which serves to ward off cyberattacks, caused worldwide chaos after an update. "It is unprecedented," said Alan Woodward, Professor of Cybersecurity at the University of Surrey, in the south of London, to the news company Bloomberg. The share price of the Texan company Crowdstrike subsequently plummeted. In "Zuger Zeitung – Schweiz am Wochenende" on 20 July, Marc Ruef, Head of Research at the Swiss IT security company SCIP, responded to the question "What is in store for the security company Crowdstrike now?" by saying: "If many of the companies affected by the IT failure claim damages, it could become very expensive; the IT company could even go bankrupt." The day before, IT security expert Sven Fassbender, CEO of the information security company Zentrust, said on the "10 vor 10" program on the TV channel SRF, however, that the stock price would quickly recover and that growth in this sector was very high. Two experts, two completely divergent forecasts regarding the future stock price of a company that made headlines. Today we know that the stock price of Crowdstrike has recovered significantly since 19 July – the correct forecast was naturally pure luck, as it could just as easily have gone the other way.

Concentration risks – indexing harbours dangers

Passive investing is gaining increasing popularity among institutional investors – it is, so to speak, "herd mentality on a high level". Last year, they were proven right once again, as it was difficult for active investors to surpass the high returns of passive indices. However, we like to remind everyone of the year 2022, when our countercyclical and conservative policy massively outperformed the corresponding benchmark returns in both equities and bonds. Therefore, the year 2024 should not be overvalued or interpreted as "proof" of passive investing. Pitfalls loom. In the past, we have repeatedly pointed out the dangers, concentration risks, and pro-cyclicalities of indexed investing. In 1900, the United States had a rather modest weight of 14.5 percent in the world stock index, while Great Britain held a significantly higher share of 24.2 percent. At the end of November, the weight of the USA was 73 percent, while that of the UK was only 3.6 percent. If you consistently index, you bear enormous concentration risks in the land of endless opportunities. In the throes of the Japan euphoria, the Land of the Rising Sun had a weight close to 50 percent in the world market index at the end of the 1980s. Shortly thereafter, the bubble burst and the Japanese stock market lost up to 80 percent of its value. Those invested in indexed portfolios were blindly caught up in this madness.

> “Not many indulge in the greatest luxury of all: a mind of their own.”

Alec Guinness, British actor (1914 – 2000)

Concentration risks have also emerged within the American stock market. The share of the Magnificent Seven in the capitalisation of the S&P 500 has risen from 5 percent to well over 30 percent in the past 15 years. Apple alone holds about the same weight in the world market index as all German and Swiss companies combined. Tesla, meanwhile, is valued at 100 times its earnings and is as “valuable” as the car manufacturers BMW, BYD, Ferrari, Mercedes, Porsche, Toyota and VW combined.

In the Swiss Market Index (SMI), the heavyweights Nestlé, Novartis and Roche alone account for nearly half of the market capitalisation of all listed Swiss companies. Accordingly, we welcome the fact that in our internationally diversified portfolios, we practise a tendency towards equal weighting, because especially the food giant Nestlé, which was traded as a “widows and orphans investment” during the Corona crisis, was a major disappointment last year. In the long run, it makes no sense to get blindly caught up in these pro-cyclical developments and bear such concentration risks. We are therefore deeply convinced that replicating stock markets through indexing makes no sense from a risk consideration perspective. In doing so, we consciously accept the possibility of trailing behind some indices, especially in boom years. Despite all the criticism, we do not wish to demonise passive investing. It shares with us the long-term thinking that stocks of good companies are held for eternity.

> “It is bad for the mind to be always part of unanimity.”

Christopher Morley, American journalist and author (1890 – 1957)

Even when buying fixed-interest bonds, the passive approach is to be rejected. Notably, those who pursue indexed investing prefer precisely the countries with the highest debt levels. In 1900, the USA had a rather modest weight of 5 percent in the world bond index. Due to rampant American debt practices, this weight increased to well over 40 percent by the end of last year. Absurdly, precisely those debtors with the highest debt levels account for the largest shares in a bond index. Investors who consistently invest passively automatically follow this pro-cyclical shift to the kings of debt – which is crazy. For us, this type of investing is out of the question.

Asset management is not only about returns but also about risk management. Benjamin Graham, author of the legendary 1949 book “The Intelligent Investor” and mentor of Warren Buffett, was never a proponent of passive investing. He ensured that the stocks he held in his portfolio were fairly valued and he always saw himself as an investor, never as a speculator. He advised a sensible, but not excessive, diversification in the portfolio. Benjamin Graham’s wise philosophy has not lost any relevance to this day.

There is little Switzerland in Switzerland

As you know, we primarily manage the equity portion of our portfolios according to sectors and only secondarily by countries. When we look at the revenue mix of the largest Swiss companies we hold in our portfolios, it becomes clear that this approach makes sense. The food giant Nestlé generates just 1.2 percent of its revenue in Switzerland, while around 32 percent comes from the United States and 6 percent from China. The pharmaceutical company Novartis achieves approximately 3 percent of its revenue in Switzerland, 40 percent in the USA, and 7 percent each in China and Germany. For Roche, the share of its revenue in Switzerland is 1.9 percent, while 47 percent is in the USA. Similarly, the Swiss share of revenue generated by the technology company ABB is a modest 1.2 percent, while it is 26 percent in the USA, 14 percent in China, and 6 percent in Germany. The company with the highest share of revenue in Switzerland is the in-

surance group Zurich with 7.4 percent. Nonetheless, the share of revenue generated in the USA is five times higher at 36 percent.

Anyone who believes that buying a Swiss corporation would conservatively place a lot of Switzerland in their portfolio is mistaken. The headquarters may be in Switzerland – filled with many foreign executives, by the way – but the dependence of these companies on the world market, and especially on the global superpower, the USA, is enormous. Anyone who thinks they can largely escape dependence on global events by solely focusing on Switzerland as an investment destination is making a mistake. Furthermore, there are many companies outside Switzerland that are among the global leaders in their field. Despite our appreciation for Switzerland as an investment destination, we advocate an approach of international sector and stock diversification in dealing with equities. We do consider it important for companies to be headquartered in a democratic country.

Real estate – rock-solid or "high risk"?

As you can see from our accompanying article "How the Wealthiest Invest Their Money", which was published on 28 August in "Finanz und Wirtschaft", Swiss and German investors are very fond of real estate ownership. On average, the share of their "concrete gold" is almost ten times their stock holdings. There are certainly good reasons for this, such as the desire to own a home and the fact that real estate is the second most lucrative asset class after stocks. Furthermore, many investors who invest their money for the long term acquire real estate funds with the aim of achieving a solid return with modest risks. However, there are frequently unpleasant surprises.

In mid-August, UBS announced its intention to liquidate the "Credit Suisse Real Estate Fund International". The price had fallen 50% within three years. This led to panic among investors. The real estate fund simply could not accommodate the withdrawals triggered by a wave of sales, which is why it was closed and will be wound up over the coming years. How was this possible? The fund, set up in 2005, diversifies its international real estate holdings according to the fund prospectus in "quality properties", especially in commercially used properties and residential buildings in economic centres characterised by creditworthy tenants as well as long-term leases. The selected centres include the cities of Austin, Brisbane, Boston, Frankfurt am Main, London, Toronto, Vancouver, Warsaw, Washington and Wellington. The promise to invest in quality properties and diversify globally gave investors a warm feeling of security. Ultimately, the fund management had to admit that a massive correction of market values had to be made due to a revaluation – a fiasco for the fund unit holders who had actually wanted to make a conservative investment. That this happened in an environment where the sun has been shining for years in many real estate regions around the world is astonishing.

> "Real estate funds have the potential for a bank run problem, unlike real estate companies. In the current situation, this could spell trouble for some funds."

Andreas Loepfe, real estate economist and member of the investment committee of the federal pension fund Publica, "Handelszeitung" online, 10 August 2023

The treacherous nature of the real estate industry is also evident in a Credit Suisse fund for pension funds, "CS 1a Immo PK". At the beginning of 2024, it became public that this allegedly secure billion-dollar vehicle for investors to tap in the future, whose largest position is an investment in Zurich's Sihlcity shopping, office and residential centre, was facing considerable cash outflows. The fund's price was under pressure, and the fund management was unable to sell Swiss real estate worth several hundred million francs within a year to redeem the pension funds that wanted to cash out. What did the management do? In the spring of 2024, Credit Suisse abruptly decided that the fund would no longer be traded daily at market rates. Instead, it

switched to a purely accounting-based Net Asset Value (NAV) with extremely restrictive selling conditions, effectively making it impossible for investors to sell their shares. The announcement had the bizarre effect on the day it was made that the (accounting) price, which had nothing to do with a market price, skyrocketed by almost 20 percent. In the investors' portfolio statements, "CS 1a Immo PK" is therefore looking great again. Wonderful for those pension funds or investors who can naively deceive themselves into thinking their investment is now back on solid ground. Also wonderful for the fund management, which can charge hefty management fees at an inflated level. But those who are not naive know that the price explosion on the day of the switch to the accounting NAV is a mirage. If the fund wanted or needed to sell its real estate, it would be settled at the market price and not at a fantasy accounting price. We are very familiar with this "phenomenon" of accounting-enhanced values from the private equity industry and similarly in dealing with illiquid infrastructure assets.

> "The bells toll a different tune. There is no return to the cherished normality of upward."

Donato Scognamiglio, CEO and co-owner of the Zurich Information and Training Centre for Real Estate (IAZI) and Professor of Real Estate & Finance at the University of Bern.

There is also unrest in the German real estate market. Virtually overnight at the end of June last year, the open-ended real estate fund "UniImmo Wohnen ZBI" of Union Investment, a fund subsidiary of the cooperative DZ Bank, was devalued by 17%. Investors were shocked. The reasons cited for the price drop were the interest rate increase, exploding construction costs, and increasing regulatory requirements, which led to a "considerable decline in investor demand" for residential properties. According to "Handelsblatt", this was the biggest single-day loss that investors in real estate funds had endured since the financial crisis in 2008. The fund, with a volume that peaked at over EUR 5 billion, is one of the largest of its kind. It was launched in 2017. Particularly bitter for investors was the fact that the fund was marketed as a low-risk product. Now investors can hardly get out, as it can be terminated at the earliest 24 months after purchase, and then there is still a 12-month notice period to observe. The above examples of funds vividly demonstrate that the returns on real estate investments are often grossly overestimated and the risks underestimated.

The former head of Raiffeisen Bank, Pierin Vincenz, was also caught up in the risk of his real estate investing. His villa in Morcote (Ticino), which he bought in 2015 for CHF 6.5 million, went up for auction in the spring of 2024. After the property almost found a buyer for CHF 2.55 million, Dölf Früh, a former friend of Vincenz, stepped in. According to press reports, since Früh had granted his friend a property loan of CHF 4.3 million at the beginning of 2019, he made an offer of CHF 4 million and remained without competition. The market value of the Vincenz property is therefore likely to be somewhere between CHF 2.5 and 4 million – in any case well below the original price Vincenz paid in 2015. The lesson from this: the true value of a property only becomes evident during a sale.

Gold serves only as a crisis hedge

Gold enjoyed a spectacular rise in price last year – by the end of November, the return in the reference currency of Swiss Francs was around 35 percent. The reasons for this are manifold. Firstly, geopolitical conflicts play a role because they mean uncertainty for the markets. Secondly, the yellow metal is likely boosted by the globally exorbitant and still rising sovereign debt. The gold price has finally gained a tailwind from many investors' fear of an economic downturn. The associated hope for falling interest rates is known to foster demand for gold. According to the industry organisation World Gold Council, central banks from China and India, in particular, are acting as buyers. The buying spree of the two BRICS countries is likely linked to their desire to become more independent from the superpower, the USA, and the American dollar. In response to the inva-

sion of Ukraine, the West has notably frozen Russian foreign exchange reserves. China and India are trying to prevent a similar situation from happening to them through their gold purchases.

> "Gold is an investment in monetary chaos."

Jim Grant, American editor of "Grant's Interest Rate Observer".

From a longer-term perspective, the current gold rush must be sharply relativised. The annual return on gold calculated in Swiss francs from 1974 to 2024 – over a 50-year horizon – was just 3.2 percent. After deducting inflation, which averaged 1.6 percent during this period, investors are left with an annual real return of 1.6 percent.

Compared to gold, stocks performed significantly better over the same period. The annual return on Swiss stocks was 8.0 percent – after deducting inflation, an outstanding real return of 6.4 percent per annum remains. Anyone who understands the mechanism of compound interest knows that such return differences have monumental long-term effects. Anyone who invested CHF 100,000 in Swiss stocks in 1974 now has a fortune of CHF 4.69 million; those who invested the same amount in gold must settle for a fortune of CHF 0.48 million. The final value of stocks is therefore almost 10 times higher than that of gold after 50 years. Additionally, the fluctuation risks, measured by annual volatility, are even higher for gold (17.7 percent) than for stocks (15.1 percent). All that glitters is definitely not gold. As the author outlines in his book "Über die Gier, die Angst und den Herdentrieb der Anleger" ("About Greed, Fear and the Herd Instinct of Investors"), gold is not a core investment of an overall portfolio but can definitely have a supplementary character with a share of, for example, 2 percent.

With the Trump euphoria, Bitcoin is going through the roof

Since the election of Donald Trump as the 47th President of the United States of America, there has been no stopping the price of Bitcoin – the sound barrier of USD 100,000 was broken at the beginning of December. Let's not forget that just three years ago, he labelled cryptocurrencies as fraud. After his campaign was significantly funded by crypto enthusiasts, Trump announced his intention to make the USA the "Bitcoin superpower" of the world during his second presidency. Donald Trump's enthusiasm for Bitcoin & co. has also spilled over to conservative Swiss financial institutions such as PostFinance and the cantonal banks of Lucerne, Zug and Zurich. In Zug, public transport buses bear the state institute's advertising message in large letters: "Krypto? Aber sicher." ("Crypto? Certainly.") As an occasional bus passenger, one rubs one's eyes in disbelief – especially at the word "certainly". Can that end well?

> "The true strength of the blockchain lies not in speculative bubbles or currency losses, but in its potential."

Serge Kaulitz, Head of DLT/Blockchain & Digital Assets at Lucerne Cantonal Bank, "Crypto" supplement of "Finanz und Wirtschaft", 16 October 2024

What are the reasons why more and more people are investing their money in cryptocurrencies? An illuminating study, "Crypto-assets in Switzerland: Awareness, Relevance and Investment Reasons" by researchers Andreas Dietrich, Reto Rey and Simon Amrein at the Lucerne University of Applied Sciences and Arts (HSLU), was commissioned by the crypto-provider PostFinance last year. 71 percent of respondents buy Bitcoin or other cryptocurrencies out of curiosity, interest or just to try it out; 50 percent believe in their potential for gains, 30 percent see them as a diversification opportunity, 17 percent don't want to miss out, and 14 percent buy because others have also invested (mul-

tiple responses were possible). The above purchase reasons describe typical herd behaviour characteristics. People buy because prices are rising and because others have made money off them. No one buys Bitcoin with the conviction of acquiring a long-term, productively value-enhancing real asset – because it isn't one. It is merely the hope that a crazier buyer will pay more than you paid – the famous "greater fool" phenomenon.

> "Towards the end of the cycle, which is characterised by irrational euphoria, one should sell all these tokens without exception. Their value will fall by 90 percent."

Markus Städeli, economics editor of the "NZZ am Sonntag", 24 November 2024

We do not rule out the possibility that the price of a Bitcoin will soon reach a million dollars. Irrational prices know no rational bounds – there are no valuation benchmarks for Bitcoin, which has no intrinsic value and yields neither interest nor dividends. Equally, the price could be zero in a few years – which is probably where it belongs from a rational perspective. Thorsten Hens, finance professor at the University of Zurich, commented on the Bitcoin euphoria in the "NZZ am Sonntag" on 8 December as follows: "This market reaction is a kind of self-fulfilling prophecy." Even if half the world will soon be euphoric about this digital dream world, we are not getting involved in this enchanting hocus-pocus.

Private equity and infrastructure investments: a likely story!

Private equity is theoretically an interesting asset class as it represents real capital, like stocks. Investing in companies not listed on a public stock exchange promises high returns. In the industry, annual average returns of 15, 20, 25 or even 30 percent are regularly heard of. However, the private equity industry is, to a large extent, purely a marketing event. Instead of clear-cut facts about the true returns and risks of this asset class, success stories are boasted about companies successfully sold or brought to the stock exchange after intensive support by private equity providers. This "storytelling" includes companies like Breitling, Dell, Facebook, Hilton, and VAT. It is reported that the early investors increased their investment tenfold, thirtyfold or even fiftyfold. That might be true, but firstly, those are absolute exceptions – perhaps one in 100 startup or buyout companies achieves such success in the end. A much larger proportion goes bankrupt. Secondly, an average investor will never have the chance to participate early in the most promising gems.

> "Performance measurement is not that easy for various reasons. But this is irrelevant anyway because private equity performs worse by all conceivable standards than, for example, the S&P 500 (the US stock index)."

Markus Städeli, economics editor of "NZZ am Sonntag", 22 September 2024.

In the opaque segment of private equity, a major bluff by the financial industry is taking place. Ludovic Phalippou, a renowned finance professor at the University of Oxford, has been researching the field of unlisted companies for many years and is considered one of the world's biggest critics. In his LinkedIn post on 9 March 2024, he writes that the IRR (Internal Rate of Return) declared by the industry "has absolutely nothing to do with real returns and is an absolutely useless piece of information". In his statement, Phalippou presents an interesting calculation referring to the American industry leader KKR, which has claimed annual returns of over 25 percent for its investors since its inception in 1976: "To see what annual returns of 25.5% over a period of 47 years would mean, take just USD 100 million invested once in 1976 with KKR. This

would have become USD 4.2 trillion today, which is no less than Japan's GDP... Why are the SEC, FCA, and other regulatory authorities sleeping at the wheel?" Phalippou reaches the devastating conclusion that there is bluffing and trickery in dealing with private equity returns and that investors are being deceived. The fact is that investments in publicly listed stocks can achieve better long-term returns with a fraction of the fees and enjoy much greater transparency than private equity investments.

"By international comparison, we are clearly too conservative with our equity ratio, which is also due to the framework conditions. What bothers me is that pension funds are looking for improvements in the wrong places. People believe they can miraculously realise additional returns with alternative investments. The empirical evidence for this is weak; private equity is not an asset class. Nevertheless, everyone wants these expensive, illiquid products. The products are advertised as less volatile and more loosely correlated. This is solely due to the valuation method, which has nothing to do with (traded) market prices."

Dr Roman von Ah, board member of the Swiss Financial Analysts Association (Schweizer Finanzanalystenvereinigung, SFAA) and chairman of the board of the Training Centre for Investment Professionals (Ausbildungszentrum für Kapitalanlagen, AZEK), interview in "Schweizer Personalvorsorge", 04/24

It is repeatedly heard in the industry that investing in alternative investments, particularly in private equity, is rewarded with a so-called illiquidity premium. Dr Roman von Ah is one of the leading experts in the Swiss capital market scene. He has extensive practical and academic experience. In an interview with the pension fund magazine "Schweizer Personalvorsorge", he speaks plainly. He says that he would never invest in private equity. The propagated illiquidity premium will not actually land with the clients but in the pockets of the product providers. If anything, one should invest in these providers: "The best evidence for this is the private equity firm Partners Group, whose listed stock has been a sensational investment".

At present, special caution is advised when investing in private equity. According to the rating agency Moody's, many corporate holdings of private equity giants such as Apollo, Clearlake Capital, Platinum Equity or Ares suffer from excessive debt burdens and are therefore exposed to an increased risk of default. Some private equity firms have grown significantly in recent years and are having great difficulty offloading their investments at advantageous prices. As a result, so-called "continuation deals" are being forged, questionable transactions within a firm's own group – companies are being sold to each other. Certain market observers therefore fear that an economic downturn or rising interest rates could unleash a storm on the private equity market.

"The illiquidity premium is being skimmed off by the finance industry. If you want to finance pensions, this is dreadful. And the fairy tale of low volatility and correlation is simply outrageous nonsense. We actually learned this in 2008, when Yale and Harvard ran into disaster with their illiquid investments. Calpers, the largest American pension fund, has still not recovered from the fire sales they had to make in 2008."

Dr Roman von Ah, board member of the Swiss Financial Analysts Association (Schweizer Finanzanalystenvereinigung, SFAA) and chairman of the board of the Training Centre for Investment Professionals (Ausbildungszentrum für Kapitalanlagen, AZEK), interview in "Schweizer Personalvorsorge", 04/24

Since the year 2020, pension funds have been allowed to invest up to 10 percent of their funds in infrastructure projects. Consequently, more and more such products are coming to market. The life insurer Swiss Life, which also promotes its services as a wealth expert to private investors, issued a new product last year that is

positioned in this trendy segment. The "Privado Infrastructure" fund, which offers private investors access starting at an amount of CHF 1,000, invests in, among other things, unlisted private hospitals, fibre optic operators, highways, battery storage facilities, airports, waste incineration plants, small hydropower plants, and telecom towers in Europe and North America. The vehicle is also involved in the construction of the new Terminal 1 at New York's JFK airport. Swiss Life's goal is to create a "high dividend product" with the infrastructure fund for investors thinking long term. The euro-denominated product aims to generate attractive net returns of 6 to 9 percent annually. The question is: how realistic is that?

> "I am always amazed by the sheer force with which trends like infrastructure emerge. The empirical facts and the costs hardly matter any more... If it's stated in the law, if there's a quota and also political pressure, then no one dares to say we won't do it. I have experienced this pressure myself on investment committees. For me, it's clear with infrastructure: there is little robust return evidence for these investments; the costs are too high; and an exit is not possible or prohibitively expensive... The clients (note: pension funds) read the consultant's recommendation and go along with it. That's it."

Dr Roman von Ah, board member of the Swiss Financial Analysts Association (Schweizer Finanzanalystenvereinigung, SFAA) and chairman of the board of the Training Centre for Investment Professionals (Ausbildungszentrum für Kapitalanlagen, AZEK), interview in "Schweizer Personalvorsorge", 04/24

We have serious doubts that even half of Swiss Life's promised returns can be delivered. However, the famous "bottom line" can only be calculated in half a century – the vehicle has a lifespan of 50 years. 50 years! Who would want to invest their money in a completely illiquid and opaque construct for 50 years? Furthermore, the fund is exposed to a significant currency risk and can take out loans. From experience, we know that the use of leverage, especially with illiquid investments, can be extremely dangerous. In times of crisis – which are almost guaranteed within 50 years – it acts as an accelerant. Moreover, it has been shown in the past that state actors involved in the relevant infrastructure projects often do not adhere to the contracts with private investors or have changed the conditions afterwards. The issuer of "Privado Infrastructure" is undoubtedly a reputable life insurer. Nonetheless, we advise: keep your hands off this and similar products, which primarily enrich the providers, not the investors. Even the openly disclosed annual fee is a horrendous 1.9 percent – and we don't even want to talk about the hidden fees.

According to Roman von Ah, it is appalling how much in returns is lost with private market investments, namely private equity and infrastructure. Nevertheless, the trend towards these high-margin and opaque products is not only a reality in the context of pension funds. UBS, for instance, recommends a 20 to 40 percent share in private market investments to its clients in their "House View Investor's Guide" – this boosts the bank's earnings significantly. Furthermore, the only remaining major Swiss bank also recommends a 7 to 11 percent share in hedge funds. This is the cumulative madness of illiquidity and opacity. This trend is associated with enormous cost implications for pension funds, as a study by Swisscanto, a subsidiary of Zürcher Kantonalbank, reveals with brutal honesty. Within a decade, the average asset management costs of pension funds have increased by over 40 percent. The negative impact on returns is obvious. Legendary investor Warren Buffett consistently avoids all conceivable and inconceivable product innovations that the industry relentlessly hawks to investors each year. We are firmly convinced that his mentor Benjamin Graham would view it the same way.

> "Pension funds should make as many equity investments as they can bear, well-diversified and at reasonable

costs. Everything else we discuss is clearly of secondary importance, including potential returns."

This concluding quote from Roman von Ah perfectly encapsulates the conviction we have lived by for decades.

Quality media court the product artists

As is well known, quality media such as the "Neue Zürcher Zeitung" are under significant cost and revenue pressure. Advertising revenue in print editions has been steadily declining for years. Desperately, publishers are seeking ways to compensate for the dwindling revenue. In doing so, they risk selling their soul and relinquishing their independent reporting. In the "NZZ" on 21 June, for example, the special supplement "Alternative Investments" featured editorials by industry representatives such as LGT Capital, iCapital, Pictet and Nuveen, all of whom euphorically and uncritically praise private equity, private debt and infrastructure investments to the skies. Long-time readers of the paper missed the balanced reporting that would give both proponents and critics of alternative investments a voice.

"Having good taste means knowing, above all, what we must reject."

Nicolas Gomez Davila, Colombian philosopher (1913 – 1994)

An enlightening glance – with the help of a magnifying glass – at the fine print of the special supplement reveals: "Supplements are not produced by the editorial team but at NZZone by our service provider for journalistic storytelling: NZZ Content Creation… guest contributions are commercially acquired content." Aha, so this is not about conveying well-founded knowledge from independent and critical journalists, but about nebulous storytelling by marketing-driven product artists who pay significant sums for their advertising message in the "NZZ". This renders the content of the articles effectively worthless. By contrast, the author of this year-end letter regularly publishes editorials in "Finanz und Wirtschaft". He neither receives payment for his contributions nor pays for them.

UBS is the best bank in the world – really?

In their media release on 14 August, in which UBS published their quarterly results, Switzerland's largest bank proudly points out that it has been awarded the title of "World's Best Bank" in the "Euromoney Awards for Excellence 2024". We wholeheartedly congratulate UBS, which serves as custodian bank to a large portion of our clients, on winning this award. After all, it has faced numerous challenges in the past: near-collapse and government rescue during the financial crisis, massive losses with hedge fund vehicles such as LTCM and Archegos, and numerous lawsuits, legal proceedings, convictions and money-laundering scandals, which it has had to contend with. Now UBS seems to be back on a successful path. The award is proof "of the effectiveness of our global strategy, reach and ability to serve our clients," writes UBS. The honourable award, granted by the British financial magazine "Euromoney", is in part a recognition of UBS for the rescue or takeover of CS to prevent a potential systemic crisis.

"Beauty contests are always relative: you can win them if you make fewer mistakes than the others."

Markus Städeli, economics journalist for the "NZZ am Sonntag", 7 April 2024

As reported by the "NZZ am Sonntag" in its 18 August issue, "Euromoney" awards are controversial. The financial magazine awards hundreds of prizes annually in various categories. The criteria for the award decisions are apparently very vague and almost every bank receives an award. In 2018, "Euromoney" named the then CS head Tidjane Thiam Banker of the Year. Today, many regard him as the bank's gravedigger. Particularly bizarrely, as recently as the end of March 2023, "Euromoney" recognised CS as the "best bank for

succession planning and wealth transfer" – although two weeks earlier it had collapsed. What is galling about the lavishly celebrated awards ceremonies in London is also that the winners have to pay for them: according to insiders, a place at the gala dinner costs several thousand pounds. In addition, there are usage fees to market the awarded title. It is also expected that expensive advertisements will be placed in the financial magazine. In total, an award is said to cost between £20,000 and £100,000, as reported by the "NZZ am Sonntag". This raises the question: what are awards worth that are given out in abundance and essentially have to be bought?

> "The UBS managers will continue to play in the big casino of the global financial world."

Sergio Rossi, banking expert and professor of macroeconomics at the University of Fribourg, "Finanz und Wirtschaft", 2 September 2023

In the summer, the "UBS House View Investor's Guide – July 2024" landed on our desk. In it, the best bank in the world promotes its fund "UBS US Income Sustainable Equity Fund". It is an "actively managed, defensive equity fund that invests in US companies likely to provide high returns thanks to share buybacks and dividends". The fund relies on the sale of covered call options, which further strengthens its defensive orientation. Additionally, sustainability is a key focus. That may sound all well and good at first glance. However, those who look at the graph next to the text will be rubbing their eyes. From it, the fund's return assumptions can be gleaned. While an annual 11.27 percent (in USD) is expected for the fund, UBS specialists only anticipate an annual return of 2.5 percent for "normal" US equity funds (also in USD). What a monumental difference! The supposedly conservative UBS fund is projected to generate returns for investors that are four to five times that of a riskier US equity fund. With a touch of irony, we note that such ultimate returns magic is definitely reserved only for the best bank in the world. But seriously: we consider such product praise and expectations for returns, calculated with deceptive accuracy to the second decimal point (!), to be, to put it politely, a misleading of investors. Such fairy-tale promises definitely belong to the land of dreams.

> "There is often a culture of arrogance in banks."

Björn Johansson, owner of Dr. Björn Johansson Associates, specialising in the search for top executives

It is enlightening to glance at the small print, which for the writer of this text is decipherable only with reading glasses: "All content labelled as 'investment ideas' or 'investment proposals' is intended by UBS only for information and marketing purposes. All investment ideas are fully sourced from business areas outside the UBS GWM Chief Investment Office. These business areas are not subject to statutory requirements regarding the independence of financial analysis. Therefore, it is possible that the described investment proposals do not fully reflect the views of the UBS GWM Chief Investment Office." Unbelievable: imagine if we were to give you investment recommendations, only to write in the small print that they are predominantly marketing in nature and we might not even believe in them ourselves, or indeed pursue a completely different investment strategy personally. UBS, the best bank in the world? Yes, at least in marketing.

> "Every yoghurt is labelled better than some banking products."

Hugo Rey, former long-distance runner and Swiss cross-country champion

Last summer, a report by the "Neue Zürcher Zeitung" revealed that UBS wants to prevent scrutiny of its dealings with a despot at all costs. According to the

report, USD 76 million of former Yemeni President Ali Abdullah Saleh's assets might be of criminal origin. In May 2017, the Financial Market Supervisory Authority (FINMA) filed a criminal complaint against UBS with the Federal Department of Finance (FDF). There is a suspicion of a breach of the reporting obligation in accordance with the Anti-Money Laundering Act. Subsequently, the Office of the Attorney General of Switzerland (OAG) initiated criminal proceedings on suspicion of aggravated money laundering. The Federal Prosecutor demanded comprehensive documents and information from UBS, including internal reports to FINMA and email communications of the two employees responsible for the client relationships with the Saleh family – considering the serious allegations, one might think this a matter of course. The managers at UBS see it differently. They are resisting the request with all their might. The client advisor and his superior take the stance that "the transactions were an ordinary gift in the Arab world, which is why the usual checks were not carried out". In April of this year, the FDF fined UBS for breaching anti-money laundering reporting obligations. UBS, the best bank in the world? An independent asset manager would probably have to close its doors immediately and permanently in the face of similar allegations and after the publication of such a reputation-damaging report in the "NZZ".

> "Patience is a good quality. But not when it comes to eliminating grievances."

Margaret Thatcher, former Prime Minister of the United Kingdom (1925 – 2013)

We would like to emphasise at this point that we have enjoyed a long-standing and very trusting collaboration with the custodian bank UBS. Many respectable, conscientious and qualified employees work at the bank. We are convinced that they do not deserve having their employer constantly pilloried in the media. Nevertheless, the managers of the "best bank in the world" would be well advised to act a little more modestly. Otherwise, they risk, as so often in the past, losing their grounding.

It seems that Axel Lehmann, the last Chairman of the Board of Directors of Credit Suisse, which spectacularly collapsed in March 2023, has definitively lost his grounding. In an article written for the Lausanne-based IMD Business School for Management and Leadership, Lehmann offers tips to other board directors on crisis management. The "four effective ways for a board of directors to manage a crisis" reads like a list of findings from a management textbook, as reported by CH Media in mid-November. However, Lehmann does not reference "his" collapsed Credit Suisse as an instructive example but rather the Uber scandals that engulfed the ride-sharing service in 2017 – an approach that borders on self-irony and denial of the truth. The fourth and final piece of advice in Axel Lehmann's advisory column is that board directors should lead by example. Lehmann definitely cannot refer to the Credit Suisse example in this regard. For the benefit of students, Lehmann would be well advised to refrain from publishing further instructive management articles – as such articles from the "instructor" could turn into instruction for him.

Independence in academic research also under scrutiny

During the financial crisis, supposedly "independent" rating agencies awarded large bundles of junk bonds with the highest rating, shortly before many of them monumentally imploded and became virtually worthless. It should be noted that rating agencies are paid by the very companies whose bonds they rate Note that the very companies that issue the bonds pay the rating agencies to rate them – that didn't work then and can't work in the future. Who would want to antagonize their clients, on whom they are economically dependent, with a poor rating? Conflicts of interest are pre-programmed. In asset management, the independence of an asset manager is the cornerstone for ensuring that there are no conflicts of interest and that they are in the same boat as their clients. Even "pseudo-in-

dependence" is not sufficient to uncompromisingly pursue the interests of clientele. As we explained in our editorial "Maldives Instead of Kickbacks" in "Finanz und Wirtschaft" on June 15, there are still numerous conflicts of interest in the investment business. Anyone offering high-margin alternative investments such as hedge funds, private equity, private debt, infrastructure or crypto assets, and thus collecting hidden fees or even kickbacks, is not independent.

> "It quickly becomes clear why the clients of the stock market casino own so few yachts. The most beautiful ships in the harbour belong to those who run the casino."

John Bogle, American pioneer in the area of index funds and founder of Vanguard (1929 – 2019)

We increasingly have doubts as to whether our universities and colleges, which receive immense sponsorship funds from banks, are able to conduct and publish uncompromisingly independent research. According to a survey by "CH Media", there were 162 professorships in Switzerland supported or funded by private entities as of the end of July last year. For example, UBS, as the successor to founding partner CS, sponsors the HSG Center for Financial Services Innovation with substantial amounts in the millions. UBS is the official campus bank of the University of St. Gallen (HSG). Urs Wietlisbach, founding partner of the private equity firm Partners Group, is also a significant sponsor of HSG. The universities of Zurich and Basel, as well as ETH Zurich, benefit from donations in the tens to hundreds of millions from UBS. We cannot assess to what extent this sponsorship influences the research activities of academics. The mutual expectations and obligations are governed by contract. While both university administrations and bank managers emphasise the unrestricted freedom of research and teaching, the question still arises: is that realistic, given such financial entanglement and possibly an implicit dependency? We have our doubts. In our view, it is hardly a coincidence that there are very few critical studies on the investment policies of financial institutions or on questionable alternative investments, opaque and overpriced products and cryptocurrencies coming from the research departments of the respective universities. In the scholars' chambers, everything goes through the "softener" or a complex topic is academically dissected without any claim to practical relevance. Unfortunately, this brings the students little or no benefit for their future lives in dealing with money. After completing their bachelor's or master's degree, they often have little idea about the practicalities of investing.

> "Whenever money flows, either direct dependency arises or the appearance of such. Both should absolutely be avoided."

Andreas Brenner, Professor of Philosophy at the University of Basel and the University of Applied Sciences and Arts Northwestern Switzerland

The University of Oxford is also richly endowed with sponsorship money. In 2019, it became known that the founder and CEO of the world-leading private equity firm Blackstone, Stephan Schwarzman, had donated GBP 150 million to the English elite university. Schwarzman increased this sum by a further GBP 25 million in 2022. It is well known that Ludovic Phalippou, one of the world's most renowned critics of private equity, has been teaching at the University of Oxford for many years. Will he be able to continue conducting uncompromisingly independent research and publishing in the future? We can only wish it for him and ourselves. However, the headwind that blows directly or indirectly in his face is likely to become substantially stronger with near certainty.

When quality media outlets sell parts of their independent journalistic potential to well-heeled financial institutions, and, furthermore, numerous university

chairs are sponsored by banks, one should not be surprised if many investors repeatedly fall for the crude tricks of the finance industry. The pinnacle of irony is finally reached when the state takes this as impetus to create a monstrous regulatory authority to protect investors.

Roger Federer: a pointer for money managers

On 9 June 2024, Roger Federer gave a speech to students at Dartmouth College in New Hampshire. The tennis star's statement that he won almost 80 percent of his 1,526 matches in his career but only 54 percent of his points was intriguing. That is astonishing. Intuitively, one would probably have assumed that he was able to decide at least 70 percent of all points in his favour.

> "You learn a line from a win and a book from a defeat."

Paul Brown, American coach in American football (1908 – 1991)

Roger Federer's statement reveals an analogy to asset management. In investing, too, it is a completely utopian goal to win or beat the market every single year or in 85 percent of years. The champions are those asset managers who, on average, are somewhat better and, above all, more consistent than the competition over the years. On the tennis court, Roger Federer achieved this by often winning the decisive points and avoiding silly mistakes. The latter is crucial in investing to be at the top in terms of performance over the long term.

How will things go in 2025?

As you know, we do not make forecasts – at least not for a short horizon of one year. Following the interest rate cuts by the Fed, ECB and SNB last year and because inflation in the major industrial nations is largely under control, moving towards 2 percent or below, there is reason for optimism. In addition, there are good chances for further interest rate cuts in the United States of America, in Europe and in Switzerland. However, at the same time, we caution against complacency. Contrary to popular belief, falling interest rates are not a guarantee of a bullish stock market. There is no consistent interpretation, based on the experience of major crises (Dotcom/9-11, financial, and coronavirus crises), of how rate cuts impact stock markets. Often, their effects are significantly delayed.

> "The average is quite useless as a basis for forecasting; many people have drowned in rivers that are on average only half a metre deep."

Mark Dittli, economics editor of the online newspaper "The Market", 29 November 2024

When, in the wake of the Dotcom/9-11 crisis, interest rates were repeatedly and significantly cut after the turn of the millennium, stock prices tumbled for a full two years before recovering in spring 2003. Recession fears triggered the drop. A similar pattern emerged during the financial crisis. After the Fed significantly lowered interest rates from autumn 2007 onwards, stock prices plummeted until spring 2009, before the recovery began. There is no reliable correlation, only a weak one, between interest rate changes and stock market performance. What is particularly new compared to the coronavirus period is this: bad news – for example, regarding economic performance or job growth – is genuinely bad news for the stock market again. During the coronavirus period, it was paradoxical: bad news about economic prospects and the threat of a looming recession put the stock markets in a celebratory mood because central bank interest rate cuts were expected as a consequence.

Economically, China, once the showcase nation of emerging markets, is severely strained. At the end of September, the leadership of the Communist Party announced comprehensive stimulus measures for the Middle Kingdom, and the Chinese central bank cut interest rates to support the struggling real estate market. This sparked short-term euphoria

on the Chinese stock market, which has been disappointing for years. Nonetheless, we remain sceptical and continue to steer clear of this market. Politically, China is an unpredictable dictatorship. With our multinational companies, which are based in democratic countries, we are sufficiently present in this "emerging" country with all its opportunities and risks.

Rarely before was the performance gap between the American S&P 500 and the European and Swiss indices as wide as in the past year. With all due respect for the economic power of the USA, we do not expect this trend to continue at a similar pace. This is supported in part by the valuation difference: while the average price paid for the S&P 500 is 23 times corporate earnings, the price/earnings ratio for European companies is just 14. European stocks can therefore be classified as relatively cheap, whereas American dividend stocks are now considered rather expensive. What worries us in the global context is exploding sovereign debt, especially American debt. It already amounts to 120 percent of GDP. In 2023, despite a well-oiled economic situation, the US budget deficit was a hefty 6.3 percent. This cannot go well in the long run.

> "One can always rely on the Americans to do the right thing after they have tried everything else."

Winston Churchill, British Prime Minister and Nobel laureate (1874 – 1965)

Even if we are not capable of making reliable forecasts, we can certainly promise you that we will not fall prey to fashionable trends and the procyclical behaviour of the product industry in the future either. It is important to resist the ever more adventurous "innovations" and the lucrative temptations of the finance industry. The strategy consulting firm Boston Consulting Group concluded in its study "Global Asset Management 2024: AI and the Next Wave of Transformation" that only 37 percent of newly launched funds are still on the market after 10 years. The majority, 63 percent, are scrapped due to lack of success. In 2010, the percentage of funds that still existed after 10 years was at least 60 percent.

Innovations are reserved for the companies whose stocks are in our clients' portfolios. Client-oriented asset managers, by contrast, are characterised by stability, discipline and adherence to principles. Crucial for long-term success in investing is the consistent implementation of a low-cost, countercyclical and transparent strategy with high-quality direct investments limited to the most promising asset classes. If one follows these virtues, one can look forward to the investment year 2025 with confidence – whatever may come.

Charitable foundation

An increasing number of our valued clients are considering contributing part or all of their assets to a charitable foundation during their lifetime or after their death. In recent years, we have been asked by interested parties to explore various options on this subject. We have discarded the idea of establishing an umbrella foundation ourselves, which we could offer as a platform to our clients, because running a charitable foundation requires the technical knowledge of specialists, and the personnel and administrative costs are enormous. This might also have raised critical questions regarding our independence. After evaluating various options, we have concluded that a collaboration with renowned external experts, who have a lot of experience in this area, is the best solution for our clients.

> "When a man says money can do anything, you can be sure he has never had any."

Aristotle Onassis, Greek-Argentinian shipping magnate (1906 – 1975)

In the past year, we have held constructive discussions with high-ranking representatives of the Swiss foundation sector. Today we are convinced that we can provide interested parties with professional advice and

offer solutions that are more cost-effective compared to the offerings of banks. Should you be interested in learning more on this topic, please feel free to contact us at any time.

Finally, we would like to once again point out that, if you have not done it already, you are invited to introduce your children or potential heirs to us or to establish a separate client relationship for them. In the hope that the "worse case scenario" will not occur for as long as possible, it is advisable to plan early and set the course across generations.

> "Always fly first class – otherwise your heirs will."

"Dr Doom" Marc Faber, stock market guru and author

For the New Year 2025, we wish you and your loved ones all the best, and above all, good health. We would like to thank you for the trust you have placed in us and look forward to working with you in the future.

With kind regards, on behalf of the entire "Hotz Team".
Your

Dr Pirmin Hotz

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Opinion

AI as a miracle investment tool

Pirmin Hotz

Artificial intelligence is used increasingly in asset management. However, investor expectations and the risk of disappointment are high.

Artificial intelligence (AI) has been booming for some time. It will increasingly become integral to our lives, for example in medical diagnosis, automated driving, fraud prevention and the use of search engines, voice assistants and navigation systems. Which raises the question: Will AI revolutionise the world of asset management and what can it deliver as a predictive tool for stock, bond and currency markets?

Many investors dream of a chatbot that can predict stock prices, interest rates or the value of the dollar. Anyone concerned with the predictability of exchange prices must ask how efficient liquid capital markets are, i.e., how quickly new information is incorporated into prices. After all, forecasts can only be systematically successful – and not purely by chance – if the “prophet” possesses knowledge and information that is not yet reflected in exchange prices.

Since the Nobel Prize was awarded to Harry Markowitz and Eugene Fama, there has been no doubt in serious financial research that at least liquid stock and bond markets are highly efficient. In a highly technologised and connected world, new information about changes in corporations, interest rates and currencies travels around the globe in a matter of seconds, quickly affecting prices.

It is therefore no coincidence that even the world’s leading financial institutions, with their legions of highly qualified analysts, fail to achieve systematic outperformance with their active funds. Past experience has shown that this sobering reality applies to even the most powerful chatbots. By the time the chatbot receives a query about the impact of the Fed’s interest rate decision on the dollar exchange rate, or the impact of Novartis’ latest earnings on its share price, the information has already been priced into the market.

High-frequency traders already use AI

It may be that markets are not fully efficient in the extremely short time frames of milliseconds or seconds in which new information speeds around the globe and is incorporated into exchange prices. In this time frame – barely perceptible to humans – extremely skilled computer scientists, mathematicians and physicists in High Frequency Trading (HFT) use sophisticated and very complex programs or strategies to exploit information advantages. This essentially removes the remaining inefficiencies from capital markets. This can only be achieved with massive amounts of data (big data) and self-learning, high-performance computers (machine learning). Algorithms analyse patterns and correlations on exchanges that have a high probability of predicting a short-term trend.

For example, if the computer knows from past data that there is a high probability of a short-term rise in the price of gold when the US S&P 500 falls due to an economic warning and the dollar tends to weaken simultaneously, it will try to take advantage of this.

> “AI will never give better advice than the people who feed it.”

There’s a 60% or 65% chance that the price of gold will actually rise in response in the next second, while there’s a 35% or 40% chance that it will fall. It takes thousands of such or similar trades for a leading global high-frequency trader to make money by the end of the day. Strictly speaking, AI for predicting exchange prices has been around for a long time.

However, no chatbot in the world will be able to predict exchange prices over a time horizon of weeks, months and certainly not a year. All the information has long reflected in the exchange prices by the time the user submits their query to the robot. As a result, neither private nor institutional investors will be able to predict exchange prices in the future, no matter how sophisticated AI becomes.

The value of AI in asset management is therefore not in predicting exchange prices, but in gathering information, structuring portfolios and selecting stocks or

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bonds. Similar to robo-advice concepts, investors can specify individual preferences, the preferred quality and risk of their investments, and define restrictions or exclusions.

In order for AI to provide the investor with an optimal recommendation, the investor needs to ask the chatbot the right questions. If the user asks imprecise or misleading questions, they risk receiving recommendations that are against their interests. AI will never make better recommendations than the people who feed it. Experience with robo-advisors shows that success has its limits. To date, both the volume and growth of funds managed by robots remain modest.

A poor psychologist

AI gathers extensive information from newspaper articles, academic papers and books. But it is precisely here that the dangers lurk. These are often written by authors who put their own interests before those of potential users. AI will find it difficult to tell in certain texts whether it is reading a justified opinion, a courtesy report from a 'bought' scientist, or a marketing specialist from a bank who has to meet his manager's product sales targets.

The usefulness of AI becomes even more questionable when chatbot providers are funded by advertising. In this case, there is a risk that the chatbot will prioritise recommending high-margin, complex, opaque and client-unfriendly products. The recommendation would then be artificial at best, but certainly not intelligent. In addition, when it comes to AI, the user cannot attribute bad advice to a human or complain to someone. A chatbot acknowledges its 'client's' dissatisfaction without emotion.

Trust remains the key currency

The most important currency in the investment business is trust. This is built through face-to-face meetings, giving investors the opportunity to look their human advisor in the eye, assess their seriousness and honesty, and discuss their preferences, fears and concerns. Depending on whether the stock, bond or currency markets are sunny, stormy or going through a divorce, the mood of investors can change quickly. Responding with empathy and understanding remains beyond even the most sophisticated chatbot. AI is a terrible psychologist.

AI's knowledge is superhuman, but unlike humans, it lacks morality. Only people with heart, soul and passion can offer honesty, personalised competence, personal empathy and trustworthiness. AI can be useful as a tool, but it will never replace the human advisor.

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Opinion

Investing money like the wealthiest

Pirmin Hotz

A study conducted by UBS sheds interesting light on the investment policies of the wealthiest people in the world. What the average investor can learn from them.

Many investors grapple with the question of when is the right time to buy and sell equities or which stocks might be the most promising. Such questions may seem exciting, but they are fundamentally irrelevant or at least of secondary importance. Achieving long-term success on the stock market is ultimately not the result of oracle-like predictions, but rather the consequence of an optimised investment strategy and the selection of the most promising asset classes. A look at the allocation of family offices responsible for managing the assets of wealthy families reveals some interesting insights.

A total of 320 single family offices all over the world were analysed in the “UBS Global Family Office Report 2024”. The total assets held by the included families totalled over $600 billion, which, according to the authors, makes the study “the most comprehensive and revealing of its kind”.

The ultra-rich, those that have assets worth several hundred million or even several billion available for investment, do not amass their wealth with savings accounts. Large wealth is built through entrepreneurship. So it’s hardly surprising that 50% of the assets analysed are invested in equities, undoubtedly the most attractive form of investment over the long term. Of this figure, 28% is invested in listed securities and 22% in private equity (PE).

Plenty of equities and little real estate

Listed equities make up 31% and private equity18% of the holdings at family offices domiciled in Switzerland. The high proportion of unlisted equities may come as a surprise at first glance, but not on closer inspection: This is particularly high not least because it also includes extensive direct investments in companies where family shareholders often exert active control.

In comparison to the wealthiest, who have half of their assets invested in equities, only about 7% of the average Swiss person’s savings were invested in equities in 2023, according to SNB data. In contrast, Mr and Mrs Swiss have allocated 47% of their assets to real estate. Their largest chunk of wealth by far is driven by the desire to own a home, something that requires a high level of mortgage loans. This preference for concrete gold represents a monumental difference to the investment policy of family offices. The wealthiest invest just 10% of their assets in real estate, predominantly in direct investments. Equities are therefore the undisputed number one in the real value ratio, a figure that exceeds 60% for the world’s wealthiest people – far ahead of houses, condominiums and commercial buildings. While average investors tend to systematically overestimate the (net) return on real estate investments and underestimate the risks, the wealthiest adopt a significantly more defensive stance in this respect.

> “Gold is not a lucrative investment in the long term.”

In what other investments have the wealthy put their money? The share of bonds and liquidity in bank accounts remains surprisingly high. For instance, 19% of assets are invested in listed fixed-interest securities and 2% in private debt, while 10% are held in bank accounts. It seems that even the super-rich, who essentially have a very high risk capacity, crave a certain degree of security. They want to be able to react flexibly to all possible developments with almost a third of their assets. But those who now assume that the wealthy would hold a high share of gold because of their need for security are mistaken. Only 1% is bunkered in the yellow precious metal.

With good reason: The fluctuation risks are arguably at least as high as those of equities, whereas the long-term return just compensates for the level of inflation. Gold looks unlikely to be a lucrative investment in the long term. Investments made in infrastructure, art and commodities can also be considered fairly negligible. Each of these categories represents less than 1%

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of the total wealth of the affluent. Art is more of a hobby for them than an investment.

The 5% share allocated to hedge funds is surprising. These complex products, which involve a lot of leverage, incur very high fees, usually making their returns sobering over the long term. Why do family offices continue to invest in hedge funds and PE fund-of-funds structures in spite of the fact that investors are concerned about liquidity and the associated exit opportunities, according to the UBS report?

Making yourself irreplaceable

It may sound cynical: As is the case with some pension fund consultants, family office managers also harbour a certain interest in complexity as a way of consolidating their own role as 'supervisor' in relation to their wealthy clients and making themselves irreplaceable. This is achievable through a certain amount of complex products that require intensive monitoring and often lack transparency. It can also be assumed that family office managers receive nice compensation from the well-oiled marketing machinery of the financial sector.

There are also interesting findings when we consider the regions in which the wealthy invest their money. It transpires that family offices from all over the world are subject to a significant home bias. American family offices invest 82% in the United States, whereas the European representatives invest only 38% in this region. In turn, the super-rich from America invest a mere 10% in Europe, while investors on the old continent invest a staggering 54% in their region.

Strong home

The distinctive home bias suggests that the wealthiest are active investors. This is because if they were to invest passively on a consistent basis, then their country of origin should not have a significant impact on the geographical distribution of their assets. When it comes to listed equities, passive investing would mean, for example, that the MSCI World equity index, over 60% of which is composed of American companies, ought to be the benchmark for all family offices – irrespective of their geographical location. This is not the case, leading to the interpretation that passive investing is being rejected.

What can average investors learn from the investment behaviour of the super-rich? Firstly: The vast majority of our long-term disposable assets ought to be invested in equities – whether they are in listed or privately held companies. Since private and presumably also most institutional investors do not have privileged access to excellent target companies in the private equity sector, in contrast to the wealthiest, they are advised to limit themselves to equities traded on a stock exchange.

Secondly: Both Swiss and German investors place far too much emphasis on real estate, the returns on which tend to be overestimated and the risk underestimated. Thirdly: Gold and cryptocurrencies play no relevant role in the wealth of the wealthiest. Fourthly: Family offices make active investments and focus on only a few, albeit the most promising, asset classes.

The Oracle of Omaha, Warren Buffett, once summarised it as follows: "The difference between successful people and very successful people is that very successful people say 'no' to almost everything."

PIRMIN HOTZ is the founder and owner of Dr. Pirmin Hotz Vermögensverwaltungen, based in Baar, Switzerland.

HZ

Pension funds

Population ageing impacts on interest rates

Thomas Hauser

Interest rates have been low in recent years. One reason for this is demographics. Pension funds should draw their own conclusions.

Long-term interest rates in Switzerland have fallen dramatically since the early 1990s. At the time, the interest rate for ten-year government bonds was around 7 per cent; by 2020, it had fallen to below minus 1 per cent and has only recently risen slightly into positive territory. Interest rates on low-risk bonds are influenced by a number of factors, the most obvious of which is inflation: While inflation was above 5 per cent in the early 1990s, it was minus 0.8 per cent in 2020. High inflation leads to high interest rates and vice versa. If you subtract inflation from the nominal interest rate, you get the real interest rate. It measures how much purchasing power you effectively gain when you invest money in bonds. This real interest rate has varied considerably over time; since the 1930s, it has fluctuated between zero and 2.5 per cent, but before that it was significantly higher, hovering around 5 per cent. There are international studies that suggest a link between demographics and interest rates.

Capital affects interest rates

Generally speaking, if a country saves and accumulates more and more capital, there will be enough to go around and the 'price' of this capital will dop – i.e. the interest rate will fall. Capital is accumulated, for example, when a country's population moves away from subsistence farming towards employment in industry or the service sector and its average age increases. One of the consequences of this is that more capital is saved for retirement during working life. When you retire, you are essentially sitting on a pile of savings. If a significant portion of this capital is held in bonds out of prudence or for regulatory reasons (e.g. BVV-2 provisions for Swiss pensions), this may have an impact on the overall level of interest rates.

> "Ageing poses many challenges – and also contributes to keep long-term interest rates low".

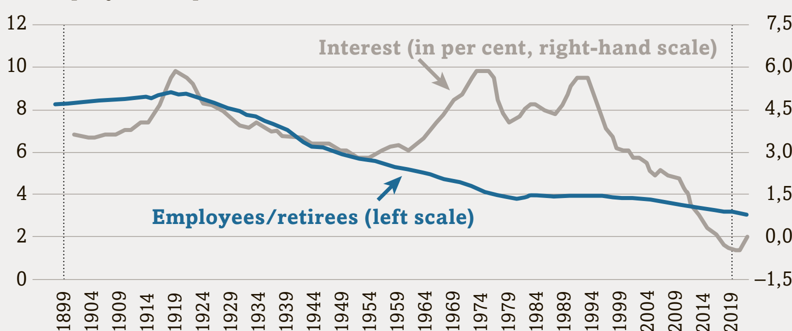
Bonds may play a less important role in the strategy than they used to.

An example: We assume that the portion of the Swiss population in the age bracket 26 to 65 ("working population") is actively saving. The population over the age of 65 ("pensioners") has accumulated capital to draw on or lives on income from capital. The more retired people there are relative to the working population, the higher the capital stock tends to be and the lower the interest rate can be. This ratio is shown in the graph. Also shown is the interest rate on long-term government bonds – presented as a five-year rolling average to smooth outliers.

One should not over-interpret such a graph, as interest rates deviated massively to the upside during the inflationary phase of the 1970s and 1980s, for instance. However, both the demographic ratio and the

Negative trend

Swiss interest rate from 1899 to 2022 and the ratio of employees to pensioners



Sources: Federal Statistical Office, SNB, own calculations

interest rates have shown a negative trend over this long period of more than 120 years. Increased capital accumulation could therefore have a downward effect on interest rates.

Pressure remains

This insight – even if correct – is of only limited use for investing. That is because the potential demographic impact, which is very slow to materialise, is overridden in the short term by other effects such as monetary policy or inflation. Structurally, however, the demographic pressure on (real) interest rates persists due to the ageing of society. This is likely to cause interest rates to move more between zero and 3 per cent than between 3 and 5 per cent. For investors, this may mean that bonds will play a less important role in their strategy than in the past. This restructuring process has been massively accelerated by the negative interest rates in recent years, and, given demographic trends, it is unlikely to be reversed in the long term.

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