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Independence over illusions

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When investments in stocks and bonds yield minimal returns even during good market phases, the underlying issue could be due to misguided incentives.

There is a saying in financial circles: “How do you make a small fortune? Give a large one to a banker to manage.” There is a kernel of truth in this statement, because in practice most portfolios are riddled with expensive financial products. Many products lack transparency, so it is not easy to see how funds are actually being invested. There is a clear reason for this plethora of products – over 14,500 funds are registered for distribution with Bafin – and the artificially created complexity: the wrong incentives. According to UBS’s Global Investment Returns Yearbook 2024, equities provided returns of 5.1% per annum in real terms, i.e. net of inflation, from 1900 to 2023. Value creation primarily stems from successful entrepreneurship, reflected in stocks, not from financial advisors. Yet many bankers, asset managers and investment gurus promise dazzling returns with their supposedly accurate forecasts and so-called financial innovations. Through complex products, they convey an illusion of superior competence by offering the seemingly best products for every need.

No added value

But scientific facts are exposing this marketing machine: The forecasting ability of professionals is very poor, as various studies have shown: For example, Jeffery Busse studied the “performance and persistence in institutional investment management” and published the results in the Journal of Finance in 2010. His study of more than 4,600 investment products found that, on average, their market positioning based on forecasts did not add value. Hedge funds also promise to outperform the market through timing and selection. However, data from early 2004 to late 2023 reveals that hedge fund performance lags the market by 7.2% (per annum!), according to the HFRX Global Hedge Fund Index, which tracks the returns of the MSCI World. The artificially created complexity of the investment world creates a dependency on advisors. The root cause is misguided incentives: The financial industry profits from expensive products – the more specialised and complex, the more expensive. Meanwhile, customers are gradually and almost imperceptibly bled dry, because they do not directly pay the high fees hidden within the funds. The costs only become apparent over time in the form of unsatisfactory net returns.

More transparency, less complexity

Financial advisors are in a constant conflict of interest between their clients’ welfare and that of their employer or their own bonus. So what should asset owners be looking out for? Firstly, the financial service provider must be independent. They are only independent if they charge their fees transparently and do not profit from products. As soon as indirect fees are embedded in the products, independence in decision-making is comprimised: A bank will tend to favour its own funds as an investment over others, earning additional revenue from the product fee, regardless of whether this is the best choice for you as an investor. Secondly, in addition to cost, complexity can be reduced by investing directly – in equities and bonds. Packaging investments into products is common today, but is not advisable. A simple investment strategy is cheaper, more transparent and yields a higher net return in the long term. Thirdly, attention should be paid to the security of the financial service provider: What is their reputation, how often have they been involved in legal disputes, and how much of its balance sheet is equity?

> «The artificially created complexity of the investment world leads to dependency on advisors».

A critical approach

Long-term success does not require overpriced financial products or the illusion of secure forecasts. The key success factors for long-term wealth accumulation are a consistently transparent and low-cost investment strategy, an independent provider without conflicts of interest, and a critical mindset of the asset owner.

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