Premium Banking

Private banking rating BILANZ was searching for the best bank for Miss Moneypenny and her 20 million. And it was a small private bank that came out on top in the final.

BY ERICH GERBL

The 70-year-old has a great sense of humour and a surprisingly strong grasp of investments. “Call me Miss Moneypenny,” she says, putting the investment experts under pressure with questions that show off her vast expertise. Miss Moneypenny is on a secret mission: she’s undercover, posing as a client for BILANZ’s private banking rating.

The eight-member judging panel, headed up by university professor Thorsten Hens, went undercover alongside the test client in search of the best services in Swiss private banking (see “How mystery shopping works” on page 96). In the written part of the test, St. Galler Kantonalbank (SGKB), Valiant, and Bank von Roll came out on top. These three banks were then invited to present their proposals in Zurich, at the idyllic Belvoirpark restaurant. It was only once there that they discovered they weren’t really meeting with a potential client— but that BILANZ was behind the inquiry. In the end, the panel of experts named Bank von Roll the overall winner of the 17th Private Banking Rating.

LONGEVITY RISK

Miss Moneypenny is an attractive undercover client. She recently sold a house and now has 20 million Swiss francs in liquid assets. The money isn’t being set aside for her children or for a rainy day — she intends to spend it. Miss Moneypenny hopes to enjoy her retirement to the fullest and is planning to spend one million francs per year, →

plus taxes. The senior lives in the city of Zurich in a grand, mortgage-free home valued at another 20 million francs. This property is earmarked as an inheritance for her children.

You'd think this would be a comfortable starting point for a relaxed retirement, but even this very wealthy woman faces a common challenge in her financial planning: she doesn't know how long she'll live for. Financial experts call this longevity risk. On top of that, the future of the financial markets remains uncertain. Fortunately, there's plenty of excellent banks in Switzerland on hand, willing to help her navigate this dilemma.

SGKB and Valiant work with what are known as pots to secure the high expenditure over 20 years and to utilise the opportunities on the capital markets. It was the experts from Valiant that explained the pot strategy most clearly to the client and to the panel. To ensure short-term asset utilisation, the money managers from Bern would fill Pot 1 with one million francs. Since the bank would invest in low-risk call and fixed deposits, the expected return on this liquidity portfolio would be one percent. Valiant would fill a second pot with Swiss corporate bonds with a term of one to three years, worth three million francs. The bonds would be issued by 20 borrowers with strong ratings, such as Swiss Life and Holcim. The expected return there would be 1.25 percent per year. Taxes are optimised by buying bonds with a price below 100. This way, the return is mostly generated through tax-free capital gains and less through taxable distributions.

"IT'S IMPORTANT TO POINT OUT THAT THESE PORTFOLIOS ALSO LOSE MONEY."

Michael Schetzer

Whether the pot model works in the long run depends on Pot 3, which is filled with 16 million francs. With this pot, the money managers are primarily aiming to tap into the opportunities for returns on the stock markets. The bank, which is represented in 15 cantons, would invest the 16 million through a dynamic asset management portfolio consisting of 65 percent shares, 29 percent bonds, five percent gold, and one percent cash. The expected return, at 4.74 percent, is significantly higher compared to Pots 1 and 2. This also applies to the projected volatility, which is more than twelve percent.

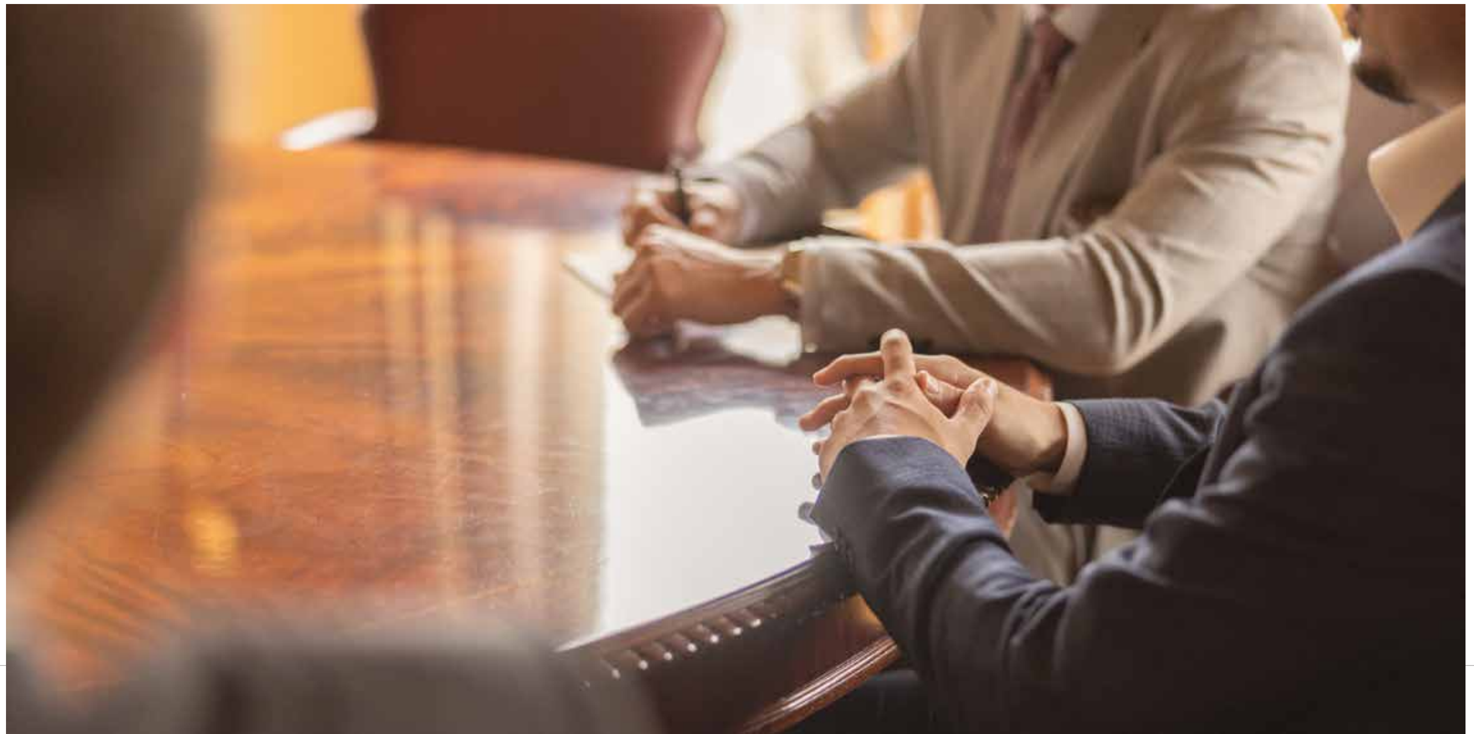
THE POPCORN EFFECT

If all goes to plan, the low-risk Pots 1 and 2 are replenished with profits from the dynamic portfolio. "This is known as the popcorn effect. A lot of asset managers have followed this approach for years," explains panellist Ueli Etzweiler. "With the liquidity portfolio in Pot 1, your living expenses are covered. Pot 2 provides an extended liquidity buffer. Pot 3 focuses on capital gains to help you achieve your long-term goals," says Valiant expert Markus Umbricht, summarising the concept for the potential client.

Pots are used to make it easier for clients like Miss Moneypenny to visualise the investment. "From a didactic perspective, the pots are effective — scientifically speaking, they wouldn't be necessary. But in the end, it's the client who needs to understand it, not the scientist," says head judge Thorsten Hens.

At first glance, the pot model seems like the perfect solution. Excess returns from the long-term portfolio of risky investments are siphoned off and at the same time the low-risk pots are refilled.

It becomes problematic when the expected profits fail to materialise. "If there's a prolonged stock market crisis and I have to keep on drawing from the low-risk pots, they'll eventually run dry," says Hens. In that case, shares would have to be sold, even during a slump in the market — and that doesn't come without consequences. "If the portfolio value is at a lower level, it can't recover if funds are continually being withdrawn," explains Alex Hinder, one of the judges.



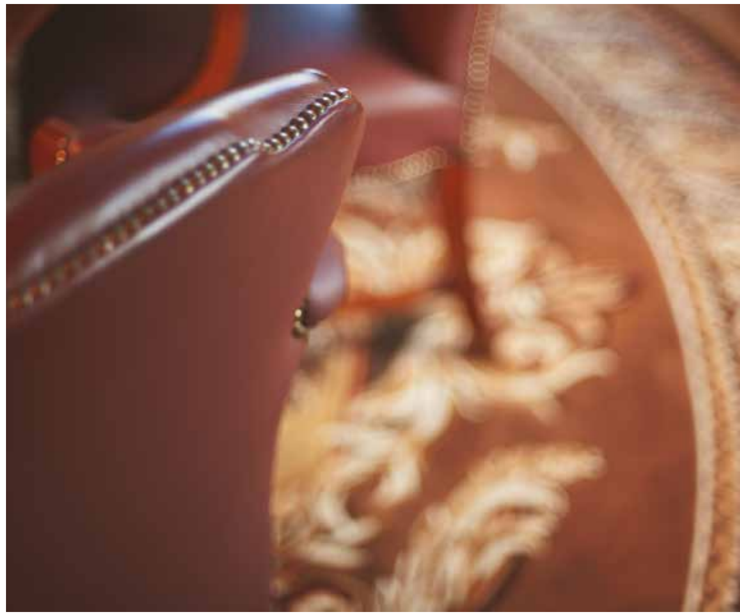
CONTROVERSIAL POTS

Valiant is also aware that the pot model can break down during a prolonged market correction. If the equity allocation no longer matches the client's risk profile, the asset manager has to take action. "We have a certain degree of manoeuvrability, but in the end, the overall risk must stay within limits," says Valiant CIO Renato Flückiger.

Bank von Roll isn't interested in using pot models. "The portfolio is a self-contained whole, and it has to work that way," explains Michael Schnetzer, Head of Asset Management at the bank. He believes pots give a misleading impression because, after all, who knows what shares will be worth when they're actually needed. "Our approach is slightly more technical, but closer to reality." The team from the small private bank made a strong impression on the judging panel. "They presented the scenarios most clearly and honestly," said Peter Wüthrich. Nadja Bleuler praised their structured investment process and scientific approach.

According to Bank von Roll, the days of booming market returns are a thing of the past. "Before, returns were extraordinarily high. In the future, we expect them to be lower," says Schnetzer. Backtesting was used to calculate a return of 4.4 percent for their investment proposal. However, over the next 20 years, they expect it to be only 3.4 percent.

To demonstrate to Miss Moneypenny how the closed portfolio could develop, Schnetzer simulated 10,000 possible future scenarios using the block bootstrap method. Most of the 10,000 simulations show an increase over



20 years. But around a tenth of the 10,000 scenarios involve losses. "It's important to point out that these kinds of portfolios also lose money. There's no magic solution for securing profits when building up a portfolio, you have to be honest. Our solution is systematic, meaning we employ regular rebalancing and a bit of strategy," he says. Shares are sold when they've risen more than other investments and the liquidity is invested in bonds. If the markets correct, the experts take the opposite approach. Since mechanical rebalancing can lead to underperformance in longer-term trends, it's combined with some strategic adjustments.

To make the most of opportunities in the financial markets, SGKB expert Stefan Gähwiler would invest 66 percent of the securities portfolio in equities. Geographically, the focus is on Switzerland, which makes up 45 percent. SGKB takes prides itself on its expertise in the home market, investing in 24 individual shares, ranging from ABB to Zurich, as well as the UBS SMIM Exchange-Traded Fund (ETF). SGKB covers European, North American and Japanese equities via ETFs, while five percent is invested in thematic funds. The expected annual return for the portfolio is 4 percent.

Even though individual shares are a cost-effective alternative and SGKB is known for its expertise in Swiss equities, this strategy hits a sore spot with the client. Miss Moneypenny had a bad experience with individual shares many years ago: "I've had plenty of bad experiences. Banks that believe they can beat the market come across as arrogant to me. I'm convinced that investing passively is the way to go." As a result, the request for proposals emphasised cost-effective ETF solutions.

BANK VON ROLL PRIVATBANK

QUESTIONABLE HOME BIAS

Peter Wüthrich appreciates that, unlike the other two finalists, Valiant took sustainability into account when selecting ETFs. To avoid becoming dependent on a single provider, they chose a mix of ETF providers. In Valiant's asset management portfolio, shares make up 65 percent, with 38 percent being invested in Swiss shares via three ETFs. This means the Swiss equity market overrepresented in relation to its importance at Valiant — just as it is in SGKB's portfolio. The client isn't impressed: "Over 38 years, I've done much better with US shares and the MSCI World, hedged in Swiss francs, than with Swiss shares. I don't get why Swiss banks swear by Swiss shares so much." However, Valiant's experts believe the Swiss equity market is highly attractive on a risk-adjusted basis. "We're firmly convinced that Swiss shares should be favoured," says CIO Renato Flückiger.

Panel judge Nadja Bleuler wonders why the SGKB team hedges currency risks in foreign shares. But Thomas Stucki expects the Swiss franc to grow in appreciation in the long term. "As long as inflation in Switzerland stays lower than in the US, the franc will strengthen over time. On average, that means losses on foreign currencies." The franc tends to be particularly strong when the markets are more turbulent. 'If we're already suffering exchange rate losses, we don't want to lose even more on the currencies," says Stucki.

The jury is less in favour of that strategy. "You shouldn't fully hedge equity investments — that's a mistake in my view," says Alex Hinder. The Bank von Roll experts recommend not hedging currency risks in shares and a long investment horizon of 20 years, unlike bonds. Michael Schnetzer even prepared a section of the presentation dedicated to the lack of sense in currency hedging. The fact that diversification via foreign currencies increases and that the value of machines is similar in all currencies are two of many arguments against hedging.

> *"WE'RE FIRMLY CONVINCED THAT SWISS SHARES SHOULD BE FAVOURED."*
>
> *Renato Flückiger*

Bank von Roll's portfolio has a 40 percent weighting in shares, with Switzerland accounting for 15 percent. Investments in the Swiss market are made via three ETFs and five individual stocks. The bank follows a similar

approach in Europe and the US. Given the current geopolitical uncertainty, Bank von Roll recommends building the portfolio gradually. "If someone presses the big red button, shares plummet and you're sitting on a loss that you won't recover from for decades," says Schnetzer.

At ten percent, the proportion of gold is notably high. Gold bars are stored at the bank's headquarters in Zurich and taken out of the vault during annual client meetings. Panel judge Nadja Bleuler notes that gold should actually be "underweighted" according to the tactical model presented. However, Roll has special reasons why it doesn't do this. The bank was founded in 2009 by the von Finck family — long-time believers in gold. "Gold is so firmly anchored in the bank's DNA that it has never been underweighted," says Schnetzer. Still, adding gold to the portfolio makes sense: "Gold has proven to be a stabilising factor in the portfolio." Over the last 20 years, adding gold at the expense of bonds has increased returns and even slightly reduced risk.

ALL-IN FEE OF 0.3 PERCENT

All three providers offer low fees. Bank von Roll charges an all-in fee of 0.3 percent per year for the asset management mandate. Valiant applies a flat fee of 0.225 percent for the three million in Pot 2, and 0.45 percent for the asset management portfolio (Pot 3), which includes transaction and brokerage costs. The indirect costs of collective investments of 0.17 percent are also included. "The rate is lower than in the prospectus. We fought for you — all the way to the top," says Markus Umbricht. At SGKB, the Comfort Private asset management mandate is 0.4 percent from 20 million. The package price is based on the total value total of accounts and securities. "Only Valiant mentioned that VAT of 8.1 percent is added to the fees. That's something you have to tell a private client," criticises panel judge Peter Wüthrich. Low fees are important to Miss Moneypenny. But which bank she ultimately goes with — well, she's keeping that to herself. ■