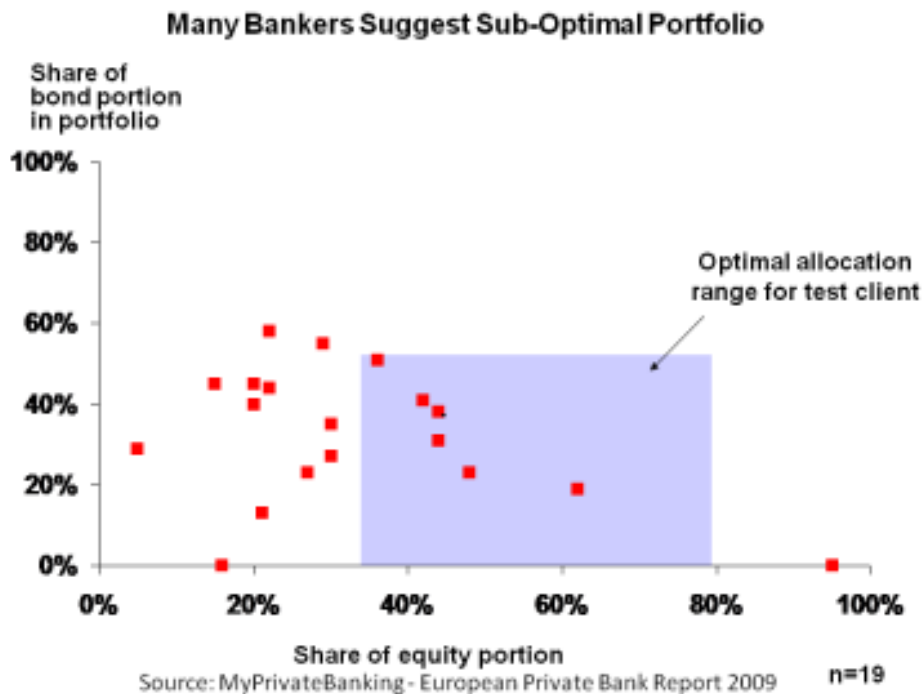


Wealth: Results of Survey on Private Banks

The Missing Long-Term View in Asset Allocation

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The investment proposal is the basis for all future decisions and in [our survey we thoroughly analyzed the proposal we received from 20 major european private Banks](#). In a good proposal the wealth manager should firstly summarise his understanding of the client's personal situation, his investor personality and any specific suggestions or restrictions the client wishes. The wealth manager should outline his overall strategy. The critical part of the

investment proposal then shows how the bank would allocate a client's assets across various asset classes. This will make or break the investment performance of the client. We saw following major good and bad characteristics in the proposals:

What we liked overall: Diversification, open platform and ETF's

- Diversification well established standard: More than half of the banks reached the full score of 10 points for diversification. Only three banks were below 5 points (two of them because the proposal was incomplete). Diversification was applied in most cases to all asset classes: Stocks came from different regions, also including smaller corporations and different sectors. For bonds we found in many cases an overweight of corporate bonds, which made sense given the low returns of high quality government bonds. Overall wealth managers paid attention to different maturities, sectors and currencies within the bond asset class. If alternative investments like hedge funds were proposed we saw in most cases a fund of fund or multi-manager strategy.

- Open platforms become popular: The times when a private bank would largely offer its own in-house products are – with some exceptions – over. In five cases the bank offered zero of their own products. In three more cases the share of in-house vehicles was below 10%! We recall the times – just a few years ago – when a client had to go to an independent wealth manager to be able to select his products from the full range of all providers. Now this has become standard at many banks and we are hopeful that those lagging the trend will be converted soon. However, we found two cases where large banks offered the test client a portfolio almost 100% wrapped in their own products (structured products and funds). It is beyond us how such significant players in the market can ignore market trends so thoroughly...
- ETFs and index products gaining in importance: ETFs (exchange traded funds), index funds or similar passive products are the up and coming trend in asset management. Half of the evaluated banks has now included such cheap and straightforward products in their portfolio proposals. These so-called passive products (because they mirror usually just an index and are not actively managed) are now not only penetrating the asset class of equity products but also bonds and commodities.

What we do not like overall: Only few banks offer optimal asset allocation

- Few banks offer optimal asset allocation and many try to time the market: We have conducted our survey during a period of extreme volatility in the stock markets around the globe. Indexes had come down 50% or even more over the preceding 18 months (since mid 2007). Hence we were not very surprised to find many bankers proposing to engage in some market timing. In most cases these bankers suggested either to have no stocks at all in the asset allocation or to keep the stock portfolio very insignificant. In six cases the portion of stocks in the portfolio was 20% or lower. Advisers then promised to increase the equity portion of the portfolio once “the market bottomed out”. Our standard reply was to ask for a good indicator of a market bottom. No satisfactory answer came up. At most we got some references to technical analysis; one banker even stressed his “excellent gut feeling” which reportedly had called many market bottoms and highs over the last decades correctly.
- Pro-cyclical behaviour: This is somewhat similar to market timing. We found that many banks proposed to our client an overly conservative portfolio allocation given the very weak stock markets. The test client explicitly indicated that he had a long-term outlook and did not need any of the invested funds in the foreseeable future. In addition, the client was of relatively young age and had an independent income. Despite all these very clear facts a quarter of the banks suggested a quite conservative portfolio allocation with 20% or less in

stocks. In one case the wealth manager suggested to our client even to hold more than 80% in cash. Our only explanation for this behaviour is the psychological effect of the crisis which made the bankers highly risk averse. We diagnose this as a typical pro-cyclical behaviour; a behavioural pattern which leads in the long-term to a below average performance.

- Vagueness of the proposal: This is a point which did not influence the grading but we have been still a bit put off. A significant minority (25%) of banks was not willing to spell out their proposal in very much detail. In some cases we had to phone the wealth manager to get more details in writing (like the specific products). In other cases we had to organise a second meeting to get these details. In one case we never received a written proposal, only some oral explanation. We find this behaviour strange – to say the least. Our test client has offered to the banks very openly all required personal information in order to receive a detailed proposal after the first meeting. To force a client to come to multiple meetings just to see a list of investment products seems to us a waste of client time.
- Stuffing the client with in-house products: 30% of banks proposed in-house products for more than 40% of the portfolio. Two proposals contained even more than 80% of in-house products. When we checked on the internal fees of these products in one case we found an average of about 2% of invested assets. That is on top of regular advisory fees!