Banque Cantonale de Genève je connais mon banquier

BCGE Group investment philosophy

Banque Cantonale de Genève je connais mon banquier

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

Banque Cantonale de Genève je connais mon banquier

5th edition

Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier
Banque Cantonale de Genève je connais mon banquier

BCGE
The Swiss Bank of Geneva

To illustrate this document, we have been captivated by the satellite views of planet earth, nocturnal and industrious, buzzing with human and economic activities, projects and businesses. It is here, in these dazzling islets visible from space, that economic value and wealth are created, underpinning the asset performance that the best portfolios seek to select and acquire.

Discovering and understanding our universe: an approach which provides rich insights for getting to grips with the world of investment and capturing the best stocks.

Here, we pay tribute to some of the exceptional minds which have informed and inspired our investment philosophy and methods.

Introduction

Which stocks should be selected from amongst the nebula of financial investments? How should an asset portfolio be constructed so as to preserve capital and target a respectable return? General knowledge of finance is not enough to be able to structure a strong portfolio. Leading-edge expertise is needed to be able to discover, analyse, choose and assemble the best stocks in the investment universe.

The BCGE has been perfecting its investment philosophy for private and institutional customers for several years now.

This is the Bank's fourth, enriched version of its investment philosophy in brochure form. It is an exceptional philosophy in terms of quality and originality, based on the history of the financial markets and on an overview of the global economy. While it includes the advances made in quantitative finance, the subject is handled with immense finesse and falls far short of that technocratic blindness which leads many investors down the road of heavy losses generated by concepts and products based solely on fragile assumptions.
The BCGE's investment philosophy is founded on eight theses:

1 Finance is an applied art and not merely a quantitative technique
2 Performance is produced by the real economy and its businesses
3 Good asset allocation is the result of critical and eliminatory choices
4 The best investment stocks are identified thanks to open architecture
5 A high dose of diversification boosts return and minimises risk
6 The structural simplicity of a portfolio enhances its robustness
7 The investor must assert his objectives, his time horizon and his vision of risk
8 It is the investment philosophy that determines a portfolio's performance, not the size of the bank or the individual talents of its executives

Despite its disparities, Europe, the world's leading economic power, is the richest and most developed global region. European entrepreneurs are active in all business sectors: industry, agribusiness and services.

"And yet, it does go round!"
Galileo Galilei (1564-1642)

Galileo, professor of mathematics at the University of Padua, thought that physical laws should be based on experience, and that this would enable the sciences to advance. In 1609, to verify physical laws, he constructed a telescope with which he was able to observe the heavens and verify the theories of Copernicus, refuting Ptolemy's ancient astronomy inherited from antiquity.

Summary

Finance: an applied art, not just a quantitative technique

The financial markets are by nature, unpredictable in their fluctuations[1]

Investors are frequently confused by the sudden swings in stock market performance and indicators. The irregularity and unpredictability of performance raises questions. It brings capitalists, small and large, up against a crisis of traditional values and the loss of common benchmarks. Some pull out of the markets completely, others opt for extremely costly hedging and defence strategies.

The markets are buffeted by mass psychology

Today, the capital and share markets, to quote two examples, have become globalised. This means that offering players (borrowers and issuers) and "on the ball" investors are in a position to act and overreact on a wide scale, from no matter where, on the slightest piece of information or rumour. This technical ability amplifies the old phenomena of rallying or collective panic, thereby ensuring that speculative mass movements and herd behaviour influence day-to-day share prices substantially. Speculation naturally plays a recognised, useful role within the economic system, in that it helps to fuel the markets with liquidity. The speculative energy and the attraction surrounding betting and gambling on the markets are factors to be taken into account. Furthermore, it is an increasing trend with modern tools such as online trading, automated trading[2] and a growing gambling culture[3].

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

A disjointed profusion of assumptions is the substitute for explanations

All sorts of views, often conflicting, and the offer of hermetic products leave the investor confused and sceptical. Be it articles in the financial press, prospectuses from the banking industry or the occasional academic paper, a disjointed profusion of assumptions abound which simply fail to satisfy every investor's need for an explanatory overview.

Understanding the markets and structuring one's investments with an intelligible approach is the legitimate aspiration and duty of any investor, private or institutional.

1 Jean-Baptiste Alphonse Bachelier, *Theory of Speculation* in the *Scientific Annals of the Ecole normale supérieure*, vol. 3, no 17, 1900, pages 21 to 86.
2 "As high-frequency trading comes to dominate daily activity in securities worldwide, regulators and traditional investors alike fear some of the interlopers may bring dangerous distortions." Jeremy Grant, *Up against a bandsaw*, in *Financial Times*, 3 September 2010, page 7.
3 In 2009, the legal gambling market worldwide totalled USD 335 billion, two-thirds of which came from casinos and lotteries, in *Online gambling. You bet*, in *The Economist*, 10 July 2010, page 14.

Methodical, realistic and constant management

Obviously, managing a portfolio cannot be based simply on an opportunist, day-to-day approach, nor influenced by erratic stock market fashion trends. The BCGE's investment philosophy is founded on a process which traces consistent and durable guidelines and action. Portfolio management has to be methodical, realistic and constant.

Methodical, in the sense that it is performed using a structured and documented process[4].

Realistic, since the key issues at stake, such as protecting capital and maintaining the optimum level of liquidity, preclude speculative fantasy and impose a sceptical view of the investment markets.

Constant, because meaningful results can only be obtained in the long term via a high level of discipline and a precise focus.

Choose an investment philosophy and stick to it

Our customers expect a management style to be transparent and understandable. They want their bank to assert its choices and its position on the subject of investment and wealth management. We have noticed that when our philosophy encourages customer commitment, it generates a common understanding, even an intellectual partnership between investors and fund managers. Our customers also expect the mandate to be managed in keeping with the guidelines set out in each delegated act and that the chosen objective is adhered to in the long term. "Say what one does and do what one says."

Opt for a secure execution model: the mandate

The main objective of a classic and sustainable management approach, as advocated by our organisation, is to protect capital as best as one can, regardless of the extent of market turbulence. The philosophy summarised here serves as the framework for the strategic management of the portfolios entrusted to us. This management is executed exclusively under the discretionary mandate and is conducted centrally. Our view is that the responsibility for investment management cannot be shared between a client and his bank. The management responsibility is entrusted to the bank, which relies on its stable and rigorous operating processes. Any investor without sufficient infrastructure[5] and time has very little chance of obtaining quality results.

> "It is much more natural for fear to consult than to decide."
> *Memoires*, Cardinal de Retz

4 Among wealthy private investors' demands which emerge from several surveys: "adoption of an institution-like investment approach that follows a structured process, looks for financial solutions rather than products to buy and takes an unemotional approach to investing", Merrill Lynch, *World Wealth Report* 2004, CapGemini, page 14.

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

Performance: built on the real economy

What does the real economy teach us?

Financial techniques, together with the institutions that utilise them, have become powerful tools today[6]. The "financial" economy (stock exchange, financial markets) which used to live in harmony with the so-called "real" economy now has what can sometimes be termed a predominant influence on it. No single area of the real economy escapes the influence, even if temporary, of the financial world. The price of raw materials, the value of companies or the property market are all inter-connected with finance, whose speculative aspects has had global repercussions.

Even if this new reality has affected the financial asset management profession, it has not changed its most important rules. The fundamentals remain intact because the psychology of the players is a timeless factor. Furthermore, however powerful the financial currents may be and however significant an impact they may have on asset pricing, it is not certain that these effects are durable. A return to the true economic value of the "targeted" assets wins the day in the long run. "The real economy influences the markets and not the contrary[7]." It is therefore essential to take market behaviours on board, even if their volatility sometimes makes them irrational, as well as to protect oneself from them. Hence the main focus of movable asset management must be to capture value added by the top players in the real economy; a ruthless selection of the most productive and the most solid companies, of all sizes, quoted on the stock exchange or accessible through private equity, wherever they may be in the world. So, to create performance[8], we base ourselves on the real economy and not the casino economy.

"Real" economy – "Financial" economy

"Real" economy	"Financial" economy	
Production of goods and services Value added by players / entrepreneurs (productivity)	Services and financing for the real economy High added value	Virtual Redistribution without value creation
Considerable net added value	Considerable net added value	Marginal net added value

The financial economy can be subdivided into two sections, one which is highly productive and useful to the overall economy, the other a sort of zero-sum game (the casino) where risks, profits and losses are exchanged. This second section is definitely not useless because it injects liquidity into the economy, albeit a marginal contribution given the limited resources employed and the attention this activity receives.

"Money doesn't grow on trees."

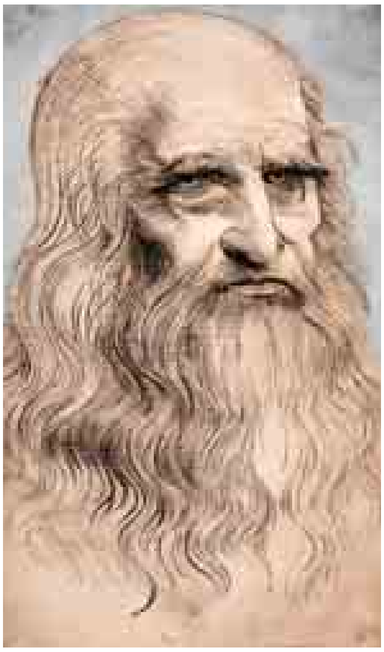
Quebec proverb

6 "Without the very low key interest rates offered by issuing bodies, hedge funds would not have the fire-power that the issuers are denouncing", Pierre-Antoine Delhommais, *And if the central bankers went away on holiday…*, in *Le Monde*, 23 July 2006, page 2.

7 Quote from Clive Granger, Nobel Prize for Economics 2003, reported by T. Thöni, *Le Temps*, 18 August 2006.

8 "[…] the selection and weighting of the investment categories must not be based on strategic optimisation, but firmly on economic principles." R. Banz, B. Eberle Hæringer, T. Häfliger, Pictet LPP 2005 Indices, "*The new family of indices for Swiss pension funds*", November 2005

The United States is a huge and rich territory whose economy is one of the most competitive in the world. Endowed with numerous natural resources, the most dynamic sectors of its economy are electronics, aerospace and biotechnologies.



“Simplicity is the ultimate sophistication.”
Leonardo da Vinci (1452-1519)

Painter, inventor, engineer, scientist, humanist, philosopher, a universal mind who, five hundred years on, still fascinates. Spanning the period between the 15th and 16th centuries, he illustrates and embodies the Renaissance, with its advances in the artistic sphere, but also in terms of the sciences and, above all, of the scientific approach.

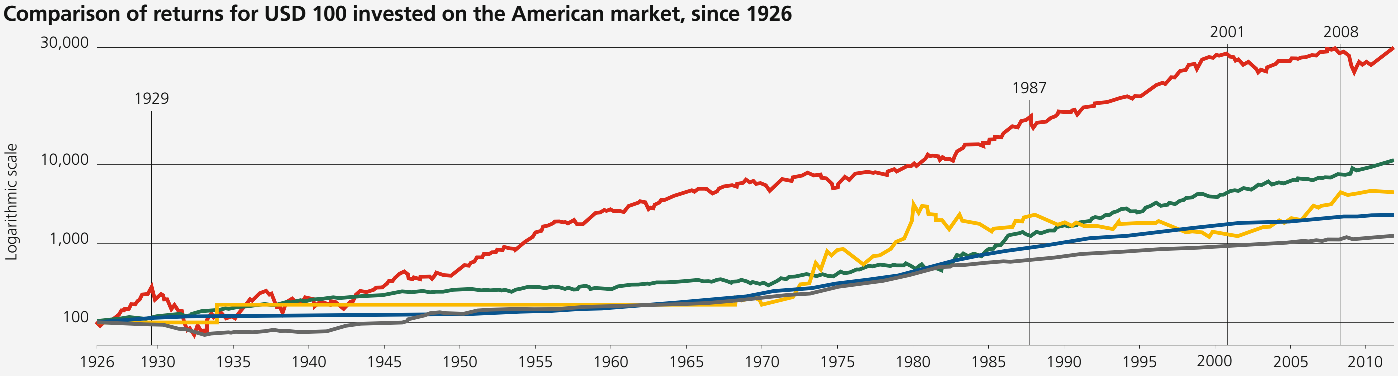
Agriculture is still the most important sector of activity in South America. Although there are substantial mining and oil resources, they are unevenly spread across the countries. Brazil is the leading economic power, with Argentina, Colombia and Venezuela trailing a long way behind. The west of the continent is less developed, but is exporting more and more raw materials to Asia.

Shares: the best performing asset class

The huge productivity gains generated by new technologies, the improvement in management methods and production processes are accumulating in the value of the world's best companies (shareholder value creation)[9]. As a result, we favour corporate activities on a worldwide basis (World Equity, using specialised investment funds in each geographic area or in specific industries). Conversely, we discard purely speculative financial strategies such as those conducted by some hedge funds together with "tactical" approaches towards inert assets (commodities for example) which in themselves do not generate any added value.
We check that the fund managers we choose adhere to this fundamental approach and that they possess an adequate primary analysis infrastructure to be able to select the top 1,000 amongst the best companies (large or small) in the world.
Lastly, we ensure that the positions are constructed and maintained patiently[10] in order to harness the increase in intrinsic value of each company.

Historically, which asset class has generated the best performance?

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



Annual return

Source: Ned Davis Research

■ Shares 9.5% ■ Money market 3.8% ■ Treasury bonds 5.5% ■ Gold 4.6% ■ Inflation 3.0%

A number of conclusions can be drawn from this historical perspective:

- Shares offer a higher return compared to other asset classes over a very long period
- Investing on the money market, which entails less risk, slightly outperforms world inflation and therefore, at best, preserves the capital but delivers no additional performance
- Overall, bonds offer a satisfactory risk return ratio, but no other attraction
- Gold is very volatile and its track record disappointing. It can be of interest to speculators
- The major stock market crashes of 1929 (depression), 1987 (black Monday), 2001 (11 September) and 2008 (sub-primes) must be put in perspective by the investor who is looking at a long-term investment horizon, because their implications for index performance are modest

It can obviously be argued that history does not necessarily repeat itself and that what was true from 1926 until today does not prefigure future trends. Indeed, it is not a question of constructing an investment thesis merely on the back of an empirical study of statistical series, in the way quantitative finance sometimes does. Even though historical observation provides clear evidence that share performance exceeds that of other asset classes, the explanation lies, in our view, in the observation and understanding of the economy by a commercial bank which experiences it. It is an established fact that the best companies at a global level create the real economic added value.

9 "The stock market, after all, is supposed to mirror the economy, indeed, outperform it", Daniel Fisher, *The great stock illusion, in Forbes Global*, 2 July 2002, pages 65 to 66.
10 "Patience is the greatest virtue for achieving long-term success", Philippe Rey, in *L'Agefi*, 11-13 August 2006.

An investment philosophy which results from eliminatory choices

Selection and prioritisation of guiding principles

Contrary to appearances, managing a portfolio is a complex discipline. Management is not an exact science. And, like all social sciences, it is a field of conflicting ideas between different schools of thought. In our view, management is an art, an applied art based both on proven scientific methods and conceptual choices.

Financial asset portfolio management is constructed with the help of guiding principles[11] which are chosen and prioritised[12].

It is via this order of preference that each financial institution differentiates itself and characterises its management. This is the central philosophy behind the management of all entrusted portfolios, whether they cover privately owned or institutional assets.

We adopt three categories of principles: those of certainty, quasi-mathematical, those of semi-certainty (empirical conclusions available) and those based on intuition ("feelings" about the markets).

The "laws" of certainty

In the process of prioritising the guiding principles and then taking account of them to construct the model portfolio, we clearly promote the laws of certainty or irrefutability, for example:

- The superiority of open architecture over own products (page 17)
- The advantage of a high degree of diversification (page 18)
- The need for a strategic allocation which is balanced and in line with the investor's risk tolerance
- The imperative of simplicity, which paves the way for a synthetic management approach, whereas a high degree of complexity paralyses it[13] (page 20)

The principle-driven architecture of the investment doctrine

Principles of certainty

- Well-balanced strategic allocation
- Very high diversification
- Open architecture
- Simplicity to give greater portfolio robustness
- Risk assessment
- Past performance does not predict future performance

Empirical principles

- Fundamental factors favoured in the financial analysis (assess quality of the companies, in-depth appreciation of the real economy)
- Higher return of shares in the long term
- Difficulty in generating significant performance without risk

Intuitive principles, not officially recognised

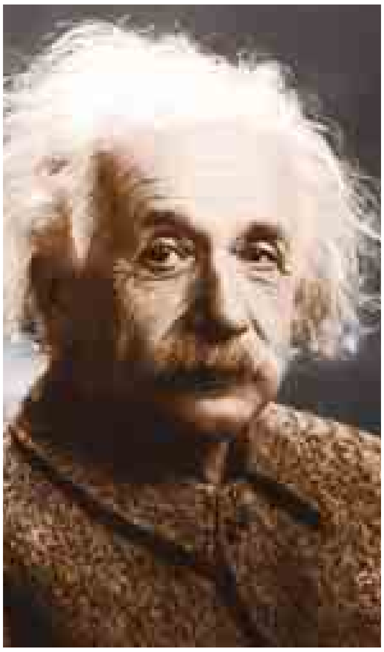
- Short-term speculation and favourites[14]
- Market timing
- Hedging strategy with leverage effect and other derivatives

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

12 The elementary basis of our approach is the optimisation of the portfolio in the light of modern concepts such as structural decorrelation. As most specialists agree on the fundamental rules of sound management, the intricacy of the art lies in prioritising and weighting them so as to structure the portfolio coherently and cohesively. Structural decorrelation differs from purely statistical decorrelation, whose major drawback is instability over time. It views the performance of a financial asset according to its very essence and reflects the fact its performance differs from that of other financial assets for intrinsic reasons: any two assets are structurally decorrelated because of their very nature and not on the basis of simple statistical considerations (pages 17 and 18).

13 "Conscious thought can only focus on a limited number of elements". Study by the University of Amsterdam, quoted by *National Geographic*, title: Psychology, July 2006.

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



"The creative personality must think and judge by himself, because the progress of society depends exclusively on his independence."
Albert Einstein (1879-1955)

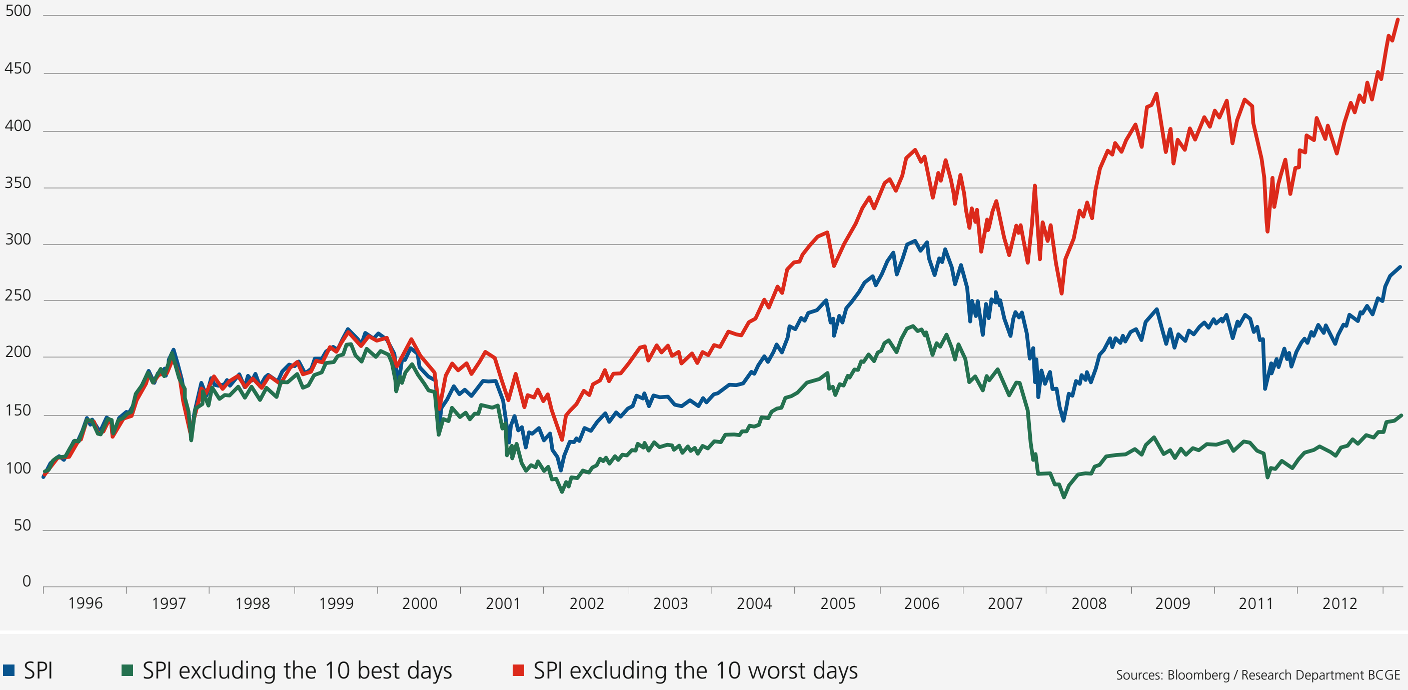
The genius of the 20th century, or even of the millennium. The founder of modern-day physics.

At the start of his scientific work, Einstein realised the inadequacies of Newtonian mechanics, and his special theory of relativity stemmed from an attempt to reconcile the laws of mechanics with those of the electromagnetic field. He dealt with the classical problems of statistical mechanics and the problems in which they were merged with the quantum theory: this led to an explanation of the Brownian movement of molecules. He investigated the thermal properties of light with a low radiation density and his observations laid the foundations for the photon theory of light.

In 1905, he proved the famous $E=mc^2$ formula, resulting in the equivalence between mass and energy.

The Arabian Peninsula, the junction between Asia and Africa, plays a critical geopolitical role. Africa, paradoxically the world's poorest continent, contains 30% of the planet's mineral resources: 40% of its gold, 60% of its cobalt and 90% of its platinum.

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



Sources: Bloomberg / Research Department BCGE

The empirical principles

The second stage is to incorporate the empirical principles into the model. For example:

- The premise of a higher return on shares in the long term
- The direct link between the quality of companies and institutions and the performance of their securities
- And the difficulty of outperforming the indices over time, with respect to bond management

The realm of intuition

Lastly, we are sceptical when it comes to principles governing portfolio organisation which emanate from feeling, belief or an act of faith. Market timing (see graph on the left) or short term speculation, be it on securities, currencies or rates, both provide good examples of this.

Value cannot be created sustainably or seriously by buying a position and reselling it within a few days. That is random speculation. Yet it is this very simplistic operating pattern which constitutes one of the main dogmas of "playing the stock market" and is still extremely widespread investment behaviour these days.

This three-tier architectural selection is complemented by quantitative controls and financial engineering, which ensure that risk budgets are respected and that quality control is maintained.

"There are no average truths."
Diary of a Country Priest,
Georges Bernanos

The Asian continent is inhabited by over 4 billion people, 60% of the world's population. Asian countries have very different economies, some are highly developed, while others are emerging or rapidly developing. Asia is home to 6 of the world's 25 largest economic powers (8 including Russia and Turkey): China, Japan, India, South Korea, Indonesia and Taiwan.

"Science is the only human activity which is truly progressive. The body of positive knowledge is transmitted from generation to generation."
Edwin Powell Hubble (1889-1953)

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

The best stocks are identified with the help of open architecture

Open architecture, its technical role and its ethical component
Once the strategic allocation has been determined, and the approach finalised for the equity portion compared to the risk reducers, namely fixed revenue assets (bonds) and cash (currency investments), the share sub-fund then needs to be integrated. This involves a substantial amount of research and filtering work given the wide range of investment opportunities that exist[15].

We have opted for an open architecture. In other words, we entrust the choice of these asset categories to the world's top experts using collective investment instruments. The firms we select possess the appropriate infrastructures to perform constant in-depth financial analysis for each individual company and possess a detailed knowledge of the various geographic and currency areas they deal in.

This approach means that our customers can gain access to advisors with the highest level of management experience in the various share markets, be it the small or mid caps in the USA, or the premium large caps in Asia.

Our role as independent stock picker means that choices can be made exclusively based on the quality of the individual managers and their multiple parameters (experience, track record, stability of style, bottom-up analysis, etc.).

We consolidate the compelling advantages of the open architecture approach with a consistency check and ensure that the different firms due to collaborate on what is effectively an umbrella fund are stylistically compatible. The very opposite of an in-house, single-culture product range.

Open architecture substantially increases the expectations of success as regards the choice of securities. It also constitutes a somewhat rare ethical commitment to independence and objectivity.

15 The investment fund world requiring filtering is substantial: according to the databases used by professionals, European investors have access to more than 12,000 funds.

High dose diversification to boost return and minimise risk

Diversifying the positions of securities

Although scientifically proven, the effects of risk reduction and performance improvement as a result of diversification are not always obtained with the anticipated degree of intensity in practice.

The attachment that some investors display towards securities from their home country market (home country bias)[16], a lack of "rebalancing" discipline when the performance of a security stands out or, in another example, instinctive "market timing" operations, lead to many portfolios having exposures which are concentrated on certain risk categories.

The portfolio's diversification rate can only be maximised via centralised management and the portfolio's continual adjustment to the allocation grid. An additional factor is resorting to investment funds, as they are strong diversification multipliers at a reasonable cost.

In applying the "certainty" principle of diversification, we take a cautious view of the peremptory statements made by certain experts on the "laws" of correlation[17]. Quantitative finance which, in many situations, predicts and advises on the future, bases its forecasts on the study of historical statistical series. It is better than nothing. But these are thus only statistical models which have made it possible to prove that there was, or was not, a correlation between certain classes of assets, and this for life. Furthermore, a strong correlation does not necessarily imply that there is a direct link.

While these are proven approaches in the study of space and meteorology, it is far more complex to draw up a model for finance which is both an applied art and an applied science with substantial human interference. One of the key problems is that "the relationship between the different assets changes over time[18]". It can be compared to changing the rules of the game halfway through. This weakens the alchemies of probability.

16 Some examples of "massive losses in home country stocks": Swissair (2001, Switzerland), UBS (2008, Switzerland), GM (2009, USA), Lehman (2008, USA), BP (2010, England), etc. In this context, see J.K. Galbraith, *A short history of financial euphoria*, Penguin books, 1990.
17 See the definition of structural decorrelation, note 12 on page 12.
18 "The problem is that the relationship between asset changes over time", (original quote), E. Chancellor, *Diversification, the diworsification pitfall*, in Breaking views, viewpoint proposed on 17 April 2006, 17:03. Edward.Chancellor@breakingviews.com.

In consequence, we ensure that it is absolutely necessary to implement diversification in different asset classes, and that we really are dealing with areas that are too closely correlated in the long-term future beforehand. Decorrelation, the issue that interests investors the most when they rely on the principles of correlation, also suffers from being relatively asymmetric. The high decorrelations observed in bull market scenarios simply vanish when there is a massive downturn, at the very moment they would be needed the most.

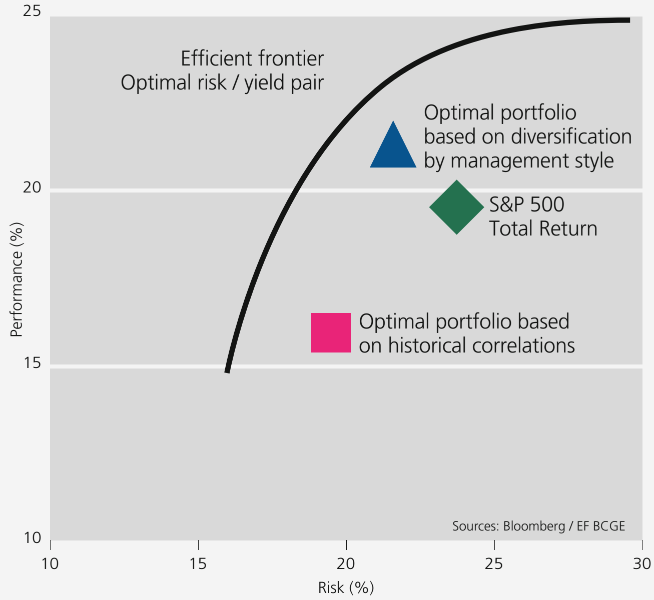
As a result, we endeavour to optimise diversification at the overall strategic allocation level and to maximise it within each asset class. Strict management of this parameter provides ample opportunity to outperform the indices, particularly in bear market scenarios.

Diversifying styles

An open architecture type of management tries to find the best fund managers worldwide. Uniting different visions and approaches solidifies the final mix of a portfolio[19].

Does the diversification of styles yield even more?

Comparison of the risk / yield pair
Positioning of the basket of American funds present in the BCGE Best of mandates



> "Diversify, that's my motto."
> *The Eel Pie*, Jean de La Fontaine

19 On an empirical basis, evidence has shown that the diversification of an investment fund portfolio based on the styles of management practised by the fund managers provides an effective way of overcoming the problem of the instability of historical correlations. This is because it is easier to comprehend the risks linked to the sources of a fund manager's performance once his or her management style of has been identified. This fundamental qualitative work means that an investment fund portfolio can be constructed in the knowledge that the sources are complementary. The "systemic" crisis of 2008 exposed the quantitative optimisation weaknesses that some funds had adopted (*See Quant Fund Assets Plunge After Strategies Underperform, Nomura Report Says,* in *Bloomberg,* 9 November 2010). Conversely, the BCGE's baskets of funds have demonstrated that, over the same period, an intelligent mixture of different sources of performance generates greater profit from the inefficiency of the market as a whole. The logic is as follows: if the styles of management are stable, their complementarities are more stable than historical correlations!

Aim for simplicity and distrust fads

It is better to follow one's convictions rather than trust gimmicks

The stock exchange is influenced by the sociology of fashion, arithmomancy and so-called "behavioural" finance. At regular intervals, new beliefs inundate the specialised press and recommendation summaries. Inflation dead and buried, non-stop growth, the invasion of e-commerce, carry trade, guaranteed performance, not to mention the disillusions with hedge-funds[20], exotic derivatives and structured products! A myriad of bewitching outward signs tries to impose compulsive consumption on private and institutional investors.

Even prestigious indices, supposedly reflecting pension fund performances, are celebrating the surge, in doses that are unfortunately too large, and this in private equity, property funds and hedge funds. Even commodities are banging on the door. It is only natural for the indices to adapt to the custom and practice of the markets they subserviently mirror. The problem nowadays is that they also serve as inspirational models; yet these erstwhile measurement instruments are fast becoming controlling mechanisms. Consequently, a collective and gregarious drive towards asset classes, which only has a short history of performance observation and about which we have major reservations, is now underway.

Hedge funds are giving even more cause for concern, as the concept covers a whole range of highly varied and even conflicting strategies. The action "to hedge", to protect against a risk, or conversely to accentuate one performance component, is an entirely healthy and interesting operation, provided it is performed within a precise strategic allocation framework, with a clearly defined objective, within a fixed time frame and based on tested assumptions. Merrily mixing different approaches in the same "basket" under the pretext that they are all products from fashionable finance boutiques results in a completely different situation. When short-lived capital gains from a fleeting market inefficiency, soon arbitraged in today's logged-on world, are exhausted, the pioneer investors in a hedge fund have long departed, to be replaced by second-tier investors who will realise, a few years later, that the grass is not so green and that the gardener's services cost money. Lastly, as many products are not transparent, it is difficult for non-specialists to detect the counterparty[21] and illiquidity risks attached to them. This risk has fuelled some memorable bankruptcies.

20 "Hedge funds show increasing signs that they're not invincible", Chris Hughes and A. Gangahar, in *Financial Times*, 13 July 2006, page 20.
21 "Some of these instruments are threatened by a counterparty risk which should not be ignored", J.-L. Ruiz, *Are ETFs suitable portfolio management instruments?* in *Le Temps,* 17 May 2010, page 15.

Simplicity and consistency are performance generators

Many financial products rapidly become obsolete or unsuitable because they are badly conceived and wrongly prescribed. A clear-cut, comprehensible philosophy is thus essential in the light of the avalanche of "packaged" solutions and strategies. This is demanding by definition, because it is ultra-selective, highly diversified and focused on a stable and long-term future.

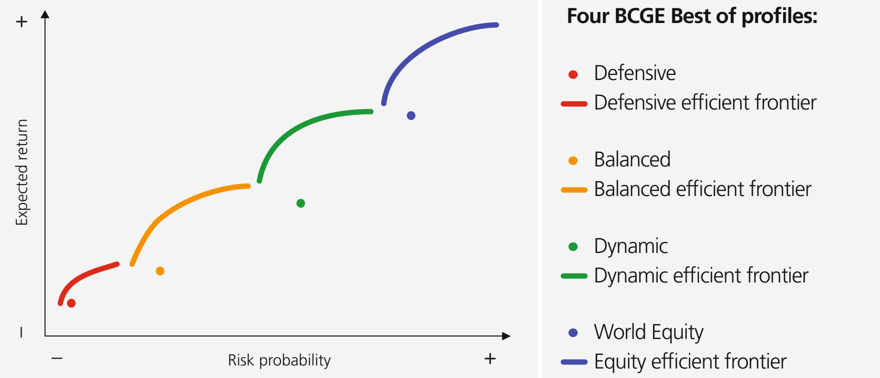
If absolutely necessary, some structured products can be employed, but they remain subordinated to a constant and simple strategic approach. They can be useful, be it in neutralising a risk component or for increasing the return expectation on an equal risk basis.

Harnessing capital appreciation by means of a perfect balance between the equity component (a choice of some 1,000 companies worldwide), liquid assets and fixed income securities is already an exercise that demands a high degree of sophistication. A muddle of too many asset classes without a track record prejudices the imperative of simplicity and long-term performance. "Useless laws weaken the necessary laws" wrote Montesquieu: a genius of a portfolio manager…

Managing the portfolio's protection against risks is also an extremely complex issue. In practice, our fund managers who sense that a risk is emerging (a substantial fall or rise in a currency for example) retain the option to protect against this risk by taking a 6 to 12 month hedge position. That only involves a moderate exchange cover cost. If one accepts that the short-term probability is at best 50%, such a strategy is limited because nobody really knows whether the risk will materialise during the period in question or a few days after the protective hedge has been lifted. The risk therefore requires prevention over the whole period, from day one through to the investment maturity date (if known). In fact, this is a sterile sort of exercise, because it is much too expensive and still imperfect, as one cannot imagine anticipating every single risk (default, rate, currency, equity, etc.). This observation explains why there has been so much disappointment in the field of structured products, as well as endorsing a simpler form of management which endeavours to minimise upstream risks via the quality of its strategic allocation (natural hedge) and the degree of diversification: the portfolio's natural defences. This well-formulated approach constitutes a robust mechanism which, when all is said and done, resists the pressures and reversals to which the market alone holds the key.

A philosophy tailored to the needs of the private and institutional investor alike

Sources: EF BCGE



The asset profile (all the components: property, securities, equity, rights, etc. of a person or institution) and the analysis of the tolerable risk level determine the positioning on the efficient frontier defined by the reward to risk ratio. There are generally considered to be four major categories of portfolio. The defensive, which favours capital preservation, the balanced, which introduces a larger proportion of shares, the dynamic, which gives a more exposed performance / risk ratio and, lastly, the near 100% equity portfolio, which is ideal from a performance perspective but carries a higher risk exposure. Finally, for qualified investors, access to the best non-quoted companies worldwide is also recommended through private equity. This segment offers attractive returns assuming the investor selects highly professional funds which genuinely contribute to the equity capital of high-growth companies.

Performance starts by preserving the capital

The historical study of returns clearly shows that capital must first be protected from the multiple forms of erosion before generating an income. Capital is immensely vulnerable, be it to inflation, theft, embargo, counterparty risk, or the loss in value of its reference currency. Hence, before worrying about profitability, the prime objective is to ensure a capital conservation strategy.

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

Having covered the issue of the doctrinal framework in the previous pages, it then has to be structured by incorporating the specificities of each individual investor.

The asset owner must define his own risk acceptance level, and decide whether he can tolerate it. This can vary considerably depending on the individual and institution. It is essential to ensure that the investor is ready to take risks and to determine the extent of the same.

The overall objective of the investments needs to be defined. The investment strategy can vary considerably depending on the aims. These may be:

- To diversify one's wealth
- To cover individual retirement needs to guarantee a "second active life"
- To support collective pension systems, in the case of a pension fund
- To get pleasure from investing part of one's capital by trying to find higher return options
- Or even to prepare a succession

The investor will try to be even more specific by choosing from the following options:

- To preserve a capital with a minimum of risk
- To obtain a better performance by taking little risk
- To improve performance by taking a moderate risk
- To obtain the best possible performance with an increased risk

Institutional investors define their investment objectives within a more binding framework than that of the private investor, which may be the result of legal and regulatory norms or of internal standards. Our investment philosophy suits all types of investors, and many institutional investors appreciate its originality.

> "It is not the buying that's instructive, it's the selling."
>
> Russian proverb

The economies of Australia and New Zealand are Oceania's economic heavyweights. Australia is the leading producer of coal, iron, and uranium, three resources for which demand has exploded since the beginning of this century. New Zealand is the world's leading exporter of lamb and deer meat and the world's number two exporter of mutton.

Reflection on risk: introspection is a must

The investor has to create an objective vision of the composition of his assets and their future use. Once the asset framework has been outlined, one already has an initial indication of its risk profile. Its initial breakdown into the different asset classes with their varying levels of risk and its degree of diversification and liquidity all help to establish this first diagnosis.

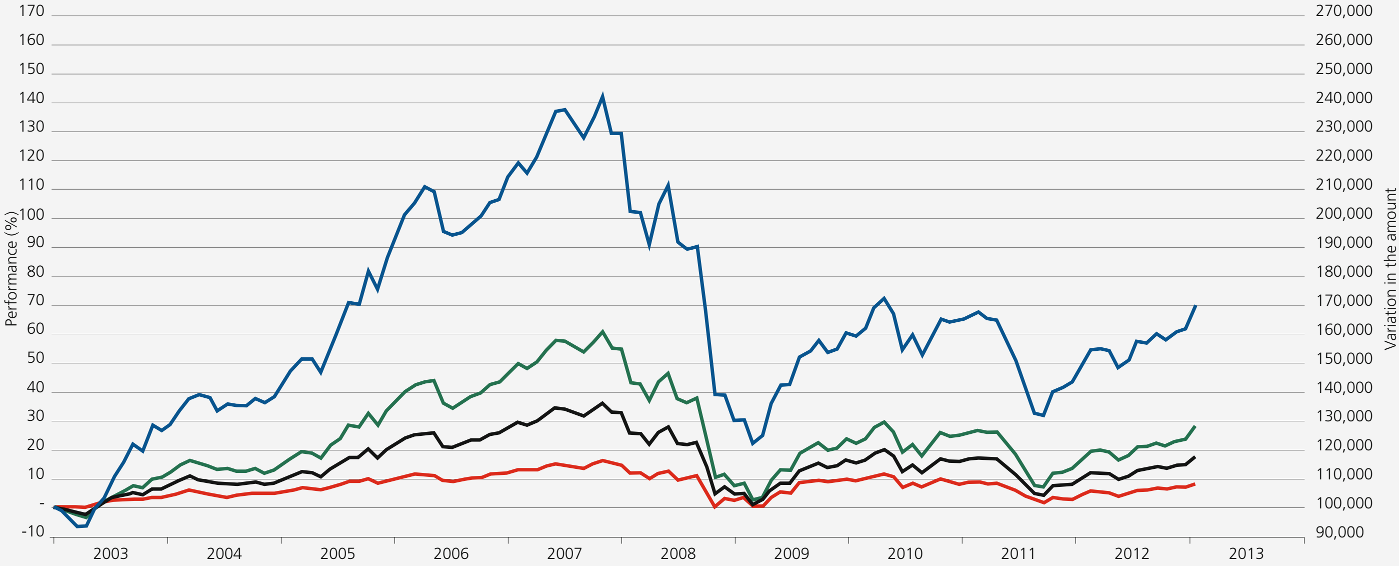
The more subjective question hinges on the capacity to support any losses. Out of 100, how much would you be prepared to lose in one year? 1%, 5%, 30% or nothing? These are the crucial questions that one must ask oneself, honestly and without side-stepping the issue. In addition to this self-analysis, a structured discussion with one's banker is also essential. He will want to check out his client's convictions, and will recommend caution if he detects signs of doubt or indecision.

The time horizon of an investment: a key factor

The choice of risk profile is key in determining the strategic allocation of the investment assets. It is even critical[22] if one accepts that the right weighting of the strategic allocation of assets is a major contributory factor to a portfolio's performance[23].

BCGE Best of performance, expressed in CHF

From 31.12.2002 to 28.02.2013 – Initial investment 100,000 CHF / including fees



	Cumulative performance	Annualised	Annual volatility
Defensive	7.7%	0.7%	4.2%
Balanced	17.0%	1.6%	7.0%
Dynamic	27.7%	2.5%	10.0%
World Equity[24]	69.5%	5.4%	14.9%

Sources: BCGE

22 "If the time available to devote to your investments is limited, then asset allocation is where you should devote it. Someone else can pick the individual stocks and bonds…", Douglas Sease & John Prestbo, *Barron's guide to making investment decisions*, New York Institute of Finance, 1999, page 55.

23 Most experts consider that the strategic allocation accounts for more than 70% of a portfolio's overall performance, with the choice of securities playing a secondary role. A recent full-page advert by Blackrock in *Le Temps* confirms this authoritatively: "The performance of your portfolio is 80% based on your choices of asset allocation".

24 Launched in August 2006. Before that date: pro forma performance.

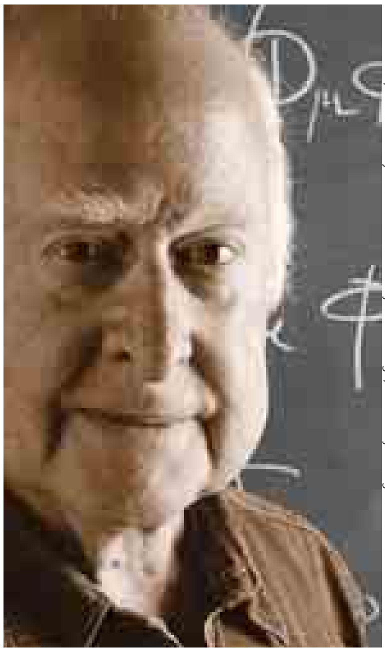
The chosen concept determines long-term performance

The BCGE has taken a very clear and unique stance in relation to investments. This approach inspires all the management operations conducted on behalf of its clients and for the bank itself. It is this method, which bears the hallmarks of classicism, caution and rigour, which also and, somewhat paradoxically, differentiates it in terms of strategy and innovation in today's world of asset management. A host of market incidents have served to test this guiding concept in recent years. Its excellent degree of resilience and the support of many of our investing clients have convinced us of the integrity of this choice. It is precisely its transparency and simplicity that attract the most demanding investors, weary of the "complicated-disappointing" duo.

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

Indeed, it is a bank's investment philosophy, and not its size, which determines the quality of a portfolio's performance. Our investment philosophy is a strategic choice which differentiates and personalises our bank, making it a lasting benchmark in what is sometimes an arrogant and often bewildering financial industry.

Blaise Goetschin
Chief Executive Officer



"It's a question of understanding! Understanding the world!"
Peter Higgs (1929-)

From the largest to the smallest, the Higgs boson is an is an elementary particle whose existence was postulated in 1964 by Peter Higgs, Gerry Guralnik, C.R. Hagen, Tom Kibble, Robert Brout and François Englert (referred to as "massive scalar boson" by the two last-named individuals). It explains electroweak symmetry interaction breaking into two interactions by means of the Higgs mechanism. It also became known as the Higgs quantum field theory.

The Antarctic is the 4th largest continent. The Antarctic treaty was signed in 1959 by twelve countries and was completed in 1991. It forbids the exploitation of the continent's natural resources, except those conducted for scientific purposes.

Contact:

Communications and Investor Relations Departement
communication@bcge.ch

Biographical notes were largely inspired by www.galileogalilei.org, www.leonardoda-vinci.org, www.nobelprize.org, www.edwinhubble.com and www2.ph.ed.ac.uk/peter-higgs.

magic pencil
This document is printed on FSC® certified paper – FSC-C008839

Banque Cantonale de Genève

Headquarters
Telephone: +41 (0)58 211 21 00
E-mail: info@bcge.ch
www.bcge.ch

22 branches in Geneva

BCGE Asset Management

E-mail: assetmanagement@bcge.ch
www.bcge.ch/assetmanagement

Quai de l'Ile 17
CP 2251, CH – 1211 Genève 2

BCGE Private Banking

E-mail: privatebanking@bcge.ch
www.bcge.ch/privatebanking

Quai de l'Ile 17
CP 2251, CH – 1211 Genève 2

Avenue de la Gare 50
CP 159, CH – 1001 Lausanne

Lintheschergasse 19
Postfach 4068, CH – 8021 Zürich

Representative Offices

Sheikh Zayed Road, Park Place
14th Floor – PO Box 102810
Dubai – UAE
Telephone: +971 43 29 83 00

Unit 1803 18/F Alexandra House
Chater Road 18 – Central
Hong Kong – China
Telephone: +852 2810 81 80

Banque Cantonale de Genève (France) SA

Place Louis-Pradel 20
F – 69001 Lyon
Telephone: +33 (0)4 72 07 31 50

Avenue Gambetta 46
F – 74000 Annecy
Telephone: +33 (0)4 50 66 03 06

Rue de la Baume 5
F – 75008 Paris
Telephone: +33 (0)1 76 77 33 90

www.bcgef.fr

291 En / 5 – 1,000 – 05.2013

BCGE
The Swiss Bank of Geneva