

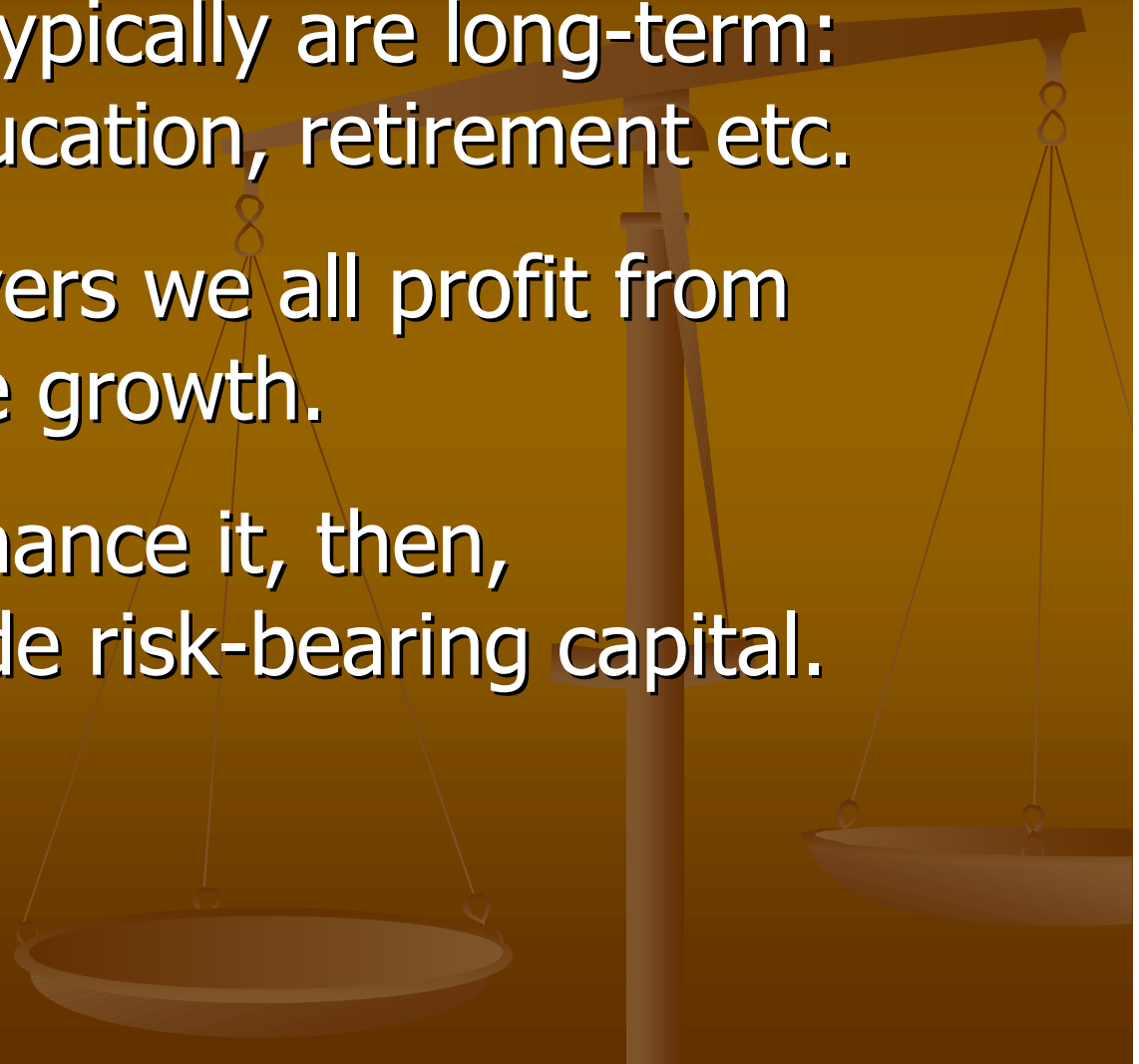


Risk Appetite of Institutional Investors

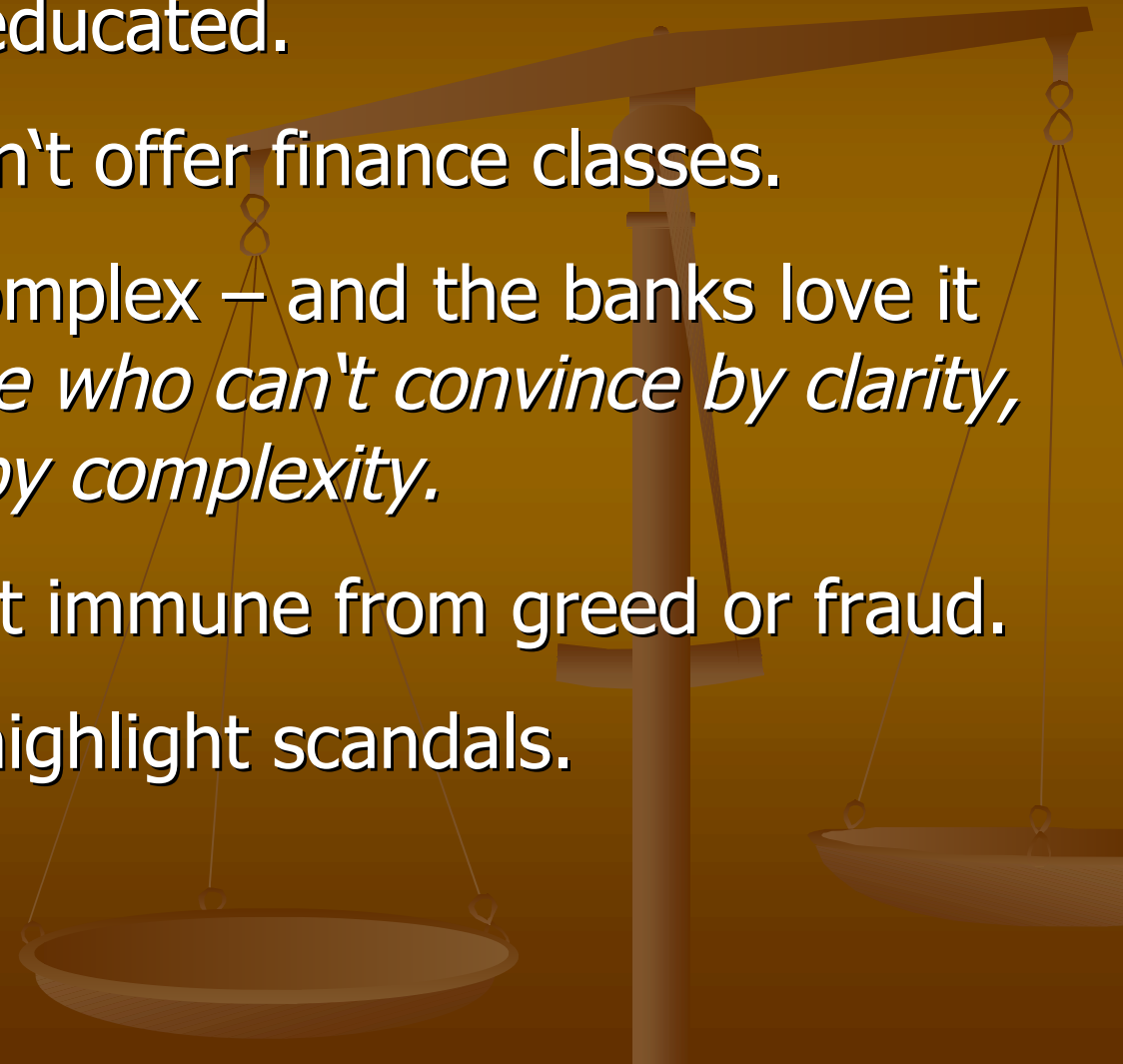
Reconciling the Principal's Risk Aversion
& the Need of Long-Term Growth

The Need of Long-Term Growth

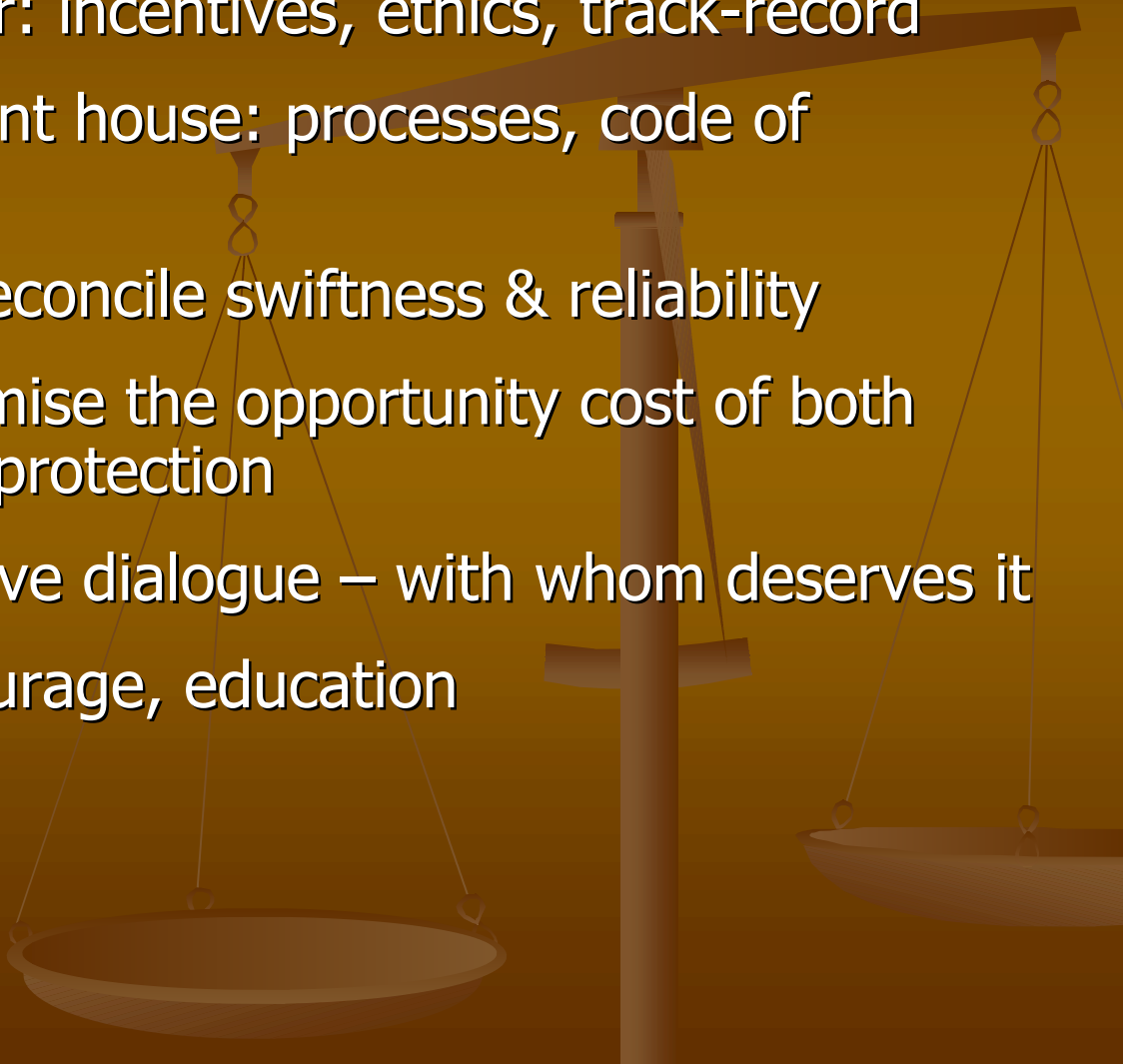
- Our savings typically are long-term: home, education, retirement etc.
- As future buyers we all profit from productive growth.
- We should finance it, then, and provide risk-bearing capital.



The Principal's Risk Aversion

- Savers feel uneducated.
 - Schools still don't offer finance classes.
 - The world is complex – and the banks love it that way. → *He who can't convince by clarity, must confuse by complexity.*
 - Bankers are not immune from greed or fraud.
 - Media love to highlight scandals.
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Brain-storming: How to Reconcile Both?

1. Portfolio manager: incentives, ethics, track-record
 2. Asset management house: processes, code of conduct, brand
 3. Rating agency: reconcile swiftness & reliability
 4. Regulators: minimise the opportunity cost of both over- and under-protection
 5. Media: constructive dialogue – with whom deserves it
 6. The principal: courage, education
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1. Individual Portfolio Manager

1. Incentives: bonus, remuneration, career advancement → bias to short-termism?
2. Ethics → the scarcest resource in the world?
3. Track-record → *The smartest investors pick the top-decile managers – and stick to them. The general public follows the brand.*

Biggest risk: too easily happy with mediocrity.



2. Asset Management House

1. Processes: → separate idea generation from execution. Controlling. Audit. Long-term incentives.
2. Code of conduct: the modern fig-leaf? → *We warned; so we are fine – legally.*
3. Brand: → The consumer is confused by complexity. So he sticks to a brand.

Biggest risk: (still) fat margins let you sleep with inefficient (cost & risk!) structures.

3. Rating Agencies

(S&P, Moody have other responsibilities than Morningstar or Lipper, but there are similarities.)

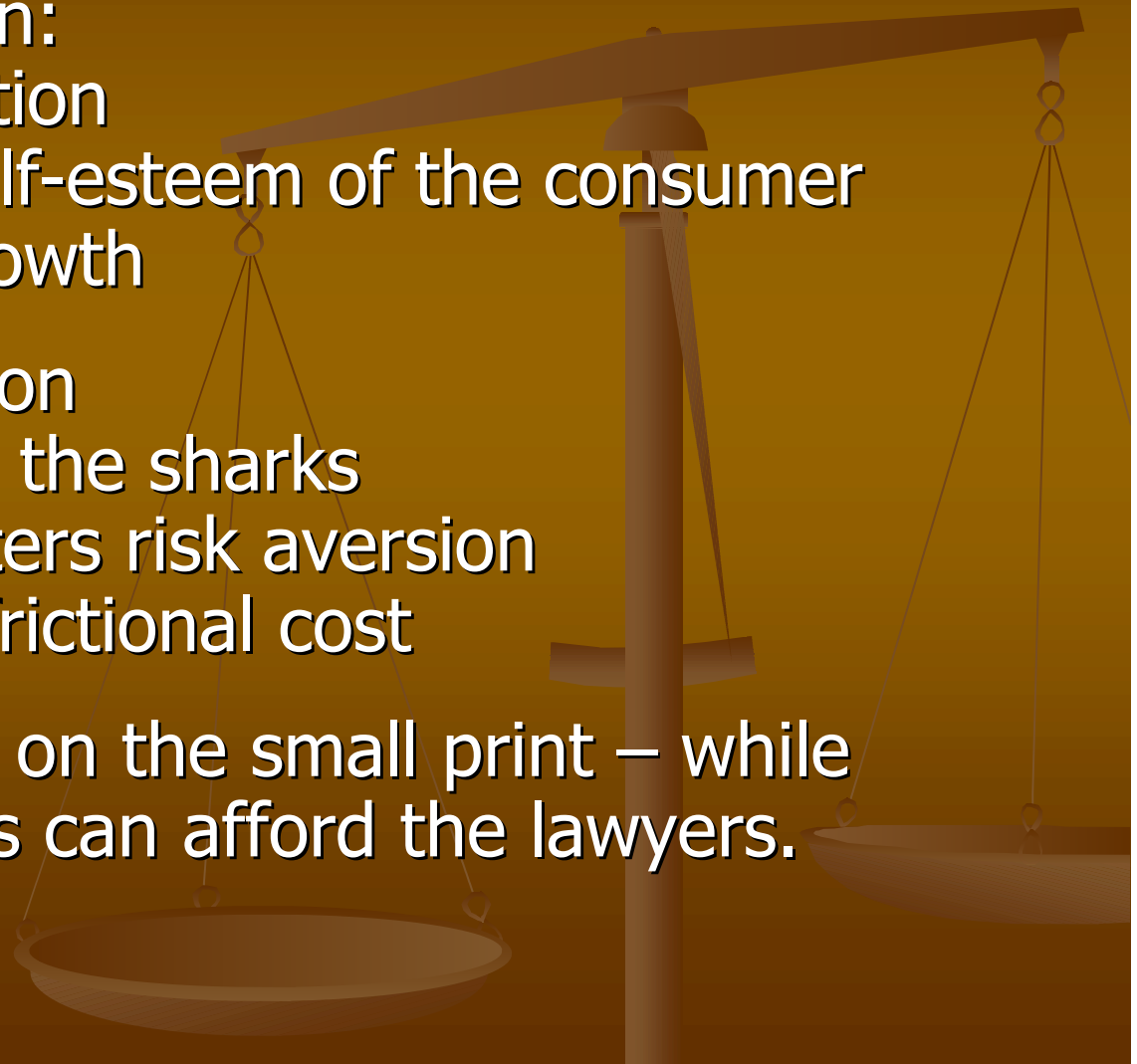
- **Swiftness:** Rating changes normally lag market performance. → No leading (=helpful) indicator.
- **Reliability:** Downgrades in the trough were often followed by upgrades when the sun shines.
Also, the worst case often materialises when ratings are still quite strong.

Biggest risk: neither swift nor reliable.

4. Regulators

1. Over-protection:
 - Kills innovation
 - Destroys self-esteem of the consumer
 - Reduces growth
2. Under-protection
 - Encourages the sharks
 - Further fosters risk aversion
 - Generates frictional cost

Biggest risk: Rely on the small print – while only the sharks can afford the lawyers.



5. Media

1. Exit versus voice: media often are the last resort for whistle-blowers. → too bad that whistle-blowers too often are not heard within the organisation
2. Over-streched resources: rarely a journalist has the time and/or knowledge to dig deeply into a matter → (over-)dependency on more or less reliable external sources (with their own agenda).

Biggest risk: seeking to make the headline, or to be the first, journalists may ruin the reputation of the hard-working performer, or make a hero out of the clown.

6. The Principal



1. Courage

- Take some (controlled) risk
- Trust your own judgement
- Understand the opportunity-cost of risk aversion

2. Education

- Parents, schools & permanent education
- Know the costs – and your willingness to pay
- Refuse to speak Latin. Don't accept smallprint.

Biggest risk: relative to the 5 groups of agents, the PRINCIPAL is less known, less visible, less powerful, less heard. But he pays for all agents.

The Huge Opportunity Cost of Lost Growth

1. Caveat emptor: your best agent is your own judgement and knowledge.
2. Beware the agents: their agenda tends to be shorter-term than the very long-term interests of the principal.
3. Exit strategies unavailable: our biggest savings are our home, employer's and state pension. Can you sell that?
4. Voice strategies difficult: journalists prefer to speak to the „professionals“; i.e. other agents.

Biggest risk: Innocent principals and interested agents face a lose-lose situation: long-term growth is lost on the altar of the agents' short-term gain.

Thank you.



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