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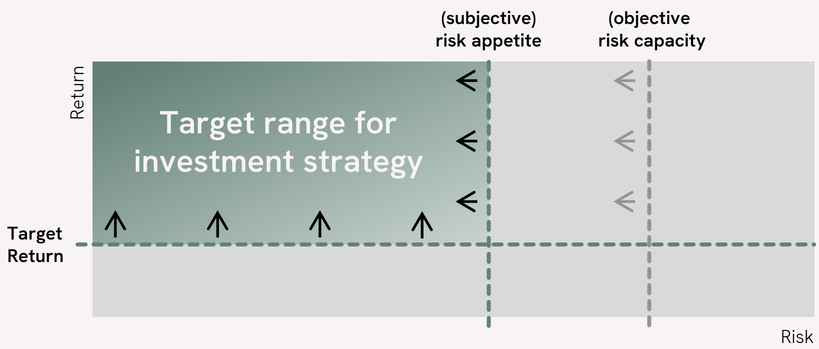
Economico Flash ⚡#15

Investment strategy: personal risk profile as a basis

Chart of the week: Determining the target range for the investment strategy



Source: Own representation

It's going to be a bit dry today, sorry. But money matters are sometimes like that. The basis for defining a strategic asset structure or investment strategy is the so-called risk profile. The target range for defining the personal investment strategy is derived from the personal risk profile. As illustrated above, the risk profile includes various ingredients, namely the personal risk capacity, the personal risk appetite and the personal target return.Risk capacity refers to the objective ability of a (private or institutional) investor to absorb losses. The analysis of risk capacity belongs to the realm of economics. For the concrete assessment, the probability is determined as to whether the investor can cover his future expenses with his assets and future income. If this probability is not high enough, there is a risk, in accounting terms, that the investor will become insolvent or, to put it another way, go bankrupt.

Risk appetite measures the investor's subjective willingness and preference to deal with investment risks and possible losses. The analysis of personal risk appetite belongs to the realm of psychology and many imaginative concepts have been developed in the industry to measure personal risk appetite. We are not psychologists and are therefore reluctant to comment here.

Ultimately, the target return measures the minimum return that an investor wants to achieve or - in the case of an institutional investor such as a pension fund - must achieve in order to be able to finance the specified benefits. In the case of private investors, the concept of target return is somewhat diffuse and cannot be defined in concrete terms, which is why private investors are often referred to as having investment objectives that are to be achieved.

If you conclude an asset management mandate or a pension securities solution (3a or vested benefits) in Switzerland, the provider is obliged under the suitability test set out in Art. 12 FinSA to carry out a personal risk profile before concluding the contract. We criticize two points in the market practices that have now been established in this regard:

Firstly, risk profiling is only ever carried out with regard to the amount you have invested and not with regard to your overall financial situation. As explained in Economico Flash 14, as an investor you do not have a risk capacity for each of your various sub-funds, but rather you only have a risk capacity that is derived from your overall financial situation.

Secondly, the risk profiling approaches widely used in the industry focus on the risk appetite and therefore the psychological aspect rather than the risk capacity and therefore the economic aspect. I would actually rather see it as a performance mandate for the industry to deal with the economic issue. As a result, the question then arises as to whether the pre-contractual risk profiling has a concrete value for you as a customer, or whether you would rather take the determination of your investment strategy into your own hands. On Economico, we have provided a simple risk profiling function that may help you with this.

Takeaways

- Risk profile as a framework for the investment strategy
- You, not your bank, are in charge of determining your investment strategy