

THE BRAVE STEP



SPIROS MARGARIS

SNB's

INVESTMENT POLICY
RECONSIDERED

AUGUST 2013



THE BRAVE STEP

The goal is it to show companies innovative and constructive strategic new solutions which we at Margaris Advisory believe will make a difference.

The more one can draw from diverse experiences, including in other industries, the more likely it is that one will find innovative non-linear solutions to a problem.

If one can draw only from linear experiences, it is difficult to escape a linear solution approach.

Each company's goal should be to provide clients with a clear value proposition and to achieve a high level of client satisfaction. The client's needs have to be understood and have to be taken seriously.

One should always put himself in the position of the client to understand where the client's problems might lie. Once you have identified your clients' problems and needs, then you have to provide them with an innovative solution that delivers true customer value, as well.

Simplicity and client benefits have to be the highest strategic goals for the management of a company. These goals will help a company to differentiate itself from its competitors. Innovation should always aim and meet this goal.

It is a strong belief that the combination of simplicity and client benefits always wins.

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SNB's Investment Policy Reconsidered

The Swiss National Bank (SNB) President Thomas Jordan has to reconsider the SNB investment policy due to the fact that its equity holdings have grown to around 66 billion Swiss francs in the second quarter of 2013.

Falling bond yields forces the SNB - like most market participants - to allocate more of their currency reserves to more riskier assets like equities.

The question is not if the SNB should establish a sovereign wealth fund – the SNB declared that they did not want to go that path and we believe for good reason – in order to manage its currency reserves, but how they can improve their investment skills to manage the equity holdings in their balance sheet.

When Jordan spoke in November 2012 about the SNB investment skills, which they have developed over the past 15 years, he failed to mention that the investment skills were developed when the SNB balance sheet was much smaller in absolute terms and consequently also its equity involvement which represent around 15 percent of the SNB currency reserves.

The new SNB investment policy should specifically target the responsibilities and investment tools of its investment committee in order to achieve cutting-edge investment skills know-how and better prepare the SNB for the challenges ahead.

The SNB balance sheet has surged to about 85 percent of Swiss gross domestic product (GDP) because of the SNB decision in September 2011 - under the leadership of Philipp Hildebrand, the former head of the SNB - to set and defend the floor for the euro at CHF1.20.

To put the SNB balance sheet size in perspective, one has only to take a look at the Fed balance sheet, which is around 20 percent of US GDP, or at the ECB balance sheet, which is around 30 percent of GDP.

Unless Jordan can credibly show that the SNB will commit to a balance sheet which will represent a much smaller percentage of Swiss GDP in the near future, they will need to seriously reconsider how they will manage those equity assets going forward.

The SNB's monetary policy has always priority to the SNB's investment policy, which takes on a subordinated role.

Nevertheless has the explosion of the SNB balance sheet significantly increased the importance of the SNB investment policy.

Jordan emphasizes that the main criteria they use to manage the SNB currency reserves are liquidity, security and return and that the importance of the criteria is exactly in that order.

As the saying goes 'last but not least', the return has gained in importance because of the possible broad serious consequences of potential losses.

SNB's Investment Policy Reconsidered *continued*

The Current internal SNB Investment Committee

When it comes to equity investments, the internal SNB investment committee practices a passive investment approach. One Chief Investment Officer leads the investment committee. The investment committee, a team of around 20 well-trained members, is responsible for implementing the investment strategy. The portfolios are managed by both internal and external portfolio managers, with the majority managed internally. External managers are also used to benchmark the performance of the internal portfolio managers.

The New SNB Investment Committee

The new approach would replace the Chief Investment Officer role with a Chief Portfolio Allocator, who would allocate equity portfolios to its investment committee members.

The new SNB investment committee members would invest the allocation of their currency reserves to equities in exchange-traded funds, equities or with external money managers.

The portfolio managers would combine the best of active and passive investing, which would break with the current SNB investment committee

approach to manage equities entirely passively and avoid any stock-picking.

Since each of the members of the investment committee has their own equity portfolio to manage, no one can hide behind the investment committee.

The performance of each investment committee member is reviewed and measured against the appropriate benchmarks on a monthly, quarterly, and yearly basis.

If a member of the investment committee falls behind the benchmark over a period of 2 to 3 years, then the membership has to be re-evaluated. Portfolio manager reviews can be performed at any time. The legitimacy of the investment committee membership can be questioned if an inferior performance warrants it.

Although such investment processes have been adopted in full or in part and have been implemented more or less successfully in the asset management industry, they have not been implemented in such a rigorous way at the SNB or any other central bank.

The equity portfolios of the investment committee portfolio managers should be managed within managed accounts,

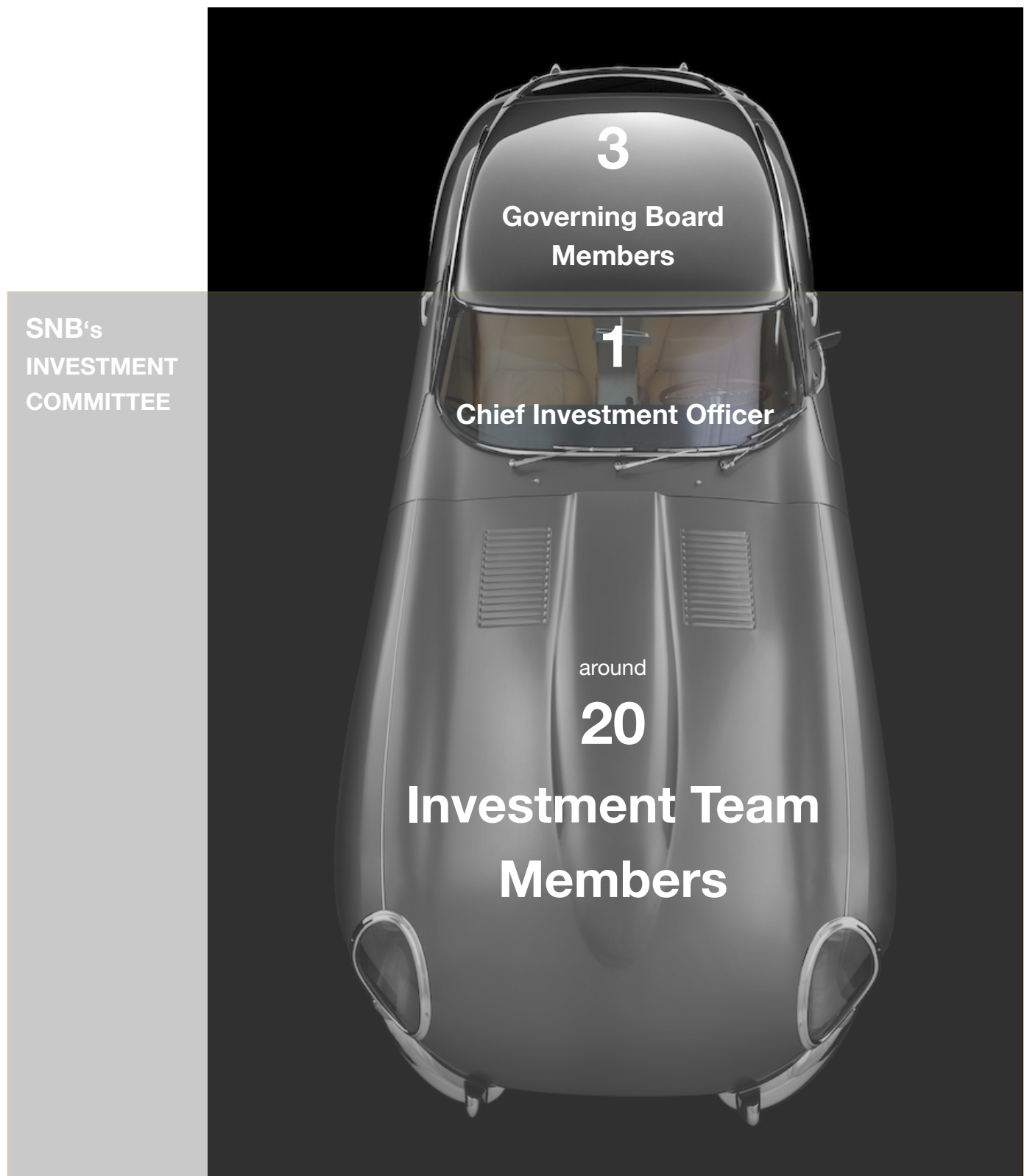
which would provide the SNB the benefits of greater transparency and control.

The benefits of the New SNB Investment Committee

- I. Combining active and passive investing will increase the probability of outperforming an equity benchmark index.
- II. Gathering valuable market intelligence.
- III. Transferring know-how from the portfolio managers to the SNB.
- IV. Increasing the chance for future annual payouts to the 26 Swiss cantons.
- V. Reporting the performance of the investment committee members' portfolios would help satisfy politicians and the Swiss people, who demand more accountability and transparency.
- VI. Only the best will apply and survive to the great benefit of the SNB and the Swiss people.

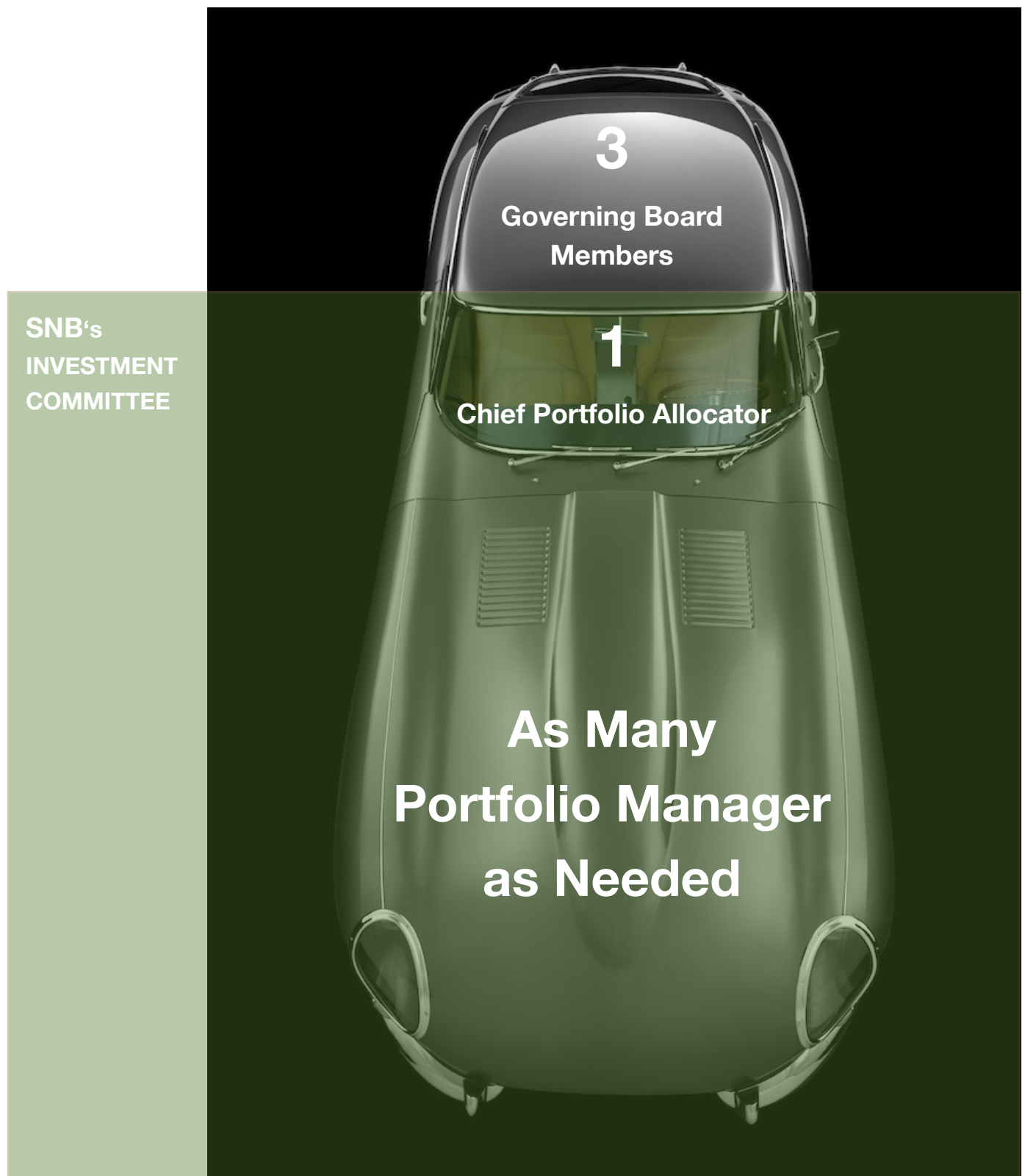
Enough reasons and benefits for Jordan and the SNB to reconsider the responsibilities of the SNB's investment committee.

Current Investment Committee



Source: Economic and finance online platform cash 16.10.2012 „Was tun die geheimen SNB-Vermögensverwalter?“

New Investment Committee



Current Equity Investments

SNB's
INVESTMENT
COMMITTEE



**Portfolio Managers
Allocate on
Passive Basis**

New Equity Investments

SNB's
INVESTMENT
COMMITTEE



**Portfolio Managers
Combine
Active & Passive**

Current Accountability & Transparency

SNB's
INVESTMENT
COMMITTEE



**Portfolio Management
Insufficiently
Accountable & Transparent**

New Accountability & Transparency

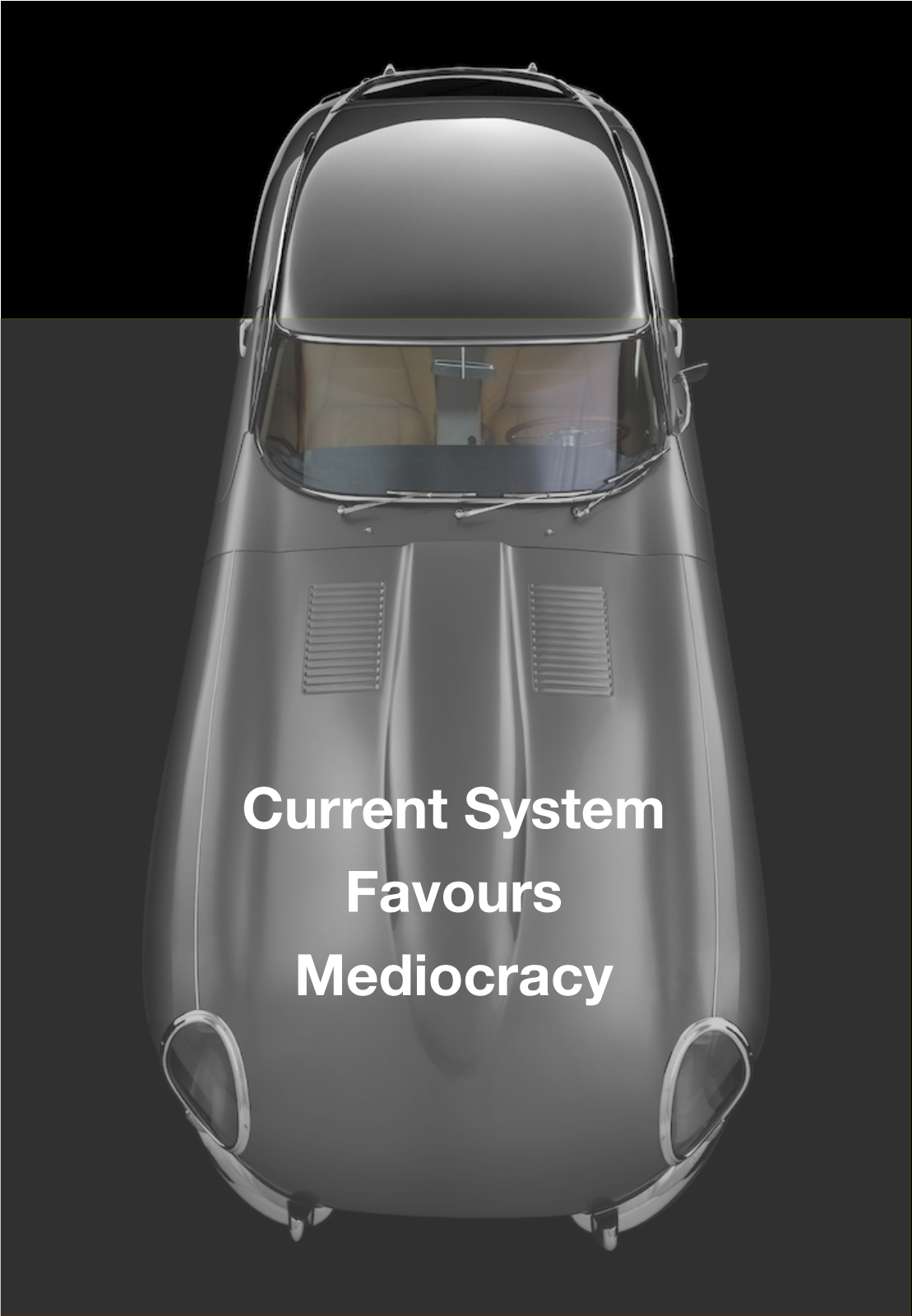
SNB's
INVESTMENT
COMMITTEE



**Portfolio Management
Unprecedented
Accountable & Transparent**

Current Portfolio Managers


SNB's
INVESTMENT
COMMITTEE



**Current System
Favours
Mediocracy**

New Portfolio Managers

SNB's
INVESTMENT
COMMITTEE



**Only the Best
Shall
Apply & Survive**



Spiros Margaris

Founder of Margaris Advisory, an innovation consulting firm, helping companies in the development of innovative non-linear solutions for the financial industry.

Born in St. Gallen. MBA Toronto University & EMBA Universität St. Gallen (HSG). Over 18 years national and international experience in investment management, sales and research for institutional clients, family offices, UHNWIs and HNWIs.

Investment committee member of one of the leading multi-family offices fund advisory firms in Switzerland and Europe. Its 10-year return placed the firm within the top 5 percent among its peers.

Placed 2nd in the equities division of Financial Trader magazine's trading competition.

Founder of one of the first innovative expert websites in U.S.A. (New York) as well co-founder of a financial software company in U.S.A. (New York), which brings accountability to investment advice through an objective, proprietary tracking and rating system.



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