Gamma Explains – Episode 4 – How To Build A Financial Portfolio

Financial education is about knowledge and behaviour. If you have more knowledge about the basic elements of financial education, you are likely to make better choices.

What Gamma hopes to do with this series is conveying a few basic elements of financial education in a very simple and entertaining way.

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Anchor:

Claudia Pensotti – Class CNBC

Guests:

Andrea Beltratti – Full Professor at Bocconi University and Chairman EFG Gamma Foundation

Hilary Wakefield – Head of Portfolio Management UK, EFG Asset Management

Amanda Cotti – EFG Talent Zurich

Alexis Chronis – EFG Talent Gstaad

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Claudia Pensotti – Senior Anchor Class CNBC
Welcome to our fourth episode of Gamma Explains by EFG Gamma Foundation. Today we're going to talk about “How to build a financial portfolio”. We're going to do it with our guests that I would like to introduce, Andrea Beltratti, Professor at Bocconi and Chairman of EFG Gamma Foundation.

Andrea Beltratti – Full Professor at Bocconi University and Chairman EFG Gamma Foundation
Thank you.

Claudia Pensotti
Thank you for being with us.

And Hilary Wakefield, Head of Portfolio Management UK, EFG Asset Management. Thank you for being with us.

Hilary Wakefield – Head of Portfolio Management UK, EFG Asset Management
Thank you.

Claudia Pensotti
But before we get to our guests, let's start by hearing what EFG talents had to say when asked about what the steps are for building a financial portfolio.

Amanda Cotti – EFG Talent Zurich
To build a financial portfolio, start by defining your goals and set a time horizon until you want to reach it, such as buying a house or saving for retirement. Then add your risk tolerance into the mix, such as how comfortable are you with market ups and downs. With that, you can build a diversified portfolio, adding equities for growth or bonds for stability. You can also add private markets.

The key is to balance your risk and stay diversified.

Alexis Chronis – EFG Talent Gstaad
Building an investment portfolio initially requires some efforts. First, you need to determine your financial goals, assess your risk tolerance, define your investment horizon and your liquidity needs.

These steps lead to an individual investment strategy, which investors use to determine their asset allocation. The asset allocation involves distributing the available investment amount across various asset classes in order to achieve the broadest possible diversification and meet the financial goals. Finally, it's about research and the selection of investments and consideration of different investment vehicles.

Claudia Pensotti
All right. So, Beltratti, we heard about what the talents think in terms of the steps that are necessary to build a portfolio. But what is a financial investment portfolio exactly?

Andrea Beltratti
Well, a financial investment portfolio is a collection of assets, and the traditional assets are actually the ones that we know very well: Cash, bonds, stocks and real estate, I would say it's one of the most important assets worldwide.

Of course, over time new asset classes have been added: Things like currencies or commodities or more recently crypto assets are things that are potentially part of an investment portfolio.

Claudia Pensotti
Well, an investment portfolio though is not one-size-fits-all. You told us a little bit about some of the asset classes. What are the other asset classes? And then how should one go about building their portfolio?

Andrea Beltratti
Well, that's not easy. And actually, the talents of EFG have already explained that there is no one-size-fits-all because we have many elements, things like liquidity needs, risk aversion, goals, liabilities. And so, to some extent the financial portfolio is different for everyone.

And of course, it could well be that the structure of the asset classes that are involved in financial portfolios also different to an entrepreneur, for example, with a lot of capital in a specific sector like textile really doesn't make any sense adding more stocks in the same sector that are listed somewhere else. So, to somebody who has lots of real estate, it doesn't make sense to also invest in real estate in the equity market.

Claudia Pensotti
So why is diversification so important?

Andrea Beltratti
Well, diversification is so important from two points of view: Simply adding more stocks and asset classes to a portfolio reduces the level of risk.

Second: Through so-called optimization techniques that are associated with the work of Harry Markowitz back in the 1950s, it is possible to fine tune the shares invested into the different asset classes depending on volatilities and correlations in order to further reduce the level of risk.

Claudia Pensotti
So let's go to hear what Hilary Wakefield has to say about these issues.

Let's start from one specific aspect, which is that U.S. Treasuries were recently downgraded. Does that mean that they're no longer considered a safe haven investment? I mean, is a 60/40 equity bond correlation still a good ratio?

Hilary Wakefield – Head of Portfolio Management UK, EFG Asset Management
That's a great question. Look, I think we need to look at the US Treasury market in the way that it is the most liquid market there is. You can invest substantial sums of money into that market. And the downgrade was really interesting because actually what really happened was that Moody's only brought down its credit rating to bring it into line with the others.

And so this was a move which was expected by most investors and it was very interesting to see that when it happened the market hardly moved at all. The yields rose slightly, but essentially it was all still in the price. The US Treasury market is still the single most important bond market or what I would call perhaps risk-free market out there in the in the fixed income land. And it makes up a really important part of that 60/40 split, which is the traditional balanced model. And we certainly believe that the 60/40 balance model is still a very valid approach.

So if you kind of deconstruct it, you're getting today on 10 year treasuries a yield by 4.3%. In absolute terms that's a very reasonable yield because inflation is only running closer to 2%. So you're getting about a 2% real yield off those treasuries. So in absolute terms it's a reasonable return and then in a real sense it's also you're getting well paid for the risk and then if you take a little bit more credit risk and you invest in the corporate bond market, the yields go up to around about 5% and 5.5%. And so from that 40% of your portfolio, you're making a very reasonable return and then of course you have the equity component, which as we all know over the longer term provides really attractive growth.

So the 60/40 model is still very relevant today.

Claudia Pensotti
How about in periods of high volatility and you know in periods like the one we're living in now with geopolitical risk that is quite high, it's creating a lot of instability. What you should your portfolio look like in those times?

Hilary Wakefield
Well, as we mentioned before, having risk free assets within your portfolio is very important in terms of the controlling the risk. Clearly equities on their own are high risk, they're very volatile instruments and they move very quickly on sentiment.

When you get big geopolitical events, it's always interesting to see which assets move and treasuries generally tend to be one of the safety trades. So, you will get moves in credit spreads, you will get moves in equities, but the treasuries generally do quite well in that environment.

Other areas which also do, you know, which areas of safety are things like gold, hedge funds or Cash, of course, is probably the most important component of the risk off, the place to be.

But a combination, so when you're looking at a portfolio and when you're looking to construct it, one of the most important things to do is to look at the correlations. And if the correlations are negative for whatever asset class you're looking at, that tends to be quite a good thing to think very seriously about incorporating into your portfolio, depending on your risk preference.

Clearly, if you're high risk going long equities and using these periods of volatility to accumulate, it makes a lot of sense. But you know if the needs of your of your portfolio, your long-term aims for that portfolio, tends to be slightly lower risk, you can be a little bit more cautious, then bringing in non-correlated assets, or assets which don't move in the same way given a particular event, that's a critical part of the portfolio construction process. And there are lots of different things you can then bring into that equation.

Claudia Pensotti
Thank you. Thank you to Hilary Wakefield, Head of Portfolio Management UK for EFG Asset Management. And thank you also to Andrea Beltratti, who is Professor at Bocconi and Chairman of EFG Gamma Foundation.

Andrea Beltratti
Thank you.

Claudia Pensotti
The three main takeaways from this Gamma Explains are one: a portfolio is a collection of assets, and the most traditional ones are stocks, bonds, cash, and real estate.

Two: diversification helps for two reasons. First, the simple increase in the number of assets stabilizes the portfolio. Second, low correlations among assets stabilize even further.

Three: a portfolio with a 60/40 combination is still relevant today, and treasuries tend to be one of the safest trades.

Thank you for having been with us in this fourth edition of Gamma Explains.

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