YOUR GUIDE:

REDUCE YOUR RISKS ON THE STOCK MARKET

YOVA

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Foreword

When it comes to investment, profitable strategies are rarely risk-free, and risk-free strategies are rarely profitable. However, there is a happy balance. If risks are managed correctly, the stock markets, in Switzerland and around the world, can be a rewarding vehicle for growing your wealth long-term.

In this guide, we outline the key risks of investing in company stocks, as well as methods that balance risk versus return. We hope you find the information useful, and we invite you to contact us if you have further questions, or would like to discuss how we can help you create a personalised investment strategy.

Kind regards,

Dr. Tillmann Lang
Yova CEO

Chapter One

ARE STOCKS A SAFE INVESTMENT?

When considering how safe any investment is, it is important to consider what the worst- case scenario would be. For company stocks (also known as shares or equities), a Global Financial Crisis would have a significant negative effect on most stock exchanges throughout the world.

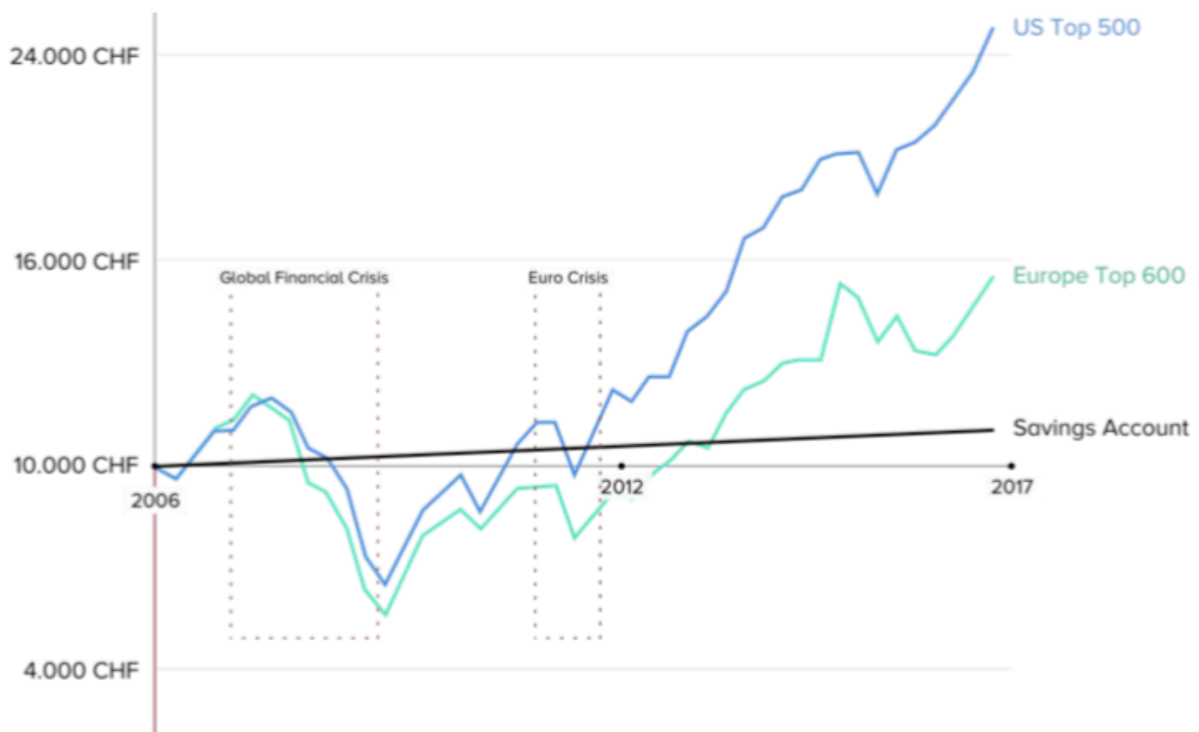
This situation first played out in 1929, when the stock markets crashed and signalled the beginning of the Great Depression. There was another crash in 1987, when the Dow Jones Industrial Average slipped 23 percent overnight. In the early 2000s, the Dot Com Bubble burst and, over a period of 30 months, the NASDAQ Composite (a stock market index focused on US information technology companies) fell 78 percent from its peak. More recently, the Dow Jones Industrial Average fell 54 percent during the Global Financial Crisis of 2007-2009.

In these situations, almost every element of the economy is hit, including businesses, real estate, commodity investments, jobs and salaries. Regardless of whether you invest in the stock market or something else, your money is not immune to a Global Financial Crisis.

The good news is the stock markets recovered from all these crashes and crises. In the last century, the stock markets have achieved average growth of around 6 percent each year - even when these downturns are included. As this graph shows, investors who ‘ride out the storm’ for a few years have always been able to return to strong gains once again. This is a key reason why it is recommended investors treat the stock market as a long-term investment strategy. You may have to wait a few years for a storm to pass, but overall the investment is almost always worthwhile.

“Even when downturns are included, the stock markets have achieved average growth around 6% every year in the last century.”

Historical performance of the stocks markets



Source: Thomson Reuters

Is this the case for Swiss equities too?

Looking at Swiss equities, historical data shows a similar story. Analysis by the Swiss private bank Pictet illustrates that for investment periods of at least 13 years, Swiss equities have never achieved a negative return - even during the periods of the greatest crises. And in the other periods, there was full appreciation.

Let us take the worst-case scenario: A person invested in Swiss equities at the beginning of 2008, i.e. during the stock market highs before the Global Financial Crisis. Such an investment would have lost 34 percent of its value one year later - but that would have only been realised if the investment was withdrawn.

As early as 2014, six years later, these losses would have been more than balanced. Withdrawing the investment at the beginning of 2014 would have generated a statistical profit of 2.1 percent. Despite one of the biggest financial crises in history and the euro crisis in 2011, the investment would have yielded a small positive return. The Pictet Yield Triangle is a helpful resource that will show you how an investment in Swiss equities would have developed if you entered the market in any year from 1926 through to 2017.

An important note:

When considering the past, it is important to keep in mind that historical data cannot predict future events. In other words, past performance is not an indicator of future performance.

For this reason, it's important to consider risk when you are investing money. In the next chapter, we present some of the main risks of the stock markets.

> "Time is the antidote of volatility. Even investors who bought stocks during the highs immediately preceding the Global Financial Crisis would have recouped all losses within 7 years."

Chapter Two

WHAT ARE THE KEY RISKS?

Market risk
As explained in the opening section, the wider economy has an impact on the financial market. Market risk is sometimes called "systematic risk", because it runs so deep it is hard to protect yourself against. It includes factors such as a recession in the economy, political turmoil, interest rate changes, natural disasters and terrorist attacks.

However, a long-term investment horizon offers you the best way to deal with market risks. Experience has shown that the market recovers in the long term after crises. With a long- term perspective you can hold your shares until the market has recovered. Depending on your risk tolerance and risk capacity, splitting your investment between bonds and equities is also a sensible method of balancing risk and return. We will discuss this topic in more detail later.

Monetary policy & interest rate risks
Compared to the last hundred years, we are currently experiencing a historic period of low interest rates. The general interest rate level has an influence on the profit expectations of your investment. The associated risk is called interest rate risk.

The relationship between interest rate and your investment is complex. In a nutshell: High interest rates usually lead to difficult conditions for companies, because they face higher interest rates if they want to borrow money. At the same time, higher interest rates mean future profits are worth less from today's perspective.

What's more, consumers tend to make fewer purchases when interest rates are high. Borrowing money is more expensive, and saving is more attractive because money in the bank earns interest. The resulting decline in consumption also affects companies and their share prices

However, all these considerations apply only "under otherwise equal conditions" if no other factors change. In reality, this is never the case. Many things happen at the same time, so the effect of interest rate on your investment cannot easily be predicted.

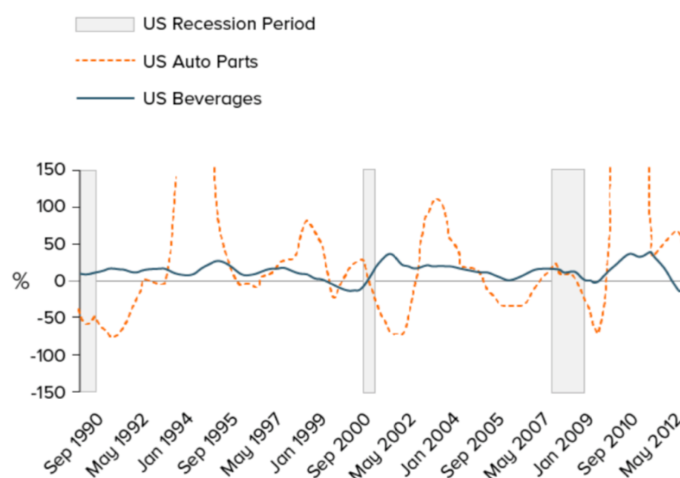
Industry risk

Most industries are vulnerable to specific events and market forces, such as drought or oil price spikes. These risks can be minimised by diversifying your investment across different industries, and being careful not to invest exclusively in industries that are susceptible to the same market forces. For example, airlines, transportation companies and automobile manufacturers are all likely to suffer if oil prices dramatically increase.

Similarly, it's important to diversify amongst cyclical and defensive industries. Cyclical industries (such as construction and tourism) are generally linked to performance of the economy - experiencing growth in boom times, but slowing down in times of recession.

Defensive industries correlate less with the general economy. This can include the healthcare sector, electricity providers and those that produce everyday necessities such as toothpaste and soap. In contrast to luxury items, the products and services of these industries tend to be in demand even in economically difficult times.

Performance of a cyclical and defensive industry over time



Source: Société Générale

Regulatory risk
Changing laws and regulations also present potential risks to your investment. If lawmakers decide to incentivise a particular technology, this may have a positive effect on some industries and an adverse effect on others. Similarly, the government can influence entire sectors through investment in new infrastructure for transport, telecommunications and energy.

Company specific risks
Whenever you invest in a company, there is a risk that the company will lose value or even go bankrupt. How great this risk is depends on both the company itself and its competitors. For example, a company could lose value if its competitor produces at lower prices or comes up with superior new technologies. Liquidity and financing risks cannot be neglected either. These occur when an enterprise is no longer able to obtain fresh money in the short term, for example through bank loans.

Currency risk
Investing in companies that are listed on an international stock exchange can result in your investment swinging up or down in value, independent to the stock price itself. If you want to withdraw your investment, you may find the timing is not favourable due to the currency exchange rate. This currency risk can work in the investor's favour, or against it. Depending on your risk profile, and how liquid you need your investment to be, you may opt to keep a strategic amount of your investment in your local currency. You can also hedge against currency risks using hedging strategies, but this is very expensive in practice.

Counter-party and issuer risks
With some financial investments, you do not invest directly in a company but into a financial product from a financial services provider. Some financial products are very complex, and put several middlemen between the customer and the investment. If the middleman defaults, you may not see your money again. This is particularly the case for derivatives, certificates and structured products. You can avoid this risk by investing directly in companies and ensuring that your shares and other securities are held in a personal account in your name. This way, they are always yours.

Chapter Three

WHERE DOES MY MONEY GO?

This is a very important question to ask any investment provider. After all, you can only assess the risk of your investment if you know that the money is in a safe place.

Yova was founded on the principle of bringing customers as close to their investment as possible. You invest directly in 30-40 shares, and these are in an account which is in your name and belongs to you. The shares are your property and you have access to your money at any time.

This means your money goes straight into the stock, not into the balance sheet of an investment firm. There are no funds, structured products or artificial layers between you and your investment. In these other cases, it is often not clear who your counter-party is when investing money and what the associated risk is.

The problem with complex financial products

We believe complex funds and financial products are not the answer for everyday investors. In the lead up to the Global Financial Crisis, people were exposed to significant investment risk without understanding what they were investing in, or how that investment product functioned.

Today, many investment products continue to be unnecessarily complicated. As a result, people often invest money in products that are not the right fit for their needs and objectives. At Yova, transparency is our guiding principle. This includes telling you:

- Where your money goes and what it does
- How your investment fits your risk profil

- How much you will pay in fees
- What services those fees pay for

Many investment providers, including major well-known funds, do not offer their customers this information. In some cases, it is buried in lengthy documents designed to 'confuse and conquer'. This is a very real problem in the industry. In February 2018, the Financial Times revealed that many popular funds end up costing investors four times more in fees than initially communicated. You can find more information: https://yova.ch/en/expertise/hidden-bank-fees/

> "As our customer, you directly own all stocks and bonds in a trading account that's in your name. You have access to your money at all times."

Chapter Four

HOW MUCH RISK DO I TAKE?

A good investment strategy is designed around your individual risk profile. Your risk profile encompasses two key assessments: Risk capacity, which is the amount of risk you can afford to carry, and risk tolerance, which is the level of risk you are emotionally comfortable with.

1. How do I assess my risk capacity?
Consider factors such as your income and total wealth, your age and time until retirement, and the number of people dependent on you for financial support.

2. How do I assess my risk tolerance?
Ask yourself: do you have an appetite for risk, or would you lose sleep over the possibility of losing money? Everyone is different, and some people don't realise how risk-averse or risk-taking they are until they create their own strategy with Yova.

The risk of being too conservative

Those who prefer a 'risk-free' option often leave their money in a bank savings account. However, if you have a goal to grow your wealth long-term, this option is problematic. Since inflation is very likely to undermine the value of money in a bank account, your assets may even shrink over time. Because the cost of the things you consume may rise faster than your savings interest. As a result, your money is constantly losing purchasing power.

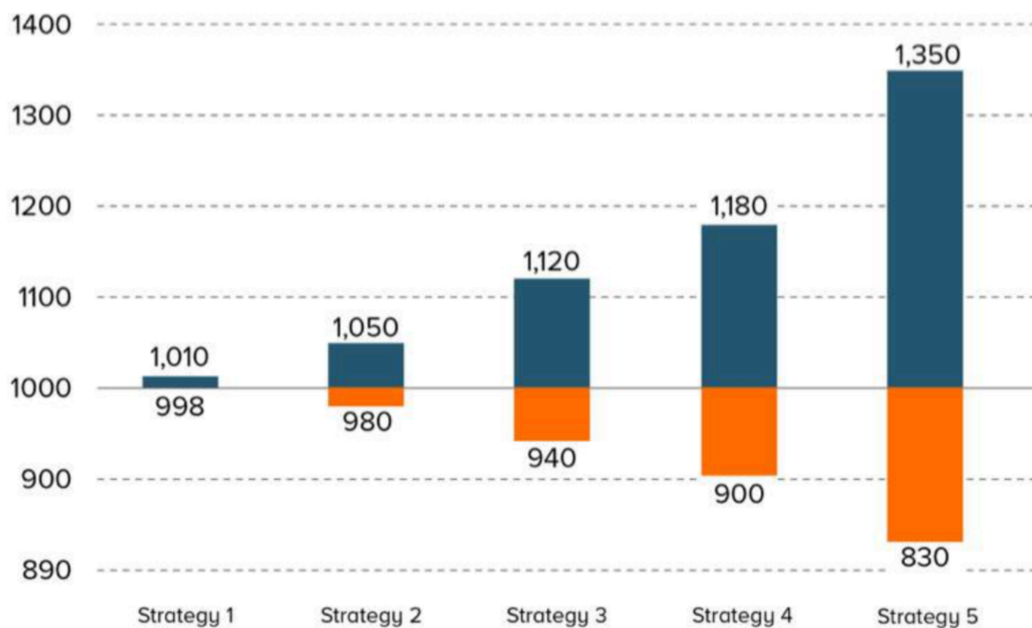
The important thing is that if you invest in the future, your risk is already lower than you might think. As we describe above, a long-term horizon, such as saving for old age, substantially reduces your risk of loss. This topic is discussed in more detail in the Knowledge section of our website (https://yova.ch/en/expertise/).

HOW CAN I LOWER MY RISK?

An effective lever for risk management is balancing an investment between shares and bonds. If you want less ups and downs (known as "volatility" in financial jargon), you should choose a portfolio with more bonds and fewer stocks.

The graph below hypothetically illustrates that the balance between risk and return changes across different portfolios. Strategy 3 illustrates the potential best and worst case scenarios for an investment evenly balanced between stocks and bonds. At each end, Strategy 5 contains only stocks, and Strategy 1 contains only bonds. As you can see, Strategy 5 offers potential to make much more money, but there's also higher risk involved.

Profit and loss expectations for different investment strategies



Source: Own Graphic

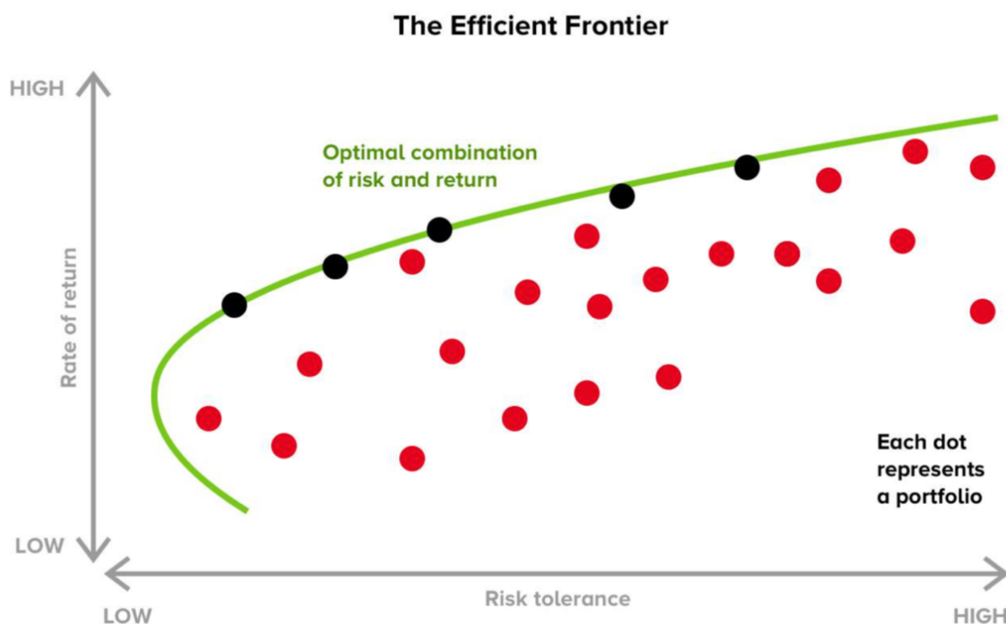
How you can balance risk & return

Yova builds its customers' stock portfolios using a Nobel Prize winning mathematical model, known as the 'Efficient Frontier'. This investing theory was pioneered by economist Dr Harry Markowitz in 1952, and has proven to be the most reliable tool for achieving returns for the last six decades.

According to the theory, there is a suitable portfolio for each risk profile that offers optimal returns. The following diagram gives you a graphic illustration of the Efficient Frontier.

Investment portfolios with an optimal risk/return ratio are in the rising green line (efficient frontier). Such portfolios offer you the highest possible profit expectations with the lowest possible risk.

In the Knowledge section on our website we deal with this topic in even more detail (see here: https://yova.ch/en/expertise/efficient-frontier-investment-theory/)



Source: Own Graphic

Chapter Six

RISK CHECKLIST

Before investing your money in any financial product, make sure you can confidently say “yes” to all these questions:

- I am aware of the worst case scenario, and I am comfortable with it.
- I could clearly explain how the investment works to a friend.
- The stocks I buy are registered directly in my name.
- My risk capacity and risk tolerance have been considered.
- The investment fits with the timeframe I have in mind.
- Practices for managing risk, such as Efficient Frontier Theory, are in place.
- I understand how much I will pay in fees.
- It is clear to me what services I receive in exchange for the fees I pay, and how these services provide value to my investment.

“Transparency is our guiding principle - where your money goes and what it does, how your investment fits your risk profile, how much you will pay in fees, and what services those fees pay for.”

Chapter Seven

FINAL THOUGHTS

It’s impossible to accurately predict what the market will do tomorrow or next year, but historical data shows the stock market has provided average annual returns around 6 percent across many years, even when financial crises are considered. For those who are able to take a long-term approach, this is an attractive vehicle for growing personal wealth.

To reduce risk exposure, investors should diversify across different industries, currencies and other factors. Buying stocks in large, frequently traded companies ensures better liquidity. For investors who do not want to take on the full risk that accompanies equities, a portfolio balanced with bonds is another option. Best practices, such as Efficient Frontier theory, optimise an according to the level of risk the customer is able to take on.

If you are interested in what your Yova investment strategy will look like, the first step is to get your personalised impact investing strategy – it's free and non-binding. Using our easy online tool, you pick the sustainable and socially responsible investment themes that are most important to you. We show you exactly what stocks we recommend you invest in. You can also adjust your financial goals and risk preferences. With every adjustment you make, our algorithm makes sure your portfolio is financially sound. This way, you can control where your money goes – without compromising your returns.

The questionnaire is designed to help us understand your financial capacity and emotional tolerance for risk. Unlike a typical investment company, we also ask what companies you would like to support, based on your hopes for the world. In addition, you can exclude particular categories, such as nuclear, tobacco or alcohol companies.

If you have further questions, or would like to discuss how we can help you create a personalised investment strategy, please contact us:
info@yova.com

Chapter Eight

ABOUT US

For many years, we wondered why investing was so tedious - and why there was no way to tailor our investments according to personal values and interests. With Yova, we took matters into our own hands. Together with ETH Zurich we've digitised and improved the methods that private banks use. Now you can invest for your financial goals. In line with your values.

Dr. Tillmann Lang
Founder – CEO

Erik Gloerfeld
Founder – Investment platform

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