



# Bulletin ■

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- **P.1 Comments on Financial and Economic Developments**
- **P.2 Measuring returns**
- **P.3 Book Review: *Au-delà de la saga Swatch***
- **P.4 Selection of Financial & Economic Indicators**

## Comments on Financial and Economic Developments

By Rolf Spielmann, CFA



Rewarding markets, exciting returns, and all this in an environment that many fear but few are able to resist. Inflation is raising its ugly head, the hurricane season could lead to severe gasoline supply disruptions, the Middle East remains a powder keg

and, as Europe knows only too well but is understandably reluctant to admit, the Russian bear is growling louder and louder. What are the options for an investment manager who is paid to squeeze the last cent out of the market? Should he stay fully invested, hoping that nothing worse will happen than an occasional hiccup à la February 26 when markets were shanghaied, or should he consider running for cover as long as real profits can be cashed in?

Some managers tell us there are no pressing reasons to cash in or even reduce positions, while others have started to cut back on a number of their holdings. The response of an investment manager will depend very much on whether he is in reality a closet indexer (no manager, however much his results might give him away, will ever admit to being an indexer...or worse still a closet indexer) or a completely independent thinker. But independent thinking is usually reserved for a) those who manage smaller portfolios b) those who have been around for several market cycles or c) those who go through the trouble of searching for real pearls. This narrows down the number of effective managers considerably.

Let us look at one exceptional manager in Europe who represents what we consider to be the best. He has been voted first in his category in Europe for 5 consecutive years, and he manages only about US\$200 million. With a track record like his you would think he could have attracted more money (which of course is true), but while he does accept new money, he does not actively look for it. He has been around long enough to have a gut feeling when to hold large cash positions and when to be fully invested. Most importantly, it is not beneath him to take the train to places that no self-respecting analyst would ever deign to visit, and it is on such trips that he will often find his pearls: publicly traded yet generally unknown companies with superb potential.

He mentioned one firm in a remote corner of Switzerland that manufactures a product that is in great demand around the globe and for which there exists only one competitor worldwide. This is but one example. How well is this company doing? Well enough to force the manager to continuously sell shares to avoid an overexposure in his portfolio. Being small allows him to take interesting positions in companies that are often closely held. Since the float is not large, once they get discovered the upside is often most impressive.

There is no replacement for hard work, for looking where others do not care to look or do not see anything, and for digging deeper faster. There are some quality managers who have made this an art. Iron disciple and ingenuity works just as well in investments as elsewhere!

## Measuring returns

Your manager has good news for you as he presents you your investment results over a nice lunch and a glass of wine in an expensive restaurant: Despite some dismal investment periods over the past year, he not only broke even but managed to make money for you, actually just over one percent. But as you glance for a split second at the dollar numbers, you cannot help feeling that the market value of your portfolio is less than what you had paid for it. Had you misread the appraisal, or were you looking at an honest mistake in your manager's reporting? You decide there is no point in spoiling the lunch, but something that so clearly does not make sense deserves an explanation.

**"...you made money as calculated by the performance, but you lost money in dollar terms..."**

Of course your investment manager is a good man who represents a reputable firm that would never bend industry standards. And none were bent: You made money as calculated by the performance, but you lost money in dollar terms. This is a conundrum that leaves many investors puzzled. Not the manager, however. Why? Because the firm's measure of investment performance is the time-weighted rate of return (TWRR), a measure that is accepted and used industry-wide.

1987 might be a good example to show why the TWRR may not give you a correct picture. That year started on a bullish note. You started the year with a portfolio value of \$1 million, and since everything was going so well, after Labor Day, on the recommendation of your investment manager, you decided to add an additional \$1 million. The money was promptly invested, since there was no point in waiting for stock prices to rise even higher. But then came October, which brought a shocking decline that hit the full \$2 million invested. Chances are that while the value of the portfolio was worth less than \$2 million at the end of 1987, the investment manager might still have shown you a positive return for the year.

The problem with TWRR is that it omits the effects of various cash inflows (and outflows) by assuming one investment at the beginning of the calculation period and measuring it to the end of the period. The result can be confusing, misleading and overall simply incorrect.

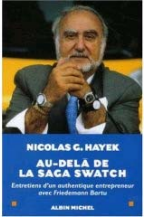
**"...a better measure might be the money-weighted rate of return (MWRR), which adjusts for the varying amounts invested and that are at risk..."**

A better measure might be the money-weighted rate of return (MWRR), which adjusts for the varying amounts invested and that are at risk. It gives a much more precise, indeed more honest picture. More investment professionals are realizing that their clients deserve to know the real picture and as investors become more sophisticated, they demand more accurate performance measurements.

**"...good or bad, we all deserve to know where we really stand..."**

The TWRR is still very widely used and is not about to be replaced by the MWRR anytime soon. Yet we are starting to see signs of a change in thinking and increasingly firms are realizing that MWRR offers benefits. Chances are that over time there will be an increasing emphasis on the MWRR since it provides a more reliable answer. Good or bad, we all deserve to know where we really stand!

## Book Review



***Au-delà de la saga Swatch :***  
Entretiens d'un authentique  
entrepreneur avec Friedemann  
Bartu

by Nicolas G Hayek

Switzerland's leading watch entrepreneur, Nicolas G. Hayek, gives away some thought-provoking secrets in a new book that is already a bestseller.

At the age of 77, Hayek, who is a household name in Switzerland, has set the record straight about his long and successful career.

It is admittedly very one-sided but it does not pretend to be anything else. In short, anyone who is interested in the recent history of watch making in Switzerland will not be disappointed.

He weaves a narrative around his difficult start as a consultant, the call from the banks to rescue the Swiss watch industry and the creation of a group that has long since become the largest watch-making concern in the world.

***"...his top priority – the product,  
the product and once again the  
product..."***

Hayek has never made any bones about what he considers to be his top priority – the product, the product and once again the product. And he is highly critical of companies that cut jobs, make people redundant or continually restructure: "Many, many managers in very big companies would reorganise their companies six times every year. They organise, reorganise, disorganise and then they forget about the main problem which is the product".

Hayek explains that people should not be considered a cost factor in a company because they are the ones that form a family. And it is that family that has to come up with the product.

***"...this is a man who sees  
opportunities where others see  
problems..."***

And what about the growing competition from places like China? Hayek is not worried. Yes there is competition, but Southeast Asia also represents a tremendous market. This is a man who sees opportunities where others see problems. Can his success be a surprise?

## Selection of Financial & Economic Indicators

Index	DJ Ind	DJ Transp.	Nasdaq	S&P500	S&P/TSX
June 30	13408.62	5098.88	2603.23	1503.35	13906.57
Monthly var.	- 1.61%	- 3.66%	- 0.05%	- 1.78%	- 1.07%
Year-to-date	+ 7.59%	+ 11.81%	+ 7.78%	+ 6.00%	+ 7.73%
Year-over-year	+ 20.19%	+ 3.50%	+ 19.85%	+ 18.33%	+ 19.46%

Index	FTSE	DAX	CAC40	SMI	Nikkei
June 30	6607.90	8007.32	6054.93	9209.36	18138.36
Monthly var.	- 0.20%	+ 1.58%	- 0.80%	- 2.56%	+ 1.47%
Year-to-date	+ 6.22%	+ 21.38%	+ 9.26%	+ 4.82%	+ 5.30%
Year-over-year	+ 13.28%	+ 40.89%	+ 21.93%	+ 15.81%	+ 16.98%

Commodities	Gold	Copper	Crude Oil	Lumber	CRB
June 30	650.90	345.00	70.44	279.70	315.37
Monthly var.	- 2.37%	+ 2.89%	+ 10.05%	+ 0.76%	+ 1.24%
Year-to-date	+ 1.94%	+ 21.05%	+ 15.38%	+ 4.37%	+ 2.64%
Year-over-year	+ 5.55%	+ 2.68%	- 4.81%	- 5.09%	- 8.97%

Currencies	\$CAN	¥	€	£	\$AU
June 30	1.0650	123.2000	1.3530	2.0080	0.8480
Monthly var.	+ 0.37%	- 1.23%	+ 0.56%	+ 1.39%	+ 2.35%
Year-to-date	+ 8.66%	- 3.49%	+ 2.46%	+ 2.55%	+ 7.41%
Year-over-year	+ 4.57%	- 7.69%	+ 5.79%	+ 8.63%	+ 14.13%

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