The world's best investor?

Colm Fagan **Diary of a Private Investor** **Update 18** **18 September 2019**

A closer look at BNP Paribas's sales material for the 'Solactive Deep Value Select 50 Index' shows that the picture isn't as rosy as was painted in the brochures.

This is the second part of a conversation with my friend Brian Woods. It would help, but it's not necessary, to have read the first part of the conversation, titled "Too good to be true", which can be found at *http://www.colmfagan.ie/documents/34_Document.pdf?d=September%2012%202019%2014:16:57*

"Colm, I took a closer look at the '*Solactive European Deep Value Select 50 Index*' we discussed last week."

"I remember it, Brian. That's the one promoted by BNP Paribas."

"Yes, that's the one."

"As I recall, BNP Paribas promised that, if the index (I'm calling it the Solactive Index, though they have other indices) is at or above its starting level at the end of five years, the bank will give punters at least 140% of their initial investment; otherwise they lose money, possibly up to 15%."

"That's it, Colm. When I looked at it first, I thought it was a fantastic offer, but you took the wind out of my sails by pointing out that, if the underlying performance of the two indices is identical, the Solactive Index will lag the EURO STOXX 50 by around 3.5% a year."

"Yes, but in the past performance stakes the Solactive Index beat the EURO STOXX 50 hands down over the last donkeys' years, despite this enormous handicap."

"That's what's puzzling me, Colm. Its past performance against the EURO STOXX 50 was unbelievably good – and I mean that. Looking at a BNP Paribas sales presentation from 2017, the Solactive Index produced an average return of 3.49% a year in the sixteen-and-a-bit years from February 2001 to July 2017; the EURO STOXX 50 (price only, excluding dividends) fell by an average 1.87% a year over the same period. That's an average outperformance of 5.36% a year for the Solactive Index. Incredible!"

"I see what you're getting at, Brian. If they both started at 100 in February 2001, the Solactive Index would be worth 176 in July 2017 while the EURO STOXX 50 would have fallen to 73. You'd be worth more than twice as much if you'd put your money in the Solactive Index rather than the EURO STOXX 50, and that's before dividends. The dividend yield on the Solactive Index would also have been much higher than on the EURO STOXX 50, making you richer again."

"If our years of studying the actuarial exams when we were young did anything for us, Colm, it is that we're able to do compound interest calculations! Your arithmetic is right, but do you really think BNP Paribas has found a magic formula for identifying shares that can deliver outsized returns over so many years?"

"Brian, BNP Paribas is one of the biggest and most prestigious banks in Europe. I've just read their 2018 Annual Report. In it, they say that they want to be among the most trustworthy players in the industry. You can't be claiming that they've ..?"

“Stop! Don’t say another word!”

“OK, Brian, but let me put it another way. Suppose you discovered a winning formula for the stock market, what would you do?”

“I wouldn’t tell a soul. I’d put everything I had, more if I could borrow it, on the shares that I’d identified as likely winners. BNP Paribas is a bank, so it can borrow lots.”

“Exactly, but that’s not what happened, is it? Instead, ordinary punters were encouraged to put their savings into a product linked to this wonderful index, with BNP Paribas promising to give them a 40% bonus, plus their money back, if the index is up after five years.”

“Strange, isn’t it?”

“Strange indeed. Here’s a thought, Brian. Most of this fantastic past performance is theoretical. BNP Paribas quote figures going back to 2001, but the index only came into existence in 2015. It’s all theoretical before then. The proof of the pudding is in the eating. It would be interesting to know how the index has actually performed since its launch.”

“I’m ahead of you on that, Colm! I’ve already done the sums, some of them anyway.   The figures I quoted earlier, which showed the Solactive Index beating the pants off the EURO STOXX between 2001 and 2017, were taken from a BNP sales presentation of July 2017. BNP Paribas have updated the presentation to include figures for both indices to June 2019.”

“And …?”

“The new presentation included figures for the eighteen years from 2001 to 2019. Once again, BNP Paribas showed the Solactive Index beating the pants off the EURO STOXX 50, but not by as much as in the 2017 presentation. By comparing the two presentations, I was able to deduce the performance of the two indices between 2017 and 2019. Guess what?”

“From the way you’re leading me on, Brian, I guess that the outperformance relative to the EURO STOXX 50 was less than in the previous sixteen years?”

“It’s worse than that, Colm, much worse. In the two years (actually, one year, eleven months) between July 2017 and June 2019, the average return on the EURO STOXX 50 was a positive 0.36% a year while the average for the Solactive Index was a negative 2.74% a year. The Solactive Index underperformed the EURO STOXX 50 by 3.1% a year. You estimated that it would underperform by around 3.5% a year, so you were almost spot on. I salute your powers of deduction, Holmes.”

“Elementary, my dear Watson, elementary. But one thing I still can’t get my head around is that BNP Paribas, a bank that wants to be among the most trustworthy players in its industry, which surely knows more than we do about the expected underperformance of the Solactive Index –“

“ and which must also know of its actual underperformance over the last two years.”

“ - still advertises its supposed long-term outperformance in its sales literature. In the circumstances, I’ve decided there’s only one thing for it, Watson. Get your hat; we’re going to have a word with Inspector Lestrade of the Yard.”

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Other diary entries can be found at http://www.colmfagan.ie/investments.php