Banca Zarattini & Co.

RISKS ASSOCIATED WITH FINANCIAL INVESTMENTS

Risk in Asset Management and Investment Advisory

In all financial assets, a return level is associated with a non-zero level of risk. This risk depends on a number of variables linked to the macroeconomic scenario, asset classes, and specific instruments used.

The investment process adopted by Banca Zarattini & Co. SA aims to identify investments whose level of risk is at least commensurate with the return sought. By means of this selection, the objective is to maintain and increase the value of the assets under management and advisory, keeping in line with the indications, restrictions, and time horizon of the investment policy.

Despite this, the inherent risk of investing in financial markets makes the final result variable and subject to losses.

Clients are invited to consult their advisors on the adequacy of the risk profile of their mandate. Past results are not indicative of future results, and the value of assets under management may vary in response to market fluctuations.

Below are the main risks associated with investments and financial instruments. For doubts, questions, or a more in-depth discussion, the Client is invited to reach out to its advisor for information; to consult the "Risks Involved in Trading Financial Instruments" booklet made available by the Swiss Bankers Association on its website; or to ask the Bank for a copy.

General Risks

Trading financial instruments involves various risks. Some risks are specific to the asset class and type of investment, while others—such as those outlined below—are more general and also depend on the specific implementation of the investment portfolio.

Country Risk

The value and availability of a financial instrument depend on the political, economic, and legal context of the country where it is issued or traded. Political instability, expropriation, nationalization, or government interventions in strategic sectors represent significant risks. Inflation, rising interest rates, or currency crises can also impact negatively. Investment security is further influenced by the quality of financial infrastructure and the level of regulatory transparency. Concrete examples include asset freezes, capital controls, or the imposition of sanctions.

Inflation Risk

Inflation poses a real threat to investors' assets, as it decreases the real value of invested capital. When a currency loses purchasing power—whether local or that of the investment currency—the real return (i.e., the gain net of inflation) can be severely impaired. This risk is particularly critical for long-term investments in foreign currencies, especially in countries with fragile economies or limited currency reserves. In such environments, central banks often struggle to contain inflation, causing significant price and exchange rate volatility. The result is a deterioration in asset values, potentially leading to substantial capital losses for the investor.

Settlement Risk

Settlement risk arises when one party involved in a financial transaction is required to fulfill its obligation (payment or delivery) before receiving the counter-performance. This creates the risk of paying without receiving the purchased instrument, or conversely, delivering an instrument without obtaining payment. This risk is particularly high in emerging markets, offshore funds, unlisted instruments such as private asset investments, and certain derivatives, where operational structures and execution guarantees may be less reliable, increasing the likelihood of delays or failures in completing the transaction.

Legal Risk

Legal risk occurs when an investment is subject to uncertainties or limitations stemming from the regulatory framework of the country where it takes place. This can involve investor protection laws, such as transparency requirements, fair disclosure, insider trading prohibitions, and management liability. The effectiveness of regulatory authorities, courts, and mediation bodies also plays a role. In weak or inefficient legal environments, investors may face difficulties enforcing their rights, particularly in cases of issuer default, potentially resulting in negative impacts on the investment.

Concentration Risk

Concentration risk, or accumulation risk, arises when an investor's portfolio is unbalanced, with a significant portion allocated to a single financial instrument, a limited number of securities, or a single asset class. Such exposure can lead to substantial losses during negative market phases, as the lack of diversification amplifies the impact of fluctuations. Conversely, a well-diversified portfolio spreads risk across a wider range of instruments and asset classes, helping to contain overall volatility. When deciding to buy or sell an investment, it is essential to analyze the overall portfolio composition, with particular attention to maintaining adequate diversification. Concentration risks should be assessed not only in relation to financial instruments, but also considering exposure to individual issuers, geographic areas, or economic sectors, to avoid excessive vulnerabilities.

According to market practice, indications of excessive concentrations may include:

- Concentrations of 10% or more in a single security
- Concentrations of 20% or more in individual issuers

Other concentrations may be considered (currency, geographic exposure, sector), while collective investments or other instruments that, by regulation, ensure adequate diversification are generally excluded from these rules.

Risk in Case of Leveraged Investments (Leverage Risk)

When an investment portfolio is financed with third-party capital or includes instruments with embedded financial leverage, it is essential to consider three specific risks.

- Leverage Effect
  Leverage can arise from credit, such as a Lombard loan secured by securities in the portfolio, or be embedded within the instrument itself (e.g., derivatives or structured products). In both cases, the leverage effect changes the risk/return profile: it can amplify gains on equity, but also losses. Fixed costs related to the credit or the structure of the instrument remain, while returns are uncertain. In negative scenarios, losses can exceed the invested capital, potentially leading to additional repayment obligations.

- Collateral Requirements
  A decline in asset value may trigger additional collateral calls (margin calls). If the investor fails to comply, the lender may liquidate part or all of the portfolio, even under unfavorable market conditions, causing further losses and liquidity issues.
- Currency Risk
  When the debt or instrument is denominated in a foreign currency, favorable interest rates can be offset by adverse currency fluctuations, increasing the overall risk.

Tax Risk
Financial instruments and invested assets are generally subject to taxation, with rates varying depending on the nature of the income generated. In particular, income is taxed differently if classified as interest or capital gains. Additionally, other taxes may apply, even if not directly related to the actual receipt of income.

Investments abroad carry the risk of double taxation when no tax treaties exist between the investor's country and the issuer's country. Some jurisdictions also impose withholding taxes that are not always creditable under Swiss tax regulations.

Regarding innovative or recently introduced instruments, tax treatment may evolve over time, especially if legislation is still under development. Finally, changes in tax laws may affect the prices of financial instruments, even without directly altering the tax burden for the investor.

ESG Risks
ESG risks (Environmental, Social & Governance) are events or conditions related to environmental, social, and governance factors that can have immediate or future negative impacts on profitability, operating costs, reputation, and thus on the value of a company or the price of financial instruments. Recent decades have shown that economic growth and globalization have brought both benefits and significant negative externalities, with effects not only on investments, but also on the environment and society as a whole. These risks may result in sanctions, loss of customers, reputational damage, or even business model crises.

ESG risks may manifest, for example, through pollution or unsustainable use of natural resources, unfair labor conditions, or opaque corporate practices. Some are classified as "physical risks" (e.g., extreme climate events), while others as "transition risks" (e.g., new regulations or changes in consumer preferences).

Although present in all financial products and partly identifiable, it is difficult to predict with precision their exact scale and timing. To manage them effectively, it is needed to analyze their causes, assess materiality, and adopt mitigation strategies, promoting proactive behaviors also from the investor.

Risks by Asset Classes

Money Market
Cash can be invested in the very short term through instruments known as "Money Market". They can be term deposits, fiduciary calls and bonds under six months. These instruments provide a return that is fixed at the beginning and, in some cases, periodically revised. This rate of return depends on the currency, counterparty risk, and the market situation.

The liquidity thus invested is subject to the following risks:

- Credit Risk: The available liquidity is entrusted to a counterparty. In the event that the financial soundness of this counterparty is compromised, all the capital entrusted is at risk;
- Liquidity Risk: The liquidity invested may not be able to be liquidated in part or in full before the natural maturity of the instrument, or may be liquidated only at a price lower than the market price;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio; and
- Market Risk: When investing in short-term bonds, securities are exposed to general market trends, so their valuation may depend on market fluctuations throughout the term of the investment.

Debt Instruments

Debt instruments are financial instruments that entitle you to a predetermined return (fixed or variable) whose repayment at maturity is guaranteed by the issuing company. There may sometimes be the possibility of early repayment. Fixed income securities are generally issued in a primary market and traded, until maturity, in a secondary market.

Debt instruments are distinguished primarily by type of issuer (government, corporate), risk (Investment Grade, High Yield), and type of fluctuation (fixed rate, variable rate, structured). In addition, there are other bonds that add a conversion option to the issuer's equity capital, such as convertibles and hybrid bonds.

Debt instruments are exposed to the following risks:

- Market Risk: Securities are exposed to general market trends, so their valuation may depend on market fluctuations throughout the term of the investment;
- Interest Rate Risk: Debt securities have greater or lesser sensitivity to market interest rates, and this sensitivity is generally (but not always) linked to the distance in time of maturity. The further the maturity, the higher the sensitivity to rates. In particular, when reference rates rise, prices tend to fall. Certain types of instruments can modify this relationship, e.g. floaters;
- Credit Risk: The security in question may not repay part or all of the assets invested due to the inability of the issuing company to meet the debtor commitments (insolvency). Credit risk has an effect at the maturity of the debt security, but it also influences the price at which it is traded in a secondary market. Credit risk depends on the soundness of the issuer, but also on the debt structure to which it refers and on any specific characteristics of the issue;
- Liquidity Risk: The security in question may not be able to be liquidated in part or in full at the market price due to the lack of buyers. Most debt instruments trade on unregulated markets and, in general, the secondary market depends on the willingness of the players to participate in the market. The liquidity risk is sensitive to the size of the issue, its credit risk and general market conditions; and
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio.

Equity Securities

Equity securities are financial instruments that entitle you to a share in a company or a common asset and its profits through dividends. In addition, ownership of these securities gives the bearer certain rights in relation to the management of the company itself, such as voting and election rights. With equity securities, all capital is at risk and repayment is not guaranteed. Equity securities may be entitled to a return and are normally traded on a secondary market.

Equity securities are exposed to the following risks:

- Market Risk: Securities are exposed to general market trends, so their valuation may depend on market fluctuations throughout the term of the investment. Compared to bonds, the volatility of equity securities is generally higher, especially in times of market stress;
- Liquidity Risk: The security in question may not be able to be liquidated in part or in full at the market price due to the lack of buyers. Most stocks trade on regulated markets and, in general, the secondary market depends on the willingness of the players to participate in the market. Liquidity risk is sensitive to the number of shares available on the market and general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio; and
- Issuer Risk: The security in question may be risk capital due to the inability of the issuing company to meet the debtor commitments. In the event of bankruptcy, the investor may lose the total capital invested and a possible partial repayment would be considered only after all other claims made against the company are settled.

Alternative Investments

Instruments that do not fall within traditional asset classes and generally pose a higher risk than other asset classes are considered alternatives. In asset management, investment in this asset class is most often indirect, through investment funds.

Commodities

Commodities are unprocessed physical goods used as inputs in the production process. Direct investment involves the physical possession of the asset, while indirect investment is possible through derivatives, especially futures and options. In this way, the investor can buy a standardized amount of a commodity at a certain future time at a set price.

Commodities expose you to the following risks:

- Market Risk: Securities are exposed to general market trends, so their valuation may depend on market fluctuations throughout the term of the investment;
- Liquidity Risk: The security in question may not be able to be liquidated in part or in full at the market price due to the lack of buyers. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio; and
- Basic Risk: The risk arises from the fact that most transactions are carried out in the derivatives market and the reference contract may not be in line with the performance of the underlying commodity.

Real Estate

Investments in the real estate sector are mostly made through indirect means, and can be divided into different sectors (residential, commercial, industrial) or types (purchase or rent). Real estate investment may also involve the use of leveraged instruments. Indirect investment avoids some problems such as high transaction costs but makes the potential for diversification with traditional assets less effective.

Real estate investment exposes you to the following risks:

- Liquidity Risk: The investment may not be able to be liquidated in part or in full at the market price due to the lack of buyers. It may not be possible to have a market price. Liquidity risk is sensitive to general market conditions;
- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio; and
- Leverage Effect Risk: The leverage effect caused by the use of debt or derivative instruments amplifies market price fluctuations, resulting in a loss that, in the case of adverse fluctuations, may reduce the capital to zero.

Private Equity/Debt

So-called Private Equity investments provide exposure to venture capital investments or debt securities not listed in the markets, the valuation of which is therefore difficult and based on very uncertain growth estimates. Investments in private equity are not normally regulated, especially with regard to the protection of investors in terms of transparency and reporting and this exposes the investor to considerable information asymmetry and, therefore, considerable risks.

Investing in Private Equity exposes you to the following risks:

- Liquidity Risk: The investment may not be able to be liquidated in part or in full at the market price due to the lack of buyers. It may not be possible to have a market price. Liquidity risk is sensitive to general market conditions;
- Commitment Risk: The investor commits a share of his/her capital for the entire term of the investment and risks significant penalties and a substantial loss of the investment in the event that he/she fails to comply with the capital calls in the terms set by the contract;
- Market Risk: The investment is exposed to the general trend of the market, so its valuation may depend on market fluctuations throughout the term of the investment. The realization of the return is subject to the market context in the exit phase;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio; and
- Leverage Effect Risk: The leverage effect caused by the use of debt or derivative instruments amplifies market price fluctuations, resulting in a loss that, in the case of adverse fluctuations, may reduce the capital to zero.

Art and Collectibles

Investments in art or other collectibles (wine, cars, etc.) are difficult to assess and belong to very specific and specialized markets.

Investing in art or collectibles exposes you to the following risks:

- Liquidity Risk: The investment may not be able to be liquidated in part or in full at the market price due to the lack of buyers. It may not be possible to have a market price. Liquidity risk is sensitive to general market conditions;
- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment; and
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio.

Risks by Type of Instrument

Direct Investment
Direct investment allows exposure to an asset class through direct ownership of the instrument in question. Direct investment may expose you to the specific risk of the instrument, in addition to the risks of your asset class.

- Specific Risk: In addition to general market risk, the individual security may be exposed to specific events related to the issuing company or issue that may adversely affect its valuation. Specific risk can be mitigated within a portfolio by diversifying into multiple investments.

Indirect Investment
Indirect investment provides access to one or more asset classes through a collective investment scheme (investment fund), derivative, or structured product.

Indirect investing can mitigate some of the risks of direct investments in certain active assets, possibly providing more liquidity or diversification, while maintaining all the basic risks of the asset classes in which it invests and resulting in higher management fees.

Collective Investment Scheme
Collective investment schemes (investment funds) are types of investments that collect the capital, generally of several investors, in a single asset, which can be invested in different asset classes. Each is characterized by its own investment strategy and/or benchmark. They also differ in the level of regulation to which they must adhere and in the type of clients to whom they are directed.

Investment funds are also subject (in addition to the analysis of the type of strategy) to the organizational and operational structure (due diligence). The fund's establishment documents, fund rules, articles of association or corporate agreement, describe the investments that a particular fund may make.

UCITS
UCITS funds are defined as all funds that follow European legislation for funds that invest in securities. The legislation aims to ensure sufficient regulation to protect the investor, obliging funds to be sufficiently diversified, to have at least bimonthly liquidity, and to invest in securities with good liquidity. Given the level of protection, funds that comply with UCITS regulations are funds that are generally suitable for all types of investors in the markets in which they are registered.

The risks to which investments in UCITS funds are exposed are:

- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment;
- Liquidity Risk: Due to the extent that the risk is mitigated by law, the investment may not be able to be liquidated in part or in full due to the difficulty of liquidating the underlying portfolio. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio;
- Leverage Effect Risk: The leverage effect caused by the use of derivative instruments amplifies the fluctuations of the value of the fund; and
- Credit Risk: In cases where the fund makes extensive use of derivatives, there is a risk that the derivative counterparty will fail to honor the contract.

ETF
A particular category of investment funds is represented by ETFs, funds that can be traded on the regulated market continuously. Characterized by being low- cost, ETFs generally passively track a benchmark index. The regulation to which ETFs are subject may vary. ETFs are distinguished by benchmark index, leverage level and index replication methodology.

The risks to which investments in ETFs are exposed are:

- Market Risk: The investment is exposed to the general trend of the market, so its valuation may depend on market fluctuations throughout the term of the investment. In particular, it depends on the performance of the reference index;
- Liquidity Risk: The investment may not be able to be liquidated in part or in full due to the difficulty of liquidating the underlying portfolio. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio;
- Leverage Effect Risk: The leverage effect caused by the use of derivative instruments amplifies the fluctuations of the value of the fund;
- Tracking Risk: Due to costs and market imperfections, it is possible that the result of the fund does not exactly replicate the benchmark; and
- Credit Risk: In cases where index replication is done through derivatives, there is a risk that the derivative counterparty will fail to honor the contract.

Hedge Funds
So-called hedge funds are funds that are based on less stringent regulations both on the types of investment and on the operational structure. As a result, hedge funds have more freedom of investment but also greater risks. Funds that comply with AIFMD regulations provide greater protection from the point of view of the structure. Hedge funds are generally suitable for Professional or Qualified Investors. Hedge funds are subject to more in-depth analysis and very high due diligence costs.

The risks to which investments in hedge funds are exposed are:

- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment;
- Liquidity Risk: Due to the great freedom of investment, the fund may not be able to be liquidated in part or in full due to the difficulty of liquidating the underlying portfolio. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio;
- Leverage Effect Risk: The leverage effect given by the use of derivative instruments amplifies the fluctuations of the value of the fund. Depending on the investment strategy, this can also lead to a zeroing of the investment;
- Tracking Risk: Due to the fund manager's decisions, costs, and market imperfections it is possible that the fund's result does not exactly replicate the benchmark;
- Due Diligence Risk: Due to poor regulation it is possible that there may be undetected risks or deficiencies in the operational structure or management activity; and
- Credit Risk: In cases where the fund makes extensive use of derivatives, there is a risk that the derivative counterparty will fail to honor the contract.

Derivatives

Derivatives are indirect investment instruments whose value depends on a characteristic (value, return, volatility) of a particular asset called the underlying asset. The most common derivatives are forwards, futures, options, and swaps and can arise from any asset class, especially Stock Indices, Currencies, Interest Rates, and Commodity Indices. Derivatives can be considered as contracts that are entered into with a counterparty.

Derivatives can be used for the purpose of hedging a risk, i.e. to reduce any loss in value, or with speculative intent, i.e. with the intention of providing an additional source of income to the portfolio.

The possibility of participating in profits and losses with a fraction of the necessary investment (leverage effect) is characteristic to derivatives. This effect exposes committed capital to amplified risk.

In addition, the use of derivatives often requires maintaining a margin, that is, a level of liquidity that the client must have in their account, equal to a percentage of their leverage exposure. The margin required may vary periodically depending on the value of the derivative and this may result in greater liquidity in the account being required.

The main risks to which investments in derivatives are exposed are:

- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment;
- Liquidity Risk: The investment may not be able to be liquidated in part or in full at the market price due to the lack of buyers. Some derivatives are not listed on a regulated market. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio;

Via Serafino Balestra 17
6900-Lugano
Phone +41 91 260 85 85
info@bancazarattini.ch
bancazarattini.ch

- Leverage Effect Risk: The leverage effect caused by the use of derivative instruments amplifies the fluctuations in the value of the investment. This can also lead to a zeroing of the investment; and
- Credit Risk: In some cases, there is a risk that the counterparty to the derivative will not be able to honor the contract.

One of the most commonly used types of derivatives is a foreign exchange forward (or currency forward), which is a commitment to make an exchange transaction on the currency market on a future date and at a predetermined rate. Although it is mainly used as a hedge against the exchange risk in a portfolio, this type of derivative entails the typical risks of an investment in derivatives listed above.

Structured Products

Structured products are indirect investment instruments created to meet specific investment needs and which have a more complex payment or redemption methodology than traditional asset classes or investment instruments. The value of structured products is typically dependent on one or more characteristics of one or more underlying assets.

The risks to which investments in structured products are exposed are:

- Market Risk: The investment is exposed to the general trend of the market; therefore, its valuation may depend on market fluctuations throughout the term of the investment;
- Liquidity Risk: The investment may not be able to be liquidated in part or in full at the market price due to the lack of buyers. Most structured products are not listed on a regulated market or do not have sufficient liquidity. Liquidity risk is sensitive to general market conditions;
- Exchange Rate Risk: In the case of investment in currencies other than the reference currency, changes in the exchange value between the two currencies may affect the final valuation of the portfolio;
- Leverage Effect Risk: Some structured products incorporate a leverage effect that amplifies the fluctuations in the value of the investment. This can also lead to a zeroing of the investment; and
- Credit Risk: Some structured products depend on the solvency and soundness of the issuer.

Loans for investing in financial instruments

The use of credit lines for financial investments exposes the investor to increased risk. In particular, in addition to the typical risks of the underlying investment, it also exposes the investor to:

- The risk of the leverage effect: using debt to increase the results of the investment amplifies the movements in the value of the portfolio. This can also result in the invested capital being reduced to zero;
- The risk of a margin call: in the face of large changes in the value of the portfolio, the Bank may request that the debt be reduced or the hedges restored (a margin call) or, in extreme cases, it may sell the pledged assets to reduce debt exposure. This may result in the closure of loss-making positions, which means that losses will be incurred without the possibility of recovery should the market turn favorable again.