STRUCTURED PRODUCTS

One well known financial commentator recently remarked that IFAs should not market anything they do not fully understand, and thus Structured Products should be outlawed for retail investors. I found that comment strange, as personally whilst I can drive a car, I do not really have any ideas of the internal workings that comment even more true when you consider the number of hybrid cars on the road. Thus I guess to comply with the financial commentator's view I should take a bus, I don't think so.

We remain quite bullish as to the rationale why Notes should be considered for many investors. Over the past 12 months from one of our providers 31 of the 35 notes we marketed called in the first year. Consider that clients who were invested long in the market over the past 12 months, have had some moments of panic, Euro Debt fears, earthquakes in Japan, asset bubbles, and now revolution in the Middle East. At least clients invested into these notes over the last year have had just one down side risk, the credit rating of the issuer. Well since it is strongly suggested that no government will let any banks fail now, it means investors in notes can sleep at night. The fact that they may be complicated, the fact that few people really understand them, well I still drive my car, it has always got me where I want to go, it works, why fix it!

How They Work - Structured Notes / Auto-Calls

Autocalls sometimes referred to as "snowballs", have three main elements:

The Guarantee or Protection
The Coupon & the asset
The Term

The Guarantee or Protection:

The majority of the notes we see are "SCARPS" Structured Capital at Risk Products. We do occasionally offer 100% guaranteed products.

The protection will typically be a 100% capital guarantee, provided the assets the note is linked to does not fall in value by more than say 50%. Thus an investor has to weigh up what he considers the likelihood of say the FTSE 100 falling say from present day 6000 to below 3000.

Many of the notes we offer provide what we term as European Protection, this means that the asset only has to be above the 50% value at the end of the term. Thus in this case the FTSE could fall below 3000, and provided it has recovered to over 3000 by the end of the term the 100% capital protection remains.

The second issue with the guarantee or protection is the security of the issuer. So for example if the issuer, or institution offering the guarantee is say Royal Bank of Scotland, then as that bank is majority owned by the UK Government then the reality is that we have to feel comfortable that the UK government will meet any commitments.

The Coupon:

The coupon or amount of return the investor receives is largely dependent upon the nature of the asset it is related to. Thus, for example, a note linked to The FTSE, The S&P 500 and Eurostox, is likely to have a much lower coupon than a note linked to the Hang Seng, The NIKKEI and the price of gold. Again a common sense approach is clear, your advisor will be able to provide the history of the assets, and you can make a judged opinion as to whether you perceive that perhaps at this time with gold at $1500.00 per ounce, you believe it will go higher, or perhaps it is as high as it is likely to go. If on the other hand as we look back just a few years, when the FTSE was at 4000, down from over 6000 and the S&P in a similar situation, many investors could see there was little likelihood of them falling by 50%, and a strong likelihood of them being higher at some point over 5 years

The Term:

Generally 5 years, occasionally 3 years. However, this is the maximum term; our actual experience has shown that over the past 12 months 90% of these notes have lasted one year or less.

How they work:

Simplicity itself. A protection or guarantee is generally provided by a major bank. An investment linked to an asset class, e.g. FTSE 100 and S&P, provided the assets do not fall by more than 50% from the "strike price", the investor will have a guarantee that they will receive their original investment back (sometimes with a deduction of a small establishment fee). Each anniversary the investment is reviewed, if the assets are at a higher price than the "strike price" the investment matures and pays out the coupon, and the return of the original investment. If the prices are not higher it rolls onto the next year, until the term, and then if the prices are still not higher, and the assets have not fallen by 50%, the investors receive back their original capital.

Conclusion:

There are numerous variances of the above, but this gives a general over view. Notes can offer coupons in excess of 20% per annum, down to around 2% per quarter. Remember these are "snowballs" so if it does not call in year one, the 20% would roll onto year two, if it calls then the investor receives 40% plus a return of the original investment. Notes offer investors some degree of protection on the downside, whilst providing attractive returns. The risks, taking out the potential of the failure of an issuer, are that if the asset class falls in value by 50%, then the investor could lose capital. Plus if the note does not mature early, the investor will only receive back their original investment.