Choosing the right investment product for the current market environment

Marc Waldhof, Sales Investment Solutions at structured products specialist Leonteq Securities gave a presentation to the Hubbis Thailand Wealth Management Forum to offer delegates insights into structured product solutions that offer an ideal fit for the prevailing global financial market conditions. Structured products (SPs) can ideally complement the portfolios of the HNW client and both provide upside potential, downside protection and recovery from loss.

WALDHOF BEGAN BY REMARKING HOW WITH markets at high valuations but again performing well after a difficult 2018, there is a lot of volatility that needs to be carefully managed. He explained that his mission in his talk was to offer delegates three solutions ideal for their portfolios amidst such global financial market conditions.

Swiss-based Leonteq, he said, had been operating from Singapore for more than seven years, offering a range of bespoke structured investment products. The firm now employs a team of 50 there and 15 more in Hong Kong, and has a new seven-strong headcount in its newly opened office in Tokyo, therefore giving it excellent coverage in the region.

The acceptable face of Shark's Fin

His first suggestion was a capital-protected note that he said basically helps investors to lock in the gains that hopefully they had already made in early 2019, but still offer them some benefit from the further upside. This product is named the Shark Fin Note. It offers up to 100% capital protection at maturity, meaning if the market does not perform, the investor's initial investment would not be at risk.

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It is suitable for investors who are moderately bullish on the underlying as it offers investors upside participation up to the predefined barrier level. Even if the underlying does breach this barrier level, a rebate coupon could be paid. Waldhof illustrated this with reference to some excellent slides for the delegates.

The underlying can be chosen by the investor so it can be an ETF, it could be a basket of stocks, it might be commodities or anything the client decided upon. Waldhof highlighted an example of a Shark Fin Note in US dollars that is 100% capital protected at the 18-month maturity, with the underlying comprising an average basket of two stocks, Apple and Google. The 'strike' level is 100% of the initial fix so the basket performance will be based according to the strike level.

He explained that if the basket moves up by 1%, the investor will receive a 1% return. And the barrier is set at 117%, which means that if the basket climbs by 17% or more from the initial level during the lifetime of the products, the barrier level would have been breached. When the barrier has been breached the investor will at maturity receive the 6% coupon, equivalent to 4% per annum return for the 18 months.

"Here we can work with our clients on a bespoke basis," he added. "They tell us their portfolio construction, their conviction list and then we can come up with a solution tailored to their needs."

Waldhof also focused on what happens if the underlying does not perform and the basket falls, for example, by 10% and thereby closing at 90% of the initial investment. Because the product is 100% capital protected, the client will still receive their initial investment back, but of course, will not receive any coupon in this scenario.

Should the basket move up 10%, this results in the client earning a 10% return, in other words in a one to one ratio, or 15% for a 15% rise in the basket. But if, on any single day, the basket breaches the 117% threshold, so for example if it ends up at 120%, instead of getting the performance at maturity the client will receive only the flat coupon, in this case, the 6% flat coupon return.

Accordingly, the sweet spot is actually in the range only up to the 117% threshold, within which the client participates along with the positive performance of the basket. But if 117% is breached, the client only receives back their capital plus the modest coupon.

Shaped and sized to fit

"You can create these products on the way up as well as on the way down," Waldhof told delegates, "for example if you have a bearish view. And we also do this on gold, which is popular. And we can do multi-issuer deals, and you will note we partner with some major global and regional European banks, and also with Raiffeisen Switzerland, which is the third biggest bank in the country after UBS and Credit Suisse, as well as being our biggest shareholder. In

short, you can really choose the credit risk you are comfortable with and then create a product the way you want it."

He added that with Leonteq's substantial investment in technology and automation over the past decade, entry tickets can be as low as USD50,000. "We can create the products for individual clients," he commented, "so we do not need to pool everybody into one individual note if it does not match their individual risk profile."

Protecting the downside

Moving on to capital protected structures with coupons, Waldhof explained that these are effectively cash replacement ideas. This SP is a straightforward trade, with a one-year maturity, and 100% capital protected; every quarter if the selected underlying stocks are up, by any amount, the product is early redeemed at 100 plus an 8% annualised coupon. The memory feature means it is accruing, and when all the underlyings, on any given quarterly observation, are above the initial fixing, the investor receives the initial capital plus the 8% coupon, which obviously is more than an investor could earn on a bank deposit in Thailand. There is no downside risk, other than the credit risk of the issuer.

This type of structure can also be based on Thai stocks, but as Leonteq is offshore, the firm must only use Thai stocks with no voting rights. "However, the bigger angle is really US, European, Japanese, and Hong Kong stocks, where there is more demand," Waldhof reported.

A cure for the morning after

The third product he highlighted is what is called a recovery product. It involves, for example, three stocks, a fixed coupon of 12% per year and some downside protection of 25% of the original capital. If for example, the investor is down 16% at a point in the structure's life, Leonteq can offer to buy back the products that are underwater and issue a new product that costs exactly the same amount with the sole purpose of recovering that loss.

"How we do this," he reported, "is that we extend the maturity and we take away the coupon which enables us to issue the note at the same price as your old product cost. That way the client has no cash flow outgoing and usually is quite happy about these proposals (proactive service focused on capital preservation, this is often appreciated, especially in bad times)."

Waldhof explained that this type of recovery product has been a popular topic of discussion with clients since December, when a lot of products, including equity, were underwater, and the clients were looking to get out of those positions without realising a loss. He then explained in more detail how the recovery structure works in practice.

He closed his talk by noting that on the strength of its offerings, the firm is in a rapid expansion phase Asia, and that the SPs it has created and that are in the production line are being well received in Thailand, where the firm is expanding robustly, working with a variety of securities houses, brokers, asset managers, and other parties. ■

Leonteq: At the Cutting Edge of Structured Products Creation and Delivery

Leonteq AG is a Swiss company active in the finance and technology sector with a focus on the structured products segment. Based on proprietary, high-powered, modern technology, the company offers products and services related to derivative investment products and predominantly covers the capital protection, yield enhancement and participation product classes. Leonteq acts as both a direct issuer of its own products and a guarantor for clients, as well as a partner to other financial institutions.

In partnerships with banks, for example, Leonteq produces structured investment products using its technology platform, which are then issued by the banks, which act as guarantees for buyers.

Alongside its core business, Leonteq also helps life insurance companies to produce capital-efficient, share-linked pension products with guarantees.

Leonteq on its website explains that its partner institutions include the banks Aargauische Kantonalbank, Bank of Montreal, CornŁr Bank, CrØdit Agricole CIB, Deutsche Bank, EFG International, JPMorgan, Raiffeisen Switzerland, Mobiliar and Helvetia Insurances.

Cutting edge platform

Leonteq combines a fully automated and integrated proprietary technology platform - designed for flexibility, innovation and transparency - with an international team of specialists.

The firm's proprietary technology platform makes it possible to instantly calculate complex structured financial products, even when tailored to individual customer requirements, and produce all the necessary documentation automatically in several languages. To do this, its system accesses over 1,200 share values and other asset classes, as well as around 80 indices as underlying assets.

Very high levels of automation lead to competitive costs per issued product, as well as allowing for small ticket sizes. This allows the firm to be at the cutting edge of cost leadership as well, helping it offer attractive pricing to the end customers, while also facilitating appropriate fees for the intermediaries Leonteq works with around the world.

Leonteq was founded in Switzerland in 2007 and was floated on the SIX Swiss Exchange in 2012. The firm now employs around 440 people globally and has offices and subsidiaries in ten countries, through which it serves over 30 markets. Alongside its headquarters in Zurich, it has offices in Amsterdam, Frankfurt, Geneva, Hong Kong, London, Monaco, Paris, Singapore, the British Channel Islands (Guernsey) and Tokyo.