Swimming with Sharks: Capital Protected Structured Solutions for Uncertain Times

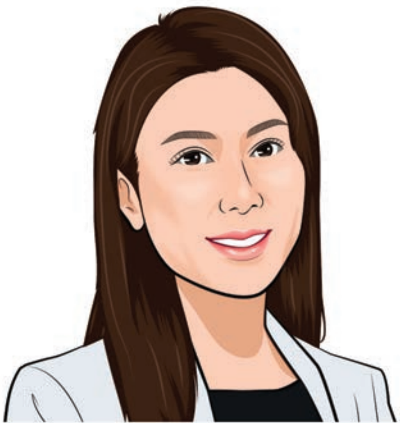
Agnes Shea, Co-Head of Private Banking Sales Asia for Leonteq Securities is adept at working with the wealth management community in the region to tailor structured investment products for the client portfolios. She gave a presentation at the Hubbis Asian Wealth Management Forum to explain why she believes that Leonteq can offer some smart capital protected structured products for Asia's HNW community, especially during volatile market conditions.

SHEA BEGAN BY WELCOMING THE POSITIVE PATH of the financial markets thus far in 2019 noting that at the time of the Forum, February 26, global markets had been on a bullish trend for several weeks. The S&P, she reported, had broken its 200-day moving average, the NASDAQ index was up 20% since its Christmas eve low, and only the day before, on February 25, China had rallied 6%.

Up again, but for how long?

"However," she remarked, "some notable market risks continue to linger in the minds of investors such as the US-China trade war, Brexit uncertainty, and signs of global economic slowdown. So, in this market environment for investors who are still moderately bullish and would like to have exposure to certain underlying assets but at a reduced risk, they may consider investing into a capital protected product called Shark Note or also called Shark Fin."

With that, Shea dived into the waters and explained that she would highlight the appeals of Shark Notes, which she said had become very popular in the wealth management world since last year. Specifically, she would cover two versions, one is the 100% capital protected version and also another template, the 95% capital protected version.



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The Shark: a wonder of creation

A Shark Note offers up to 100% capital protection at maturity, she reported, meaning if the market does not perform, the investor's initial investment would not be at risk. It is suitable for investors who are moderately bullish on the underlying as it offers investors upside participation up to the predefined barrier level. And even if the underlying does breach this barrier level a rebate coupon could be paid. She illustrated this with reference to some excellent slides she presented to the delegates.

She then offered an example. She highlighted a Shark Note in US dollar 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 she explained is 100% of the initial fixing so the basket performance will be based according to the strike level.

No basket case

She explained that if the basket moves up by 1% the investor will receive 1% return. And there is a barrier at 117%, which means if the basket climbs by 17% from the initial level on any trading day, based on the closing price that day, the barrier level would have been breached. When the barrier has been breached then the investor will receive the 6% coupon at maturity, equivalent to 4% per annum return for the 18 months, she noted.

Shea also highlighted another version with an early redemption feature, which means an investor would not need to wait until the 18 months to receive their initial investment and the coupon upon the breach of the barrier. This, she said, has become moderately more popular lately because it is more difficult for clients to invest in an 18-month product, especially when the market is becoming a little bit more uncertain.

No need for make-up

She also focused on what happens if the underlying does not perform and the basket falls, for example, 10%, thereby closing at 90% of the initial investment. "Because the product is capital protected, the client will still receive their initial investment back," she reported, "so the real beauty is they are 100% capital protect but of course will not receive any coupon in this scenario."

She also considered what happens if the basket moves up 10%. This results in the client getting 10% in 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%, at maturity instead of getting the performance the client will receive only the flat coupon, the 6%. in this case 6% flat coupon return.

Sweet spots

"Accordingly," she told the audience, "you can see the sweet spot is actually in the range only up to the 117%, within which the client participates alongside the positive performance of the basket." But if 117% is breached, all bets are off and the client only receives back their capital plus the modest coupon.

An alternative sees the investor willing to take on a 5% risk to their capital and invest in a 95% capital protected product. All other terms remain the same, but because of taking the 5% risk the rebate coupon rises from the previous 6% to 16% flat. Accordingly, if the 117% barrier does get breached on any single day the client would actually receive roughly 10.67% per annum in return.

And if for this 95% product at maturity the basket closes 10% down, the investor suffers only a 5% loss of the initial capital.

And should the basket on any day breach the 117% barrier, for example if it closes at 120%, because of the 5% risk that the investor has taken, the rebate has as a result significantly improved. "This means," Shea elucidated, "that even if there is a breach of the barrier, the client will still receive a 16% rebate at maturity." ■

Leonteq: Building its Name and Product Delivery in Asia

Leonteq is an independent financial services firm, listed on the stock exchange in Switzerland. Leonteq has around 480 employees globally in 11 offices. In Asia, the firm operates through the regional headquarters in Singapore, and has an office and onshore license in Hong Kong and Tokyo.

Switzerland is one of the largest markets globally for SPs in terms of volume, and Leonteq is one of the largest issuers. In 2018 the firm issued roughly 28,000 bespoke products, for a total traded volume globally of around CHF28.8 billion.

The firm is an expert at creating products for financial institutions, mostly private banks, securities houses, who sell them to their private clients. Leonteq also creates SPs tailored for institutional clients such as the asset managers and insurance companies, for their own investment purposes.

A key feature of SPs is that they can be customised to align directly the risk-return profile of the investors with their investment views. Crucially, they are not created by Leonteq based on any views the firm might have on the direction of any markets.

Leonteq is well known for having an outstanding technology platform, from which it can create these tailored SPs efficiently. The firm aims to be faster to price and issue new products, while proposing competitive pricing even for small trade sizes. Innovation and flexibility are core to Leonteq's abilities to suit local needs.

Structured products (SPs) are usually created from the combination of a liquid asset and a derivative, packaged in a single product. SPs are therefore tailor-made solutions that can be created on various asset classes, such as equities, indices, ETFs, mutual funds, commodities, FX, interest rates, credit and so forth.

SPs can for simplicity be defined in three categories. The first is the capital protection SP; this is typically created on low volatile underlying assets, such as fixed income and balanced funds. It allows the investor to participate simply in the fund performance with full capital protection.

The second SP would be classified as yield enhancement product. It is usually used on volatile underlying assets, such as equities, indices and commodities. Investors will receive a fixed guaranteed coupon/yield (the upside), while combining soft downside protection.

The third category is the participation product. It allows the investor to get more upside with the same downside risk inherent to the underlying asset(s); or the same upside with less downside exposure. These products are usually seen as equity replacement ideas.