Weekly Analysis

M. Alain Freymond—Partner & CIO

OPTIMIZING AN INVESTMENT STRATEGY WITH STRUCTURED PRODUCTS

SMART BRC+ Yield enhancement : a BBGI concept focused on the use of BRCs

Key points

- A brief overview and classification of structured products?
- Institutional and private investors increasingly convinced
- The 3 main forms of structured products
- Demystifying supposed risks
- Flexible instruments for all types of markets
- How to assess their effectiveness?
- SMART BRC+ Yield enhancement : a BBGI concept focused on the use of BRCs
- An alternative to bond investments?

A brief overview and classification of structured products?

Structured products may appear complex, but their popularity has grown over the last few decades, thanks to their ability to respond precisely to investors' needs and market expectations. Legislators generally consider structured products to be a specific asset, and include them in a typology that classifies non-traditional investments into a category often referred to as alternative investments. This includes virtually all assets other than cash, bonds, equities and real estate. In OPP2, in Article 53, « Permitted investments », structured products are included among « claims that are not listed in para. 1, let. b, d bis or d ter, are treated as alternative investments, in particular claims that are not denominated in a fixed amount or whose full or partial repayment is linked to conditions... ». The structred products are also explicitly mentioned as a type of financial product that falls into the category of alternative investments (Art 53 al4). Structured products often offer de facto bond-like features with certain risk and opportunity characteristics linked to another asset, defined as the underlying asset. Like bonds, they incorporate a credit risk, a coupon or a predetermined profitability structure linked to the underlying asset. Convertible bonds, which have long been well known to institutional and private investors, also incorporate the concepts mentioned above, by offering a return linked to the performance of a share, for example, under certain conditions. Bonds with options linked to inflation or gold, for example, have also long been part of the universe of investments considered by many investors as simple bonds. Art. 53, par. 1, let b, point 4 of the OPP2 simply classifies « bonds, including convertible bonds or bonds with option rights », although from a technical point of view the distinction with certain structured products is not obvious. In the case of structured products, the link with an underlying asset also exists, and can expose the investor to some or all of the upside potential, as well as some or all of the downside risk, in exchange for a coupon that is often significantly higher than the short-term market rate. In practice, many investors see structured products as extensions of their specific asset class strategies, and view them as sub-segments of their underlying asset class. For example, an equity-linked structured product could be considered as potentially forming part of an investor's overall equity allocation in order to estimate the overall exposure to equity risk over the life of the product, and in particular at maturity if the structured product were to lead to the receipt of securities instead of repayment of the note. The same would apply to equity convertible bonds.

Institutional and private investors increasingly convinced

Over the past few years, institutional investors have significantly increased their allocation to real and non-traditional assets, with the main aim of improving risk diversification and maximizing returns on their strategies by integrating real estate, private debt, commodities and structured products. It then became clear that diversification into a wider range of asset classes, with little or no correlation with equities and bonds, could improve the risk-return profile of their investment policies. Recently, when it comes to asset allocation, 60/40 (bonds/equities) or 40/60 strategies have once again proved ineffective compared to better