Products for the

everyday investor

Offering little to no risk, structured products are an obvious no-brainer.

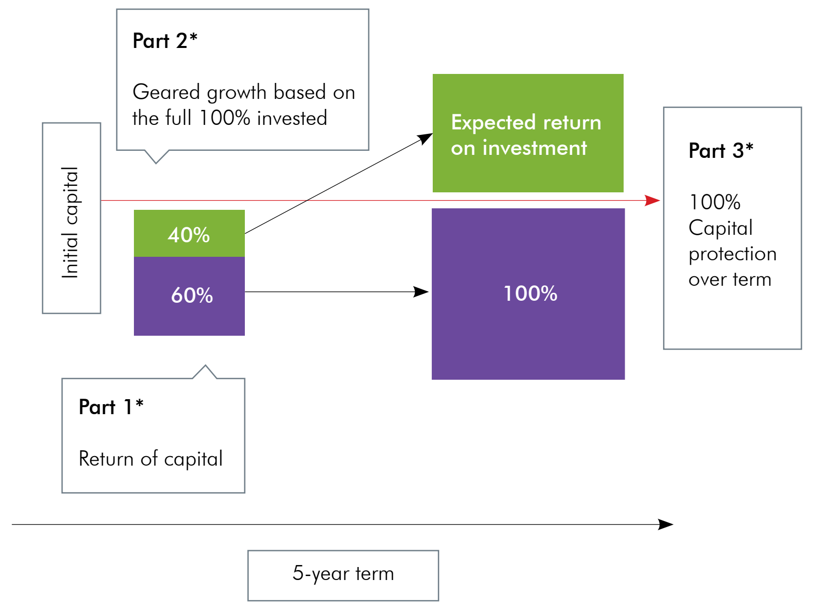
Most investment products are designed for long-term investing because the longer you have to invest, the more time you have to recover from downward markets.

But what about those of us who don't have the benefit of time and have short- to medium-term investment goals such as:

- Children going to university in five years' time.
- Good growth in the markets over the last decades but think that the market is overheated and want to protect your gains, but still want to be exposed to potential market growth in case the market recovers (as all markets eventually do).
- Already retired, but need to be exposed to the market for additional capital growth to fund living longer in an increasing inflation environment, but don't want to risk current capital.

Is there something to invest in for the medium term with little or no risk of losing one's capital? The answer is yes. Enter structured products for the everyday investor.

Due to technological advancements, structured products – once the domain of big institutions – are now freely available to the everyday investor and are excellent diversifiers to existing wealth accumulation strategies and offer capital protection over the short to medium term. Think of it as investing in the stock market with capital protection (in other words no downside risk). Who wouldn't want that?



*Assumptions (For illustrative purposes only)

- 60% of the initial investment amount after fees and costs is used to return your capital at maturity (Part 1)
- 40% of the investment amount after fees and costs is used to purchase the underlying index to provide the investment return but is based on the full 100% invested after fees and costs (Part 2)
- 100% capital protection over term (Part 3)

Source: Itransact

Financial advisers and their clients who already have these products are beginning to appreciate the phenomenal value they offer.

What is a structured product?

In their purest form they:

- Are listed shares on the Johannesburg Stock Exchange (JSE) like a normal share with a daily value.
- Typically have fixed terms of five years.
- Have varying levels of capital protection, most offer 100 per cent capital protection, shielding investors from downside risk.
- Use well-known and regulated local and offshore indices such as the SA Top 40 Index or the Euro Stoxx 50 Index.
- Have the ability to provide returns in most market conditions at very competitive fees.
- Fees are fully disclosed and paid once-off and upfront, which means that the product can grow unfettered from the harmful effect of fees charged on market growth over the term.
- Can be 'wrapped' in a five-year term endowment policy offered by a life assurer for financial planning reasons, such as ensuring the intended investment strategy is fulfilled for the benefit of the nominated beneficiaries even though the initial investor dies before the maturity date.

How do structured products work?

Simplistically, they consist of two parts:

Part 1 (Return of initial capital)
A portion of your investment is used to purchase an investment that will guarantee your initial capital back at maturity no matter what the markets do.

Part 2 (Investment growth)
The remaining portion of your investment is exposed to an underlying index to capture positive market returns over the term of the investment, but because of the benefit of sophisticated structuring methods, the returns are based on the full 100 per cent invested. This method is commonly known as gearing, or in simpler terms, a force multiplier.

What are the fees and costs?

Because most structured products are listed on stock exchanges like the JSE they have a daily share price that is determined by the issuer of the share. The fact that they are listed shares means that they are also liquid, meaning investors can sell them before their maturity date (if it is an absolute must) but at the market rate, which could mean the loss of capital if the markets are in negative territory.

The price includes all the fees and the costs of the underlying instruments and the capital protection mechanisms that deliver the initial investment amount back, plus the expected returns.

In exchange for the above benefits, the investor forfeits the dividend stream of the underlying instruments, which is a small price to pay for 100 per cent capital protection and a geared return of the market.

Other fees such as advice and administration fees are applicable and are typically under 1 per cent per annum, including VAT, making structured products low cost in relation to receiving all the value-adds like capital protection and access to markets everyday investors cannot readily access.

Are structured products regulated?

Structured products bought through authorised financial advisers and investment platforms are governed by the Financial Services Board, which was set up to administer certain acts such as the FICA (Financial Intelligence Centre Act) and FAIS (Financial Advisory and Intermediary Act). Because structured products are listed shares on the JSE, they are also governed by the FMA (Financial Markets Act).

How to invest?

Structured products are typically acquired through an authorised financial adviser who uses an investment platform, such as iTransact, to access multiple structured products from multiple issuers. Minimum investment amounts generally start at R20 000 lump sum, making institutional-grade structured products very accessible to everyday investors.

What are the risks?

Structured products are provided by banks, so the investor takes on the credit risk of the issuing bank. If the structured products are wrapped in an endowment policy, the investor also accepts the capital adequacy risk of the chosen life assurer.

Because of the capital protection mechanisms, investors do not take any downward market risk – this being the key benefit of a structured product – investing in the markets with little or no 'downside' risk.

Investors should also be aware that some structured products may cap the 'upside' growth, meaning that despite having capital protection, if markets run, investors may lose out on some of that run – but on the other hand, if markets fell, investors would be protected.

Lance Solms,
head of Itransact