QUADRA WEALTH

Structured NOTES FOR DUMMIES

Introduction

Let's face it: the term "structured notes" is not the best one. While not conveying what it is, it has the added disadvantage of sounding intimidating. The good news is that it's not as complex as it seems!

Imagine the scenario in which a novice investor is presented with two choices:

- ☑ buying the shares of Apple or,
- ☑ buying a structured note linked to the same share.

Most likely than not, our investor would not blink before choosing the first. After all, he knows Apple and is familiar with the concept of buying shares.

At the same time, a structured note might sound like a black box to him.

What if the same investor was presented with the very same options, but worded in a different way?

Would you like to buy shares of Apple directly or invest in Apple with a customization of risk and return that better matches your needs?

The conversation is immediately very different and more likely than not the investor will at least want to find out more.

And yet the only difference between both questions is that the term structured note was replaced with a much better sounding name: **customized investment.**

Not only is customized investment a better sounding name, it also better reflects the reality. A structured note is effectively an investment which has been customized to best meet the requirements of an investor.

Requirements can be anything: from the selection of the underlying asset (Apple, in our example), to the maximum loss one is willing to accept, the length of the investment, etc.

Summary

Before we dive deeper into the world of customized investments, let's understand how these products came about.

Structured notes were originally issued by banks as a cheaper source of funding.

Instead of issuing regular coupon-paying bonds to raise debt, banks would issue notes that would have an **embedded option** which would allow investors to profit from the performance of an underlying asset, such as a stock.

The bank issuing the notes would use the debt proceeds in the same manner as with regular bonds, but instead of rewarding investors with a coupon, **it would invest in an option on behalf of said investors.**

This business was mutually beneficial: while it would allow the bank to spend less money in the debt origination (the value of the option was typically lower than what the same bank would have had to pay out in interests for an identical obligation), it was also attractive for the note holders, who were looking for investment alternatives beyond the traditional fixed income but often had only bonds as permissible securities.

Structured notes were initially very simple, consisting mainly of what came to be known as the "zero plus call".

This is the simple combination of a zero coupon bond and a call option.

Example

A bank's funding cost (i.e. the price at which the institution is able to raise debt) stands at 3% per year.

This means that if the institution is to issue five-year bonds, the total cost for doing so would be an approximate 15%.

This also means that the rough value for this bank's 5-years zero coupon stands at 85%.

Now, imagine that a call option on the S&P50 Index for 5 years is worth 14%.

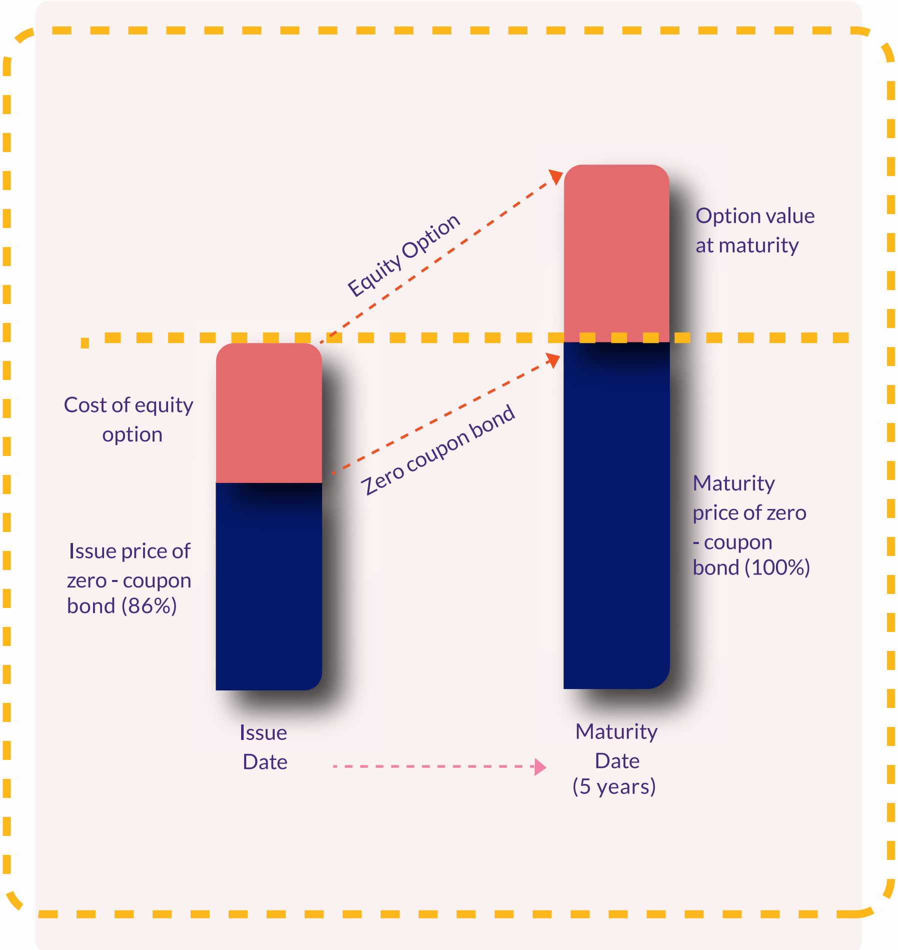
This means that the bank can offer a note which, instead of paying our 3% per year in interests, will make investors profit from any appreciation of the underlying index at maturity. Many investors took a liking to this packaged note.

They were getting the full upside of the underlying asset, while having their capital protected should the same asset display a negative performance.

The diagram shows the two components of the “Zero Coupon plus Call”, also known **as a capital protected note.**

The zero coupon bond is valued at a discount to par at inception (86% in our example) and will be redeemed at 100% at maturity.

This is the element that protects the invested principal.



The call option is the component that **generates the upside.**

It will generate a profit for note holders at maturity if it is “in the money”, i.e. if Apple has risen. It will be worthless, on the other hand, if Apple has fallen.

Still, even when the option generates no return, the zero coupon ensures **the principal is returned in full.**

What started as a source of cheaper funding for banks eventually grew into a business in its own right.

There is hardly a global bank nowadays that does not count a structured products desk as an integral (and often most important) division within its derivatives operations.

While the funding brought in by the issuance of structured notes is not negligible for big banks, that’s no longer their main driver. **Rather, money is made by marking up the total value of the packaged investments.**

A structured notes is an investment which is packaged in accordance to an investor's wishes.

How the structured note performs depends on the behavior of the chosen underlying asset.

Suppose that an investor is looking for the following:

+ **Ability to profit from an appreciating equity market, via a broad benchmark.**

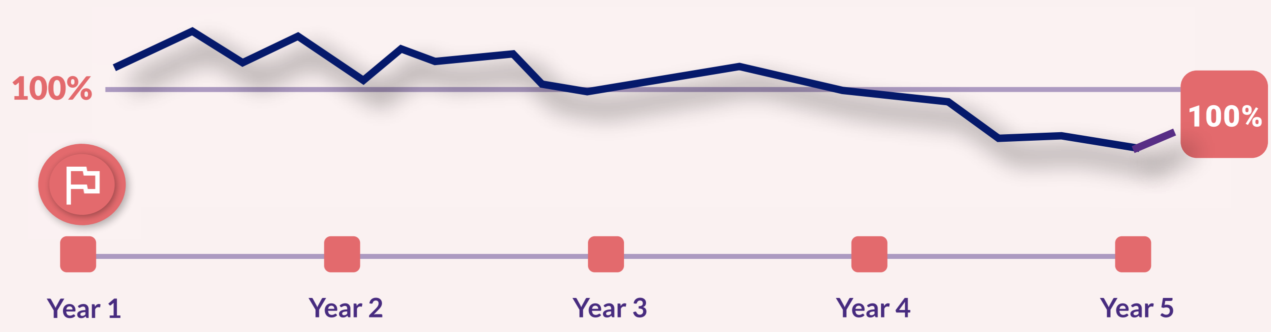
+ **Desire (or obligation) to protect the invested principal**

This investor is very lucky indeed, as his requirements perfectly fit the product we just examined. Our note would allow him to profit from the appreciation of the S&P500. Still, if the index was to decline, our investor would have his invested capital protected.

Scenario 1

At maturity, the S&P 500 has risen in value. Investors would hence receive their invested principal back, plus the positive performance shown by the index. If, for example, the index has risen by 30% after 5 years, the notes would be redeemed at 130%.

Scenario 2



At maturity, the S&P 500 has dropped in value. Investors would hence only get their invested principal back

While the investor does not know how much he will make by investing in the note, he knows in this case that he will not recover less than what he is putting in today.

This is precisely what is appealing about these notes: the ability to structure specific outcomes.

It is not about guaranteeing a return, but rather guaranteeing outcomes under different scenarios.

While structured notes can have vastly different ranges of complexity, in essence they all serve the same purpose:

to transform an underlying asset – be it a stock, an index, a commodity or any other type – into an investment that has levels of risk and return that better meet an investor's needs.

The world of structured notes is limitless.

Due to their very customizable nature, the number of combinations that can be created is truly infinite

To make matters seem more complex, depending on where and who the issuer of a given product is, names can vary immensely. Hearing the name “Snowball Athena with Oxygen” as one such product is called will surely raise the eyebrows of most investors.

One of the best piece of advice for investors venturing into structured notes is to cut through the noise provided by the creative names and focus on the important bits.

Questions to ask before starting:

+In which scenarios will I make money?

+ What are my risks?

+ Does the product fit my investment objective?

Reverse Convertible

Reverse Convertible

Apple

6 months

Barrier 70%

Coupon 10% p.a.

This is a product which:

+ **pays a guaranteed coupon**

+ **will also return 100% of the investor’s invested principal at maturity** if the chosen underlying does not finish below a given barrier.

Return Scenarios

At maturity → If the underlying is above the protection barrier

YES → The investor receives the 100%

NO → The investor receives the physical delivery of shares of the underlying at the strike price.

Benefits and risks

In which scenario will I make money?

The coupon is **guaranteed** and will be paid regardless.

Whether the investment will turn out to be profitable will **depend on how much Apple is worth in 6 months.**

If the share has not dropped by more than 30%, **I will recover my full principal.**

What are my risks?

My risk is that Apple shows a substantial negative performance, **losing over 30% of its value.**

If Apple finishes at 60% of its initial level, **investors would only recover 60% of their invested principal**

Checklist investor profile

- **I am an income oriented investor**
- **I wish to protect myself against a limited downside of Apple**
- **I believe Apple will have a slightly negative or moderately positive performance in the coming months**

Compared to a direct investment in Apple, this product will make sense if I am happy to swap a less certain upside of the shares into a certain income, while also obtaining protection against some downside.

Autocallable

Autocallable

Apple

12 months

Barrier 70%

Coupon 12% p.a.

Observation
Quarterly

The autocallable is a reverse convertible which carries one main difference:

+ it has a feature which will terminate it early on certain observation dates (hence the name).

+ **it still pays a coupon and will protect the capital** if the underlying does not end below a pre-determined barrier, but it will be cancelled automatically, returning the full principal to investors, if a condition is met.

+ Typically, **the condition is that the underlying is above its initial level** on certain dates.

Return Scenarios

At each quarterly observation

- **If the underlying is above the autocall trigger level**
  - YES: Early redemption: the product redeems at 100%
  - NO: No early redemption: the product continues
- **Guaranteed coupon**
  - YES: Coupon: 3%

At maturity

- **If the underlying is above the protection barrier**
  - YES: The investor receives the 100% + 3%
  - NO: The investor receives the physical delivery of shares of the underlying at the strike price (or its equivalent in cash) + 3%

Benefits and risks

In which scenario will I make money?

The coupon is guaranteed and will be paid regardless.

Whether the investment will turn out to be profitable will depend on how much Apple **is worth in 6 months.**

If the share has not dropped by more than 30%, **I will recover my full principal.**

What are my risks?

My risk is that Apple shows a substantial negative performance, **losing over 30% of its value.**

If Apple finishes at 60% of its initial level, **investors would only recover 60% of their invested principal.**

Checklist investor profile

- **I am an income oriented investor**
- **I wish to protect myself against a limited downside of Apple**
- **I believe Apple will have a slightly negative or moderately positive performance in the coming months**
- **I do not mind the reinvestment risk stemming from the autocall. I am ok in having my principal back before the stated maturity**

Compared to a direct investment in Apple, this product will make sense if I am happy to swap a less certain upside of the shares into a certain income, while also obtaining protection against some downside.

Participation Notes

Participation Note

Apple

18 months

Barrier 80%

Upside participation 100%

Observation
Quarterly

This product, while also affording some protection to the invested capital via a barrier offers a different kind of return:

+ instead of the income (coupon) given by the reverse convertible and autocallable, it will allow investors to **participate in the performance of the underlying.**

+ It is hence a **growth product.**

Return Scenarios

At maturity

If the underlying is above the protection barrier

YES

The investor receives the 100% + 100% of the upside

NO

The investor receives the physical delivery of shares of the underlying at the strike price (or its equivalent in cash)

Benefits and risks

In which scenario will I make money?

As long as Apple is worth more in 18 months, **I make money.**

How much will depend on the **actual performance of the share**

What are my risks?

My risk is that Apple shows a substantial negative performance, **losing over 20% of its value.**

If Apple finishes at 70% of its initial level, **investors would only recover 70% of their invested principal.**

Checklist investor profile

- **I am a growth oriented investor**
- **I wish to protect myself against a limited downside of Apple**
- **I believe Apple will have a positive performance over the next 18 months**

Compared to a direct investment in Apple, this product will make sense if I would like to maintain upside exposure, while also obtaining some downside protection.

There are various reasons that explain the huge growth in popularity enjoyed by customized investments in recent years:

Income

The majority of structured notes are **income generating investments**, such as the reverse convertibles and autocallables explained above. These notes can be built to generate very **appealing level of coupons** (ranging from 5% p.a. up to 50% p.a.), while still being linked to favored assets and offering **ample downside protection**. In the world of extremely low interest rates and credit spreads, investors who would rely on traditional bonds to generate income started to **increasingly rely on customized investments.**

Democratization

Structured notes were initially available to very few, often with minimum investment sizes in excess of USD 5 million. **One can now design a tailor-made product for as little as USD 50,000.** This has come as a result as investments made in automatizing and streamlining the issuing process of products

Competition

As more banks gradually entered the structured notes arena, naturally issuers would find themselves fighting for the same deals. This meant that banks wishing to gain market share in the issuance tables would need to sacrifice their margins. As always, **competition creates a direct benefit for consumers**. Investors who were previously wary of structured notes owing to their high fees were gradually persuaded to try out these products as **it would often be more advantageous to design a given investment strategy via a note** rather than replicating it via listed options

Emergence of independent platforms

Independent platforms such as Quadra Wealth have played an invaluable role in adding efficiency to the structured notes market. While in the early days one would phone up a bank and expect to hear back 24 hours later on the price of the desired structure, solutions as the one pioneered by Quadra Wealth meant that investors would not only **obtain an immediate level for their desired products, but also be able to compare said levels across multiple issuers**. Shopping around and getting the best price was never this easy.

Liquidity

Structured notes have come a long way when it comes to the ability of an investor to unwind his position before maturity. In the vast majority of cases, **investors can sell their positions back at any time, at the prevailing market price**.

At Quadra Wealth we would recommend that you find a structured note provider that:

is independent

This means being free to build products with any issuer. It is often the case that what is interesting for an issuing bank (issuing a product that would provide it with an exposure that would act as a natural hedge for its trading book) is not at all aligned with the investor’s best interest. **Having the freedom to advise on the best investment match, whatever the issuer, is of paramount importance.**

J.P.Morgan
UBS
citibank
BNP PARIBAS
BARCLAYS

has cutting edge platform

There is so much that technology can do for investors that it would be inadmissible not to use it. **From designing and comparing quotes for a new product, to following the progress of a portfolio, understanding the risks and accessing market intelligence,** it is virtually impossible to conceive a successful experience with customized investments without the latest technology

has multifaceted team in place

The importance of having an experienced and diverse team should not be overstated. **Understanding the constraints of investors** who are based in different parts of the globe, **being able to relate to their preferences and to communicate to them in their languages** are vital elements that aid in a **successful investment experience.**

From the moment you become a client, we put you first.

We are dedicated to helping investors like you reach their long-term financial goals and live comfortably in retirement. As a fiduciary, we are obligated to put our clients' interests first, but our values, structure and focus on you go even further:

Fees Aligned With Your Interests

Our fee structure is transparent and helps tie our incentives directly to your success. We charge a simple fee based on the assets we manage for you. We do not make money on trading commissions or by selling investment products for a commission—common conflicts of interest in much of the financial services industry.

A Tailored Approach

We create a personalized portfolio tailored to your unique situation: your financial goals, wants, needs, health, family and lifestyle. And on an ongoing basis, we work with you to understand changes in your life or financial situation that may impact your investment plan.

Unparalleled Service

Your dedicated wealth manager is here to serve you, not sell to you. Your wealth manager is well versed in your financial goals and helps you stay on track with your investment plan. She or he calls you to make sure you understand what we're doing in your portfolio and why. Our financial planning, educational resources and client events also help you understand challenging and often unpredictable markets.

Investment Experience

We have been working to make the financial services industry a better place for investors since 2007. Today, we apply that experience in helping hundreds of clients around the world reach their long-term goals. Recently we have been recognized for Excellence in Advisory Best Practice, Top Rated Independent Wealth Manager and winner of the Best Private Banking Product Award.

BEST PRIVATE BANKING PRODUCT AWARD 2021
QUADRA WEALTH
WINNER

INDEPENDENT
TOP
RATED
WEALTH MANAGER

Excellence In Client Service
2021

Simply put, we do better when you do better.

Quadra Wealth	Some Money Managers
✓ Tailors your portfolio to your goals and needs.	✗ Provide cookie-cutter portfolios.
✓ Calls regularly to keep you informed.	✗ Only call when they have something to sell.
✓ Charges one simple, straightforward fee.	✗ Sell high-commission investment products.

IMAGINE IF YOUR PENSIONS & INVESTMENTS WERE 100% UNDER CONTROL...

We ask just 3 questions to you to see if we are the right fit for each other:

1. Do you have over $50,000 in pensions or savings?

2. Do you value personal service and an equal relationship between us both?

3. Do you want a risk-free, money back service guarantee, so you have peace of mind with your investments?

When you've answered YES to all 3, we'd love to help you along your financial journey, It's now just one small step away. Simply get in touch today.

CLICK HERE TO TALK TO US TODAY