

**CURRENT SOLUTIONS**

# Staying in tune with clients' requirements

Emmanuel Naim explains how innovation need not mean complexity, and how a number of simple structured products are designed to cater to clients' needs, protecting their capital while taking advantage of any recovery in the equity markets

**S**tructured products and financial innovation have regularly been held responsible for the current financial crisis.

Yet, equity structured products are proving a reliable and resilient source of performance for investors looking for safe havens to invest their cash. And innovation does not necessarily mean creating complex solutions which are difficult to grasp.

Successful innovation is actually very simple; some of the most popular products in the private banking arena are very straightforward, such as Reverse Convertibles, where investors gain from a non-decrease, rather than from the rise, of equity markets.

Moreover, innovative products are brought into the market just to meet clients' needs and requirements. One of the valuable characteristics of structured products is that their structure and pay-off can be tailor-made to respond to any type of market scenario a client may have.

**PROPOSING THE RIGHT RISK PROFILE, AT THE RIGHT TIME**

Currently, because volatility in the market is very high, a short term, fully principal-protected product that gives the investor the rise of equity markets would come at a very expensive cost.

One way of lowering the cost of protection is to give the issuer of the note the right to redeem the



**Emmanuel Naim**

product early, for a predetermined amount.

In the current market environment, investors do not believe in a strong rebound of equity markets in the short term. Therefore, giving away an early call feature to the issuer is not something that impedes the product's performance potential, given investor's views today. On the contrary, it enables the cost reduction of capital protection.

**"SUCCESSFUL INNOVATION IS ACTUALLY VERY SIMPLE; SOME OF THE MOST POPULAR PRODUCTS IN THE PRIVATE BANKING ARENA ARE VERY STRAIGHT FORWARD"**

Of course, investors are likely to forgo strong performances in the case of a sharp rise in equity markets, as the issuer would redeem the investment early, after paying a predetermined fixed coupon.

But with a callable structured product, investors benefit from a principal guarantee in addition to a very attractive pay-off. Capital protection is really a key requirement for investors right now.

In tune with what clients are seeking, Société Générale Corporate & Investment Banking is providing this whole range of callable products on indices, rather than stocks.

When lacking visibility, investors favor the major broadband indices on stock-picking, although from a structuring point of view there is a lot of value to be added from a diversified basket of stocks, very representative of the equity market, as the decorrelation between the securities makes the call option much cheaper than on an index.

Another product idea very much in tune with current client demand

allows investors to enter equity markets at their minimum level reached over a period of time. The pay-off will be tailor made to suit the client's views.

This is a very simple example of the kind of flexibility that structured products provide by timing the market ex-post, thus increasing the performance of the product for the investor.

**AN EFFICIENT WAY OF OPTIMISING A PORTFOLIO'S PROFILE**

The Odd Lot theory shows that behavioral bias leads to the non-efficiency of investors in respect to investment timing: they have the tendency to buy at the top of equity markets, as they believe they will continue to rise, and to sell at the bottom.

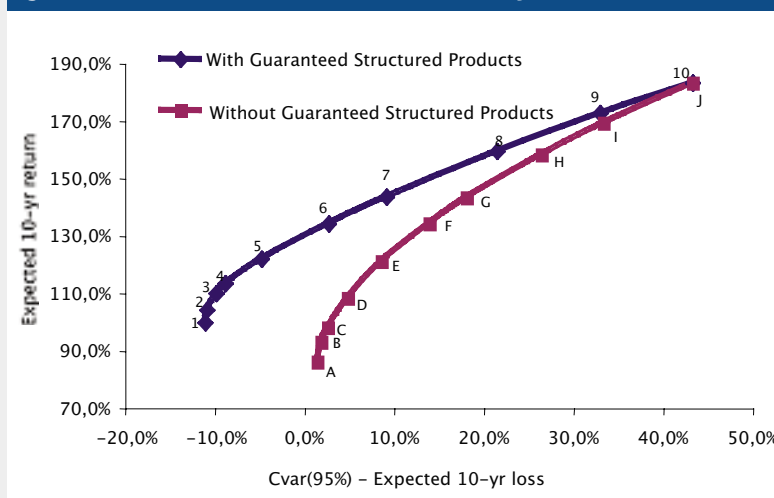
It is normal human behavior to be counter-cyclical and emotional when investing. Implementing systematic strategies, structured products keep the emotionality of investors at bay and remain free of behavioral bias.

Of course, if investors need their cash sooner than expected, or for any other reason they want to sell structured products before maturity, most providers, including Société Générale Corporate & Investment Banking, offer a secondary market where investors can sell their product prior to maturity throughout the life of the product.

Typically, the bid-offer spread is around 1 per cent and represents the cost of unwinding the product into the market.

Structured products are

Figure 1: Mean return - CVaR Efficient Frontiers (2500 scenarios - 10 Years)



Source: EDHEC

**“ONE WAY OF LOWERING THE COST OF PROTECTION IS TO GIVE THE ISSUER OF THE NOTE THE RIGHT TO REDEEM THE PRODUCT EARLY, FOR A PREDETERMINED AMOUNT”**

generally very liquid instruments. Naturally, their liquidity mirrors that of the ‘underlying’ they employ. An index or a stock both have a daily liquidity.

The results of a study carried out by EDHEC business school show that capital guaranteed structured products allow to improve the “efficient frontier” of an equity/bond portfolio allocation. Given a risk budget, the expected return of such a portfolio becomes significantly higher by adding capital guaranteed structured products.

On the other hand, given an expected return, the risk budget in

the portfolio also decreases when capital guaranteed structured products are included [See Fig 1].

Structured products are therefore a good complement to any type of balanced portfolio, in any type of market environment, be it high or low volatility, bull or bear.

The market is asking for transparent solutions, which means that it is up to the issuer to fine-tune the product to the financial sophistication of the client.

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