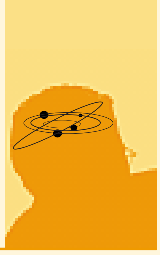


NEUTRAL ASSET ALLOCATION

FROM PAST TO PRESENT: THE CUSTOMER AND THE PRODUCT

The industry has some work to do to clear up any confusion about how structured products operate, so leading to greater customer acceptance

Structured products must be one of the biggest wins for consumerism within the financial services industry for the past 100 years. Customers' needs took pole position with bankers and investment specialists looking to deliver absolute solutions for a single client requirement.

These actions resulted in improved customer retention by virtue of satisfying explicit client demand. However, the ramifications of this pioneering thought and early academia was far greater than imagined. It initiated a revolutionary trend that would enable the financial services industry to create an entirely new market with unparalleled appeal and seemingly endless potential for client acquisition and revenue generation. This saw a paradigm shift where investors looked to decouple the concepts of risk and return and this fundamental step change has transformed the market place forever.

In the pioneering days of structured products, customer demand revolved around two mutually exclusive objectives of income or growth. Both objectives were underpinned by a strong common desire to maintain capital values or to strictly limit loss.

Today, both practitioners and investors often misinterpret structured products as guaranteed or capital protected vehicles because of this legacy. But more worryingly, investor expectation regarding structured products would seem to be somewhat misplaced as many look to structures as a means of achieving multiple objectives from a single product. Unfortunately the industry has done little to address this problem as marketing machines compete in a tightening environment for wallet share.

DEFINITION

Structured products can be defined as "any investment vehicle designed to fulfil a principal objective by combining a range of techniques or element, which individually could not achieve the same result".

Applying this definition helps to demonstrate the width and depth of this sector. The usual suspects can be found such as capital protected or enhanced growth and income vehicles. These are typically underpinned by a zero coupon with a derivative overlay and have struck a cord with private investors who can have a tailored solution for as little as €500,000. For those who can't afford their own structure the market is awash with new

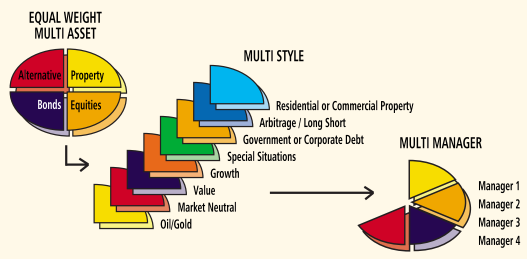
'Investor expectation regarding structured products would seem to be somewhat misplaced as many look to structures as a means of achieving multiple objectives from a single product'
Rex Cowley, Close

retail issues and a secondary market, created by the product provider, can also be accessed.

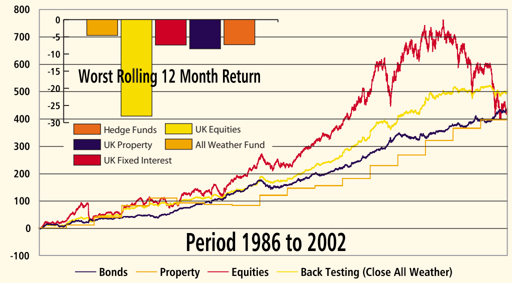
But what of the other areas of structured product? The most common or talked about is the hedge fund, which comes in many shapes and sizes from single to multiple strategies to well-diversified funds of hedge funds. Covered warrants have finally appeared in the UK after many years of being a mainstream investment in

All Weather performance data

All Weather investment process



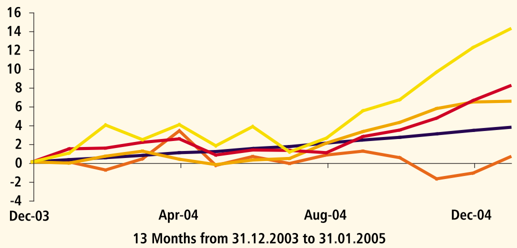
Major asset classes vs All Weather investing



These charts demonstrate the results of the Sterling Class but the similar characteristics apply to the Euro Class.

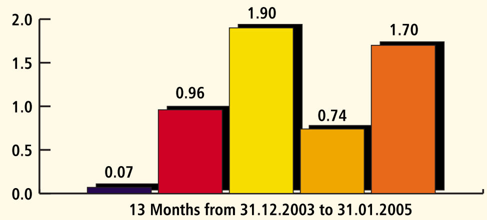
- Lipper Global Money Market Sterling (IN)
- Close All Weather GBP (MF)
- Lipper Global Equity UK (IN)
- Lipper Global Bond Sterling (IN)
- Lipper UK Offshore – Hedge Funds (IN)

Percentage growth



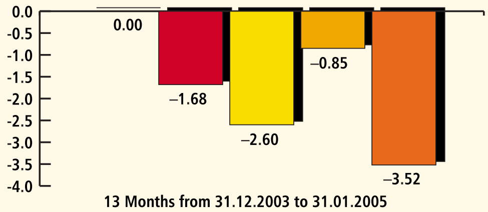
This chart demonstrates the one-year track record of the fund compared to returns associated with UK money market, equity, bond and hedge fund sectors. The graph clearly shows that the fund consistently produced returns in excess of at least two asset classes at all times and, over the one year period, the final result was a return better than bonds (Lipper Global Bond Sterling), hedge funds (Lipper UK Offshore Hedge Funds) and cash (Lipper Global Money Market Sterling).

Standard deviation



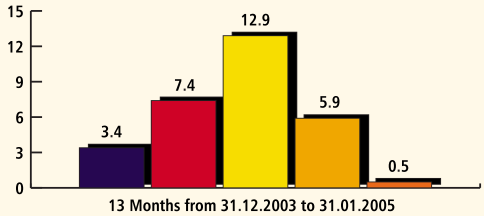
This chart is best interpreted as a measure of risk. With the All Weather Fund returning a risk substantially lower than equities and hedge funds but in line with bonds, demonstrated a favourable relationship between risk and return.

Maximum loss



This chart shows the maximum loss investors would have suffered if invested in these indicators. The Close All Weather Fund shows that the maximum downside was significantly less than equities (Lipper Global Equity UK) whilst marginally more than bonds (Lipper Global Bond Sterling).

Annual compounded return



This chart demonstrates the annual compounded return and its results support the findings of the 'Percentage growth' chart

Source: Modelling and back-testing of the various components extracted from Bloomberg, Micropal and Investment Property Databank

Europe, Australia and South Africa. Exchange-traded funds offer the structured alternative to index tracking unit trusts, and split capital investment trusts also had their day. The list goes on – and what of the industry?

Investment and private banks, asset and fund managers and the life companies are all offering some form of structured product. They aim to differentiate their offering through the wrapper in which the structure is placed or the innovative concept underpinning the structure.

THEORY

Distributors need to be ionvolved in developing innovative investment theory. Typically, investors seek returns comparable with equities over the long term but without the same degree of associated risk. Providers can give investors access to a multi-asset, multi-manager, multi-style, multi-currency structure, which is, at its heart, a sophisticated neutral asset allocation model.

The advantages of this structure are five-fold:

- Firstly, the multi-asset approach means that a client's assets are invested equally across fixed income, property, equities and hedge funds, giving them excellent diversification across a full range of asset classes. These typically have different economic cycles ensuring that two asset classes will always outperform the remaining two. This will either act as a driver for growth or a brake when certain markets fall.
- Secondly, the multi-manager approach allows the selection of a range of managers who are particularly skilled to manage the different assets classes. These managers' track records and skill place the client's assets in the hands of individuals who are most likely to add value to the portfolio.
- Thirdly, using a multi-style approach means that within each asset class, the investment team get to blend investment styles and approaches. This adds further diversification and reduces the possibility of duplicating holdings, further reducing risk.
- Fourthly, the implementation of a multi-currency approach led to the development of sterling, US dollar and euro classes where the underlying exposure is kept to the base currency of the fund. This reduces currency risk and is fundamental for conservative or medium risk investors.
- Finally, a neutral asset allocation means that the portfolio is rebalanced on a monthly basis to ensure that investors' exposure to the four asset classes is virtually equal. This means that customers are not exposed to a deliberate over or underweight asset allocation strategy. This increases risk, but remains neutral. This neutral position allows the fund to take profit from rising asset classes and reinvest into falling ones. In effect, it is continuous pound cost averaging and profit taking.

We back-tested and refined our theory with sophisticated modelling covering 17 years' worth of data before we launched such a product. Risk has been substantially reduced but not at the expense of growth. The charts on page 26 are from an independent source and validate what we say. But the success of a structured product must also be judged by new applications, which clearly demonstrate customer acceptance and investor satisfaction.

But there is more to it than that. Products must be able to address many of the concerns investors have over structured products such as a lack of transparency regarding the structure, calculation of performance and charging level. In addition providers must knock down some of the core barriers such as defined tie-in periods and lack of liquidity and introduce added features such as automatic capital draw-down to provide investors with an "income" stream while effecting income and capital gains roll-up within the product for improved efficiency.

CHOICE

Investors can also be given a choice of two pricing structures that allow up to 100 per cent allocation on day one with no bid offer spreads. Additionally, if the price falls month on month, we automatically reduce the management fee by 0.50 per cent to cushion the effect for investors.

Structured products have come a long way but much of the original rationale has given way to innovation for innovation's sake as the boundaries of structured product design are pushed in a quest for differentiation in a very busy market place. We are aware of both the shortcomings and benefits within the industry and our approach is simple. We stand in the shoes of our customers and seek to deliver real solutions for real problems, knowing that if we look after our customers they will look after us.

Rex Cowley, director products and services,
Close Private Bank Group of Companies

CORPORATE STATEMENT

The Close Private Bank group of companies comprise Close's investment, banking, custody, trustee and pension service companies in Jersey, Guernsey and the Isle of Man. The Group collectively holds c.US$1bn of cash deposits and manages investment assets of c.US$1.5bn with a further c.US$4bn of assets under administration. Its member companies are wholly owned by Close Brother Group plc in the UK, which is listed on the London Stock Exchange and regulated by the FSA. Close Brothers is rated independently as being of 'highest credit quality' (Fitch IBCA).

Close Investment Services

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