STRUCTURED SOLUTIONS

MAKING THE MOST OF TODAY'S MARKETS

Although questioned in the wake of the financial crisis that unfolded in September last year, structured investments have, in their wide majority, proven a reliable and resilient source of performance for investors. Thomas Carrega explains how they can help investors achieve their goals

Structured investments are solutions that combine non risky components – typically bonds – with options. Bond components will most often ensure a certain level of protection of the investment – partial or total – while the optional component will determine the payoff ie the "performance engine" of the investment.

The main characteristic of structured investments is therefore their ability to be tailored according to each client's objectives in terms of risk return profile. They also allow clients to invest in their own views regarding a specific area or market scenario. For example, given current uncertainties, a number of solutions now provide an optimisation of the entry point and therefore allow investors to benefit from a possible further decline of the markets before they re-enter into a bullish cycle. The flexibility of these solutions makes structured products a great diversification tool for an investor's portfolio.

Recent concerns over financial innovation have also translated into a flight to simplicity, as opposed to products that were previously seen as over-sophisticated. It is worth noting that these investments, although innovative by nature, can be very straightforward. Société Générale Corporate & Investment Banking, as a pioneer in the field for 20 years, has developed an expertise that can provide solutions that are both well suited to current market conditions and simple in concept.

The success of exchange traded funds (ETFs) in recent years illustrates this increasing demand for simple

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investments. As replication tools, ETFs give an exposure to specific markets or themes which would otherwise prove difficult or impossible to access directly. Through its asset management subsidiary Lyxor, Société Générale Corporate & Investment Banking has gained a recognized expertise in exchange traded funds and manages the largest equity ETF in Europe: the Lyxor ETF DJ Eurostoxx 50.

FINDING THE RIGHT EXPOSURES WITH THE RIGHT ASSET CLASSES

Beyond simplicity, investors are increasingly looking for decorrelation within their asset allocations. They are therefore paying attention to the characteristics offered by structured solutions according to their underlying assets. The three following examples show how structured solutions currently proposed to wealth managers allow them to take advantage of the specific features of a given asset class.

With the uncertainty in equity markets remaining, structured investments providers are asked for solutions that generate income whatever the market conditions and provide capital protection. Products such as autocallables on index or individual shares have been widely popular in wealth management over the last five years.

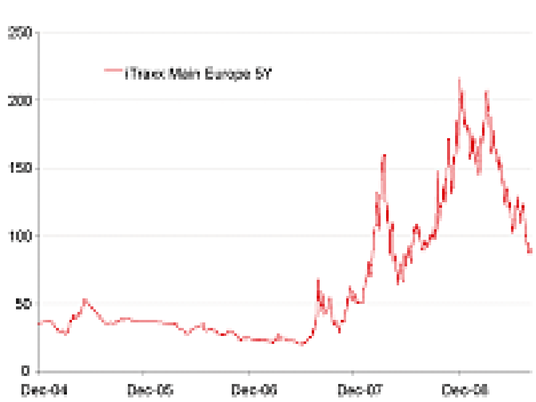
However, the challenging market conditions encountered since the summer of 2008 asked for a rethink and further optimisation of their risk/return profile.

Taking into account new parameters, and notably a record high volatility, new autocalls could be tailored to reach investors' preference towards shorter maturities, more frequent coupons and wider safety barriers. Defensive solutions such as the Phoenix Monthly, which were launched between the end of 2008 and early 2009, ie when markets were at their lowest, have since been autocalled, with, in most cases, double digit yields.

Today, as equity markets seem to normalise, the trend goes back to more "classical" solutions, with longer maturities (three to five years) and more dynamic payoffs.

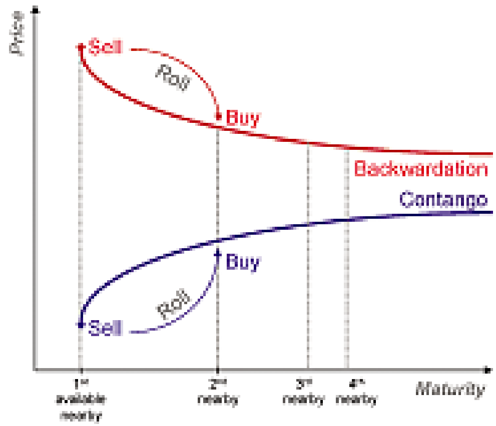
On the credit side, credit linked notes (CLN) allow investors to take a view on the credit quality of one or

Average credit spread of the 125 most liquid European companies as measured by the Itraxx Main 5Y



Source: Markit

Effect of the future contract roll on an index tracking oil



various entities. Those products offer the possibility to lock a predetermined yield (such as an investment in a bond) as long as the underlying entities do not experience a credit event, independently of any performance consideration.

Moreover, the current spreads observed in the credit market are close to historical highs and investors are starting to think of timing the market, as demonstrated by the current explosion of demand for those products. Investment in a CLN, which is similar, in many ways, to an investment in a bond, offers even more flexibility to tailor the transaction (in terms of maturity, coupons type etc) and benefit from the depth of the CDS market.

Commodities, and typically oil, are a great source of diversification within a portfolio, but commodity investing also demands great expertise in that field. Oil, being a physical asset, can only be tracked by future contracts, which need to be rolled upon expiry in order to avoid physical delivery of the asset. The roll of the contract can affect positively (backwardation) or negatively (contango) the performance of an index tracking oil.

Société Générale Corporate & Investment Banking has therefore launched a new proprietary index, the SGI Smart WTI Long Index. This index tracks the West Texas Intermediate (WTI), also known as light crude oil, which is the world most traded oil benchmark. Thanks to a proprietary algorithm, the index developed by Société Générale Corporate & Investment Banking optimises its roll yield by selecting every month the most appropriate future contract in which to roll, depending on price and maturity.

Historical simulations made between April 1st 2000 and April 1st 2009 demonstrate an average annual rate of return of 12.7 per cent of the index. Thanks to its long expertise in commodities and derivatives, the bank is able to design investment solutions that are both innovative and easy to access, opening the commodities universe to an ever wider array of investors.

To address the challenges of today's financial landscape, investors need solutions that help them make the most of every market. But an efficient asset allocation demands an understanding not only of asset classes individually, it also demands and understanding of interactions between asset classes. This is why Société Générale Corporate & Investment Banking has now merged its equity, fixed income, currencies and commodities activities within a fully integrated multi-asset class, multi-product platform.

Bringing together 2,600 market professionals, it focuses on delivering high quality investment and risk management solutions to investors around the world.

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