MULTI-ASSET OPPORTUNITIES

Seeking additional returns in a difficult environment

Multi-asset structured products are a one-stop shop for investors to capture their investment views and diversification needs, making them an appealing investment proposition. These products can be structured to give either direct exposure to the underlying assets or indirect exposure through actively managed underlyings such as funds, write Julie Wan and Federico De Palma

In the current market environment, investors who have relied on traditional asset classes like equities and bonds are appreciating the meaning of the phrase, "what goes up, must come down". After riding a bull equity market and enjoying a period of low volatility for the past few years, investors are experiencing an equities market correction and higher volatility. Many investors are facing the difficult decision of which asset classes to invest in and interest is growing in alternative asset classes for portfolio diversification.

"AS INVESTOR SOPHISTICATION HAS EVOLVED, INVESTORS HAVE MOVED FROM FOCUSING PURELY ON LOCAL MARKETS INTO REGIONAL AND WORLD EQUITIES"

Diversification is not a new concept. As investor sophistication has evolved, investors have moved from focusing purely on local markets into regional and world equities, as well as other asset classes like real estate, bonds, commodities and foreign currency.

HISTORIC PERFORMANCE

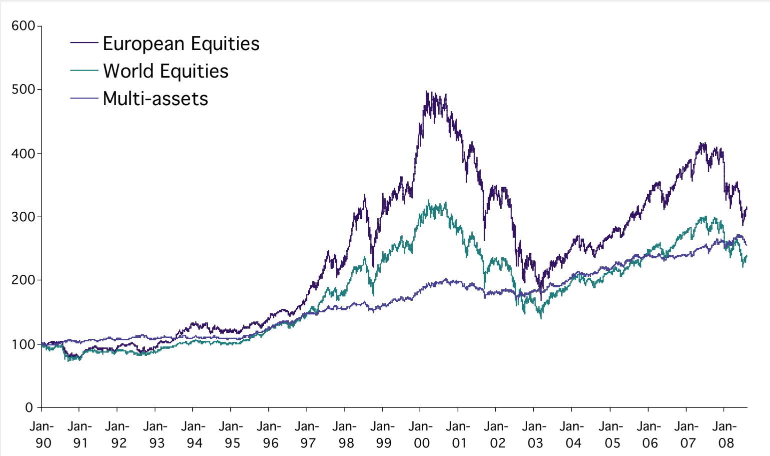
The benefits of a multi-asset strategy are easily demonstrated by comparing the historic performance of European equities, a world equity basket and a multi-asset basket. Volatility is greatly reduced in a multi-asset basket, whilst maintaining similar returns (see Figure 1).

Looking at a multi-asset basket from 1 Jan 1990 to 12 Aug 2008, it delivered similar returns to the equities baskets but with lower volatility. This is not a coincidence but is in fact supported by traditional modern portfolio theory developed by Harry Markowitz in the 1960s. His theory states that the so-called efficient frontier represents the optimal risk-return profiles achievable through adjusting weightings to assets in the market portfolio.

As these benefits become increasingly apparent in the current challenging market environment, interest has turned to investing in multiple asset classes, often through multi-asset structures. Historically, multi-asset structured products have been perceived by some investors as "complicated", "illiquid" with "highly exotic payoffs". In fact, they can be both simple, liquid and easy to trade.

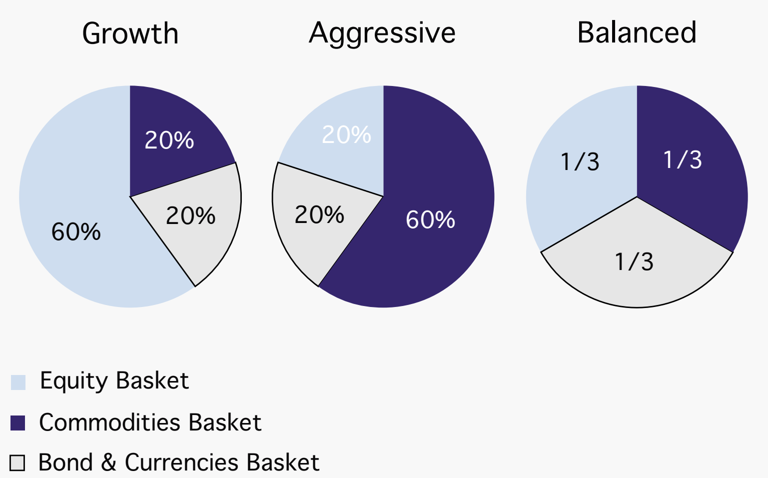
Figure 1: Historical analysis - from 1 Jan 1990 to 12 Aug 2008

Annualised	European Equities	World Equities	Multi Asset Basket
Return	6.26%	4.69%	5.08%
Volatility	19.63%	14.60%	6.15%



(i) Source: Bloomberg for period 1 Jan 90 to 12 Aug 08
(ii) European Equities refers to Dow Jones Eurostoxx 50 Index (SX5E)
(iii) World Equities refers to an equally weighted basket in Europe (SX5E Index), American (SPX Index) and Japanese (NKY Index) equity indices
(iv) Multi-Asset Basket refers to an equally weighted basket of world equities (as above), world government bonds (SBUSL Index), commodities (SPGSCIP Index) and currencies (DBHTG10U Index)
Neither hypothetical nor actual past performance are indicative of future results.

Figure 2: Investment profile allocations



Citi's history in Hybrid and fund linked products

2005
Citi set up a dedicated hybrid and fund linked structured products desk in London and New York consisting of structuring and trading, quants, client services, due diligence and back office support team.

2006
Added a dedicated structuring team in Asia and Japan

2008
Awarded Best Hybrid Product from the Asset Triple A Awards for Derivatives and Structured Products

TAILORED PRODUCTS

Essentially multi-asset structures incorporate two or more underlying assets into a single product. The underlying assets can include equities, bonds, foreign currency, commodities, managed assets (such as funds), indices, interest rates. As with any structured product, the payoffs are flexible and can be tailored to investors' needs.

Multi-asset structures give investors the opportunity to explore newer asset classes, which can be particularly attractive in light of the lacklustre performance of some traditional asset classes. Product providers can tailor products to match clients' specific risk-and-reward appetites. These products can be structured to give either direct exposure to the underlying assets or indirect exposure through actively managed underlying investments such as funds.

Some investors are unsure of which asset class to invest in or divest in the current market environment. Furthermore, asset allocation decisions are complicated.

"MULTI-ASSET STRUCTURES GIVE INVESTORS THE OPPORTUNITY TO EXPLORE NEWER ASSET CLASSES"

A structured product that can provide a solution to these dilemmas is a structure based on an automatic asset allocation mechanism.

This product works by creating three strategies representing growth, balanced and aggressive market views. Each strategy is comprised of multiple assets in different weightings. At maturity, investors typically receive 100 per cent of their initial principal, together with a pay-off linked to the best performing strategy.

As a result, investors are spared the difficult decision of choosing which asset classes to invest in at inception and the weightings of allocations of those asset classes. This product can be especially attractive for investors seeking exposure to new asset classes, with which they are not familiar.

Multi-asset structured products offer investors access to a one-stop shop for diversification in their investment portfolio and the opportunity to gain exposure to new alternative asset classes. With the inherent diversification, they may provide good returns but with lower volatilities.

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