

“People are afraid of things they don't understand.”

I'm sure bass guitarist Bill Laswell wasn't referring to structured notes when he came up with this quote. However, the intrinsic human trait of aversion to the unknown, and the hard-to-know, explains the lack of meaningful representation of structured notes in many investment portfolios.

### What is a Structured Note?

There are many kinds of structured notes, ranging from relatively simple to extremely intricate. At its core a structured note is an unsecured debt obligation (basically an IOU) originating from a financial institution, with an embedded derivative component. The issuer is usually a large investment bank like JP Morgan Chase, Goldman Sachs, Credit Suisse, Investec, etc.

The use of derivatives ties the structured note to an underlying asset - or basket of underlying assets. The underlying asset can be almost anything from shares or commodities to indices and funds, interest rates, foreign currencies and so on. The return of a structured note is normally derived from the performance of its underlying asset/s. In essence, a structured note takes a traditional security (the underlying) and replaces its usual payment features with a non-traditional payoff by use of derivatives.

Structured notes can be thought of as an alternative to other investment products like exchange traded funds or mutual funds. However, the benefit is that they will have a stated maturity date when they are to be cashed out. Structured notes are usually meant to be buy-and-hold positions held to maturity. On average, the maturity date ranges from one to seven years in length.

Most of these notes come with a fixed pay-out date upon maturity, but you can also acquire notes that pay a fixed or variable payment over the life of the product. Volatility and interest rates are the biggest factors in determining the terms of the note. As with any investment, the lower or higher the risk, the lower or higher the return is based on how the underlier performs.

Structured notes can be a great alternative investment in a portfolio, as it gives investors access to potentially higher income or growth which other asset classes, like fixed income, may not be able to provide. It can also bring many derivative benefits to investors who otherwise would not have access to them.

These notes can be used to provide more stability and further diversification to your portfolio. It can be used to protect your portfolio, as many notes have some protection in falling markets. For example, it can be an ideal vehicle to help you benefit from excellent stock market performance, while simultaneously protecting you from bad market performance.

### Risks and Considerations

Like most other investments, structured notes involve a variety of risks and each note will have its own unique set of risks and considerations.

With the highly customized nature of some structured notes, a common risk associated with the investment product is a relative lack of liquidity. Moreover, the full extent of returns from complex performance features is often not realized until maturity.

# Seed Weekly

## Structured Notes Explained



Similar to bonds, you also run the risk that the issuer of the note could default. Although cash flows are derived from other sources, the products themselves are considered to be the issuing financial institution's liabilities. So, if the issuer of the note files for bankruptcy, you may lose a portion (or all) of your principal capital.

Another consideration is pricing transparency. There is no uniform pricing standard, making it harder to compare the net-of-pricing attractiveness of different structured notes. Other risks include, but are not limited to, market risk, inflation risk, tax risk, interest rate risk, call risk, etc. The underlier is, of course, also a big decision in the purchase of a structured note.

At Seed, as and where appropriate, we take full advantages of the innovative pay-off profiles that structured notes have to offer, especially in the current global environment of very low interest rates. As illustrated in the table below, we have a variety of notes in both our global and local funds, with only a small percentage of any portfolio allocated to one individual note. Through thorough initial and ongoing due diligence, we ensure that we have a comprehensive understanding of the risks associated with each investment.

	# of Structured Notes	Total Weight in Portfolio
Seed Global Fund	4	5.7%
Seed Balanced Prescient Fund	2	5.2%
Seed Stable Prescient Fund	1	4.9%

If you have any further questions, please feel welcome to reach out to the Investment Team on [investmentteam@seedinvestments.co.za](mailto:investmentteam@seedinvestments.co.za). We always love hearing from you!

Kind regards,



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