Seed Unit Trusts – Fund Construction

In this week's article, we delve deeper into the construction of our Funds, highlighting the strategic use of investment vehicles like Unit Trusts, Segregated Accounts, ETFs, and Structured Notes. We also provide two real-world examples of Structured Notes and their potential benefits in enhancing returns while managing risk.

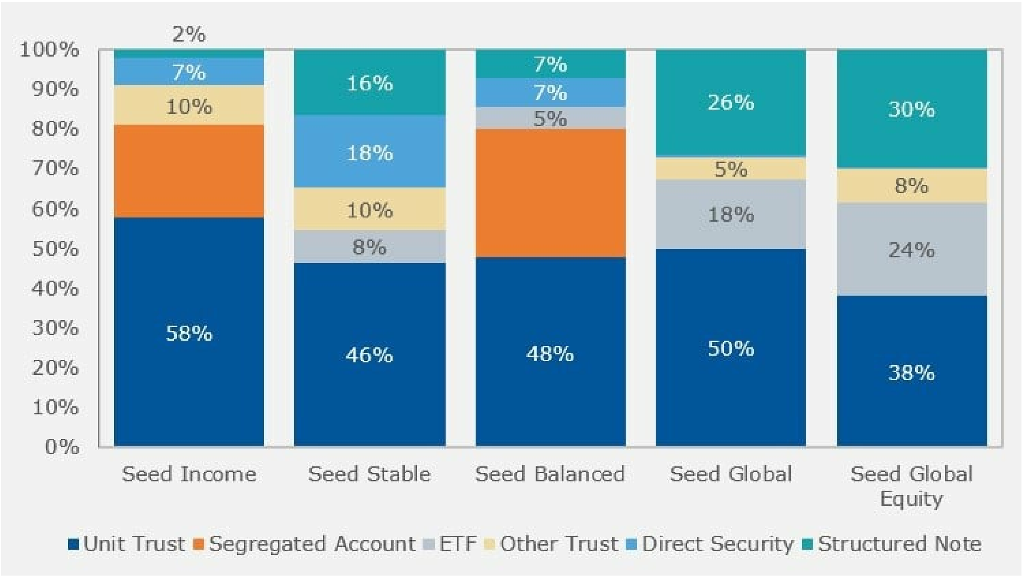
In this article Mike Browne, Seed Portfolio Manager gives insight into Seed Unit Trusts and their Fund Construction.

Unlocking Investment Potential - A Closer Look at Fund Construction and Structured Notes

Last week we took a look at the various investment vehicles that we use when constructing our Unit Trusts and gave a little detail on each of them. Did you miss out on that article?

Click to Read: Seed, Not Your Average Multi-Manager by Mike Browne

This week, we will take a closer look at the construction of each of the Seed Funds (when looking through the lens of investment vehicle) and why we make use of Structured Notes, where appropriate.



The chart above gives the breakdown of each of the vehicles in each of the Funds. As can be seen, and as mentioned last week, Unit Trusts form the bulk of the Funds, and are typically around half of the assets in each of our Funds, as they are very useful investment vehicles.

Segregated Accounts have much higher minimum investments than Unit Trusts, it therefore makes sense that our two largest Funds (Seed Balanced Prescient Fund and Seed Income Prescient Fund) are the ones to have investments via a Segregated Account. Developed markets are typically more efficient than emerging markets like South Africa, and ETF fees in developed markets are typically razor thin, which largely explains why our two global Funds have the largest allocation to ETFs. Other trusts and direct securities are more special opportunity type investments, and therefore, there isn't a pattern on the weighting to these vehicles across our Funds.

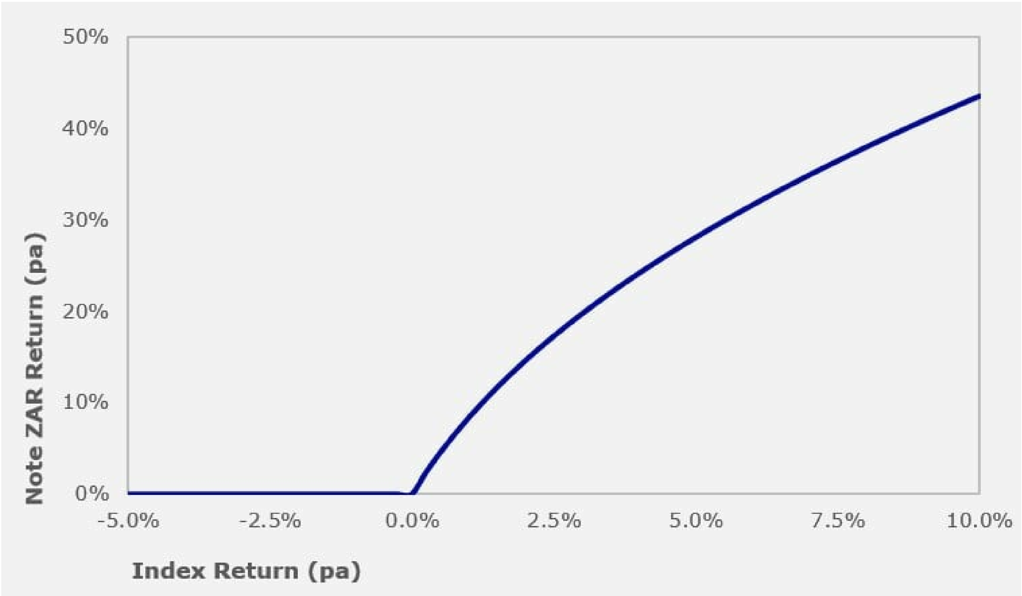
Structured Notes can typically be broken down into notes that provide a predetermined coupon based on the performance of an underlying investment (typically if it's up at a predetermined time in the future) with an element of capital protection, or notes that provide participation in an underlying investment (typically and index or range of indices) with an element of capital protection.

Structured Notes are issued by banks and the return guarantees are therefore dependent on there not being a credit event at the issuing bank. Credit risk is something that we take seriously, and we will only invest in notes issued by rated banks, and even then, will diversify our exposure across a range of banks.

To give some sense of the kind of notes that are in our Funds, and ideas that are up for consideration, let's look at two examples – one of which is currently in some of our Funds and the other which is currently being assessed for inclusion.

The first is an Autocall Note that will pay out USD 9.35% pa if the UK's FTSE100 is up a cumulative 5%. Observations are from 3 years and observed each year thereafter (only if the index isn't up 5% at any of the previous observation dates) until 8 years, with the capital and cumulative coupon being paid out at the first observation where the FTSE100 is up 5%. Capital is protected if the index isn't down more than 35% after 8 years. We think this is a great way to get equity type returns even if the equity market (in this case UK market) is only marginally up.

The other note is a Participation Note that will pay out over 1000% participation in ZAR of a systematically managed global multi asset index. The note has a 6-year term and capital is fully guaranteed. The chart below gives a visualisation of the expected payoff profile of this note given the above conditions. We would expect the index to generate low to mid-single digit annualised returns over the 6-year term (on the condition of 'normal' market conditions), but the benefit of this note is that even if the index does poorly, capital invested is fully guaranteed. If the index does 5% pa, then the note will return 28% pa, turning R 1 000 000 to R 4 400 000 over the 6 year investment term. Definitely an attractive return for any investor!



Hopefully these two articles have given you some flavour as to not only how we construct our Funds like we do, but more importantly a bit of insight as to why we use the various building blocks and how Structured Notes specifically can add an element of asymmetry to our Fund returns.

Mike Browne *CFA*
Portfolio Manager

If you have any further questions about our Funds, please don't hesitate to reach out to us on investmentteam@seedinvestments.co.za.

On behalf of myself and the team, take care.

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