

Client: Thesis Asset Management
Source: Citywire Wealth Manager
Date: 08 October 2009
Page: 44
Circulation: 0
Size: 371cm2
Value: 0

CAN STRUCTURED PRODUCTS BE AN ALTERNATIVE TO CASH?

With Libor rates still low, investors are eyeing 'fixed or floater' offerings

DRAZEN JORGIC

djorgic@citywire.co.uk

Beating cash is not an unreasonable goal for any investor and now some wealth managers are using structured products as an alternative to cash.

Over the past year, many absolute return funds that promised returns of Libor+2% in all conditions simply did not deliver. Cash deposits, meanwhile, are yielding negligible returns. Now investors are contemplating what is on offer that can genuinely outperform cash without significant risks on the downside.

With this in mind, earlier in the summer investment bank Barclays Capital launched a five-year 'best of fixed or floater' product. This offers investors fixed 3% in the first year and then the option of a fixed 3.5% return – or six-month GBP Libor plus 1.3% – in years two to five, whichever is greater.

James Grayson, investment manager at Thesis Asset Management's office in Chichester, has analysed similar fixed-floater products. He says the ones that have been collateralised – whereby the product has been securitised with government bonds – are a promising alternative to cash deposits.

He says: 'Where they have been securitised, that takes the counterparty issues out of the way. So you would be happy with it as an alternative to deposit accounts if you are looking for an alternative to cash. Plus, now some of them also offer reasonable spread on Libor and look quite attractive compared to today's interest rates.'

Richard Gadd, fund manager director at Brooks Macdonald, bought the Barclays product when it first came out in August.

'We are using that as an alternative, or putting it somewhere between cash and corporate bonds. It has a known return profile and it's quietly ticking away for us in the background,' he says. 'There is not a lot around in terms of deposit rates for cash. You can also use this product to play interest rates. So if interest rates stay low,



Hugh Adlington: Wary of guarantees of Libor-plus without declared risks



James Grayson: Corporate bonds offer better yields

Client: Thesis Asset Management
Source: Citywire Wealth Manager
Date: 08 October 2009
Page: 44
Circulation: 0
Size: 371cm2
Value: 0



you get a fixed 3.5% but if they start to take off it's tied to rates, unlike corporate bonds.'

Gadd, who frequently uses structured products, is particularly attracted by the latter point. The fact the structure is not fixed appeals to him. 'It's diversified away from pure corporate bond exposure,' he says.

David Willcox, a discretionary wealth manager at City Asset Management, also agrees that fixed-floater products could be an interesting long-term cash deposit.

He cautions that private client portfolio managers need to look at such structures on an individual basis and a lot depends on the duration of the product. He says: 'My real concern over these structures is liquidity. I don't think they are set up ideally for private clients. Things happen to private clients that are out of your control: divorces, death or children deciding that they need to tap their parents for cash. So there are definite issues with liquidity.'

Willcox points out that such products, when sold in the secondary market early, do not sell on fund value. 'I think they are a strategic cash investment, an alternative to long-term cash deposit that is not required or tactical cash that is not emergency cash.'

Meanwhile Grayson says that although these products look attractive, in practice corporate bonds still offer better yields. 'I'm still in favour of maintaining fair corporate bond exposure. You look at where today's interest rates are and you can get healthy income yields.'

'In terms of other structured products on offer in the current market, we believe synthetic zero-type products are more appealing because they are more tax effective.'

However, Hugh Addlington, investment director at Rathbones, says: 'I'm always wary of anything guaranteeing me Libor-plus without any declared risk. In our opinion it's very difficult to create that type of return profile within a liquid environment without associated risks.'