

Client: Thesis Asset Management
Source: Citywire Wealth Manager
Date: 28 January 2010
Page: 47
Reach: 6202
Size: 350cm2
Value: 3300.5



PARTICIPATION NOTES BACK IN VOGUE AS VOLATILITY EASES OFF

A drop in volatility to pre-credit crunch levels is reviving wealth managers' interest in participation notes

DRAZEN JORGIC

djorgic@citywire.co.uk

The Vix index dipped below 18% last week, its lowest level for 27 months, boosting the market for participation notes.

Since the last time investor fear hit such lows was in August 2007, some observers believe the fall in volatility signals the end of the credit crunch.

But for structured product experts at wealth management firms, the dip in the Vix has been taken as sign that it could be time to go long on volatility.

Stuart Fox, a structured product specialist at City Asset Management, has been in talks with several investment banks about structuring products that would benefit from low volatility.

He says: 'We've been in discussions with a number of providers because all the ideas flowing out at the moment are short volatility strategies. Volatility has come off a long way and I'm coming around to the idea of increasing the participation by buying a put or a call.'

'Too many of the ideas are selling volatility and there is not enough out there in term of buying it. I think it's something that we should be more actively looking at.'

Davydd Wynne, head of structured products at Cazenove Capital Management, agrees with Fox. He says the decline in volatility over the Christmas period has prompted him to look at participation notes for the first time in a long period.

He says: 'Over the New Year there was a fallow period where things were on the cusp. But volatility fell significantly and we are starting to see 100% participation notes back again. This is all quite recent.'

Wynne says the pricing of the option and the underlying components depends on the issuer, but both have become appealing once again.

'Basically if at present you are looking at the S&P and if you wish to gain index exposure and you are willing to take 1-1 on the downside, then all of a sudden the terms on the upside look quite attractive.'

Wynne says investment banks have been offering participation rates of up to 160% on the S&P,

denominated in dollars. 'Although you don't get the yield, the participation rates means that if there is a moderate to sizeable rise on the index, then you will outperform quite quickly,' he says.

According to Ryan Rogowski, director of cross asset solutions at Société Générale, the fall in volatility has naturally coincided with increased interest in long volatility strategies at the investment bank. He says: 'People have started to ask about long volatility products. The point is that if you can get a structured product that is 1-1 on the downside and 2-1 on the upside, then you don't have to worry about the alpha as your beta might outperform.'

'For example, in emerging markets, if you think it's hard to deliver alpha in a market that's going up 80% in a year, then adding a bit of gearing on the upside for mainstream underlying indices makes sense, especially if you can add value versus an active fund.'

Time to buy volatility

James Grayson, a discretionary wealth manager at Thesis Asset Management, is another investor who believes it is time to make a switch from selling volatility to buying it.

'From my perspective it's probably time to start looking at these types of structures. We haven't decided on our asset allocation calls yet but participation notes will probably look more attractive now that volatility has fallen so much,' he says.

However, Rogowski points out that President Obama's recent crackdown on banks, which unnerved investors and temporarily increased volatility, means wealth managers may have to wait another few weeks before the Vix returns to pre-crisis levels for a measurable time.

He says: 'The fall in volatility until a few days ago was much more dramatic than people had anticipated. However, the markets seem a bit spooked so for the next couple of weeks there is a window where short volatility strategies will be popular, with things like auto-calls looking attractive once again.'



Client: Thesis Asset Management
Source: Citywire Wealth Manager
Date: 28 January 2010
Page: 47
Reach: 6202
Size: 350cm2
Value: 3300.5

