Recognising the merits of structured products in the active | passive debate

Structured products are passive principles based, with attributes and merits that neither passive or active funds offer – but is this being overlooked by some advisers and investors?

Our investment thinking…

While the principles of passive investing are increasingly widely understood, it is less well-recognised that most structured products are built on passive principles, linking risk and return to indices, but with features and attributes that passive investing can't offer, such as:

- protection on the downside
- returns that may not require indices to rise
- outperformance by contract, if indices do rise

Diversifying portfolios by investment 'type', as well as asset class and geography, i.e. aligning structured products with passive and active funds, can create better diversified and potentially more balanced portfolios, with a broader combination of potentially value-adding attributes.

The biggest wave in the investing universe in recent years is the increasing acceptance of the efficacy and merits of passive / beta investing. At the same time, we are seeing increased scrutiny of active fund management and the issues surrounding it, including the reliability of the alpha that it is supposed to deliver and its cost.

The lines between active and passive are also being blurred by rules / factor-based enhanced passive propositions, broadly referred to as 'smart beta'.

The academic theory / evidence behind this shift to embrace passive and smart beta investments by wealth managers / professional advisers and investors is widely recognised and generally accepted – it is, of course, difficult to dispute academic and empirical evidence.

The principles underpinning the rise of passive investing, including understanding efficient market hypothesis, modern portfolio theory and the importance of low costs, are increasingly well-understood … and increasingly considered relevant within a more challenging investment environment. But what is less well recognised and understood by some professional advisers, unlike wealth managers and fund managers, is the role that structured products can play in the delivery of beta, the pursuit of alpha and the optimisation of risk and return profiles in portfolios.

… more to follow from our investment committee in a full future *alphaTIMES* newsletter

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There are risks associated with an investment in any structured product. It should always be understood that structured products are not suitable for everyone. Past performance is not a reliable indicator of or guide to future performance and should not be relied upon, particularly in isolation. The value of investments and the income from them can go down as well as up. The value of structured products may be affected by the price of their underlying investments. Capital is at risk and investors could lose some or all of their capital. The ‘Important risks’ section of our website highlights the key and other risks of structured products, in addition to explaining important information for Professional Advisers who wish to access the current products area of our website and who may use our structured product plans with their clients: www.tempo-sp.com/home/important-risks. Professional Advisers should access and read the relevant plan documents relating to any structured product plan of interest, in particular: the plan brochure; plan application pack, including, the terms and conditions of the plan; and the issuer’s key information document (KID), securities prospectus and final terms sheet, before making a recommendation to their clients. Professional advisers should not invest in, or advise their clients to invest in, any investment product unless they and their clients understand them, in particular the relevant risks.