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MONTHLY REVIEW



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Restructuring the Structured Products

Autumn has been and gone... As I write these words from my desk in Geneva, the first snowfalls have covered the hills and mountains surrounding the town beyond the lake. The trees, now devoid of leaves, display their skeleton of trunks and branches. Winter has returned.

I have been speaking to lots of investors this autumn. Many were hoping that the global stock market rally and low interest rates would soon repair the damage caused by last year's market rout. Some of them have been wise or lucky, or both, cutting their risky asset exposure in 2008 and then buying them back at or around the lows of March 2009. However, the truth is that most investors have been more cautious, cutting their exposures and bulking up on fixed income and cash. True, some fixed income has had stellar returns this year. But many of the investors I have met have invested in low duration government bonds... and if they chose the "wrong" currency, they have had negative returns again this year! I did not meet many investors with significant exposure to the Australian dollar, for example.

These meetings highlighted the great underlying problems facing most investors: their timing is usually wrong, the advice they receive is too often backward-looking and their ability to forecast the future is fraught with problems. Many investors want or claim to be long-term, but they end up acting like day

traders, rather like a marathon runner racing Husain Bolt on the 100 metres track: they look lost and naive. And they lose.

To add insult to injury, many of the people with whom I have spoken have portfolios literally stuffed with the structured notes so beloved by commercial and investment banks. These notes not only had expensive embedded fees (hence their attractiveness to salespeople), they also had extensive small print, brought to light when investors try to sell them. The net result for many investors has been one of usually two outcomes:

- The bank that issued the notes offered to buy them back from investors at sizeable discounts (in excess of 20 % a few months ago).
- The investor is still stuck with the notes, hoping that their price will rise along with their underlying market.

Those who chose option A feel hard done by and, in many cases, are no longer sure if their private banker is working for the bank, while those who chose Option B are sadly still holding assets below par.

This is not a diatribe against structured products. Far from it, as I think structured products can provide essential diversification, risk mitigation and access to markets or investment strategies

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that might not be available to many investors. In particular, I believe structured products are an efficient way for investors to access hedge funds that have very high minimum investment requirements. However, structured products have also been a major component of the fee and revenue stream banks were able to book from their clients without their even being aware of the true cost of such products. And when high levels of leverage were applied to these structured products, the results could – and often did – prove disastrous.

Unsurprisingly, many investors I met are looking for a way to get out of these positions or, to be more specific, as they are unable or unwilling to get out of them, to find ways to profitably maximize the use of their immobilized capital. ***There are various answers enabling investors to do just this. In particular, we have identified solutions for investors who own capital guaranteed or Principal Protected Notes (PPNs), enabling them to get their capital working more efficiently, without materializing losses.***

If you would like to talk to us about the advice we have been able to give investors in this area, please contact one of our team members.

Of course, it is not only private investors who are looking at ways of reorganising their assets. Only last week, we had the first state sponsored reorganisation, as a Dubai government owned – but not guaranteed – entity, Dubai World, announced out of the blue that it would seek a debt standstill. This event clearly indicates that working out the bubble of the last 10 years will take a long time. One figure recently quoted is that UK commercial property defaults have now reached £30 billion! The pain currently felt in both commercial and residential property markets has, to some extent, been masked by the

combination of low interest rates and QE. But as these supporting crutches are in the process of being taken away, the vulnerability of some of these markets is likely to be exposed.

The old saying, “where there is adversity there is opportunity”, is truer than ever. We are spending more time looking at ways to help in institutional restructurings in a manner that brings relief to the holders of distressed asset while providing an opportunity to investors with capital to deploy, as the current market environment is one of those rare once-in-a-decade opportunities to make serious returns. Investors who can allocate capital to these situations are likely to be handsomely rewarded. In fact, I am persuaded that these workout situations have a far better return profile than trying to determine the level of the US dollar or of the S&P 500 in 4 weeks time. As many have pointed out, the “risk trade” is alive and well: too many traders are running similar positions, long a variety of risk assets funded by shorts in the dollar!

We hold our Quarterly Investment Committee in two weeks. After having spent months on the development of a new suite of signal generators, we will be introducing them and their recommendations. Timing of the entry is critical, but so too is the ability of your investment partner to actively manage a distressed situation, get involved with the underlying company, if necessary take control and find a profitable exit. The investment horizon is longer but, in shooting terminology, the reward could be a “10 bagger”.

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