UWEALTH

GUIDE TO UNDERSTANDING ASSET CLASSES :

PRINCIPAL-PROTECTED STRUCTURED PRODUCTS

U Wealth : Your partner in mastering financial instruments.

We want you to feel comfortable making suitable investment decisions based on knowledge of the opportunities and risks of given financial instruments.

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FINANCIAL INSTRUMENTS: OPPORTUNITIES AND RISKS

The higher the complexity of a financial instrument, the higher its potential risk – but the higher, too, the opportunities for returns.

WHAT ARE STRUCTURED PRODUCTS?

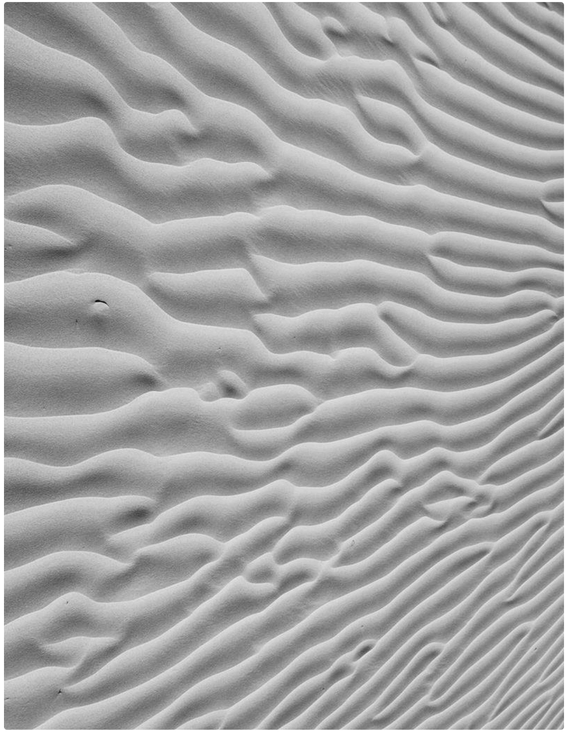
Structured products are **synthetic investment products** that usually **combine two or more financial instruments**, one of them often being an **option**.

The purpose is to **tailor the risk properties**, which cannot be found in standard financial instruments, in order **to suit the specific market expectations** and investment objectives of investors.

Structured products can give access to markets not easily covered by other financial instruments.

Structured products are **available for a range of risk categories.**

This document focuses on **principal (capital) protected structured products.** Additional explanatory material is available for yield enhancement and participation products (non-principal protected) as well as for leveraged products.



In case of ETP, product could also consist of only one Digital Asset as underlying which is not classified as a financial instrument.

ADVANTAGES/DISADVANTAGES

Advantages

Can be **used to reduce risk** by adding them to an existing portfolio. They provide

- capital protection
- volatility reduction.

They **cater to market expectations** not easily met by other instruments, e.g. sideways movements of markets or low-yield market environments.

They can offer **yield enhancement.**

They have the potential for **enhanced returns.**

There is a **broad range** of assets available.

They are **tailored** to investors' expectations.

Disadvantages

Returns are not easily predictable.

There can be **price uncertainty**.

Because they are tailored, the market may be **less liquid.**

Structured products are in most cases unsecured debt, and the credit quality of the issuer **(issuer risk)** needs to be considered.

Structured products may be **difficult to understand,** depending on the product.

The advantages and disadvantages of structured products are highly product-specific.

IMPORTANT RISKS TO CONSIDER

Important risks	▪ **The choice and quality of the issuer are important.** – Structured products expose the issuer of the product, not the issuer of the underlying, to risks. – Structured products are very specific instruments; such liquidity may be less than with other products and depends on the issuer's market making. ▪ Structured products often include option characteristics: the **price** of the product **does not move in a linear way** due to varying pricing factors. Thus, **the pay-off profile may only be reached at maturity**. ▪ If the product is quoted in a different currency, the additional **currency risk** needs to be considered. Specific structured products may hedge this risk (quanto). ▪ Each structured product has its own risk characteristics and suitability for individual market expectations. It may enhance or limit the market risks to which the underlying asset is subject. The following product categories are important.

Product category	Risk	Short description
Capital protection	Less risk	A product that guarantees a limitation of the risk of total loss under certain conditions.
Yield enhancement		A product that combines a fixed income product with an option.
Participation	More risk	A product that usually carries the full risks of the underlying with/without contingent capital protection.
Leverage		Products that make use of leverage effects to maximise possible returns at the risk of total loss.
Leverage with knock-out		Products that make use of leverage effects to maximise possible returns at the risk of total loss.

A structured product is an individual contract with the issuer of the product. Please refer to the product disclosure statements for detailed information on the rights, obligations, and risks involved in a specific investment.

WHAT TO EXPECT FROM STRUCTURED PRODUCTS

Investment horizon

- Short term
- Medium term
- Long term

Income expectation

- Capital gain
- Regular interest
- Irregular dividends

Market expectation

Different product categories cater to different market expectations. See following pages for further details.

A CLOSER LOOK AT PRINCIPAL PROTECTED STRUCTURED PRODUCTS

COMMON FEATURES CONCERNING RISK EXPOSURE

The specific risks of structured products have to be evaluated in detail on a product-by-product basis.
Nevertheless, structured products have some **common features** as far as their risk exposure is concerned.

- Investing in structured products is **not the same as investing directly in the underlying assets** involved. While a structured product inherits the risk exposure of its underlying (specifically its market risks), the combination adds new features (opportunities as well as risks).
- In many cases, structured products include an option component. This results in **non-linear pricing behaviour**.
- Structured products are **tailored by an issuer.** They constitute a debt obligation of the issuer and are not preferred debt. (1) Hence, the investor is exposed to the **credit risk of the issuer**.
- The increased complexity may cause the **liquidity risk to be higher** than with other, more standardised investment products.
- Costs/fees are usually calculated in the structured product's issue price. The **cost transparency** for the investor **is therefore not always as clear** as with other investment products (e.g. funds).
- If the product itself, or one of its underlyings, is quoted in a different currency, the **currency risk** needs to be considered. Specific structured products may hedge the currency risk ('**quanto**').
- The time to maturity has to be evaluated carefully for structured products.
  - **Maturity** varies highly and depends on the product's features.
  - Certain products may reach their pay-off profile only at maturity or on specific dates. Although the product is liquid, its pricing behaviour before maturity may not be linear like at maturity (e.g. capital protection is only valid at maturity, not before).
- Legally, structured products constitute individual contracts with the issuer. A very wide range of structured products is available. It is beyond the scope of this educational material to describe all their aspects. It is therefore important to refer to the product disclosure documents (terms and conditions) for detailed characteristics and risk disclosure.

(1) Structured products are not funds and are therefore not subject to the regulations on collective investment schemes.

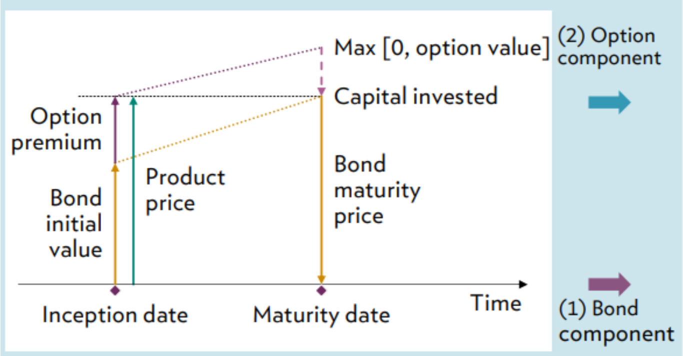
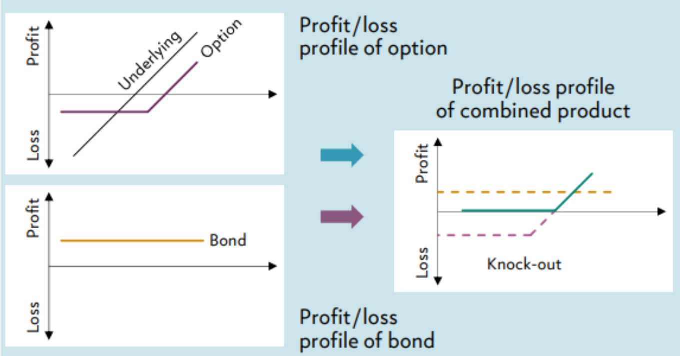
HOW STRUCTURED PRODUCTS WORK

Example: Capital protection products

The individual **characteristics of the products are determined by the combination of instruments involved**, with one of them often being an option. Thus, structured products are combination products.

'Combination' refers to both

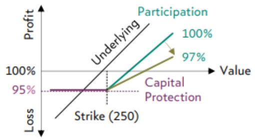
- the **profit/loss profile** at maturity date and
- the **specific risks** during the lifetime of the contract.

Example – Capital protection product	
Combination of (1) zero-coupon bond and (2) call option	
Cash flows	**Profit/loss profiles at maturity date**
	

CAPITAL PROTECTION PRODUCTS EXAMPLE

Capital protection – protection with participation (without cap)

Pay-off profile



Properties at issue

Underlying	Share YYZ
Reference price	CHF 250 (100%)
Protected capital	95%
Participation (performance)	97%
Nominal	CHF 1000
Strike price	CHF 250 (100%)
Maturity	1 year

Redemption scenarios at maturity

Value of share > strike price

Scenario 1

Redemption =
protected capital + (97% of positive performance of underlying)

For a closing price of CHF 270:
950 + (0.97 × ((270 – 250) / 250) × 1,000) = CHF 1,027.60

Value of share < strike price

Scenario 2

Redemption = (nominal × protection)

For a closing price of CHF 235:
CHF 950 = (1,000 × 0.95)

This product is a combination of two instruments: a zero-bond and a call option, and therefore also combines risks.

The product's value depends on market results as well as on credit risk of the underlying, as well as on the bond.

The product value also depends on the pricing of the option component.

As a consequence, the product's price may change in a non-linear way.

Before maturity, the redemption amount cannot be calculated and the product's value may fall below the capital-protected amount.

There are several varieties available. Capital-protection products may offer coupon payments and may include a cap or a knock-out option.

A CLOSER LOOK AT EXCHANGE TRADED PRODUCTS (ETP)

WHAT ARE ETP?

ETP are a **sub-category of structured products** and hence are technically considered as structured products but can also have many elements of fund similar instruments

The main difference is that ETP are listed and traded on exchanges while structured products are mostly traded on primary markets

ETP can be benchmarked to various investments categories, such as commodities, currencies, stocks, bonds or digital assets

	STRUCTURED PRODUCT (SP)	EXCHANGE TRADED PRODUCT (ETP)
LEGAL STRUCTURE	▪ Often unsecured debt obligations of financial institutions	▪ Legally ETPs are non-interest bearing notes (structured products) ▪ Usually set up via Special Purpose Vehicle (SPV)
OWNERSHIP OF UNDERLYING ASSET?	▪ Debt contract promises return linked to underlying asset; but ▪ SP may be hedged (1:1) or not ▪ Can trade at premium/discount to NAV and has counterparty risk	▪ Debt contract promises return linked to underlying asset ▪ ETP are typically 100% collateralized
TRADING	▪ Mostly primary markets (subscription and redemption at NAV) ▪ Secondary trading possible: Issuer makes OTC market	▪ Market making via Authorized Participants ▪ Analogous to ETF: Trading difference minimized

FOR FURTHER INFORMATION ON RISKS OR ON OTHER AVAILABLE FINANCIAL INSTRUMENTS, PLEASE REQUEST TO YOUR RELATIONSHIP MANAGER ON U WEALTH EDUCATIONAL MATERIAL.

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