BIZCOMMUNITY

Structured products have potential to scale investment despite a weak rand

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Investing abroad can be complex for South Africans. Though exchange controls were relaxed over the past few years, for the most part investing overseas requires investors to have deep pockets and a crystal ball for making currency calls.

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Investors can now take up to R1m offshore without a tax clearance certificate and a cumulative R10m per annum, with Reserve Bank approval. But, even if they are willing to do so, with the rand trading at close to R20 to the pound and R12.50 to the dollar, they will struggle to scale up their offshore investments.

At the same time, investing in developed markets like the UK, for instance, is an opportunity not to be ignored by local investors who want to diversify their holdings out of South Africa - the GDP has risen for nine consecutive quarters and consumer confidence is at a 15-year high.

The problem for investors is that, in order to enjoy a well-diversified return from investing offshore, they have to commit a significant proportion of their portfolio, make calls on the specific securities they are investing in and hope that the currency fluctuations favour them. Fortunately for them, several companies are now offering structured products which are designed to address these challenges.

Specifics vary

The specifics of a structured product varies from company to company, but in essence they offer investors a chance to put money into a pre-packaged product which tracks a diversified pool of underlying assets (often via an Index) for a fixed period of time. What makes certain structured products enticing to investors is that they can provide geared upside and limited downside return through protection of the capital invested.

Though similar to unit trusts, in that they allow investors to indirectly access holdings in diversified blue chip companies, structured products differ in that they are based on derivatives which can enhance the return of the underlying portfolio. While in most cases there is full or partial protection against any decline in the portfolio, there can be a cap on how much they can gain if the portfolio growth is higher than what was expected.

Structured products were first introduced to South Africa in the late 1990s but are not necessarily well understood by the typical individual investor. This, however, is changing, with evidence of increased demand and take-up for structured products over the past 12 months as their unique attributes draw wider appeal.

Investec, for example, recently launched its FTSE 100 Multiplier, which is linked to the UK's blue chip FTSE 100 UKX Index. Investec launched the Multiplier to provide South Africans the option of investing abroad in an affordable manner. The minimum investment is R100,000 and provides ten times the return of any growth in the Index, with total returns capped at 75% over the three year nine month investment term.

Increased volatility

Kenric Owen, head of Investec Structured Products, considers structured products to be increasingly important in the current climate. "The ability to extract leveraged returns from equity markets is vital in a difficult market with muted growth prospects. Volatility is increasing while equity markets are still expensive relative to historical levels, increasing the need for international diversification."

Many structured products focused on offshore investment have the added advantage that exchange rate is locked into the transaction, thereby eliminating currency risk. Knowing the maturity date also makes structured products very attractive when saving for a specific 'life event' such as children's education.

Jacques Snyman, principal at 5th Gen Integrated Financial Services, says that those considering investing in structured products should not see it as a silver bullet and the answer to all their investment needs. However, it provides the opportunity to enjoy a balance between risk, return and global reach with potential to scale their investment despite a weak rand.