



(UBS)

How structured investments can provide a solution for cautious investors

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Structured investments offer a solution for investors who are looking to benefit from markets' upside potential while also protecting against downside risks.

Here we look at structured investments that can help to put cash to work, gain exposure to international stocks, and increase portfolio income.

1. Holding excess cash

In recent years, many investors have been hesitant to commit new capital to the market, waiting for more favorable conditions. With global stocks up more than 20% over the past year, the opportunity cost of being out of the market has been substantial, but it has been somewhat blunted by attractive yields in savings accounts and money market funds. With interest rate cuts on the horizon, and both stocks and bond prices potentially continuing their ascent in the months and years ahead, we believe that the cost of holding excess cash is going to continue to grow from here.

Investors should continue to set aside any funds that are earmarked for spending in the next three to five years (the “danger zone” within which most bear markets occur), using a Liquidity strategy portfolio to lock in current yields and prioritize capital preservation. For investors with cash that isn't needed in the next three to five years, we recommend immediately putting that cash to work rather than waiting for a better entry point.

Autocallable growth enhanced asset return strategies (GEARS) notes are one strategy for investors with excess cash to tap into the market's upside potential, while mitigating the risk of bad timing (e.g., buying just before a market decline).

Historically, Autocallable GEARS have had a high probability of outperforming if stocks stumble or deliver middling short-term returns, in exchange for underperforming in the event of a strong short-term rally.

2. Being underinvested in international stocks

The US has outperformed its international peers for 11 of the past 14 years, boosted by expanding valuations, a strengthening US dollar, and improving profitability. We expect many US stocks' recent tailwinds to become headwinds, helping to drive international outperformance. For example, the US dollar is now 20% overvalued versus its trading partners' currencies on a fundamental basis; US profitability faces headwinds from rising interest rates, taxes, and regulation; and US stocks' extended valuations are likely to revert to more sustainable levels, both versus their own history and when compared to other markets.

When it comes to gaining exposure to international stocks, we believe that a combination of two structured investments may be the best approach:

- **Growth enhanced asset return strategies (GEARS)** notes provide enhanced upside exposure to a stock market index's price return at maturity. These notes perform best in high-return periods, when their leverage can add the most value.
- **Step return notes** provide a step return "floor" at maturity, which is a minimum return that is earned if the underlying index is above its starting value at maturity. These notes perform best in low-return periods, but also provide full upside participation in the price return of the underlying index, even if the floor is exceeded.

When combined in a portfolio as a replacement for a portion of your international stock allocation, these notes can help you to outperform in both high-return and low-return periods. These notes often also include downside protection features that allow them to outperform when markets experience mild (e.g., <25%) losses. The notes are most likely to underperform when stocks experience large losses, because the structured investments do not allow investors to benefit from the underlying index's dividends.

3. Looking to boost portfolio income

In some ways, we are in a yield-rich environment because of the Federal Reserve's rate hikes. After decades of 0.01% yields, money market funds and savings accounts are now offering yields greater than 5%. On the other hand, investors must take on exceptional credit risk to generate additional income, given today's incredibly tight credit spreads.

In our view, today's attractive yields will not last much longer. We now expect the Federal Reserve to cut interest rates by 100 basis points this year, followed by more cuts in 2025. We also expect rising high yield defaults over the coming year, as economic growth slows.

Against this backdrop, we recommend that investors be cautious about taking on credit risk and look to add duration at current levels as the 10-year yield trends from 4.4% today toward our forecast of 3.85% by year-end. Falling yields will hurt returns on cash and other short-term investments, but will boost the total return of other bond investments. For investors who have already reached their target core bond allocation, and are looking to further enhance their portfolio income, **Trigger autocallable contingent yield notes (TACYNs)** are one structured investment type that may be helpful.

Trigger autocallable notes (TANs) are another potential source of portfolio income that offers many of the benefits that TACYNs provide. Although TANs do not generate coupon payments, their call returns are generally taxed as long-term capital gains, providing a potential advantage over TACYNs and corporate bond investments in taxable accounts.

Important considerations

When considering how structured investments could fit within your portfolio, the appropriate amount and type of structures should take into consideration your objectives, as well as your willingness and capacity to accept relevant structured investment risks, such as issuer and underlying asset exposure risk, as well as a sacrifice of some liquidity (there is a limited secondary market for structured investments).

Losses are more likely over short holding periods. Therefore, if you choose to invest in structured investments with a shorter time to maturity, you may want to demand a more generous downside protection feature to the extent that you highly value the note's capital preservation characteristics.

If you would like to know more about structured investments and how they might fit into your portfolio, reach out to your financial advisor who can help you to put these considerations into context. You may also be interested in reading our educational report, [Structured Investments: Considering outcome-oriented investments](#).

Explore our full blog: [Structured investments: Strategies for three investor challenges](#), 5 June, 2024.

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