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Balancing short-term risks and medium-term opportunities

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With a highly uncertain short-term outlook and attractive cash yields, many investors are tempted to move to cash and wait for a better entry point. Structured investments are one strategy that can help investors maintain exposure to the market's upside potential while also helping to mitigate some of the market's downside risk.

Markets tend to climb the “wall of worry,” so the odds are typically in favor of staying invested. Since 1945, stocks have staged a rally in about 79% of all 1-year periods, and they've been positive at the end of 93% of all 5-year periods.

On the other hand, the short-term market outlook is highly uncertain. The Federal Reserve has raised interest rates substantially to fight stubbornly high inflation, despite growing signs of an economic slowdown and concerns over financial stability that have been stoked by a string of high-profile bank failures across the globe. As if these concerns weren’t enough, there is a small but growing risk that the US could trigger a technical default by failing to reach a timely agreement to raise the debt ceiling.

For many investors, these factors—and high cash yields—are creating a strong temptation to move to the sidelines and take the risk that they will forego upside potential.

Structured investments offer one potential solution to this dilemma. One type of note, commonly referred to as a growth enhanced asset return strategy (GEARS), may offer particular value in this environment due to current market pricing. In the next section, we will look at a hypothetical example that could be appropriate for investors who are willing to lock up their investment capital for five years. This is only an example—if this example doesn't fit your needs or time horizon, you should ask your financial advisor about other alternatives.

GEARS Example

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In **Figures 1 and 2** on page 2 of the CIO blog, we summarize the hypothetical historical returns of a 5-year structured investment with terms in line with those available at the time of writing:

- A 1-year call option: If the underlying index is positive after 1 year, the note will be automatically called, and the investor will receive their original investment plus an 8% return. If the call option is not exercised, the investor's capital will remain invested in the note until the end of the 5-year period.
- Enhanced upside participation: If the index is higher than its starting value at the end of the 5-year period, the investor receives their original investment plus 250% of the index's gain.
- "Buffer" downside protection: If the index is below its starting value at the end of the 5-year period, the investor will partially participate in the index's downside.

If the index is down 20% or less, they will receive their original investment in full. If the index is down more than 20% from its starting value, the investor will receive their original investment minus the index's loss plus 20%. For example, if the index is down 25%, the investor will lose 5% (–25% + 20%), and thus receive 95% of their original investment when the note matures.

Positioning considerations

You may want to consider this GEARS type of structured investment as a replacement for some portion of your stock portfolio. For investors who have uninvested cash earmarked for buying stocks on future dips, this type of structured investment can be an attractive alternative that helps to reduce the risk that you could miss in the early stages of the next bull market.

There is a limited market for selling structured investments prior to maturity, so we recommend against buying this note with capital that you will need in the next five years. While a structured investment with these terms historically offered some protection against losses, it could still be exposed to downside risks beyond the 20% downside buffer.

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).

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.

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Read the full blog **Structured investments: Balancing short-term risks and medium-term opportunities** 5 May 2023.

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