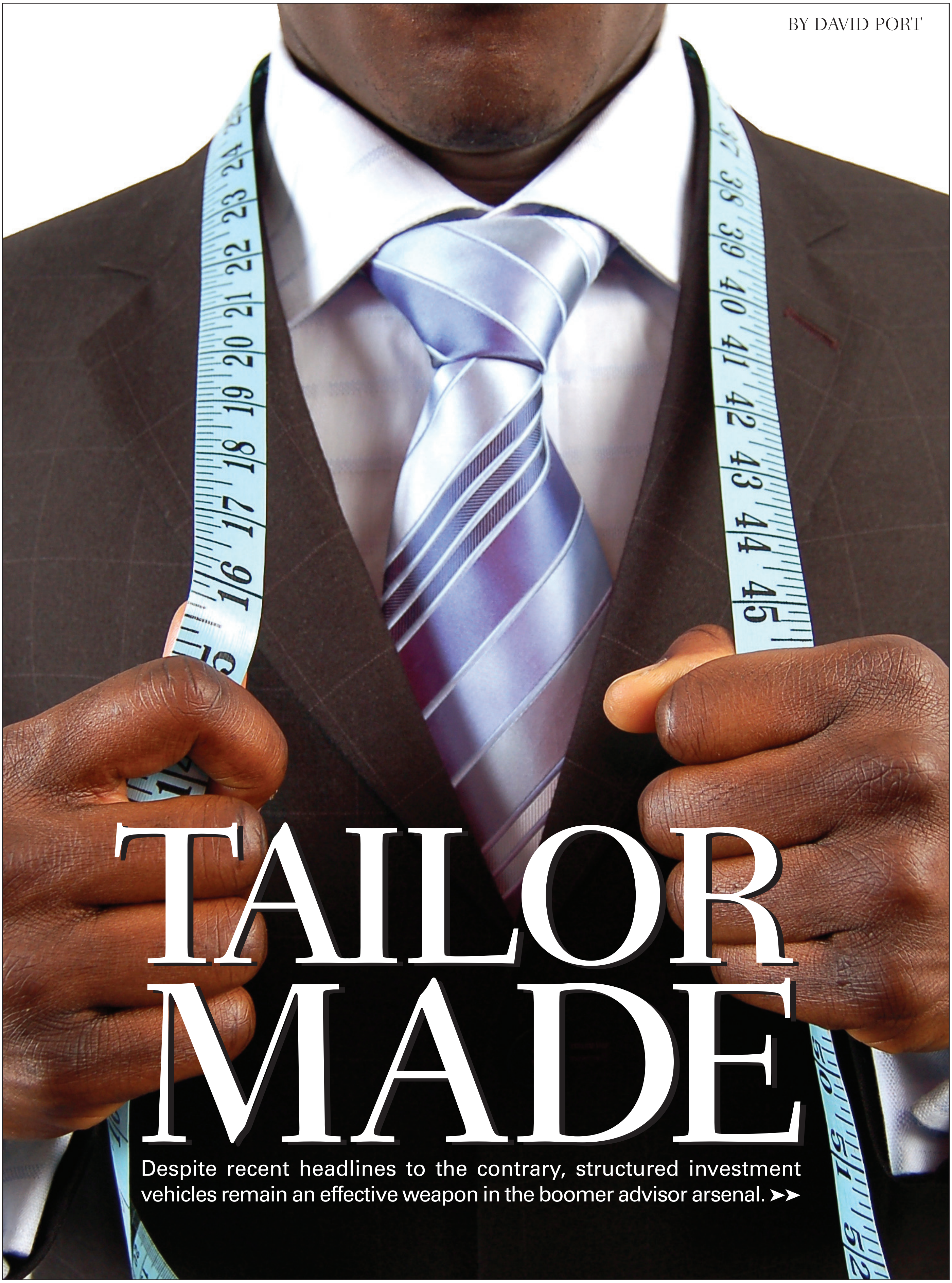
BY DAVID PORT



TAILOR MADE

Despite recent headlines to the contrary, structured investment vehicles remain an effective weapon in the boomer advisor arsenal. ➤➤

For a financial instrument that only recently has found a solid foothold in the United States, structured products are thriving. New issuance has grown dramatically in the last five years, from $28 billion in 2003 to a projected $100 billion in 2007, according to the Structured Products Association. The Manhattan-based trade organization has 2,300 members dedicated to promoting the use and understanding of structured products. The fact that so many prominent players have united under the structured-product umbrella speaks to the potential they see in the vehicle.

"The growth of structured products is likely to be nothing less than massive, even potentially marginalizing in its scope," posits David Macchia, founder and chief executive of Wealth2k, a Canton, Mass.-based company that provides retirement income solutions. "Investment companies that are slow to transition to developing outcome-oriented, principal-protected products may be run over as aggressive structured products providers begin to make significant inroads that realign market share."

So what exactly are these instruments? Essentially, structured investments are bank-created securities designed to meet investors' needs for highly specific risk and reward parameters, explains Tom Ricketts, CEO of Incapital LLC. The provider of bank-underwritten structured products says that retail products are available from major underwriting banks, including Barclays, Bear Stearns, Merrill Lynch, HSBC, UBS, Wachovia and JPMorgan Chase. But he notes they also can be customized for specific clients, making them especially appealing to sophisticated, high-net-worth investors. Structured products are linked to underlying assets or indices. Some are structured as simply as a CD; others are more complex, with moving parts and linkage to a wide range of vehicles, from hedge funds to commodities and other alternative investments.

"It's really all over the investment spectrum," says Ricketts.

Structured products generally fall into three categories based on whether they provide full, partial or no principal protection. Most vehicles, according to Macchia, "are purchased for a specific term, 1,3,5,7, or 10 years, [and] offer a measure of principal protection combined with a linkage to an external investment such as an equity index. For instance, a structured product may have a 7-year term with the principal protected in full if [the product is] held to the end of the term. This product may also provide for additional growth potential equal to, say, 110 percent of any increase in an equity index, such as the S&P 500, over the term."

BUILDING ETN BUZZ

Now that ETFs are a household word (at least in financial circles), market watchers are looking to structured products for the next big thing.

According to Christopher Yeagley, exchange traded notes may be it. The managing director at Deutsche Bank says they represent "yet another significant tool for money managers and financial professionals. ETNs can actually deliver the same type of non-correlated exposure as hedge funds, with the benefit of significantly lower minimums and lower management and performance fees."

A hybrid that combines the features of ETFs and bonds, ETNs are unsecured, unsubordinated debt whose return is pegged to the performance of a market index or currency exchange rate. Similar to bonds, ETN returns are based on the performance of the underlying index and the creditworthiness of the institution issuing the note. Thus, a drop in the issuer's credit rating can cause the value of an ETN to fall, even if there is no decrease in the performance of the underlying index. And, like bonds, investors can hold the note until maturity.

Barclays Bank introduced ETNs in 2006. Now, Deutsche Bank and others will release their ETNs into retail circulation in the months ahead.

"We've only seen them really emerge in the last 6 to 12 months," says Yeagley. "We offer two of them now, but we expect to add many new ETN products in 2008."

Seen as a viable alternative to both mutual funds and ETFs, ETNs' appeal comes mainly from their lower minimums, lower fees, transparency and liquidity. ETNs, like ETFs and unlike mutual funds, trade on an open exchange, which allows investors to move quickly.

BOOMER APPEAL

Despite surpassing the $100 billion mark in new issuance for the first time in 2007, structured investments have only scratched the surface of their market potential, says Macchia. "Penetration to date has been relatively small, but is growing rapidly."

Further penetration depends largely on the ability of advisors and investors to gain a stronger grasp of what structured products are and the value they can bring to the investment portfolio.

"More and more distributors are showing interest in the products as they become better educated about their benefits," he says. "Wholesalers are in front of advisors, teaching them about structured products and where they fit in the advisor's practice."

One point wholesalers emphasize is that the structured products sold at the retail level are far different from the structured instruments that trade at the institutional level. The latter category garnered headlines recently for damage sustained during the subprime mortgage crisis. But Ricketts makes clear that the crisis has had little to no impact on structured products at the retail level.

Macchia says that once the distinction is made, structured investments appeal to baby boomers because they allow ordinary investors to access investments that are typically available only to institutions or sophisticated, high-net-worth investors. What's more, adds Ricketts, "you can get access to these assets classes on a principal-protected basis. It's for people who want exposure to new markets, but also want a measure of principal protection."

Investors who once had to contend with huge minimums and illiquidity in order to gain exposure to alternative investments can now do so with structured products.

"If you have an opinion about something, like if you believe the dollar is going

> "When the markets are more volatile, structured products are more valuable. And 2008 looks like the kind of year where there is going to be a lot of volatility."
>
> —Tom Ricketts
> CEO of Incapital LLC

to move in a certain direction relative to another currency, structured products are an easy way to create that exposure for yourself," he says.

In the drive to meet diverse client needs, banks regularly introduce new structured products, and many are get creative in the way they link to underlying asset structures.

"In the last few years, much of the innovation [in the structured investment space] has occurred in the indices themselves," says Christopher Yeagley, managing director at Deutsche Bank in New York City, a major structured products provider. "Banks are coming up with new ways to deliver market exposure, based on factors such as revenue, return on capital, dividends and earnings."

Aware that many boomer investors prefer customized instruments to off-the-shelf products, banks that offer structured products are also showing a growing inclination to develop "one-off" products for individual, affluent investors when the dollars justify doing so, says Ricketts.

"Someone — an advisor or investor — can contact a firm like ours, explain what they're looking for and we'll go to the different underwriting banks to find the best price for the product they seek."

One-to-one relationships are also crucial to the effort to educate the investing public about structured products.

"We are happy to send someone to talk to the advisor and the client one-to-one," notes Yeagley."

Ultimately, Ricketts notes, the minimums banks require to custom-structure products for a single investor are dropping. Systems are now better equipped to handle smaller custom transactions and orders can be aggregated, resulting in lower costs. For example, a bank might take a one-off structured product to the broader market to solicit additional investors.

BIGGER THAN MUTUAL FUNDS?

Given the customization option, the rapid pace at which banks introduce new structures and the complexity of some products, the onus is on advisors to determine how they fit best with the portfolios they manage.

"In a time-weighted allocation of retirement assets," says Macchia, "structured products have a significant role to play. They can be linked to specific time or ROI targets, and they can even be custom-tailored to meet certain target needs within the larger income strategy framework."

For baby boomers in particular, he says, structured products are useful in the transition to retirement. They have the ability to afford protection beneath the accumulated assets in retirement accounts while preserving ongoing growth potential. That combination of upside exposure and downside protection becomes especially appealing during periods of market volatility, Ricketts says.

"When the markets are more volatile, structured products are more valuable. And 2008 looks like the kind of year where there is going to be a lot of volatility."

This means an even greater influx of U.S. investment dollars into structured products, as well as additional product development.

"We will see very significant product innovation, including the emergence of simple, intuitive and outcome-oriented products," Macchia predicts. "Transparency and liquidity will be noteworthy features. Daily pricing will provide investors high liquidity and vital confidence. In Europe, structured products have already won the battle. In the U.S., this European model may yet carry the day." b

ONLINE EXTRA

Stay on top of industry-specific headlines and what they mean for your business by watching the daily broadcast of ProWeb Cast News. Tune in to www.producersweb.com/news for a summary of the day's biggest stories.

> "Wholesalers are in front of advisors, teaching them about structured products and where they fit in the advisor's practice."
>
> — David Macchia
> CEO, Wealth2K