THE AUSTRALIAN
Business
WITH THE WALL STREET JOURNAL.

April 01, 2009 02:21am AEDT

Capital protection proves popular with investors

Geoffrey Newman | April 01, 2009

Article from: The Australian

CAPITAL protected equity market products seem to offer a safe way to back into equities in these volatile times and the banks have been rushing to market with new products.

JPMorgan last week launched its ASX 20 Growth investment product, which gives investors upside exposure to a portfolio of 20 of the largest ASX-listed shares while limiting downside risk. The Commonwealth Bank launched two new offerings last month and Macquarie Bank and Colonial First State have popular products.

These offer an exposure in the stock market in which the investor's capital is partly or fully protected should the value of the equities fall below the value of the initial investment.

It is a product ripe for the times as investors continue to worry about the possibility of a financial market meltdown but at the same time see signs of equity markets bottoming and are concerned about missing out on an upswing in share prices.

"The ASX 20 Growth product suits investors who want exposure to blue-chip Australian stocks but who don't want to put their savings at risk if share prices remain volatile," JPMorgan equity derivatives and structured products executive director David Jones-Prichard says.

The Commonwealth Bank last month offered two new products, each requiring a minimum investment of $10,000. One offers 100 per cent capital protection but limits the possible returns from the equity portfolio to 15 per cent annually. The other has no capital growth limits but up to 20 per cent of the investor's capital could be lost, depending on how far the share market falls over the term of the investment.

Commonwealth Bank structured investments head Suzanne Salter says there is a $1 billion market in Australia for this type of investment and self-managed superannuation funds make up half of the bank's client base.

"Demand has grown significantly from last year," she says.

Super investors like the bond-like behaviour of capital-protected funds, particularly at a time when interest rates are low and returns on cash are poor, Salter says.

"The ability to make returns exceeding that of a standard term deposit as well as limiting the risk of your investment capital resonates well with conservative investors," Salter says.

Promoters of capital-protected products also argue that with the value of the stock market having halved the risk of equities falling further is low. Wren Investment Advisers' Andrew Quinn urges caution. "I think you have to be very careful with these products."

Capital-protected equity investments are generally too expensive, Quinn says. In other words, the returns they are likely to produce are inadequate given the associated fees and opportunity costs of putting money into such products, which typically lock in the investor for five years and charge substantial break fees.

The low risk of a negative return cited by the product purveyors is precisely why investors should be wary, Quinn says. Assuming an 11.8 per cent long-term return for the share market, the chances of being

in the red after a five-year investment are low — about 1.6 per cent.

Investors are paying for capital protection when capital loss is unlikely as long as the shares are held for the full five years, he says.

“If you’ve got a five-year holding period and you are not being forced to sell, what are you paying for?” he says. “For most people they are too expensive for the protection they get.”

Investors can achieve a similar sort of risk profile by simply adjusting the level of risky assets versus cash in their portfolio, Quinn says.

One firm that has recently decided not to launch a product is Tyndall Investment Management. Managing director Brett Himbury says it was ready to go with a similar product in November but pulled out at the last minute when it became clear the investment case did not stack up for his customers.

Just because many new products are coming to market it does not mean now is the right time to buy, Himbury says. In fact fund managers tend to outperform investors over time because the latter generally flock to an investment just when returns are peaking.

Copyright 2009 News Limited. All times AEDT (GMT + 11).

All times are EST. © MarketWatch, Inc. 2008. All rights reserved. Subject to the Terms of Use. Designed and powered by Dow Jones Client Solutions. MarketWatch, the MarketWatch logo, BigCharts and the BigCharts logo are registered trademarks of MarketWatch, Inc. Dow Jones is the registered trademark of Dow Jones & Company, Inc. Intraday data delayed at least 15 minutes. “Intraday data is provided by Interactive Data Real Time Services and subject to the Term of Use.” FXQuoteTM provided by GTIS, an Interactive Data Company “Historical and current end-of-day data provided by Interactive Data Pricing and Reference Data”. FTSE (Footsie) is a trade mark of the London Stock Exchange and the Financial Times and is used by FTSE International under license.