

Intuitive approach: it's like building a car...

Imagine you want to drive from Paris to Milan; for that purpose, you buy a car. If you wanted to make money by investing in equities you would buy a stock that in your opinion would have a fair chance to rise in value. Now going back to your trip from Paris to Milan, you'd maybe think, hmh, the road could be long and dangerous, maybe I should buy a car with an airbag and an anti-lock brake (ABS) System. In the equity market, buying an airbag and ABS system would be equal to buying a [capital guarantee](#) on top of your stock investment. This simple action, combining stock exposure with a capital guarantee, would already form a structured product. If you further reflect that you wouldn't know how to get from Paris to Milan and that a GPS in the car would be helpful, then if you don't know whether this is the right moment to enter the stock market, or not you could add a look-back option to your stock investment. To summarize we have:

Comparing structured products to building a car

Building a car	Building a structured product
You would like to drive from Paris to Milan	You would like to invest in a stock
The road could be long and dangerous	You add an airbag and an ABS system
You don't know the best way to drive from Paris to Milan	You don't know if it's the right moment to enter the stock market

You can thus compare structured products to the options of a car. The car represents the underlying asset, and the car's options represent the structure of the product. Structured products are in fact a financial underlying asset and an option pasted together. The financial underlying can be a stock, an index, a commodity a fund etc. The option can be a call, a put, it can be plain vanilla or exotic. Several options can be added to the underlying asset. In addition, a single structured product may be linked to several assets. So it becomes rapidly complex. You can imagine that counting the possible combinations of every option with every underlying will

already result in a tremendously large number. Add to that the fact that you can have several underlying assets combined with several options and the number of possibilities approaches the infinite. Add time (two similar products issued one day apart will not have the same parameters due to market movements) and the possibilities are in fact infinite.

Adding options does cost money, and leaves you with less to begin with. Does it pay off? How do you know? As with the car, it might be a good idea to include some features, which are useful to you, even though you hope never to use them. When you buy a car that includes an airbag, you certainly do not want to make use of it someday. The ABS also comes in handy, but you use it only as a last resort brake. Are these options free? No, they cost something! These options are of the *insurance* category. They prevent or smooth the worst-case scenario, a crash. A capital guarantee enters into this category. Whatever the underlying asset does, you will not lose your capital, it is guaranteed (unless the issuer of the product goes bankrupt). Does an investor want a capital guarantee to be triggered when his product matures? Certainly not, since if that scenario were to occur, it would mean that the underlying did not behave as expected and the return on capital would likely be zero percent. Yet a logical reason to spend money on a capital guarantee would be the uncertainty about the future performance of an underlying asset. Since it is seldom possible to know beforehand how an asset price will evolve in the future, investors with low risk appetite will be better off with the option than without.

What about the GPS in the car? This feature can be considered as a *performance enhancement*. It allows a driver to reach a destination faster, without losing his way. In structured products, it can be compared to the look-back feature. A look-back allows the buyer to set the level of strike of an option some time *after* it was bought, which amounts to the same as buying a stock now at a chosen price of some days ago. The buyer will always select the best price for himself: if he bought a look-back call, he will choose the lowest price the market reached within the look-back period; if it was a put, the highest price will be selected. Hence the name of the option, look-back: the buyer looks back at what the market did and chooses the best strike for himself, improving his performance. Obviously, this feature can be quite expensive. When constructing or choosing a structured product, best avoid features that are not necessary, but stick to those features deemed essential.

Structured products are not an asset class by themselves, even though some like to think so. They are means to either enhance the performance or reduce the risk of your portfolio. Structured products do not come for free, there's no such thing as a "Harry Potter" product

summoned out of a magic wand. Whether they are of use to you is a call that only you can make, because only you know your own risk-return profile.

More about structured products in the menu " [Know-How](#) ".