Why your portfolio should have a structured product

Your Money
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A STRUCTURED product (SP) is essentially a portfolio-restructuring tool. It is a platform of fixed-income and derivative instruments, similar to a mutual fund. Its layer of derivatives gives it the flexibility needed to blend with a portfolio and enhance its risk-to-return performance while matching an investor's objectives. High-risk, high-reward SPs can form a part of equity while its lower risk designs can be plugged into debt.

Nifty-linked debentures are constructed to meet investors' desired returns by taking a little market risk. By virtue of their structure, such products have in the past outstripped the benchmark by a generous margin. They are one of the few asset categories that generate a sizeable alpha, or returns over and above the Nifty.

In terms of cost, it is a reasonably charged instrument that attracts a one-time charge of 0.5-3% against the 2% management fees charged annually by a mutual fund or even insurance that attracts around 1.25% per annum. Are they suitable for retail investors?

SPs are suitable for you if you are:

- Looking for a product that complements and enhances performance of the current portfolio;
- Looking at diversifying market risk in the true sense (unlike investing in multiple equity MFs that depend on upward market movement);
- Looking for strong returns over an approximately three-year investment horizon; and
- Comfortable with a minimum ticket size of ₹25 lakh and are willing to take a credit risk.

Types of investors

They come in low- to high-risk varieties, for all kinds of investor requirements and appetites. These products are particularly popular among HNIs and corporate bodies due to their large ticket size and strong returns, coupled with a three-year investment span.

Like any financial instrument, these too have their risk-reward payoffs. So, adventurous investors tend to gravitate towards non-principal protected varieties while conservative ones look for complete principal protection. But, historically, considering three-year average rolling returns, the Nifty has never dropped below 20% in the past decade.

So, as far as risk is concerned, providing partial protection of up to a 15-20% fall in the Nifty could be a safe bet even for conservative investors. However, product-based investment styles seldom make good returns for the portfolio as a whole. For best results, it is important to design a suitable strategy with the help of a product expert. A well-designed strategy utilises SPs in different combinations, which can help an investor reap benefits across market seasons — capture bull runs or generate benefits in dull and negative market scenarios.

SIMPLY PUT

- Since their inception in India in 2005, there has not been a single default or delay by any structured product (SP) issuer till date
- An important factor that investors should consider while buying an SP is the degree of transparency offered by the service provider with respect to the investment. It may be prudent to consult one's wealth manager on this
- Investors tend to fall for ratings while ignoring the issuer's true credibility. The actual risk depends on an issuer's competence and expertise. Pick an issuer with a strong background

Risks involved

Interest and faith in this asset category is escalating with the current SP market at ₹10,000 crore, and growing. Since its inception in India in 2005, there has not been a single default or delay by any issuer till date. Yet, one must pay close attention to the not-so-obvious risks associated with this product.

An important factor that investors should consider is the degree of transparency offered by service providers with respect to the investment. Considering this varies from one wealth service provider to another, it may be prudent to consult one's wealth manager and select a service provider according to one's comfort and need for transparency.

Investors tend to fall for ratings while conveniently ignoring the issuer's true credibility. Ratings, which are measured on the basis of a fixed set of parameters, often reflect the risk perceived by an investor rather than the actual risk one may be subject to. The actual risk depends on an issuer's competence and expertise. It is, therefore, necessary to pick an issuer with a strong background and superior product designing skills.

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