



STRUCTURED NOTES GUIDE

- Short-term structured products
- Explanation of key phrases found in the KNG Data Sheets
- Classic auto-cancellation
- Self-canceling income
- Auto-cancellation of memory entries

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Short Term Structured Products



We're often asked for short-term structured products and generally we suggest investment options that may have longer terms - although often still with the possibility of early auto-calls to "lock-in" gains. The reason for this approach may not always seem apparent, but perhaps the easiest way to look at it is in terms of probabilities (something that has a large influence on structured products in particular).

The example below contrasts two possible Structured Products

Underlying:	Worst of FTSE 100/Eurostoxx 50/ Nikkei 225 Indices	Underlying:	Worst of Goodrich Petroleum/ SunEdison Inc./Halcon Resources Corp./ Chesapeake Energy Corp.
Payoff:	Semi-annual, 100% strike auto-call	Payoff:	Fixed income
Coupon:	6% semi-annual (12% p.a.)	Coupon:	2.5% per quarter (10% p.a.)
Total Fees:	8% (Bank + Distributor + Commission)	Total Fees:	10% (Bank + Distributor + Commission)
Barrier:	60% final level	Barrier:	50% final level
Term:	Max 6 years	Term:	1 year
*Possible Outcome:	A: 20% p.a., 16%13.7% (6yrs) B: 100% return of capital C: 40% or more loss	*Possible Outcome:	A: 20% p.a. return B: 50% or more loss NB. No option for return of 100% of capital

**Possible outcomes include the cost of the fees which need to be recovered.*

The first product has been designed to be suitable as part of a balanced portfolio for more cautious investors and pension funds (for example). The aim is to deliver good levels of growth based on the performance of mainstream stock market indices. If clients don't receive these good levels of growth, they're likely to receive their full capital back (effectively just over 1% p.a. to cover fees) with only a small probability of any capital loss.

The short term product linked to individual stocks has only two possible outcomes, a high return, which is amplified massively by the fees being taken over only 1 year, or a loss of at least 50% of an investor's capital. With interest rates so low, the probability of any investment delivering a 20% return over 1 year is very low indeed. There is no option for a return of capital (effectively 10% p.a. growth to cover the fees) so the greater probability – the only other option - is for a loss of at least half the investor's money. This product is more of a gamble than an investment.

A number of advisers have seen their clients suffer massive losses of capital on shorter term structured products, especially when unfeasible returns and huge fees have been taken. The products haven't been designed with investors in mind and the higher commissions probably haven't compensated the advisers for the anguish they've suffered either.

Thankfully most issuers are now taking a more sensible approach to their international businesses, so, with the exception of EFG (who are still issuing structured products with exceptionally high fees taken out), there are fewer unsuitable offers out there.

If you want to offer your client short term investment opportunities, the returns on offer will be low and commission payments small – unless you and your clients are prepared for a high probability of huge losses.

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Structured Products – An explanation of key phrases found on IDAD Factsheets



Issuer and Counterparty:	The name of the Bank that is issuing the note
Credit Ratings:	Rating given by Credit Rating Agencies, one of the factors used to gauge issuer risk
Maximum Term:	Maximum number of years the note will run for if it doesn't autocal early
Investment Structure:	Type of note, i.e. Semi-Annual Memory Income Autocall
Autocall:	An investment where there are opportunities for the investor to receive capital back early (subject to certain conditions)
Autocall Opportunities:	The frequency in which the structured product can 'autocall'
Autocall Trigger:	The level at which an underlying needs to be in order for the structured note to 'autocall'
Income Rate:	The percentage of income that is potentially due to be paid (sometimes includes a memory feature)
Income Trigger:	The level at which an underlying needs to be in order for the income payment to be paid
Memory Feature:	Where income previously unpaid, will be included when the income trigger is next activated
Capital Protection Barrier:	Provides a fixed level of protection at maturity i.e. a 60% Final Level (European barrier) means that the underlying has to fall by more than 40% before any capital is at risk
Underlying Basket:	The indices or stocks that make up the investment
Subscription Period:	The length of time the note is open for new trades
Issue Price:	The price paid for the note; all IDAD notes are purchased at 100%
Strike Date:	The start date of the note and the date that the levels are recorded to be used for observation dates
1st Coupon Observation:	The first date at which the note can potentially qualify for an income payment
1st Autocall Observation:	The first date at which the note can potentially return the investors capital back to them
Final Observation:	The final opportunity ahead of maturity date for the note to qualify for early maturity
Maturity Date:	The end date of the note (if it hasn't already autocalled)
ISIN:	Structured product identifier number to be used on your trade instruction

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DEFINITION

The Classic Autocall product is a fixed term investment which can mature early, meaning investors can potentially receive their capital back before the note reaches its full term i.e. 6 years. An autocall will take place if a specific underlying is above a pre-determined trigger level. Within the note there will be set observation dates where the autocall event can take place. For each investment the observation dates should be clearly stated on the factsheet. The frequency of the observation dates can vary however, the most common periods tend to be, quarterly, semi-annually or annually.

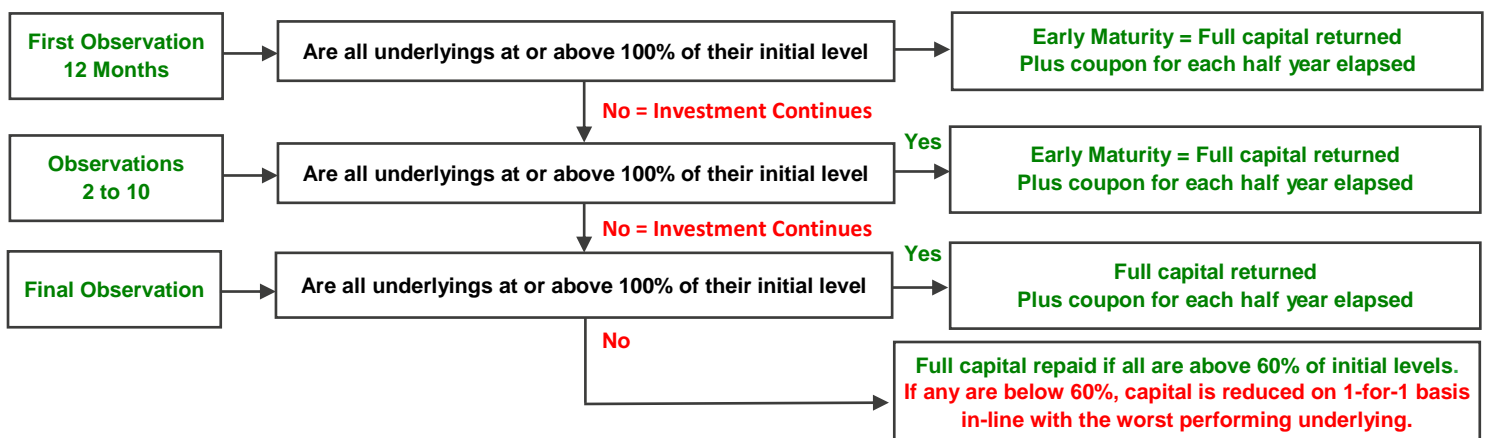
In addition to the opportunity for capital back early, the autocall note is also designed to offer the investor a coupon payment over a fixed term. Again, this is based on the underlying asset being above its initial strike level on the set observation dates. If the note does autocall, the investor can expect to receive their capital back along with the appropriate coupon payment. If the note does not autocall at the first observation date but later qualifies at a subsequent observation date, the coupon will ‘snowball’ which effectively means the coupons will ‘roll up’ and be paid in a lump sum when the note autocalls.

Most autocall products incorporate a protection feature so that, if the autocall trigger has not occurred before the scheduled maturity date, the invested capital benefits from a level of protection. The performance of the underlying in relation to the protection barrier level will determine how much capital is protected and so how much will be returned at maturity.

The diagram below demonstrates how a simple autocall product linked to an index operates. For illustration purposes only, it is assumed that a single index and final level (European-style) barrier have been used. In this example of a six year semi-annual autocall investment, the autocall trigger level is 100%.

Consequently the investment autocalls if the underlying index is 100% of its initial level on any of the semi-annual autocall observation dates, first autocall opportunity at 12 months. The coupon of x% is paid if the product calls on the first observation date, two times x% if the product autocalls on the second date and so on up to and including the maturity date. Should the index level be below the protection barrier level (set at 60%), then capital will be at risk and will be reduced on a 1-for-1 basis.

HOW THE INVESTMENT WORKS



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The Income Autocall

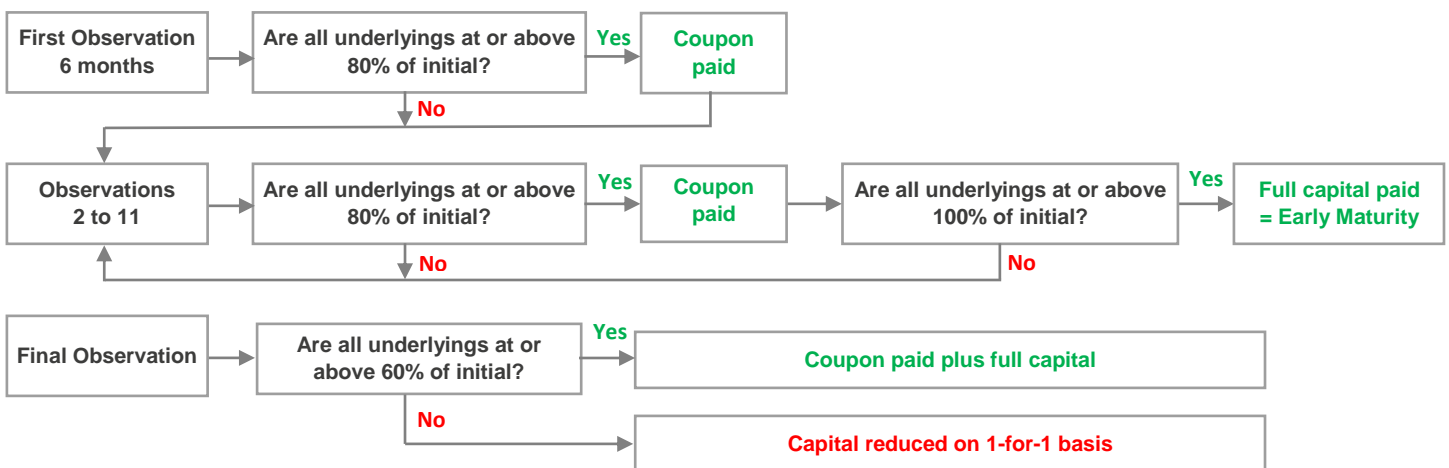
DEFINITION

An income autocall product is a structure based around the classic autocall with the difference being it provides the opportunity for regular income payments across a fixed term. The product is also known as a Phoenix and like the classic autocall has the benefit of regular opportunities for possible early maturity.

The payment of the income is conditional upon the underlying being at or above a specified level. An example would be that the income payment would be triggered where the level of the underlying at the observation date was at least 80% of the initial level. Should this not be the case then no payment is made. As with the classic autocall, the product continues until an early maturity is triggered or full maturity is reached. For a detailed explanation of how an autocall works please refer to "The Classic Autocall - how the investment works".

The diagram below demonstrates how and when the income payment would be triggered and possible outcomes where the investment is structured as a 6 year investment, with semi-annual observation dates (first autocall opportunity at 12 months), 100% of initial level as the trigger for the note to autocall, 80% income trigger level and the final level capital protection barrier set at 60%.

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Indicative Terms

Issuer	European and US investment banks with investment grade credit ratings
Maturity	1-year
Available currencies	EUR / USD / GBP
Daily fall required to trigger Barrier Event	-20% / -15% / -10%
Barrier Level	80% / 85% / 90%
Downside Leverage (DL)	10x / 20x
Barrier Event observation period	1-day (close-to-close)
Underlying indices available	MSCI World / EuroStoxx 50 / S&P 500
Capital Protection	Capital at risk
Coupon Payment	At maturity
Coupons	Pricing available on request

Investment Rationale

Stability Notes serve as cash alternative investments, which provide investors with an enhanced fixed interest rate and return of capital providing the underlying index does not fall by more than a specified amount on a single trading day (close-to-close) over the investment term – i.e. *downward gaps*. Investors are only exposed to one day *downward gaps* in the underlying index that are larger (in absolute terms) than the pre-defined amount that would trigger a Barrier Event – i.e. they are not exposed to downward trending markets nor to multiple *downward gaps* if each *downward gap* is less than the pre-defined amount that would trigger a Barrier Event.

The notes are suitable for investors who are willing to have a short exposure to 1-day *downward gaps* in a major equity index for one year and are comfortable with senior unsecured credit exposure to the issuer.

Investment Description

- At maturity, if no Barrier Event has occurred, the note pays 100% + Fixed Coupon
- At maturity, if a Barrier Event has occurred, the note pays max {0%, 100% - DL x (performance below the Barrier Level on the day of a Barrier Event)}
- An investor suffers a loss equal to the product of DL and 1% for every 1% that the underlying index performance is below the Barrier Level, and (typically) misses out on the coupon

Low Risk Stability Note

- Barrier Level of 80%
- Downside Leverage of 10x
- “80/70” Stability Note

High Risk Stability Note

- Barrier Level of 90%
- Downside Leverage of 20x
- “90/85” Stability Note

Payoff Example: an “80/70” Stability Note

• No Barrier Event

If the underlying index does not fall by more than 20% on a single day (close-to-close), the investor would receive back their initial investment plus the coupon at maturity

• Barrier Event

If the underlying index falls by 21% close-to-close, the investor will lose 10% of their investment (1% x 10x leverage)

If the underlying index falls by 25% close-to-close, the investor will lose 50% of their investment (5% x 10x leverage)

If the underlying index falls by 30% or more close-to-close, the investor will lose 100% of their investment (10% x 10x leverage)

Risk Recycling by Investment Banks

Stability Notes allow investment banks to offset some of the risk that they generate through their retail structured product business. Investment banks that offer Constant Proportion Portfolio Insurance (CPPI) based products can use stability notes to cover the “gap risk” caused by CPPI products within their trading books. Not all investment banks are active in the Stability Notes space, but those that are, tend to price either Low or Higher risk Stability Notes more aggressively depending on the “gap risk” that they need to cover within their trading books.

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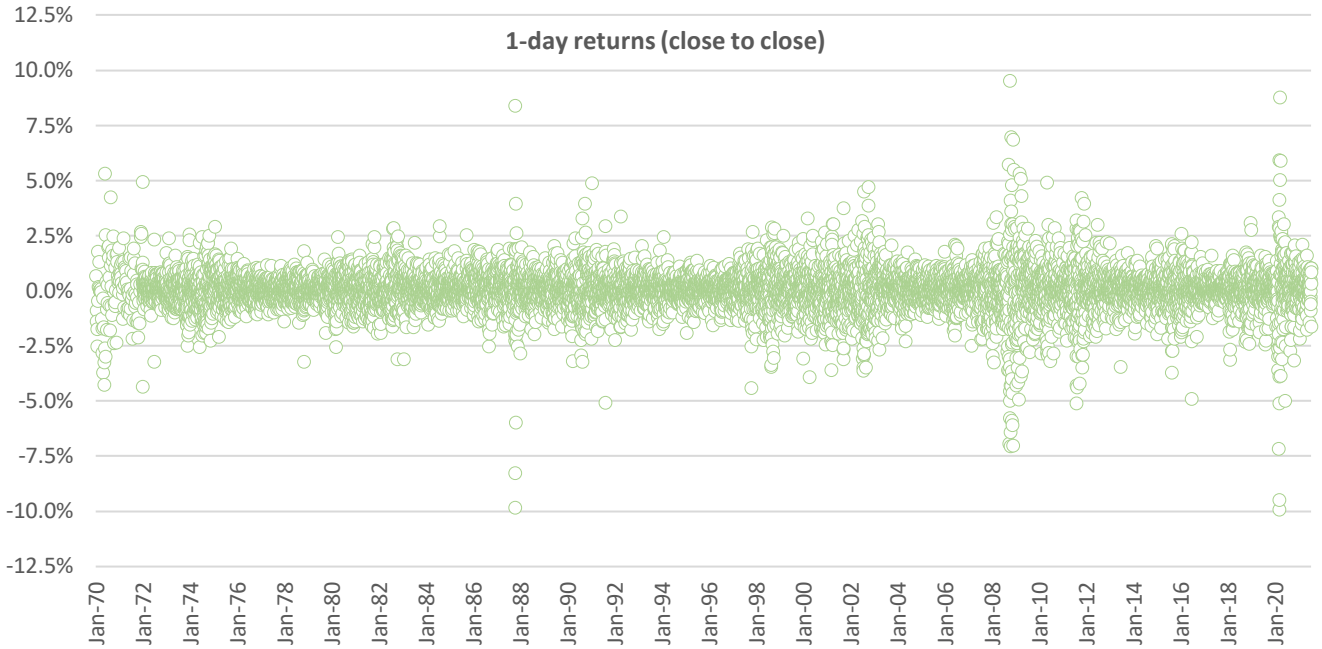
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Historical Context

We have examined the daily movements of the index since its earliest data point on 31 Dec 1969. Analysis covers 13,055 trading days over a 51-year period. As can be seen from the analysis below, the worst daily performance of the index was -9.92%. Therefore, a Stability Note with a Barrier Level of 80% would have always returned 100% capital and coupons.

Source: Bloomberg 23.07.2021



Index Start Date 31 Oct 1969	
Date	10 Worst Daily Performance
12 Mar 2020	-9.92%
19 Oct 1987	-9.84%
16 Mar 2020	-9.51%
20 Oct 1987	-8.27%
09 Mar 2020	-7.17%
15 Oct 2008	-7.06%
01 Dec 2008	-7.01%
29 Sep 2008	-6.95%
22 Oct 2008	-6.41%
20 Nov 2008	-6.10%

Index Description

The MSCI World Index captures large and mid cap representation across 23 Developed Markets (DM) countries. With 1,563 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. DM countries include: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the USA.

Source: MSCI Factsheet June 2021

Daily Performance Range	Number of Daily Returns within range	Percentage of Daily Returns within range
More than 0%	6,936	53.13%
0% to -5.0%	6,103	46.75%
-5% to -10%	16	0.12%
-10% to -15%	0	0.00%
-15% to -20%	0	0.00%
Total	13,055	100.00%

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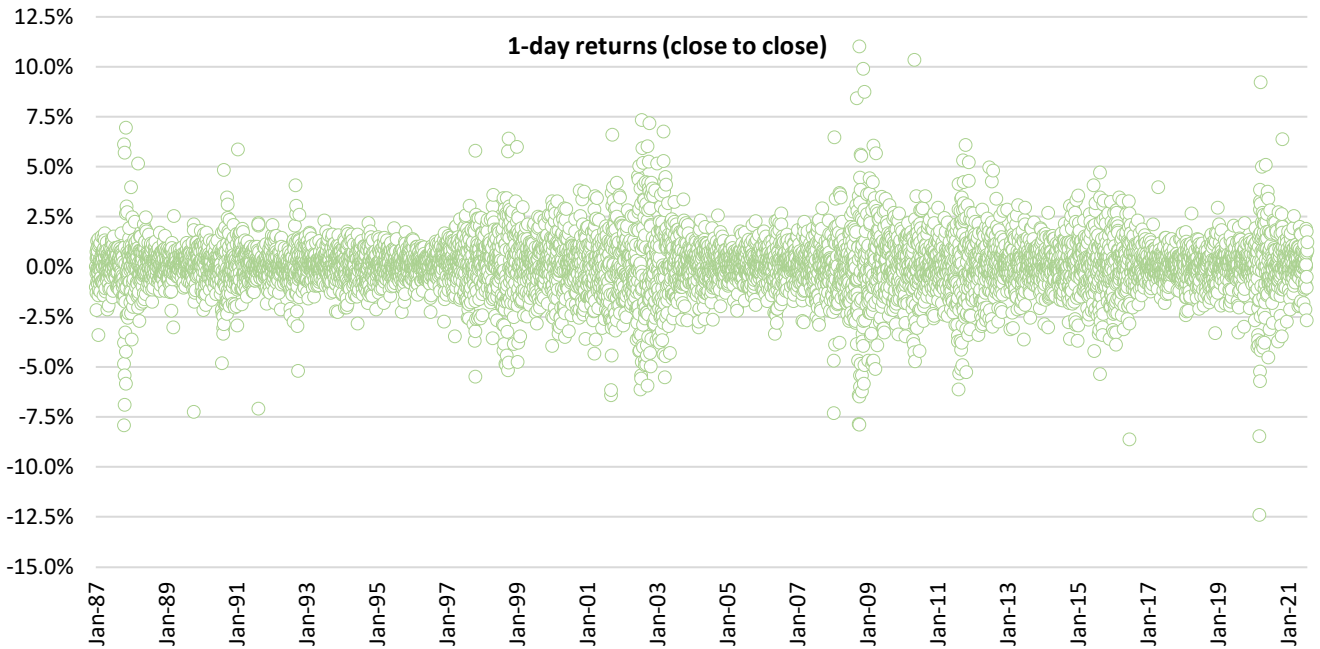
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Historical Context

We have examined the daily movements of the index since its earliest data point on 31 Dec 1986. Analysis covers 8,907 trading days over a 34-year period. As can be seen from the analysis below, the worst daily performance of the index was -12.40. Therefore, a Stability Note with a Barrier Level of 80% would have always returned 100% capital and coupons.

Source: Bloomberg 23.07.2021



Index Start Date
31 Dec 1986

Index Description

The EuroStoxx 50 index represents the performance of the 50 largest companies among the 19 super-sectors in terms of free-float market cap in 11 Eurozone countries. These countries include Austria, Belgium, Finland, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. The index has a fixed number of components and is part of the STOXX blue-chip index family. The index captures about 60% of the free-float market cap of the EURO STOXX Total Market Index (TMI).

Source: EuroStoxx 50 Index Factsheet June 2021

Date	10 Worst Daily Performance
12 Mar 2020	-12.40%
24 Jun 2016	-8.62%
09 Mar 2020	-8.45%
19 Oct 1987	-7.93%
10 Oct 2008	-7.88%
6 Oct 2008	-7.86%
21 Jan 2008	-7.31%
16 Oct 1989	-7.24%
19 Aug 1991	-7.09%
26 Oct 1987	-6.88%

Daily Performance Range	Number of Daily Returns within range	Percentage of Daily Returns within range
More than 0%	4,676	52.50%
0% to -5.0%	4,194	47.09%
-5% to -10%	36	0.40%
-10% to -15%	1	0.01%
-15% to -20%	0	0.00%
Total	8,907	100.00%

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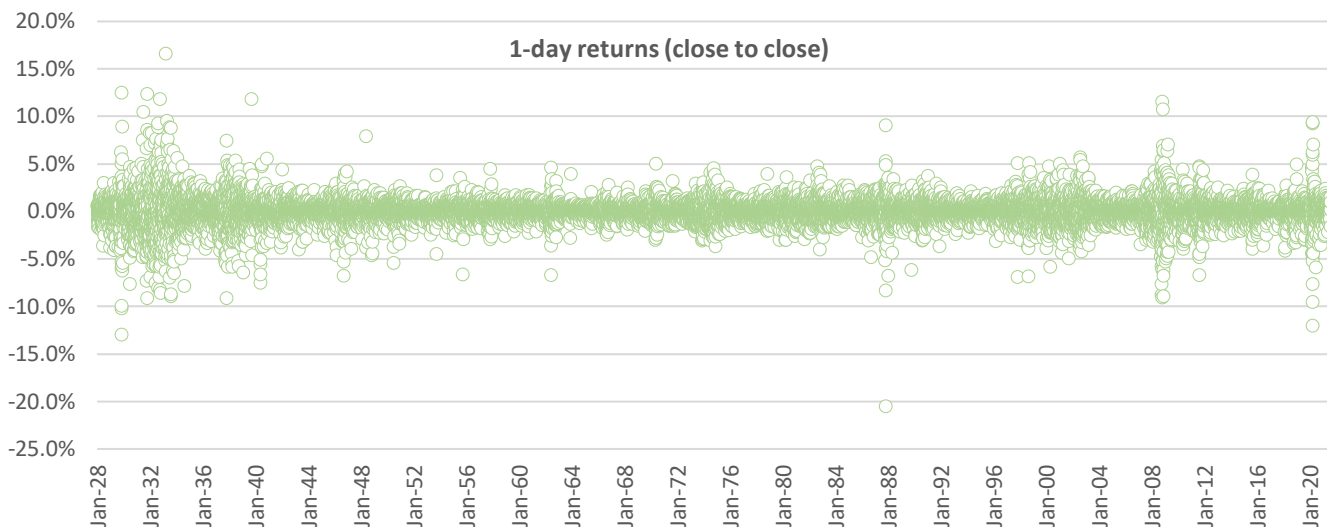
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Historical Context

We have examined the daily movements of the since its earliest data point on 30 Dec 1927. Analysis covers 23,502 trading days over a 93-year period. As can be seen from the analysis below, the worst daily performance of the index was -20.47% with the second worst being -12.94%. Therefore, a Stability Note with a Barrier Level of 80% would have lost 4.7% on one single day out of 23,502.

Source: Bloomberg 23.07.2021



Index Start Date	30 Dec 1927
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Date	10 Worst Daily Performance
19 Oct 1987	-20.47%
28 Oct 1929	-12.94%
16 Mar 2020	-11.98%
29 Oct 1929	-10.16%
06 Nov 1929	-9.92%
12 Mar 2020	-9.51%
18 Oct 1937	-9.12%
05 Oct 1931	-9.07%
15 Oct 2008	-9.03%
01 Dec 2008	-8.93%

Index Description

The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 11.2 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 4.6 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization. Source: S&P 500 Index Factsheet June 2021

Daily Performance Range	Number of Daily Returns within range	Percentage of Daily Returns within range
More than 0%	12,319	52.41%
0% to -5.0%	11,102	47.25%
-5% to -10%	76	0.32%
-10% to -15%	3	0.01%
-15% to -20%	0	0.00%
-20% to -25%	1	0.00%
Total	23,502	100.00%

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