

Revisiting Capital-Protected Structured Deposit

The recent Sunday Times article (10 Sep 06) highlighted UOB's Champion Deposit - a capital-guaranteed structured deposit - and comments from finance professionals on its pros and cons. From this article, it can be seen that even professionals have differing views on its benefits. After the May/June equity market correction, investors are now more risk adverse, which may explain the flurry of such products being launched by various banks in recent months. We previously wrote about structured deposits in the Jan 06 edition of this newsletter, noting their characteristics and underperformance in a rising equity market. Today, with increased uncertainty and risks in global markets, is it wise to switch into such products? We would like to share some of our views.

Obviously, the suitability of such products depends on factors such as the investor risk tolerance, time horizon and the intended use of funds. It may not be wise for investors who need to withdraw funds before maturity to invest in structured deposits despite the possibility of early redemption, which is not assured. In so doing, the investor face potential capital loss and redemption penalties. Investors drawn to the attractive return indicated should also think again. The attractive return is generally fixed for the first year, with subsequent gains depending on investment performance. In the worst-case scenario, investors end up with annual returns lower than that of fixed deposits.

We also think that it would be good for investors to understand the investment strategy and form a view whether that strategy has a reasonable chance to do well. For example, if the deposit is referenced to commodities, investors should invest only if they are positive on commodities.

For investors able to tolerate some volatility and potential losses, there are options to manage their investments in a defensive manner. This includes investing in different asset classes, increasing the allocation to fixed income assets, and switching into defensive and high dividend yielding stocks. In the management of our portfolios, these are the strategies that we adopt in these uncertain times.