The world of structured notes

There is a wide array of structured notes that issuers are creating to keep pace with changing market conditions, increased competition and investor sophistication. While the nature of these structures continues to evolve, there are a handful of notes that are most prevalent. Due to the combination of equity and fixed income-like characteristics of these structured notes, it is imperative that investors fully understand the components of each issue before making any investment decisions.

While the following information does not encompass the vast universe of structured notes, it is intended to serve as a basis for understanding the various structures that are commonly offered through RBC Wealth Management.

Market-linked notes

Investors who demand principal protection but are seeking defined exposure to an equity, index or basket of securities may be attracted to the structure of a market-linked note. Market-linked notes allow the investor to participate in potential limited equity-like growth based on the positive performance of the underlying equity or index, while providing the safety of 100% capital preservation when held until maturity. Typically, any increase in a reference index will be paid out at maturity, although certain principal protected notes may be structured to pay periodic coupons.

Buffered return notes

Investors who are looking for an equity-related investment with some downside principal protection may be interested in a buffered equity note. An investment in a buffered equity note allows the investor to participate in upside price movement on the underlying equity or index, with upside participation that may be capped or uncapped. In the event of negative performance by the stock or index, investors are partially principal protected by the downside buffer, which is typically 10–20%. For example, a note with a 10% buffer would protect the first 10% of any negative underlying performance—if the index performance at maturity was -15%, investors would realize a loss of only -5%. Buffered equity notes should be treated as an equity investment, as there is full principal risk below the buffer.

Enhanced return notes

Investors seeking an equity-like investment with the potential for increased or leveraged upside participation may be drawn to the characteristics of an enhanced return note. The notes are typically linked to an equity or index, wherein the investor may receive two or three times the upside move in the price of the underlying up to a predetermined cap or maximum gain level. For example, a triple return note tied to the performance of the S&P 500 Index, with a maximum return of 14%, would earn three times the upward price movement, not to exceed 14%. Enhanced return notes should be treated as an equity investment, as there is no principal protection and the performance of the note is directly tied to the underlying equity or index.

Contingent income barrier notes

Contingent income barrier notes are hybrid securities with characteristics of both fixed income and equity investments, and are commonly linked to the performance of an equity index, single equity, or basket of equities. Investors in these securities are seeking an income stream with yields that exceed interest rates in the traditional fixed income markets. Coupons typically are not guaranteed and will pay only if the underlying asset(s) closes above the predetermined coupon barrier on relevant periodic observation dates during the term of the note. Full return of principal is also not guaranteed, and is contingent upon the underlying asset(s) closing above the predetermined principal barrier on the final observation date. If the underlying asset(s) closes below the principal barrier on the final observation date, the note would be subject to a loss of principal equivalent to the full amount of the price decline of the underlying asset.

Contingent income barrier notes are most suited for investors who

Investment and insurance products offered through RBC Wealth Management are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, or guaranteed by, a bank or any bank affiliate, and are subject to investment risks, including possible loss of the principal amount invested.
Structured notes have some complex features and may not be suitable for all investors. Notes are senior, unsecured debt of the issuer and, as such, any return of principal, market-linked return and payments at maturity are subject to issuer’s credit risk. Investors do not receive dividends paid by the underlying index or its constituent stocks. Notes may have a limited or no secondary market. Prior to maturity, the price at which the notes can be sold, if at all, may be at a substantial discount from the principal amount.

Considerations
The world of structured notes is quickly evolving and ever-changing, so investors can expect new and more sophisticated structures to emerge. It is imperative that investors understand the complete terms, risks and possible consequences of the note before investing, as each structure is slightly different and constructed for different objectives and market conditions. When considering a structured note for your portfolio, request a prospectus or preliminary prospectus, which will contain more complete information including the terms and conditions of the note. Structured notes represent an unsecured debt obligation of the issuer. When purchasing structured products, an investor has a legitimate and compelling need to look at the creditworthiness of the company issuing the notes, as all downside protections and payment features are contingent upon the solvency of the issuer. The benefits of all structured notes may not be fully realized unless held to maturity. While the issuers of structured notes intend to provide interim liquidity, there is no guarantee that a secondary market will exist.

For more information on any of these and other investment opportunities, please contact your RBC Wealth Management financial advisor.

Reverse convertible notes
Reverse convertible notes are hybrid securities, possessing characteristics of both fixed income and equity investments. While the structures and features vary, reverse convertible notes usually mature in one year or less. They are typically linked to the performance of a single equity, but can also be linked to an index, commodity or a basket of underlying equities. Reverse convertible notes are designed to pay a relatively high fixed periodic coupon. The notes return par value to the investor at maturity, as long as the underlying equity remains above a downside barrier level. Reverse convertible notes are most suited to an investor comfortable with owning the reference stock but who believes it will be range-bound over the note’s term, meaning the share price will trade in a range above the downside barrier level, but below the coupon percentage on the upside.