Absa Fund Linked Solutions – Product capability

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Introduction

Absa Corporate and Investment Banking (Absa CIB), a division of Absa Bank Limited (Absa) has established a new business platform where investors can apply different strategies (protection, leverage, risk management) on South African-based Collective Investment Schemes, making use of an Absa-issued Note. We will however only be focusing on a Rand-based version of a very successful Dollar-based solution here, where an international asset manager is selling their Dollar based investors an 80% capital protected solution on a basket of Exchange Traded Funds (ETF's) tracking the S&P 500 Index. In this instance Absa CIB is only providing the required capital protection by making use of Time Invariant Portfolio Protection (TIPP), implementing it through the Absa Fund Linked Solutions (AFLS) platform. The rapid growth of the AUM of this solution illustrates a clear global demand for capital protected exposure on international indices, especially with global economic and political uncertainty on the rise.

South African investors have similar concerns and as mentioned above, this document will be focusing on a Rand-based version of the same solution that can be created on the Absa Fund Linked Solutions (AFLS) Note platform. As is the case above, protection will be provided by making use of TIPP. So, what is TIPP and why is it different from the more traditional forms of capital protection offered through various structured product variations?

Time Invariant Portfolio Protection

TIPP, also known as continuous protection, has no fixed term (unlike many structured products) and an investor can choose to institute TIPP at any point and suspend TIPP at their discretion. Another unique feature of the TIPP is that the protected amount (i.e., the specified capital protection level) is a percentage which is applied to the highest closing Net Asset Value (NAV) of the portfolio comprising the performance asset (i.e., S&P 500 index) and the protection asset (i.e., low risk asset) during the term of the strategy. This means your capital protected amount grows with the NAV of the portfolio! Many existing structured products, with capital protection features, may only return your day one initial investment amount if the market is to fall below the protected level and require you to hold the product to term to get back at your invested capital.

Below find a simple formula and example which illustrate the dynamic capital protection mechanism for a TIPP strategy with an 80% pre-specified capital protection level:

Initial protected amount = Protection percentage x Initial reference portfolio NAV (initial investment amount at the start of the protection strategy)

	Reference Portfolio NAV	**Highest reference Portfolio NAV**	**Protection percentage**	**Protected amount**
TIPP Start	*1,000,000.00*	*1,000,000.00*	*80%*	*800,000.00*
Time 1	*1,030,000.00*	*1,030,000.00*	*80%*	*824,000.00*
Time 2	*988,800.00*	*988,800.00*	*80%*	*824,000.00*
Time 3	*959,136.00*	*959,136.00*	*80%*	*824,000.00*

Time 4	*968,545.00*	*968,545.00*	*80%*	*824,000.00*
Time 5	*968,536.00*	*968,536.00*	*80%*	*824,000.00*
Time 6	*1,113,816.00*	*1,113,816.00*	*80%*	*891,052.80*

As shown in the table above, Time 1 has a higher reference portfolio NAV than Times 2 through 5. Therefore, the protected amount for Time 2, 3, 4 and 5 uses the Time 1 highest NAV multiplied by the protection percentage (80% in this example) to compute the protected amount of R824,000. The protected amount stays at this level even though the value of the reference portfolio falls. Only at Time 6 does the reference portfolio achieve a new high value, which then increases (ratchets up) the monetary value of the protected amount.

As is the case of the existing product mentioned earlier, whereby the capital protection solution is provided on the S$P 500 Index, we have also found that in terms of demand for traditional capital protected structured products amongst retail South African Investors, the bulk of this is on two indices:

1. *S&P 500 Index (US Equity Exposure) ~* ***R1.7bln*** *Retail Structured Product market capitalization (data source - JSE)*
2. *MSCI World Index (Global Equity Exposure) ~* ***R9.2bln*** *Retail Structured Product market capitalization (data source - JSE)*

Because we have seen large global demand for capital protection on the S&P 500 and MSCI World Indices we have created two solutions using the S&P 500 and MSCI World Rand based Feeder funds as underlying assets (Reference asset) using TIPP on the AFLS Note platform. These two solutions are:

1. TIPP 80% capital protection on the S&P 500 Index Rand 1nvest Feeder Fund
2. TIPP 80% capital protection on the MSCI World Index Rand 1invest Feeder Fund

It should be noted that the above solutions are merely simple examples of the platform's capability, however, they are powerful illustrations of this capability as will be seen in the back testing analysis below. The 1nvest Feeder Funds have been chosen as illustrative reference assets given their size and low tracking errors while giving ZAR exposure to these international indices.

Back Testing

The next section looks at the performance of these TIPP 80% capital protection strategies back tested, taking all Note and protection charges into consideration from the inception date of each of the 1nvest Feeder Fund's and then comparing them with various large funds in the different ASISA fund categories. Inception dates as follows:

1. 1nvest S&P 500 Index Feeder Fund – ***07/03/2018***
2. 1nvest MSCI World Index Feeder Fund – ***14/03/2018***

Back testing summary

Strategy	***Return (Annulised)***	***Volatility***	***Maximum Drawdown***	***Growth on Protected Amount***

1nvest S&P 500 Feeder Fund (ZAR) - unhedged	19.90%	19.40%	23%	
1nvest S&P 500 Index Feeder Fund (ZAR) + TIPP80	***14.50%***	***14.30%***	***14%***	***11.10%***
1nvest MSCI World Index Feeder Fund (ZAR) - unhedged	17.70%	18.20%	23.30%	
1nvest MSCI World Index Feeder Fund (ZAR) + TIPP80	***11.90%***	***13.20%***	***15%***	***8.40%***

Apart from the > 10% p.a. performance of the strategies over the back tested period (explored further below) a key point to highlight is the growth of the protected amounts. For the S&P 500 strategy the protected amount grew by 11.1% p.a. and for the MSCI World strategy the protected amount grew by 8.4%.

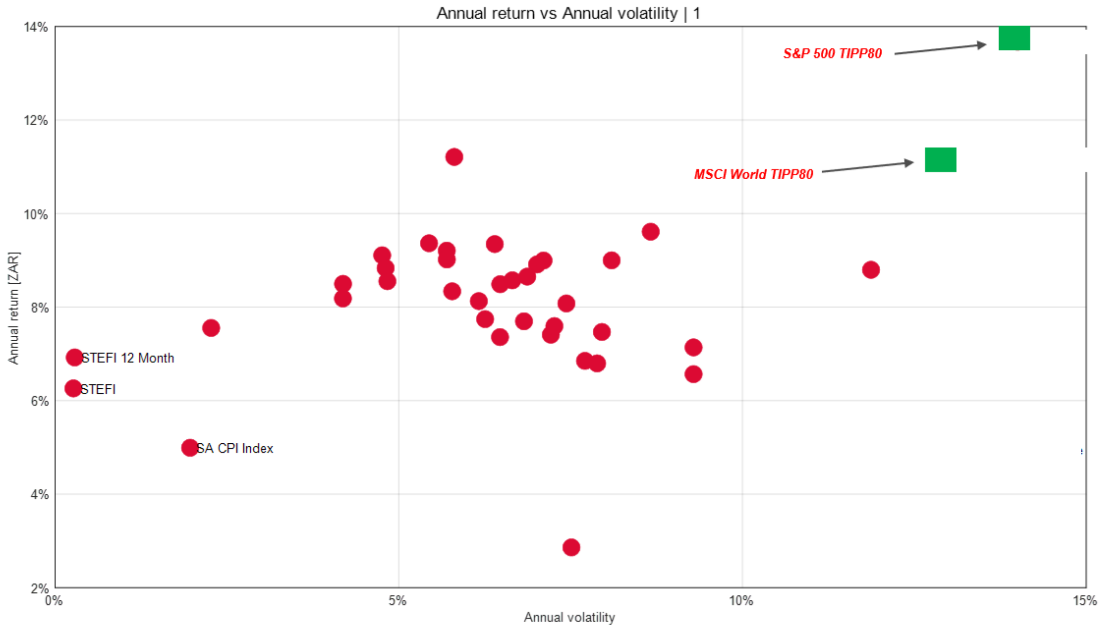
This growth on the protected amount is from a starting point of 0. What does this mean? In the example above of 80% TIPP based solutions, the protection level starts at -20% (80% capital protection of 100% initial capital invested). So, by stating that the protection starts from 0, we are saying that the p.a. growth recorded in the above table is post the initial -20% gap being covered. This is a key differentiating aspect of the TIPP strategy vs conventional capital protection strategies which don't offer any growth in your initial protected amount, i.e. if the index that is tracked falls below the original protected amount at maturity of the product, investors will only receive their invested amount back.

Other investment considerations

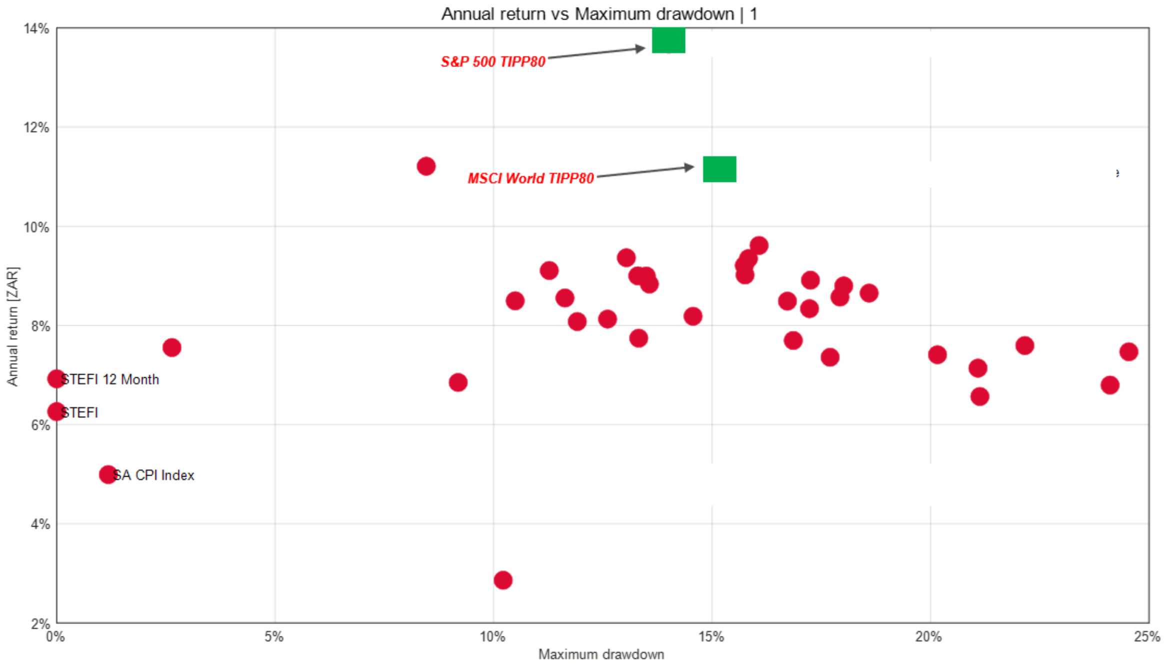
A key component of any investors decision making process is to consider all alternative options available to them critically on a *risk adjusted basis*. Therefore, the below graphics illustrate both the risk-adjusted performance of the two 80% capital protection solutions and maximum drawdown relative to the below benchmarks and large funds in the different ASISA categories. It is important to note that the ASISA performance data does not include any protection whereas the two Absa solutions do:

1. Short-term cash benchmark
2. Long-term cash benchmark
3. SA CPI Index
4. ASISA Multi-Asset Low Equity Fund Universe (*source: Morningstar*)
5. ASISA Multi-Asset Medium Equity Fund Universe (*source: Morningstar*)
6. ASISA Multi-Asset High Equity Fund Universe (*source: Morningstar*)
7. ASISA Multi-Asset Income Fund Universe (*source: Morningstar*)

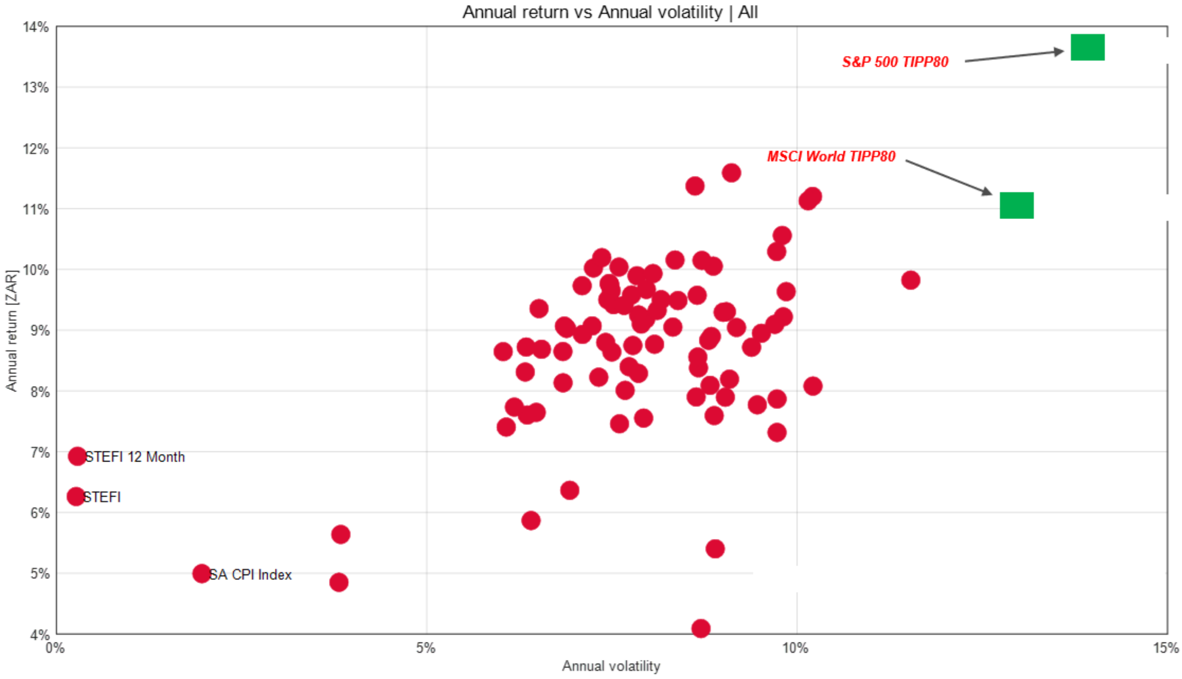
FLS Bespoke product range vs ASISA Multi-Asset Low Equity Fund Universe (Annual Return (ZAR) vs Annual Volatility)



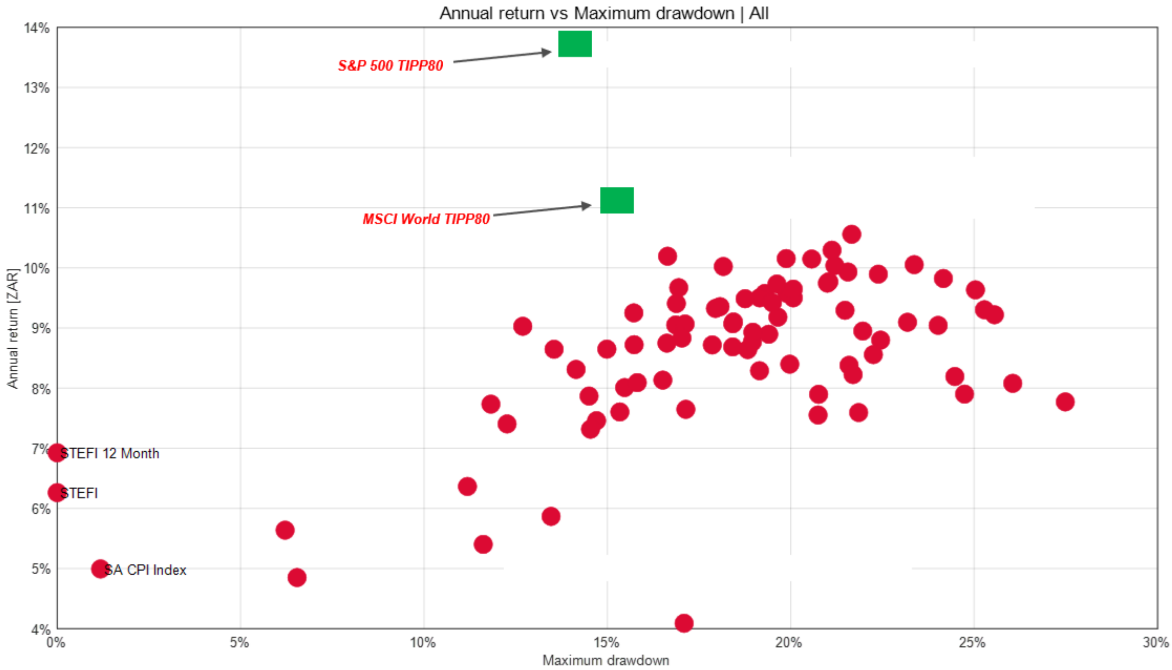
FLS Bespoke product range vs ASISA Multi-Asset Low Equity Fund Universe (Annual Return (ZAR) vs Maximum Drawdown)



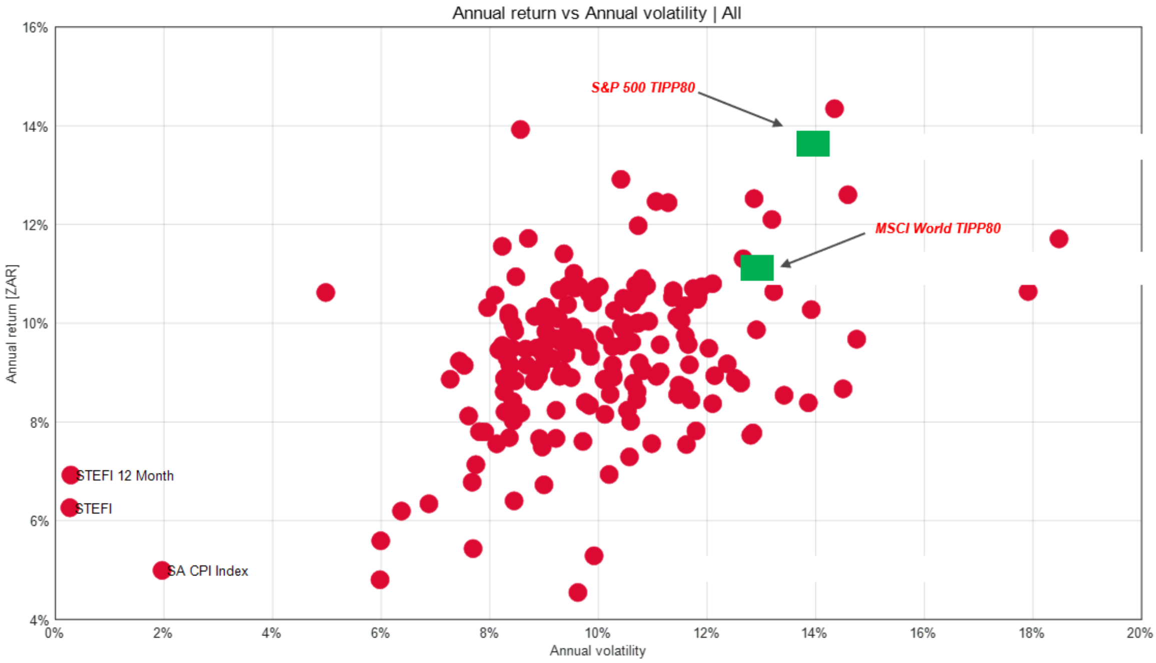
FLS Bespoke product range vs ASISA Multi-Asset Medium Equity Fund Universe (Annual Return (ZAR) vs Annual Volatility)



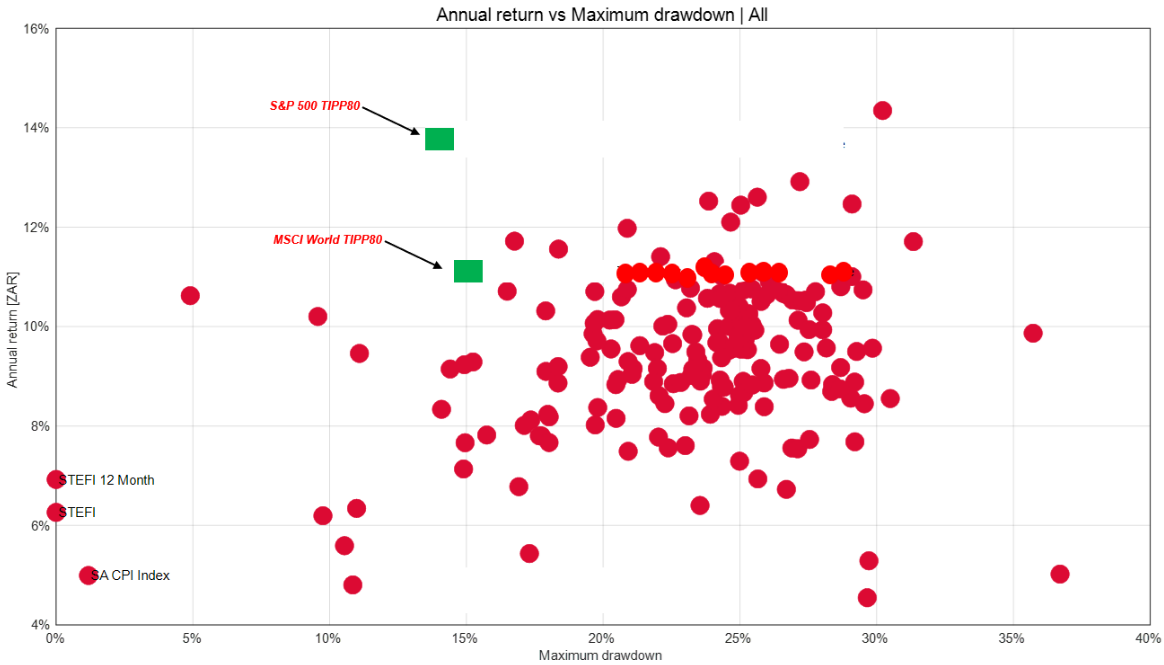
FLS Bespoke product range vs ASISA Multi-Asset Medium Equity Fund Universe (Annual Return (ZAR) vs Maximum Drawdown)



FLS Bespoke product range vs ASISA Multi-Asset High Equity Fund Universe (Annual Return (ZAR) vs Annual Volatility)



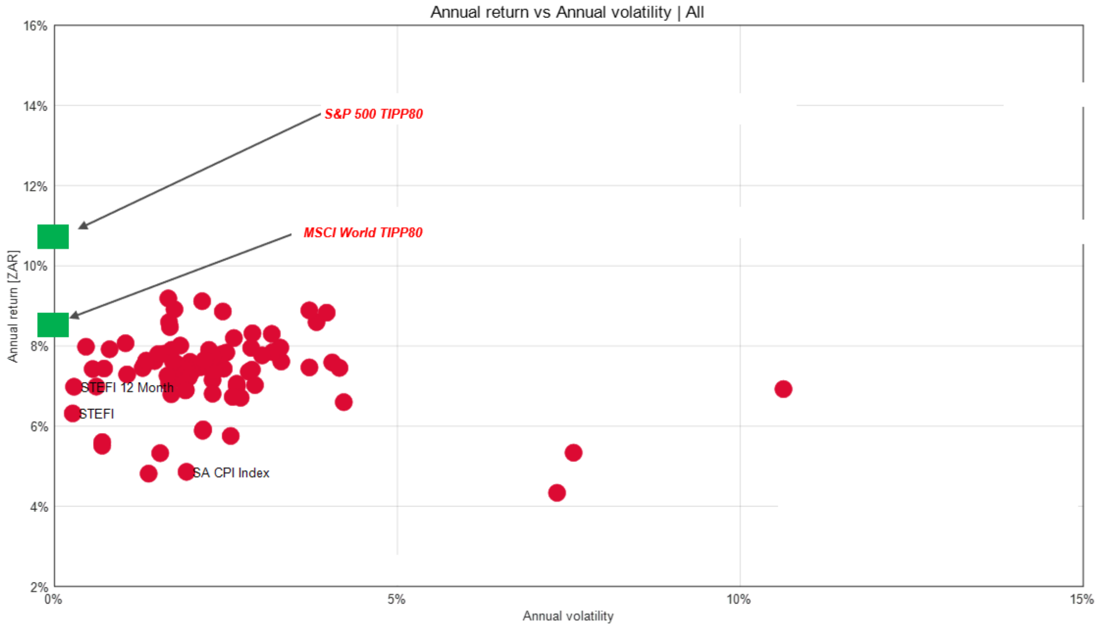
FLS Bespoke product range vs ASISA Multi-Asset High Equity Fund Universe (Annual Return (ZAR) vs Maximum Drawdown)



From the above analysis we can see the potential for improved risk adjusted returns when applying capital protection via TIPP on international Rand-based indices. These two solutions also outperformed both a cash and inflation benchmark whilst also illustrating even the outperformance of top-tier ASISA Multi-Asset High Equity funds in terms of return (over the back tested period). All with a capital protection aspect attached.

In the next graphic we illustrate the performance of the strategy capital guarantee annualized return figures relative to the ASISA Multi-Asset Income Fund Universe:

FLS Bespoke product range vs ASISA Multi-Asset Income Fund Universe



In this graph we see that the growth in your original capital protected amount exceeds the annualized returns of most of the ASISA Multi-Asset Income Fund Universe (over the back tested period). This provides investors with the opportunity to grow their initial protected capital amount at higher rates than Income funds.

Conclusion

The above is used to illustrate a simple but powerful use case of the Absa Fund Linked Solutions platform. TIPP offers a unique alternative to traditional capital protection structures. It also answers an immediate need from South African investors in terms of gaining access to offshore markets with an element of safety given the rise in uncertainty in global markets. The solutions presented are available immediately on the AFLS platform on an individual investor basis and the same capital protection solution can be provided on most CIS funds in South Africa. The above is simplified for illustrative purposes but with the final outcomes emphasized, however all technical details of the implementation of the methodology and the full capability of the AFLS platform can be gained on request.