Pursuing Alpha in a Low-Growth Environment

Buffered notes are designed to help outperform during low to moderate growth environments, while reducing market downside risk.

May 2023

Right, wrong, or indifferent, investors often weigh their portfolios' performance against the broader market. There are plenty of vehicles that perform well during a double-digit growth environment, but how do investors consistently generate alpha during single-digit or negative market scenarios?

Buffered notes, a type of structured investment, are designed to offer a unique approach to generating alpha during periods of low to moderate growth.

HOW DO BUFFERED NOTES WORK?

Buffered notes can give investors an opportunity for leveraged exposure to the upside of the underlier, typically an index, ETF, or stock–up to a stated cap. These notes offer protection on the downside that come in the form of a buffer.

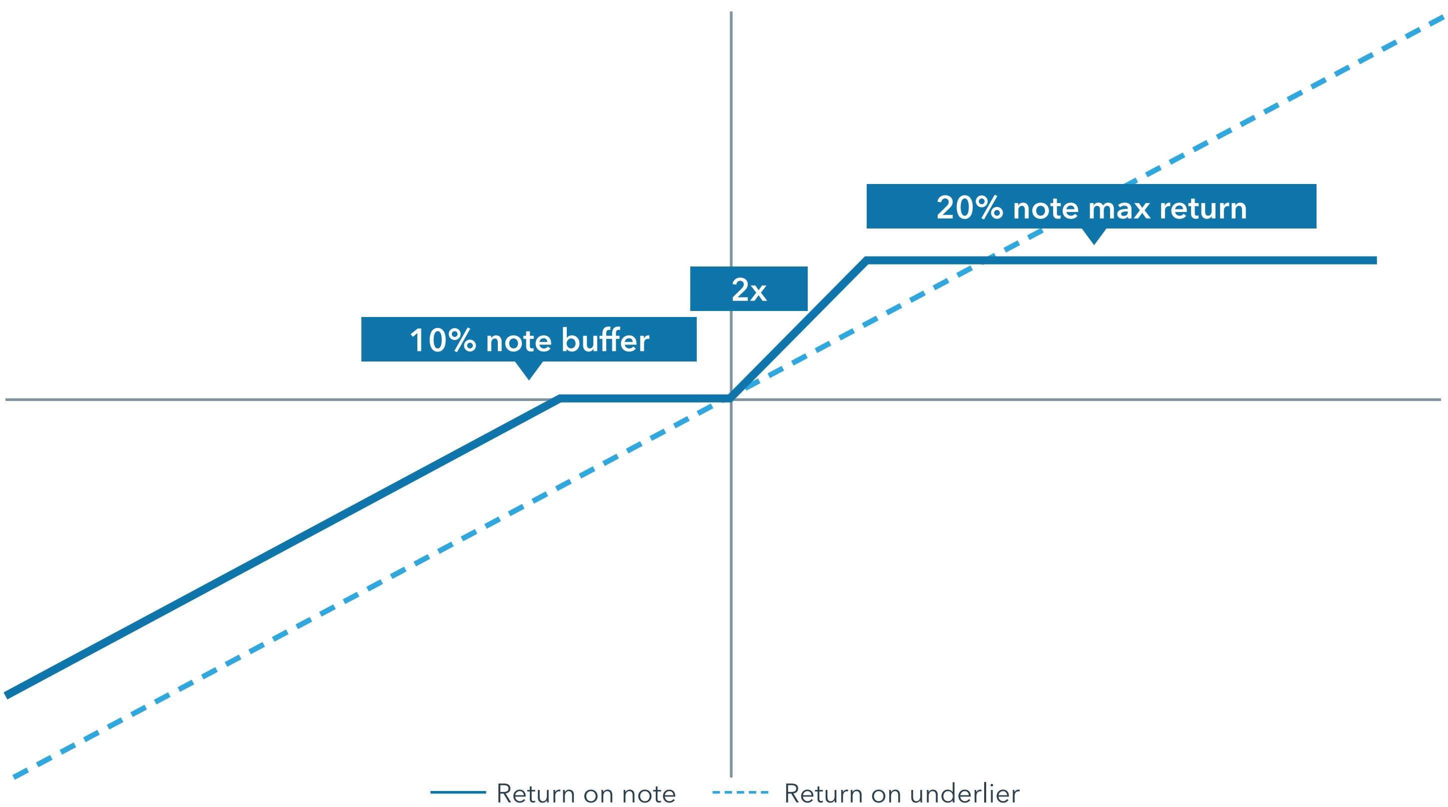
A buffer is a form of protection of an investor's principal. The buffer absorbs a fixed percentage of the underlier's decline, after which the investor participates in the decline in the underlier.

In exchange, investors are exposed to the credit risk of the issuer and must be willing to hold their investment for a fixed term, to the maturity of the note.

Let's consider a hypothetical note with the following specifications:

Underlier	Term	Protection	Payment Details
S&P 500 Index (SPX)	2-year	Hard buffer: 10% (max loss of 90%)	Upside participation: 2x, up to 20% max return

Hypothetical note payoff at maturity



Volatility and credit spreads are two of several factors that affect the terms of any given note.

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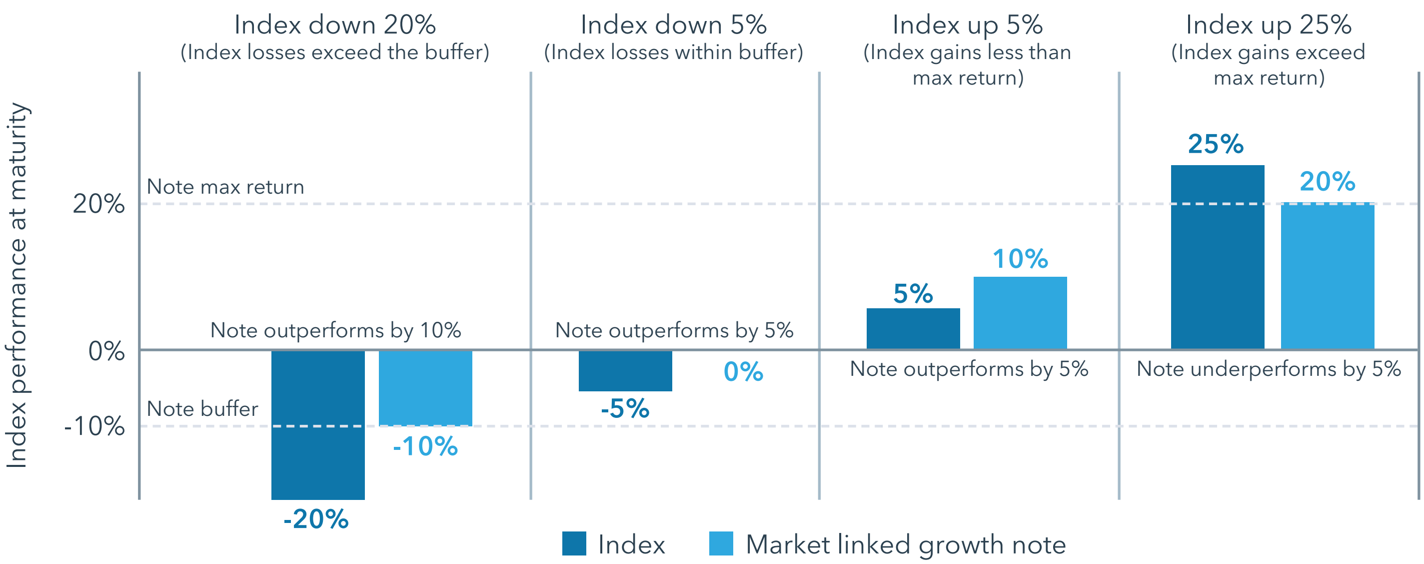
Over a two year term, this hypothetical note provides upside participation of 2x the performance of the underlier, SPX, up to a 20% max return. It also has a 10% hard buffer, which absorbs a fixed percentage of decline in the index and, after that, losses are one-to-one with the underlier.

If SPX is down by 10% or less at maturity, the note holder receives principal back. However, if SPX is down by more than 10% at maturity, the note would be exposed to losses in excess of a 10% decline in SPX, outperforming the index by 10%.

HOW DO BUFFERED NOTES PERFORM?

Let's look at four different market scenarios and outcomes for this hypothetical note.



The visual above represents returns at maturity for a hypothetical structured investment and is for illustration purposes only. It does not reflect any specific structured investment and is solely intended to help you understand how different protection methods work.

Benefits:

- **Enhanced upside:** Some buffered notes deliver more than 1x participation in gains of the underlying index, up to a stated cap. The leverage generates outperformance during low to moderate growth environments.
- **Downside protection:** Buffered notes can offer risk mitigation with a hard buffer.

Considerations:

- **Credit risk:** Structured investment holders are exposed to the credit risk of the issuer and must be comfortable with the issuer's creditworthiness throughout the life of the trade.
- **Liquidity and statement value:** Structured investments are buy-and-hold investments, which means that investors must hold the note until maturity in order to receive any investment returns or principal, and there is no guaranteed secondary market. Issuing firms or dealers may be willing to buy back a structured investment before maturity but may do so at a discount to statement value and are under no legal obligation to provide liquidity.
- **Price return:** Holders of a structured note do not receive any dividends paid by the underlier, while a direct holder of the underlier itself may be entitled to dividends.

WHO SHOULD CONSIDER BUFFERED NOTES?

Investors with equity exposure as part of their asset allocation, who are willing to add credit risk to their portfolio and sacrifice some near-term liquidity, may want to consider allocating a portion of that exposure to buffered notes.

Let's say an investor has a 60% allocation to equities, and within that allocation are mutual funds, ETFs, and stocks.

By taking a third of that equity allocation—or 20% of the entire portfolio—and reallocating it to buffered notes, the overall equity portfolio would now have features that help position it for certain market conditions.

In this reallocated portfolio, the 40% allocated to equities that remains invested in uncapped traditional investments would give the investor full upside and downside exposure. The portfolio would outperform the buffered notes if the markets outperform the cap, while the 20% invested in buffered notes would outperform during down to moderately-up environments.

INFORMED INVESTING

Structured investments come in a wide variety with different terms and conditions. There's one for almost any market outlook or investment goal, giving investors the chance to stay in the market and choose how much protection they need to feel comfortable.

When considering any structured investment, investors should understand the type of protection it offers, if any, as well as its pay-out potential, by carefully reviewing the offering documents before investing.

iCapital®

60 East 42nd Street, 26th Floor
New York, NY 10165
212.994.7400

www.icapital.com

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