

PERLES +: A RECOVERY TRADE FOR 2009

In last week's column we reflected on the economic indicators that coincide with stockmarket recoveries, especially noting that recoveries traditionally occur after high spikes in volatility start to subside. While volatility is undoubtedly higher still than many of us have experienced, key indicators show that it has started to subside, and it is reasonable to assume that we are closer to the start of a stockmarket recovery than we were at this time last year. We noted that it's impossible to predict the timing of any recovery, but also that it's certainly a valid reaction to start to think about re-positioning portfolios to benefit from the recovery. Quite a few investment product providers think so, too, and there is much talk amongst providers of the need to provide "recovery trades" as soon as possible this year. Enter UBS which has just launched an innovative product which provides investors with exposure to the ASX 200, with limited capital protection and a minimum return for the life of the investment.

Called PERLES +, (Performance Linked Equity Securities) the product is designed as a deferred purchase agreement and provides exposure to the ASX 200 for either a 14 month or 2.5 years. Deferred purchase agreements are a very simple and robust mechanism used by many structured products – they provide for the delivery of the underlying asset at the end of the product term, or allow the investor to choose to sell that asset and receive the cash proceeds instead. During the term of the investment the product provides the investor with the specific attributes of the structured product, in this case a minimum coupon and limited capital protection.

The only drawback with deferred purchase agreements is that they don't allow investors to obtain tax deductions upfront for interest on borrowings used to buy them. That's the result of some crazy rules introduced in the previous Government's "Ralph Review" – but these so called "tax shelter" rules do still allow for interest expenses to be deductible over the full period of the loan. That means gearing is still tax effective (and so it should be, on the basis that under our income tax system we can legitimately deduct expenses incurred in the production of assessable income), it just means that investors can't get big upfront deductions for these types of investments. There is also a CGT event at the time the product matures – only really a concern when the product pays a profit – but unfortunately in the case of this CGT treatment, there is no rationale for it other than the ATO desire to grab as much tax as it can, whenever and wherever possible.

PERLES + key benefit is that it provides investors with a fixed coupon which is paid unless the ASX 200 falls from its starting levels by more than 35%. The 14 month version pays a coupon of 9% and gives investor upside capped at 25% from starting levels. The 2.5 year product pays investors a high 23.5% but does not cap the upside. Sounds perhaps a little complex and risky – but well worth considering if you don't feel that the Aussie stockmarket is likely to fall by another 35% during the investment term. You may find it difficult to get information about PERLES +, as the bank doesn't have its own Australian website and there is nothing about the product on the global site – but no doubt a call to the bank's Sydney office will get you to right desk for further information.

Tony Rumble

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