ASK THE **ADVISERS**

The views and opinions expressed in “Ask the Advisers” are solely those of Keith Singer.

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How to Beat the Market

Many investors choose active money managers because they are hoping to outperform the stock market. Unfortunately, beating the market remains elusive. Not one of the 2,132 actively managed stock or bond funds significantly and regularly outperformed the market over the last five years.*

For the 20-year period that ended in 2021, less than 10% of US stock funds beat their benchmarks. For those in the know, there is a way to automatically beat the market without additional investment risk.

This past September while the S&P 500 was down significantly trading under 4000, my firm negotiated with one of the world’s oldest banks to issue a five-year growth note linked to the S&P 500. The terms of the note are as follows: At maturity, the note will mature at par plus 1.6 times the growth of the S&P 500 Index. In other words, after five years, if the S&P 500 had gained 70%, the investor would receive 60% more than the gains of the S&P 500 index. (In this case 102% vs 60% for the actual index). The bank uses derivatives to hedge the transaction and create the note for the investors. If the index ended up 20% lower in 5 years, the note would mature at a 20% loss just as if you had owned the index.

The one caveat is that owing a banknote does subject the investor to the credit risk of the issuing bank which investors in the S&P 500 don’t have. But in this case, our clients accepted that additional risk so they could significantly outperform the S&P 500 in anticipation of the index bouncing from the recent market correction.

These notes can also be designed more conservatively. If investors simply want to match the returns of a major index, they can do so with downside protection. For example, we can design a note that will match the returns of the S&P 500 but if the market drops 20% the investor loses nothing. A properly structured note may give investors more reward with less risk.

Source: NYTIMES