Unicorn Note

Most investors who invest in the stock market are trying to get returns that hopefully can keep pace with the broad market indexes. If your portfolio beats the S&P 500 (which is the benchmark by which most stock investments are measured) over long periods of time, then you will likely be in the top 10% of all investors.

A major US Bank is offering a 5-year note that will grow at twice the returns of the S&P 500 excess return futures index (SPXFP). Additionally, if the index is down between 1 and 40%, the note will mature with the same percentage gain as the percent drop in the index.

If you invest $100,000 and the index is down 26% at the end of five years your bond will mature for $126,000. Conversely, if the index is up 50% and your note hasn't been called prior to maturity your $100,000 will be worth $200,000 (50% gain x 200%). After the first year, the bank has the right to call your note and return your principal for an 18% per year gain. If at the end of five years, the index is down 41% you will lose 41% of your money.

The good news is that the S&P 500 index has been down more than 40% from five years earlier only once out of every 2500 rolling 5-year periods.* The S&P 500 futures excess return index is highly correlated to the S&P 500 index. However, it does tend to underperform the index slightly when interest rates are relatively high like they are now.

If interest rates fall as expected the SPXFP will have an even higher correlation to the S&P 500 index than it currently does. When this happens, subsequent notes linked to this index will offer less leverage than is currently available. Therefore, if you think interest rates are going to fall, this is a great time to lock in leveraged notes that are linked to this index. Getting double the return of this index is one way to beat the market with less investment risk than direct stock market investing.

*Bloomberg