



INVESTMENT PLANNING

Asset Allocation: Capital-Guaranteed Linked Notes

By John Niekraszewicz, BMath, FCSI, CFP, FMA, JVK Life & Wealth Advisory Group

The land surveying profession has seen a lot of changes over the years. With advancements in technology, AOLS members have equipment and skills today to identify opportunities never before thought possible. In much the same way, technology has helped the financial services industry to use zero-coupon bonds, options, derivatives and leverage to engineer the fastest growing asset category in Canada - capital-guaranteed linked notes.

The capital-guaranteed linked note got its start in its simplest form, when Royal Trust issued the first market-linked guaranteed investment certificate in 1992. The certificate's return was linked to an underlying general market index such as Standard & Poors 500 corporate index or the Toronto Stock Exchange 100, and the bank guaranteed that an investor would at least recover his or her initial capital at maturity.

In 1998 more exotic "structured notes" appeared. At the outset, they resembled the old market-linked GICs, but were simply linked to more diversified underlying assets such as hedge funds, mutual funds, and blue chip stocks.

The total value of assets invested in capital-guaranteed linked notes, although dwarfed by the \$520 billion mutual fund industry, is the fastest growing asset category in Canada.

In 2004, linked note manufacturers issued 56 notes and by the end of that year, assets jumped by 29% to \$5.3

billion. The appeal of capital-guaranteed linked notes is not just the guarantee of your original investment, but also the high probability of equity-like returns.

What type of investors are attracted to this asset category?

- Aging investors who want to own equities but with a floor under them. In other words, they have downside protection because their capital is guaranteed when the note matures.
- Bond investors who don't need yearly income, but who want bond-like protection.
- GIC investors who are not very excited about the low interest returns available.
- Segregated fund investors who think that the typical 10-year capital protection of such funds is too long (segregated funds are the insurance industry's version of mutual funds).
- Investors who have been burned by equity markets and who won't return unless they have their capital guaranteed.

With an average of 1-2 capital-guaranteed linked notes issued every week, each different in structure, there is a lot to understand and evaluate. Our duty as financial advisors is to be selective and advise notes that are issued by manufacturers with a proven track record and have a secondary market for early liquidity. Also, since notes can be linked to different asset classes, such as blue chip Canadian, US and Global equities, or alternative asset classes,

combining different notes can create the desired asset allocation strategy.

As with any investment, talk it over with a professional financial advisor to make sure that it fits with your overall strategy. This is similar to the way you would use technology to identify the location of underground utilities before putting iron bars in the ground.

John Niekraszewicz, B.Math, FCSI, CFP, FMA, (Nick-ra-shev-itch) is a Certified Financial Planner and President of JVK Life & Wealth Advisory Group. JVK Life & Wealth Advisory Group is a licensed Mutual Fund Dealer and Limited Market Dealer. For a reprint of this article in Newsletter format, call 1-800-767-5933 or info@jvkgroup.com.

AOLS Statutes and Professional Exams

November 24 & 25, 2005

Toronto, Ontario