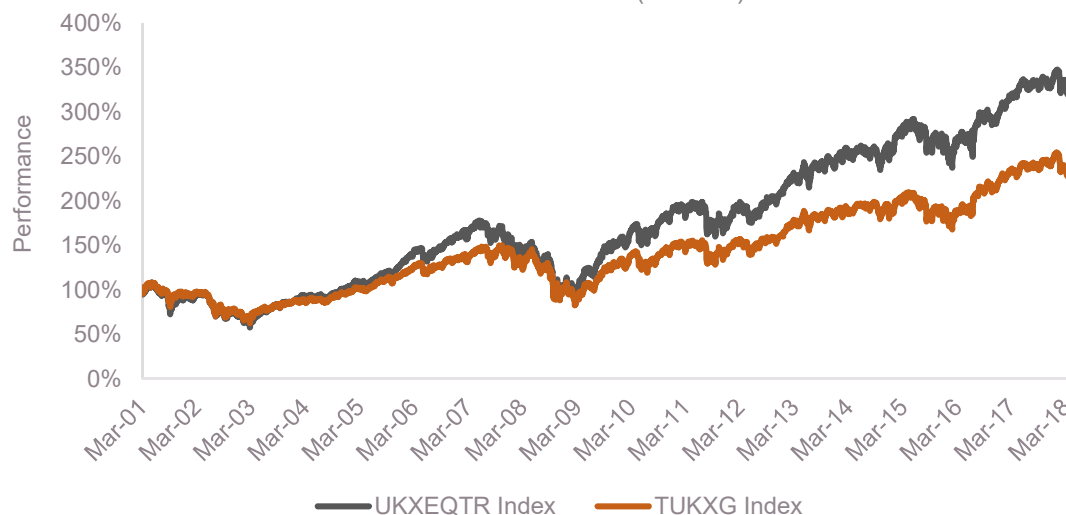


Napoleon Dynamite – A French Bank’s Answer To Improved UK Equity Pricing

What do Napoleon Bonaparte and a UK Equity Index have in common? No, it’s not a joke about someone being short... It is simply that this writer has been reading about both this week. Indeed, on the anniversary of Napoleon being proclaimed Emperor of France, Fortem are pleased to introduce a new pricing index offered by our French partner bank Societe Generale, which offers better terms and more diversified UK Equity Exposure to your traditional products written on the FTSE 100.

With a name as catchy as the FTSE 100 Fixed Dividend Equally Weighted Custom Index, we’ll refer to this from now on as UKXFD. There are two parts to this index. The first is that it is equally weighted. The FTSE 100 is a great example of a market cap weighted index that is over exposed to the performance of the 10 largest companies (~44% of the index at time of writing). Were you invested in a traditional large cap UK Equity Income Fund, it is likely your weightings to the top 5 alone would be well in excess of 30%, given Shell, BAT and HSBC’s propensity for strong dividends. This lack of diversification has been a cause for concern for many of our clients, and so, an equally weighted index, where each stock only represents 1% of the total index, may well be of interest. As you can see from the below graph, there is certainly an investment rationale for equally weighting.

Historical Performance of FTSE Equal TR (UKXEQTR) versus FTSE 100 TR (TUKXG)¹



The value of investments and the income from them can go down as well as up and the investor may not get back the amount originally invested. Past performance is not necessarily a guide for the future.

*“[Equal weighting] ...forces you to buy low and sell high; the most basic rule in investing”
- Forbes, 29/03/2016 -*

As is apparent, the equally weighting logic stacks up favourably vs the FTSE 100, even in extreme market drawdowns. The second feature of this index is that the UKXFD index extracts a fixed dividend of 50 points (currently ~4.75%²) and reinvests the realised dividends of the index. So why does the index do this? **Pricing!**

To remind readers, the value of longer dated future dividend streams may trade at a discount to their future values. This is because banks sell options on capital return indices, and are then left long dividends. As such, they tend to err on the conservative side of estimates, marking them down, both to reduce risk and also in order to shift them on to the savvier investors amongst us. This has little to do with real world investment views and all to do with risk mitigation for the banks.

As a result, your structured product pricing deteriorates. Please see [here](#) for further information on this. Therefore, were one to price on the basis of real world dividend assumptions, with analysts’ expectations built into that process, you arrive at the above fixed dividend, thereby mitigating the conservative bank levels, and significantly improving your product terms. This would only make sense however, if the underlying indices performed roughly inline with each other and an investor were not taking undue added risk...

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Markets this week:

Rates (bps)		
	Current	Change*
GBP 1yr	85.9	1.1
GBP 3yr	121.4	4.9
GBP 5yr	143.4	8.2

Equity Indices (%)		
	Current	Change*
FTSE 100	7,779.69	0.71%
S&P 500	2,728.69	0.04%
Nikkei 225	22,838.37	0.35%
Eurostoxx 50	3,587.74	0.62%

5yr Credit Spreads (bps)		
	Current	Change*
Citigroup	52.89	3.83
Credit Suisse	65.06	1.56
Deutsche	116.50	4.46
GS	62.80	3.36
HSBC	25.18	0.98
JPM	47.17	2.82
MS	60.09	3.26
Sant UK	39.74	1.07
Soc Gen	36.36	-0.93

Commodities & Currencies (%)		
	Current	Change*
Gold	1,288.96	-2.30%
Oil (CLA)	72.12	2.01%
GBPUSD	1.3501	-0.30%
GBPEUR	1.1449	0.98%
GBPJPY	149.587	0.97%

5yr Implied (vol pts)		
	Current	Change*
FTSE 100	16.09%	-0.07%
S&P 500	18.64%	0.06%
Nikkei 225	18.40%	-0.05%
Eurostoxx 50	17.35%	0.04%

*Source Fortem / Partner Banks
Weekly changes for Data as at
17th May 2018 at 16:30

¹Observed from 01/03/2001 to 01/05/2018

²Yield derived from respective indices’ closes on 10/05/2018

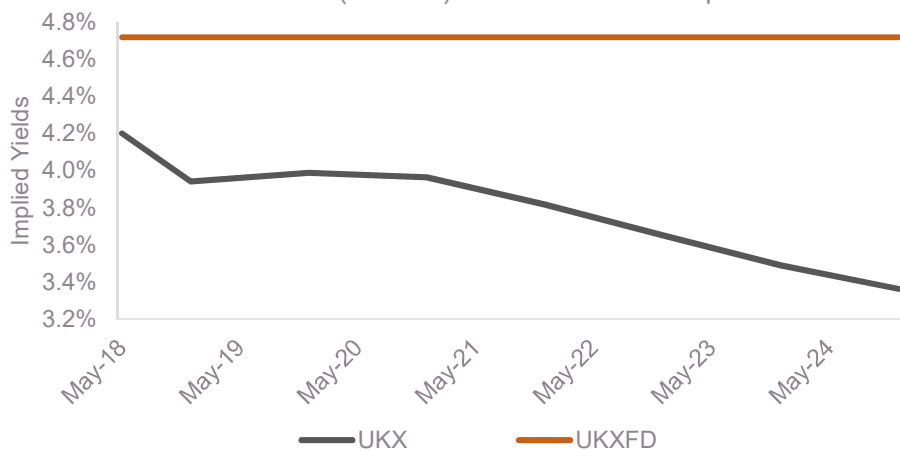
Friday Night 'Lights

18th May 2018



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Implied Dividend Yields of FTSE 100 (UKX) vs FTSE EW Fixed Dividend (UKXFD) Based on Current Spot Levels³



³As at 15/05/2018

⁴The performance of the below table is taken from the price return indices (on which the products are written) and anything prior to 01/03/2017 is backtested. Observed as of 10/05/2018

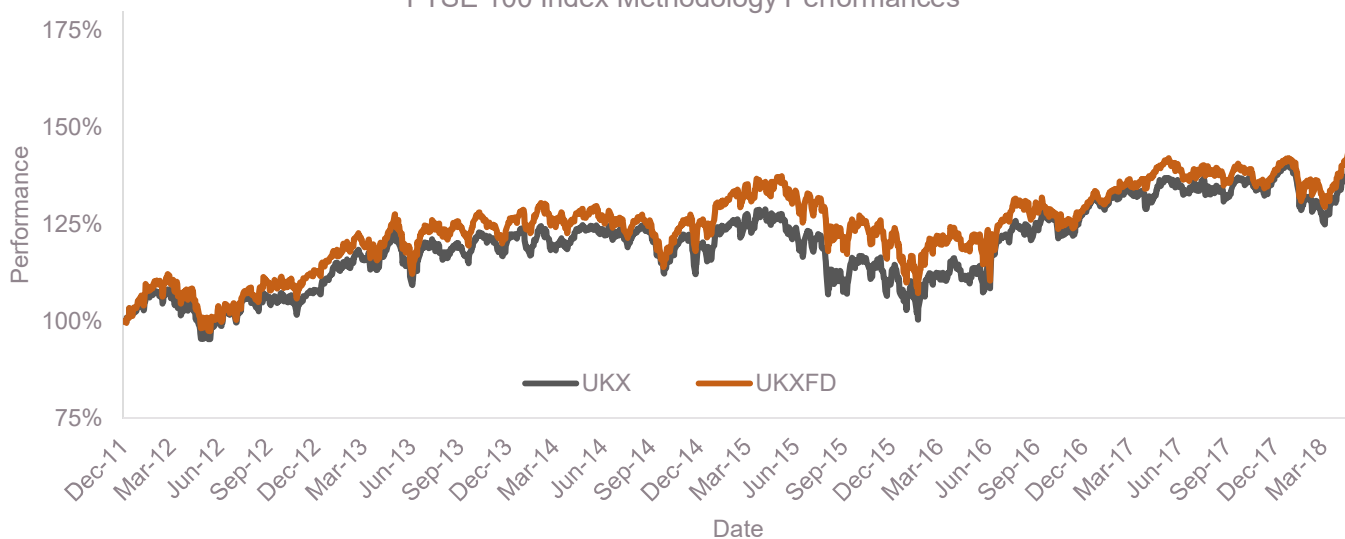
⁵Observed from 23/12/2011 to 16/05/2018

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Index Performance Comparisons⁴

	Last 5 Years		1 Year		Since Launch (01/03/2017)	
	UKX	UKXFD	UKX	UKXFD	UKX	UKXFD
Annualised Return	2.93%	3.05%	3.63%	2.52%	3.07%	4.39%
Volatility	13.71%	13.99%	9.96%	9.37%	9.94%	9.22%
Max Drawdowns	-22.06%	-21.88%	-11.44%	-8.83%	-11.44%	-8.83%

FTSE 100 Index Methodology Performances⁵



So, the equally weighting element stacks up in its own right, and as you can see from the above table, the two indices have performed relatively similarly over the last 5 years from a risk perspective. So the final question is whether the fixed dividend element improves pricing to enough of a degree that it makes switching, a worthwhile investment decision. Please see below for a comparison on pricing:

Indicative Pricing Comparisons – Priced between 14/05/2018 and 16/05/2018	UKX	UKXFD
FTSE 6yr Stepdown Autocall with 65% EKIP	6.14%	7.15%
FTSE 6yr Flat Autocall with 60% EKIP	9.40%	10.60%
FTSE 6yr Phoenix with 60% EKIP & 65% semi-annual coupon barrier. Annual Autocall Barriers at 100%	4.8%	5.40%

Napoleon Dynamite pricing indeed... Please get in touch for the full study, or to see information and pricing on other geographies.

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