German investment looking up, proceeding with caution

With investor confidence being slowly rebuilt, UniCredit's Juliane Bürger offers some valuable insight and advice to investors into choosing the right product, the advent of reverse convertible product offerings and the market volumes, now that it is showing signs of recovery

Structured Products: How have retail investors' appetites for risk and investment requirements changed in Germany?

Juliane Bürger (JB): After the sharp price correction in almost all asset classes during the crisis, retail investors have become extremely cautious in their asset allocation. This has created a demand for simple and easy-to-understand investment products with either attractive coupons or special safety features.

Structured Products: What should investors look out for when choosing a product?

JB: To start with, the risk-return profile and market expectations of the individual investor are important factors. Based on this, there are many tools that are available to help the investor choose the product that best suits his needs. For example, the Deutscher Derivate Verband (DDV) – the German association of structured products providers – classifies products into five risk categories based on a value-at-risk (VaR) concept. In addition, there are various companies providing product ratings to investors.

As with any investments in bonds or notes, the investor always needs to take into account the credit risk of the issuer.

Structured Products: In light of upward market trends and the new German tax regime, what products is HVB focusing on?

JB: With deposit rates remaining at extremely low levels, fixed-income-oriented investors are seeking alternatives such as step-up bonds, floaters and even credit linked notes on selected corporates or sovereigns.

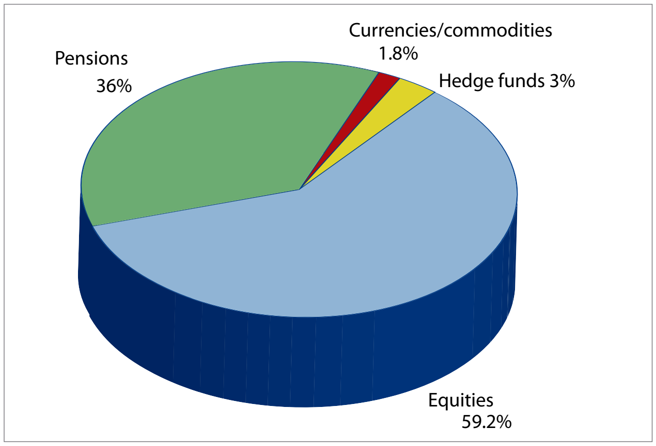
While the impressive comeback of equity markets such as the DAX® are bringing stocks back into focus for many investors, fear of possible setbacks, however, is raising the demand for alternatives to direct equity investments. Once again, the investors' focus is on classic products within the structured products range, such as capital-protected participation certificates and reverse convertibles. What these products have in common is that they combine opportunities for attractive returns with comfortable safety buffers and short maturities. On top of this, they have lost their tax disadvantage compared to non-capital-protected and non-coupon-paying structures.

Structured Products: Why are reverse convertibles in particular demand?

JB: The great popularity of reverse convertibles is hardly surprising. It is precisely at times of stock-market turbulence that the advantages of investments of this nature can best be felt. They combine a comfortable level of conditional protection with opportunities for an attractive return. The high volatility seen in stock markets makes it possible to achieve high coupons, meaning that reverse convertibles represent a clever alternative to the low conventional interest rates currently available. And there is another important consideration beyond this: with the introduction of the final withholding tax, bonds have lost their previous tax disadvantage. Whereas previously interest payments had to be taxed by reference to personal tax allowances, this changed at the start of the year, at which point they became subject to a final withholding tax of 25%.

From January to June 2009, the open interest in reverse convertibles has almost tripled to EUR 1.426 billion, according to DDV, with HVB – whose parent company is UniCredit Group – being a leading product issuer in Germany.

1 Investment products by asset classes



Deutscher Derivate Verband, open interest June 30, 2009

Structured Products: What further developments have been made by HVB to enhance the reverse convertible product family?

JB: As a result of the financial market crisis, German retail investors have been seeking protection against temporarily extreme market volatility. Investors holding barrier products, which until then had mainly a continuous observation feature, were greatly affected by the sell-off. In order to immunise barrier reverse convertibles against temporary sell-offs of the underlying, the barrier observation at maturity only was introduced. This feature allows launching products with high safety buffers and attractive coupons.

In order to cater for the demand for short-dated products, an auto-call feature has been added to the barrier feature of 'observation at maturity only' to create so-called 'Zins Express Certificates'. In the past, this feature showed performance-enhancing effects over a long time period on barrier reverse convertibles.

Structured Products: Which products have been developed in order to catch up on losses resulting from the financial markets crisis?

JB: Among the various strategies developed, the so-called 'Top' Certificates had great success among investors and were well-received in the financial press. These products pay a fixed digital amount at maturity if the underlying trades at or above its initial level at maturity. Otherwise, it is redeemed according to the underlying's performance. As an example, HVB has issued a Top Certificate linked the DJ Euro Stoxx 50® Index. At maturity, after 4.5 years, the investor will receive – in addition to 100% of the notional – an additional payment of 72% if the index trades at or above its initial level set at start of the product's life. Otherwise, the return payment reflects exactly the index performance.

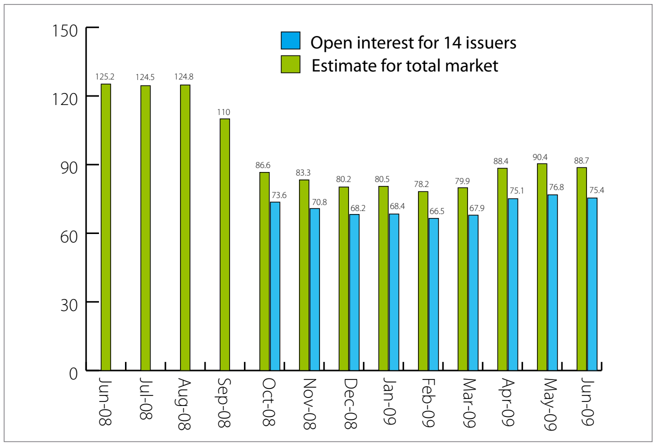
Therefore, these types of products are particularly suited for investors that currently own structured products that have turned into so called 'Delta 1' products, i.e. tracking the price performance of the underlying, and believe that the underlying will trade at least at the same level or higher in the future.

Structured Products: What are today's volumes like for the German retail structured products market, and how far has it recovered from the shock of the Lehman Brothers collapse?

JB: As of June 2009, the open interest in the German structured products markets was estimated by DDV to be EUR 88.7 billion. On a per-asset class as an underlying basis, the two highest-ranked asset classes were equity with 59.2%, followed by fixed income at 36%.

Compared to the low in February 2009 of EUR 78.2 billion in open interest, the market has recovered and is stabilising around the EUR 90 billion mark. There has been a big shift in asset class as underlying. Fixed income products have gained substantial market share since the beginning of this year, reflecting the German retail investors' preference for safety.

2. Market volume since June 2008



Deutscher Derivate Verband, open interest June 30, 2009

Structured Products: When can you see market volumes recovering to 2007 levels, if at all?

JB: With the industry's adapted product range and the recovery of financial markets, investors are coming back into the structured products market. Besides this factor open interest is also influenced by the market value of the outstanding products. Rising equity markets combined with increasing investor risk appetite should support market growth in the future. Hence with the return of equity markets to their old highs seen in 2007, so should the market volume.

Juliane Bürger

Contact details

Juliane Bürger
Managing Director
Head of Retail Products Germany, Austria, CEE
t: +49 (0)1803 131412
e: anlageprodukte@unicreditgroup.de
www.zertifikate.hvb.de