Structured Note Research Series

Equity Repair Strategy

A defensive approach for brighter days

July 2022

Introducing the 'Equity Repair Strategy' with Structured Notes

Key Implications

- After one of the worst first-half of the year finishes for global stocks on record, clients are likely uneasy about putting cash to work in fear of further downside to come.
- Advisors can help clients in a risk-conscious way through an "Equity Repair Strategy" utilizing structured notes.
- A Growth Note with soft downside protection offers enhanced upside returns, allowing clients the potential to make up for losses quicker, with downside protection in case we haven't seen the bottom yet.
- Strategies like these can allow the advisor to take advantage of market conditions while making conversations with clients more productive.

Putting cash to work in a falling market is one of the toughest mental hurdles for financial advisors and their clients to overcome. Advisors may think a bottom is nearing and want to deploy cash to lock-in an attractive cost basis, however their clients are too nervous to put money to work for fear of losing more. Inevitably, markets tend to recover, and clients often miss the rally.

Structured notes have complex features and may not be suitable for all investors. They are sold only by prospectus and investors should read the prospectus and pricing supplement carefully before investing as they contain a detailed explanation of the risks, tax treatment, and other relevant information about the investment. The tax treatment of structured notes varies depending on the offering, and can be uncertain in some cases. Structured products are sold through financial professionals and investors should consult accounting, legal, and/or tax professional before investing.

An “Equity Repair Strategy,” as we call it, using structured notes, helps retail investors working with financial advisors invest in the stock market, but in a risk-based approach.

We saw this in 2008-09. The March 2020 plunge seemed to feature better investor behavior, but perhaps that was due to the swift nature of the pullback. This time around, however, stocks have been sinking for months on end – some niches of the market are 80% or more below their highs from early 2021. For perspective, the U.S. stock market’s 20.6% loss during the first half of this year was the worst H1 since 1962 and 2nd worst since 1935 for the S&P 500, according to BofA Global Research.

A game plan is needed now more than ever to protect against further downside in the market while participating in the potential rally that ensues. Halo has you covered. An “Equity Repair Strategy,” as we call it, using structured notes, helps retail investors working with financial advisors invest in the stock market, but in a risk-based approach. It goes like this – an investor can purchase a Growth Note with soft protection should equities keep dropping, while having enhanced upside potential to benefit from a longer-term market rebound.

Equity Repair Strategy Part 1: Downside Protection

This structured note solution can solve a common psychological problem among so many investors. Many recognize that timing the market bottom is futile, but what is less discussed is an even bigger risk – missing out on future bull markets due to short-term fear of more losses. Structured notes can help mitigate this conundrum by offering a level of downside protection in case the advisor is “early” in their market timing, making the advisor and their client more comfortable attempting to put cash to work in a volatile market such as today’s.

Barriers (soft protection) and buffers (hard protection) can help investors dial in a more precise risk-reward profile.

A commonly used protection in Equity Repair Strategies is what’s called “soft protection.” Specifically, soft protection acts like a barrier – the investor is protected from losses up to that barrier. If the barrier is punctured on the maturity date (and on the maturity date only), the investor is fully exposed to the loss of the underlying asset, just as they would be if they bought the underlying asset outright, excluding dividends. Soft protection is different from “hard protection,” where the investor is buffered against losses by the amount of hard protection selected.

Soft protection is often used over hard protection in Equity Repair Strategies for two primary reasons. First, advisors who adopt this strategy typically have the thesis that the market is either at, or nearing, a bottom. As such, while soft protection is a less conservative form of protection compared to hard protection, the advisor can typically have deeper protection on the structured note without sacrificing as much on the upside, as they would using hard protection (Note: try using the Halo Pricing tool to compare the upside potential between soft and hard protection).

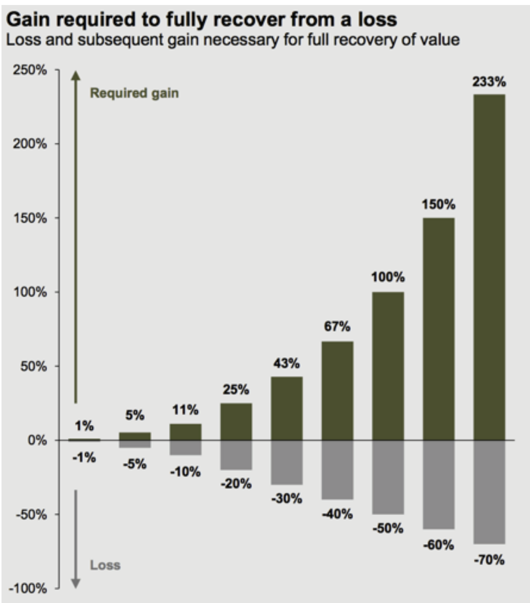
Second, soft protection can provide more upside in the structured note, making the Equity Repair Strategy more effective if we are indeed near the bottom.

Equity Repair Strategy Part 2: Enhanced Upside

To the above point, the enhanced upside is the key to the Equity Repair Strategy. The goal of this strategy is to get the portfolio back to even faster than you would if you simply owned an index fund. As a refresher, the more the market has fallen, the more upside it takes to get your portfolio back to even.

Consider the below chart from J.P. Morgan Asset Management: The gain required to fully recover from a bear market is massive. For those who held once high-flying tech stocks and the so-called “stay-at-home” plays from early 2021, unrealized losses might be 50% or more.

Exponential Gains Are Required Just to Get Back to Even



Portfolio Loss	Portfolio Gain To Recover Loss
-10%	11%
-15%	18%
-20%	25%
-30%	43%
-40%	67%
-50%	100%
-60%	150%
-70%	233%
-80%	400%
-90%	900%

Exponential

Source: J.P. Morgan Asset Management, 3Summit Investment Management

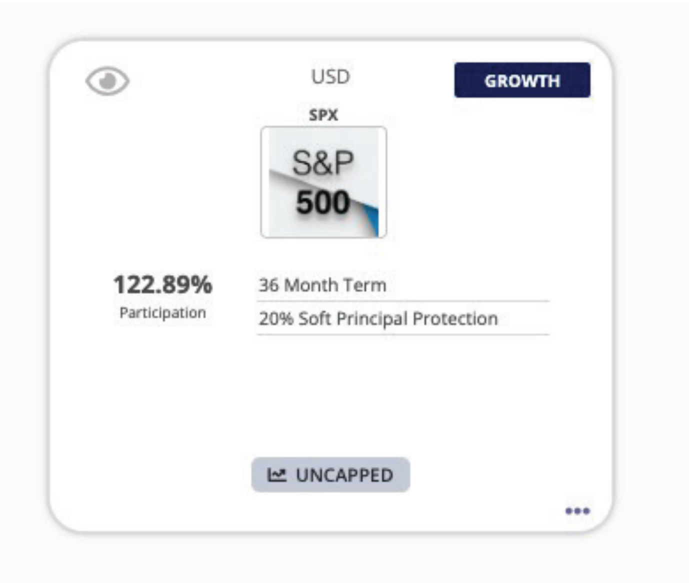
With a structured note in the lens of an Equity Repair Strategy, the investor can earn enhanced upside exposure versus the market due to the note’s uncapped upside (the participation rate) over a period of, say, two or three years (depending on the term of the note). As a result, an equity repair strategy may bring the portfolio back to its highs quicker than what would be seen with a passive index fund.

Structured note pricing is one area that can potentially benefit from market volatility.

Moreover, the pricing of Equity Repair Strategies, a form of Growth Note, can be quite compelling in market conditions such as these. Higher volatility and rising interest rates can significantly improve the upside participation rate achieved on a Growth Note, while allowing the investor to “lock-in” protection at depressed market levels. Utilizing this strategy can make the advisor’s conversations with clients even more productive because the client is getting the opportunity to have volatility and rising interest rates work to their advantage versus the other way around with stocks and bonds.

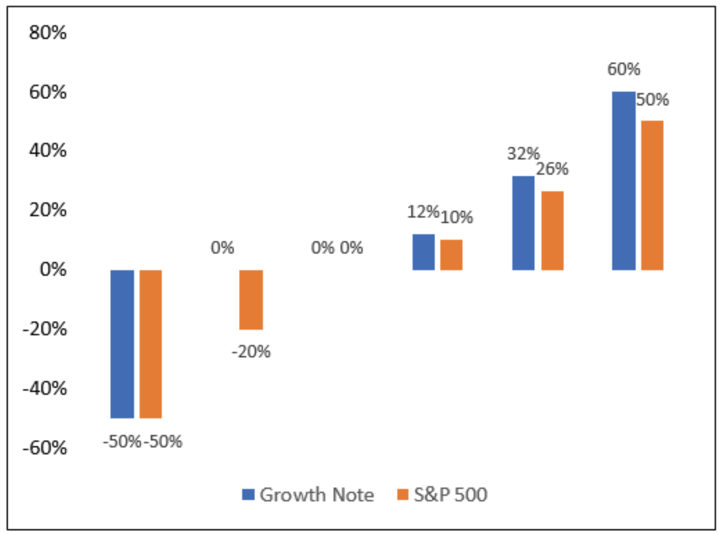
Let’s outline an example. If the market should rally back to near all-time highs, a note with a maturity of two or three years could provide enough time for stocks to find their footing. From current levels near 3810 on the S&P 500, a 26% gain is required to reclaim the 4818 all-time high notched in early January 2022. If that happens over three years, a Growth Note featuring a 120% participation rate would pay out slightly more than 31%. This trade idea example is an example of how an advisor can help anxious clients get back in the game.

Visualizing the Equity Repair Strategy



For illustrative purposes only. *Indicative pricing as of 7/6/2022. Changes to terms and pricing should be expected.*

S&P 500	SPX Price Appreciation	Growth Note Return
1905	-50%	-50%
3048	-20%	0%
3810	0%	0%
4191	10%	12%
4818	26%	32%
5715	50%	60%
7620	100%	120%



Halo's Competitive Marketplace: The Next Generation of Structured Notes

Halo Investing's work in derivatives pricing, market structure and risk management make it a new breed of FinTech helping to bring advanced investment management capabilities to investors of all walks – regardless of account size.

Halo is an award-winning technology platform for protective investment solutions. Headquartered in Chicago, with offices in Abu Dhabi, Zurich, and Singapore, Halo was co-founded by Biju Kulathakal and Jason Barsema in 2015 with a mission that focuses on putting "impact before profits," providing access to impactful investment opportunities previously unavailable to most investors. Through the Halo platform, financial advisors can easily access structured notes, market-linked CDs, buffered ETFs, and annuities, as well as a suite of tools to educate, analyze, customize, execute, and manage the most suitable protective investment product for their portfolios. Through the platform, advisors can also access liquidity on their existing structured notes. Halo has received a growing number of honors, and was recently named one of Fast Company's Ten Most Innovative Companies of 2021.

For Whom Does the Equity Repair Strategy Make Sense?

An Equity Repair Strategy using the structured note vehicle might be useful for a variety of client types. Consider a couple that has a low to moderate risk tolerance. Perhaps they own a balanced portfolio of 60% stocks and 40% bonds. Through the first half of 2022, the client would have endured losses never before experienced in their lifetimes. According to Bank of America Global Research, the cookie-cutter 60/40 allocation had its worst first six months to a year since 1932. This year's drubbing was also the first time since 2001 that both stocks and bonds fell in the first half. The equity side of their portfolio must now do some heavy lifting to get back to even – but it can be done. An Equity Repair Strategy can help client portfolios get back to even faster, while making client conversations easier during these challenging times.

The equity repair strategy is not to be confused with leverage.

To this point, it's important to realize the Equity Repair Strategy is not a "double-down" strategy. The investment product simply uses a low-cost method to capture enhanced future upside in the stock market with some downside protection in the event we haven't seen the market bottom. Said differently, the Equity Repair Strategy can help investors sleep at night should volatility continue, while ensuring clients own a product that can help them reach their financial goals.

What Historical Bear Markets Look Like

A benefit of utilizing Equity Repair Strategies that have a maturity date of 2 or more years is that we are allowing the market enough time to recover losses, but there is protection if the Bear Market continues for the next six or 12 months. Looking at historical data, bear markets since 1956 tend to go on longer than six months, but not a whole lot more. According to LPL Research, the average Bear Market on the S&P 500 lasts 11 months.[1] As for the ensuing recovery, Guggenheim Investments analyzed all past downturns and found that when the S&P 500 drops between 20% and 40%, which has happened nine times, the average number of months it takes to get back to even is 13.8 months.[2] That's why now could be an ideal time to execute an Equity Repair Strategy using Growth Notes.

The Bottom Line

It's time for a reset. The first half of this year was painful for so many investors holding traditional portfolios of stock and bond funds. The S&P 500 and the fixed-income market endured losses few people have ever seen. The Equity Repair Strategy can help investors recover losses more quickly compared to owning a plain index fund, while offering a level of downside protection against further market declines. Structured notes can also be a simpler option for investors rather than purchasing a leveraged mutual fund, such as 130/30 funds, and put options. The long-short leveraged mutual fund and put options approach requires constant rolling of put options in order to achieve similar returns to those of a structured product. It can be a useful way to help risk-conscious investors with their inherent uneasiness about putting cash to work in a falling market, while still helping them hit their longer-term financial goals. Just as important, it can strengthen the advisor's relationship with the client by offering a strategy that allows them to take advantage of current market conditions instead of sitting back and taking the body blows the market is currently giving us. This is the protection Halo can offer an advisor's portfolios and their client relationships—critical during stressful times such as these.

Halo is the first marketplace dedicated to protective investing. By enabling new levels of risk-reward personalization, investors can better align their investments with unique portfolio objectives.

The Halo platform powers cost-effective institutional strength capabilities, once available only under ultrahigh net worth relationships. By allowing investments to target a concern (inflation or downside risk) or leverage a theme (lower market beta), Halo's protective investment suite of structured notes, annuities, and buffered ETFs allow for participation in market upside, while providing a level of downside cushion.

Halo believes in transparent, streamlined access to protective investment solutions—all made possible with technology.

For more information, visit www.haloinvesting.com or email marketplace.sales@haloinvesting.com

Important Disclosure

Investors should be aware that there is often a cost to purchasing options (premium) to achieve leveraged returns with structured notes. In aggregate, that cost is reflected in structured note returns.

Investors should be aware that structured notes do not capture returns from dividends on the underlying index. For example, the S&P 500 Index does not include dividends whereas an S&P 500 Index fund pays dividends (thus it is a total return product capture both price returns and dividend income). The return difference between the S&P 500 Index, on which a structured note might be priced, and funds tracking it will grow larger (in favor of the funds) over time.

Investors should be aware that structured notes have counterparty risk, and therefore, should require a higher return to be equivalent to an index fund on a risk-adjusted basis. Structured note pricing should include a risk premium to compensate investors for that added risk.

Investors should be aware that structured notes have finite terms. An added burden and risk structured note holders face is reinvesting proceeds at maturity.

Investors should be aware that structured notes are less liquid than heavily traded exchange-traded funds (ETFs). Moreover, most mutual funds can be redeemed at Net Asset Value (NAV) each day. Investors are generally not compensated for reduced liquidity in structured products. Structured notes should be priced to account for their relative lack of liquidity.

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