Insignia Financial

Investor Update

February 2024

In the last update we focussed on past performance and gave some thoughts on the year ahead. Once again we give some colour on recent performance and our near term outlook for the Fund. A flat January post a very strong finish to 2023 didn't surprise us. February, thus far, has been strong and we feel very confident around current positioning.

Continuing our focus on educating investors around Structured Notes, we dig a little deeper into the mechanics of an Autocall. Often Structured Notes are pitched in such a way as it can be difficult to understand, with complex terminology that tends to confuse investors. This is unfortunate as mostly they are a relatively straightforward invetment, with a small number of key variables driving the yield - interest rates and volatility being the most important.

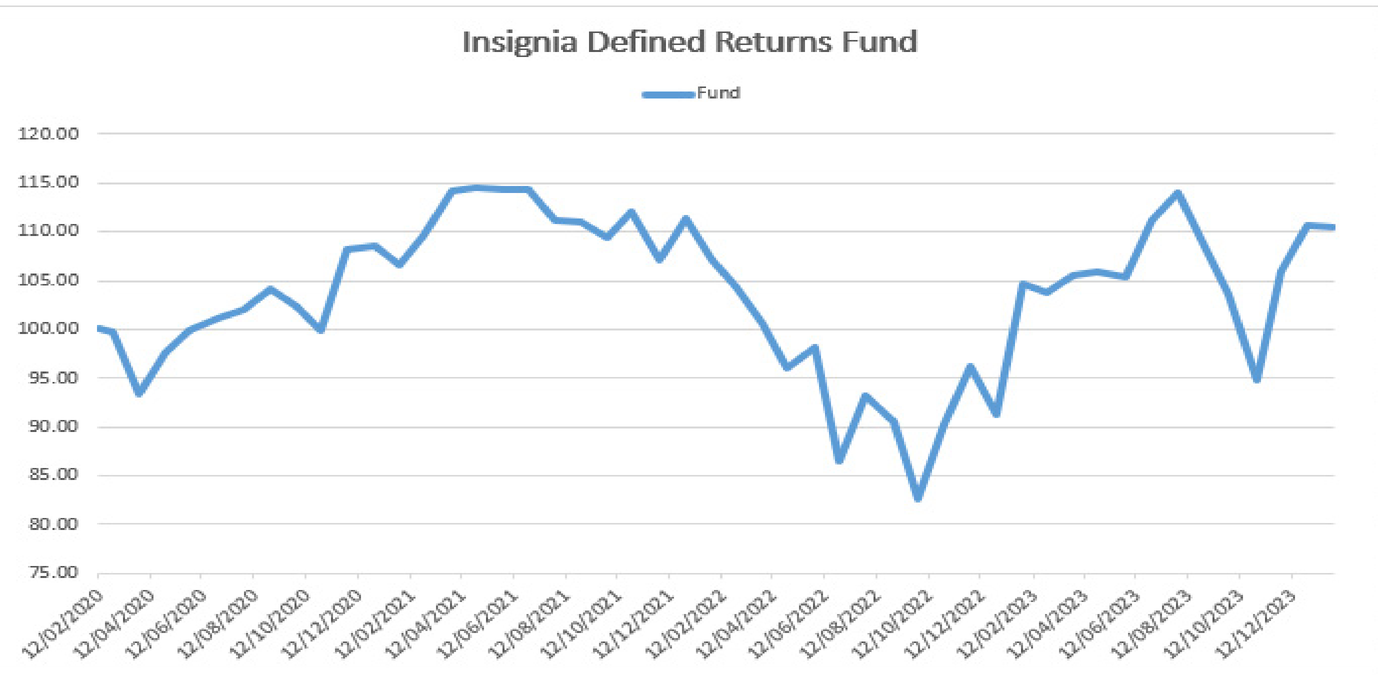
We finish with a review of a Note that we recently purchased - " Worst Of Autocall" Note containing Nestle, Wells Fargo and HSBC - yielding 13%.

Insignia Team

Peter Murphy (CEO), Don Walshe (CIO), Shane O'Neill (Head of Distribution), Aiden O'Donnell (Investment Consultant)

Defined Fund Performance - Life to Date

As per the January 2024 NAV, the **Ballybunion Insignia Defined Returns Fund** is up 10.5% since inception in February 2020.



Performance Update - January 2024

January 2024 ended with a -0.2% return

After a strong finish to 2023. January was a 'slow' month by comparison. The marginally negative result was a consequence of a slight up-tick in volatility on the final day of the month.

As noted in last months' update, our US Banks position was Autocalled in January, delivering a 14% return over a one year hold period. We replaced this with a defensive structure containing Roche, Pernod Ricard and Diageo. This carries a very attractive coupon of >15%.

Our timing was good and the note is off to a positive start. Although early days and a long way from maturity, both Pernod Ricard and Diageo trade above the barrier for the Star feature, meaning that based on current spot pricing the note is capital protected. Of course this only counts at maturity, but a nice start nonetheless.

February has been a strong month with most positions higher. A particular highlight is our Twin-Win position on the Biotech sector. The Twin-Win Note allows us benefit if an underlying moves up or down over a particular time period.

We recently added a new holding, a "Worst Of" Autocall note with HSBC, Nestle and Wells Fargo as the underlyings. With a coupon of 13% and a star feature included, we view the risk reward as favourable. More details on the new position below.

Looking forward, we are very confident around current positioning. Although volatility conditions are not ideal, we are still finding attractive opportunities with strong risk reward characteristics. Cash levels remain higher than average, which leaves us very well resourced to capitalise on any market dislocation that may arise in the future.

The Fund has a good mix of new positions that are trading as expected and some legacy holdings that are steadily improving and offer asymmetric returns, if they continue to move in the right direction.

Given how the Fund is positioned at the moment we see it as a very risk controlled method of gaining access to the Equity market.

Structured Notes - Pricing dynamics

A question we are often asked is what drives the yield on the our notes? Every Structured Note will be slightly different but in basic terms it is made up of a Bond Component (issued by the counterparty) and a derivative element (puts and/or calls). Both are packaged together to ultimately solve for a yield or coupon. Whilst there are lots of contributing factors, the two/three components that really drive the pricing are:

1. Interest Rates/Counterpatry Risk

2. Implied Volatility of the underlying stocks in the Note

Interest Rates/Counterparty Risk

The bond component (issued by the counterparty) which is embedded within the Note will account for the bulk of the cost of the Autocall. Very simply, we buy a bond issued by a counterparty at a discount and this is repaid at par on the maturity of the note. The cost of this bond will depend on a number of factors:

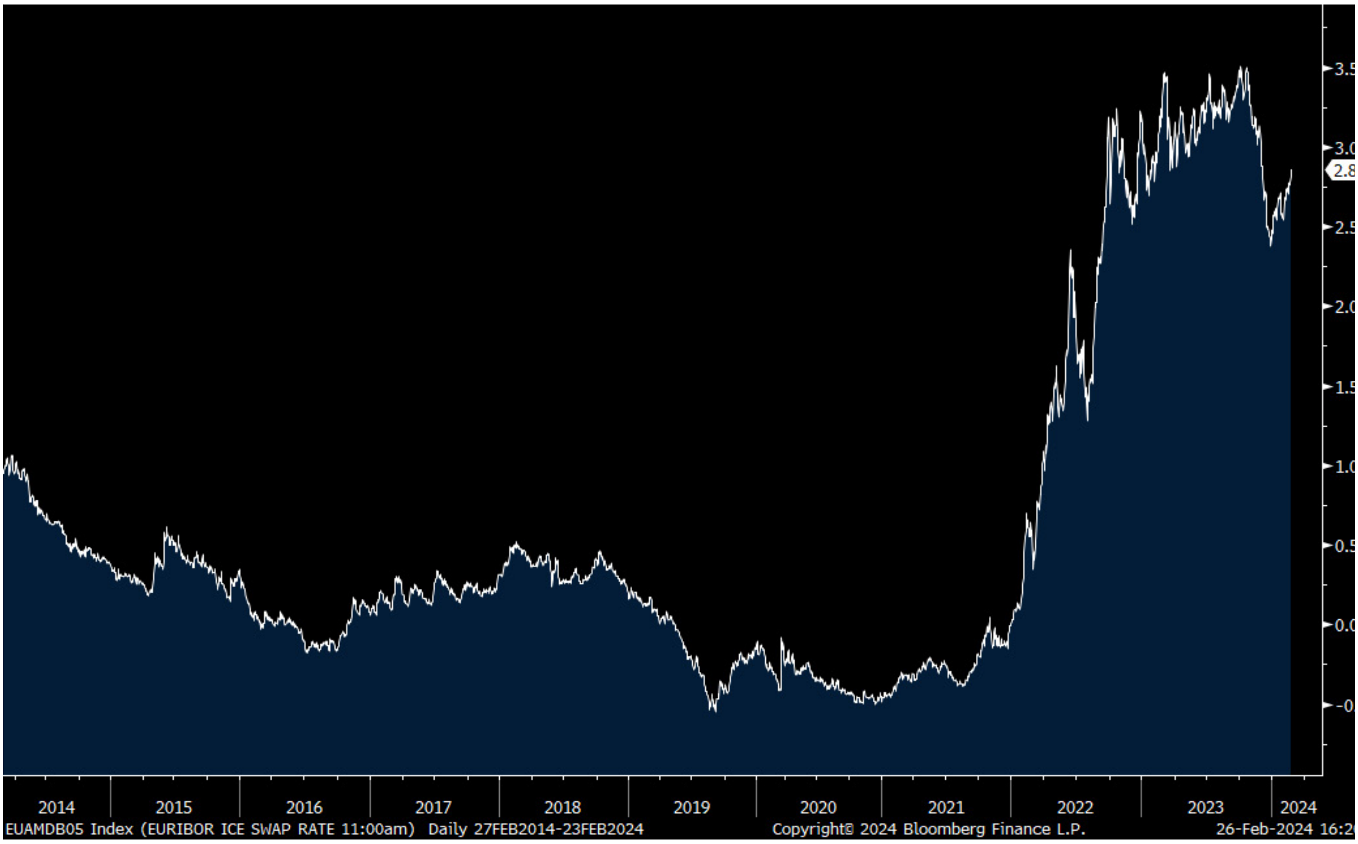
- Interest rates (Higher rates = higher yield = lower cost to purchase)
- Credit Rating of the Issuer (Lower quality = higher yield = lower cost to purchase)
- Duration of the Note (Dependant on the shape of the yield curve)

In simple terms, an autocall with a lowly rated, higher risk counterparty, will price much better than a low risk, highly rated option. (I'm sure it's well understood, but to state the obvious - we only deal with Investment Grade or better and our default will always be towards the highest quality counterparties)

Clearly, the macro environment for pricing autocalls and other structured notes changed dramatically in 2022 as post-Covid inflation expectations drove yields and interest rates higher (Fig 1). Dwindling inflation fears through 2023 suggest that we are past the interest rate peak and now the debate has moved on to the 'normalisation' of rates and the question of where rates are likely to settle over the medium to longer term.

Whilst the transition from a low/negative rate environment has caused volatility in the Fund returns profile, a more normalised rate environment is a long term positive for the Fund.

Fig 1: Euro 5-year Swap Rates (2014-2024)



Source: Bloomberg

Implied Volatility of the Underlying Stocks in the Note

The implied volatility of a stock is essentially a measure of how big a move is 'implied' by current option prices. The more volatile a stock is, the higher the implied move will be. For example Tesla has an implied volatility of 45% whereas the equivalent for Coca Cola is 13%.

An important driver of the yield on a notes is the premium (income) earned from selling put options (insurance). Obviously the more volatile the stock, the greater the premium generated, resulting in a higher coupon on the autocall. An autocall on Tesla therefore will generate a much higher coupon than an equivalent using Coca Cola.

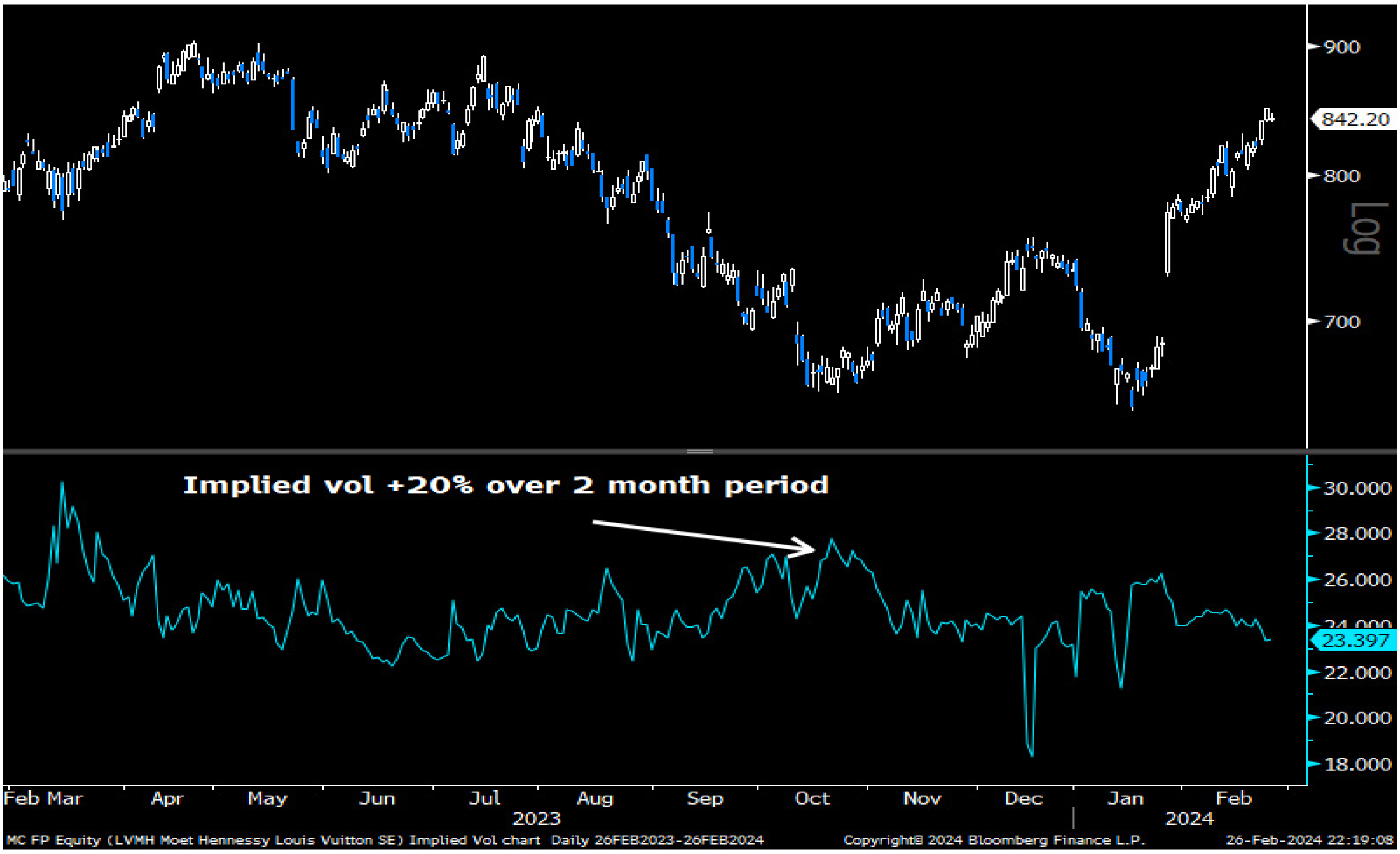
Implied volatility is merely a point in time prediction on how much a stock may move over a certain time period. It is well proven that realized volatility tends to be lower i.e. the expected large move, typically doesn't materialise. This is very common in situations where a stock is weak or sentiment around it is overly negative. Put pricing becomes more expensive as investors scramble for protection. As we are sellers of this insurance this scenario is advantageous.

In the same way that a fundamental long only fund manager wants to buy a stock at a discount from a valuation perspective, we are looking to strike a note when the implied volatility is higher than average and we feel that it is mispriced.

By way of example, in October 2023 we purchased a Note with LVMH as one of the underlyings. LVMH is one of the largest companies (by market cap) in Europe and typically has a low implied volatility. Fundamentally it is a name we like, but due to the volatility profile we have struggled to access it.

However, as equity markets sold off between August and October, implied volatility for LVMH increased by 20%. This, coupled with some share price weakness, presented us with an attractive entry point and one where we felt that implied volatility was mispriced. So far this has proved correct, and at present the note is trading above par and will likely call in April for a 7.5% return over a 6 month hold period.

Fig 2: LVMH - Share price & implied volatility



Source: Bloomberg

Clearly it would be very easy for us to just structure notes with the lowest rated issuers, using the most volatile stocks as underlyings. The yields on offer would be eye-watering. However, the risk reward (on multiple measures) would be unfavourable. We in fact take the opposite approach by using a diverse group of highly rated counterparties and looking to gain our exposure through well capitalized companies.

Our job is to consider all of these factors that influence the pricing and find the 'sweet spot' that delivers a 7%-9% p.a. (net of fees over a rolling 5 year period) return for our investors . The current combination of higher interest rates and low volatility means we have to be selective in our exposures and be ready to deploy cash when volatility spikes, which it inevitably will at some point.

Fund Update - Over the past 2 months

New Notes:

- Worst of Autocall with Star Feature - Chevron/Exxon Mobil/BP; 14% Annual Yield
- Worst of Autocall with Star Feature - Roche/Pernod Ricard/Diageo - 15.4% Annual Yield
- Worst of Autocall with Star Feature - Nestle, Wells Fargo, HSBC - 13% Annual Yield

Matured/Called

Worst of Autocall - Goldman Sachs, Bank of America, JP Morgan; One year hold; 14% Yield

Featured Note

Worst of Autocall with Star Feature

- **Underlyings - Nestle** (Consumer Staples), **Wells Fargo** (Financials), **HSBC** (Financials)
- **Capital Barrier - 60%** (i.e. the worst name can fall 40% before our capital is at risk)
- **Final Coupon Barrier - 82.5%** (i.e. the worst of name can fall 17.5% and we can still earn all of our coupons)
- **Star Feature** - If any of the three stocks finishes 5% higher than the initial level at maturity, the product automatically has a capital protection feature, irrespective of what happens the other two stocks.
- **Annual Coupon - 13%**

Trade Rationale

Given that our Banks note matured in early January, we have been on the lookout for a way to add some exposure to the sector in an effort to diversify at a Fund level.

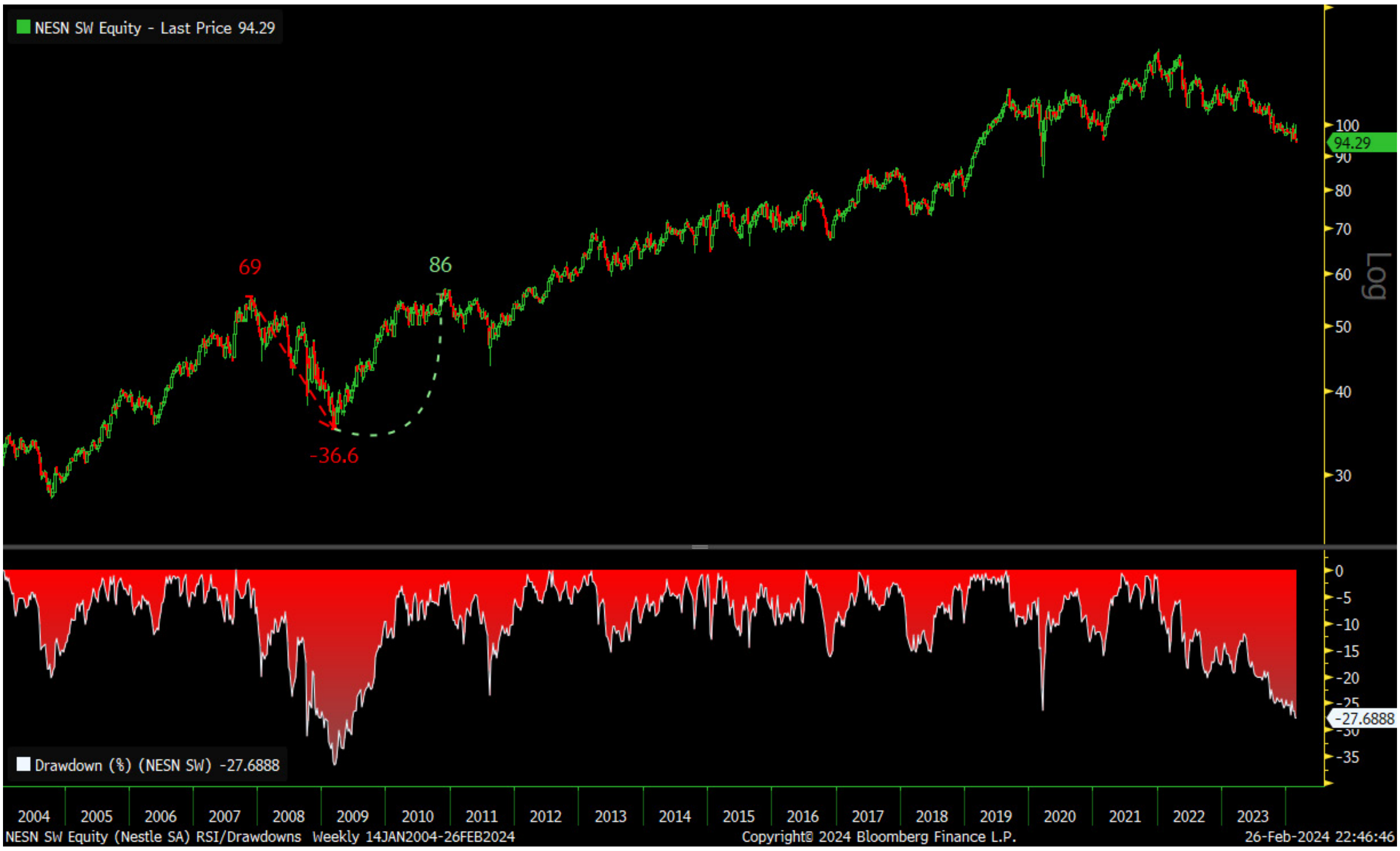
HSBC declined post its most recent results and we felt that this presented an opportunity. Wells Fargo is one of the largest US banks and we think fundamentally it pairs well with HSBC. Nestle may seem like a strange bedfellow, but there is method to our madness,

As we have included a Star Feature in the note, adding something uncorrelated to the others makes sense. Remember with the Star Feature if one of the stocks is >105% of the initial value at maturity (4 years away) the note is automatically capital protected.

Nestle trades close to 52 week and 5-year lows. It is currently 28% off its high, which is extreme drawdown territory for it, only bettered by the 36% move lower during the Great Financial Crisis.

Given its scale and global reach we expect that over time it will recover and remember we don't need it to appreciate in price to realise the full value of the Structured Note.

Figure 3: Nestle Price Chart & Drawdown (2004-2024)



Source: Bloomberg