

LEVENDI – BUILT FOR A SMOOTHER RIDE

INTRODUCTION

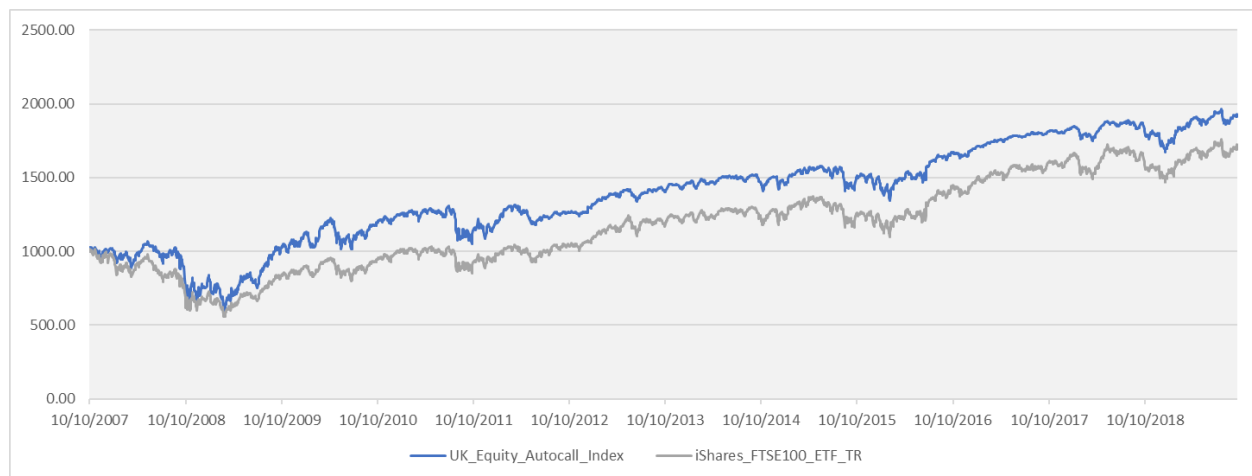
The Levendi Fund has been set up to offer the attractive returns that are available from investing in a diversified portfolio of Autocalls but modified to meet the needs of lower risk investors. The Levendi fund aims to offer the following:

- A high probability of offering a positive return.
- Low and stable volatility
- Minimise the chance and scale of losses.
- Offer a degree of protection when markets fall.

AUTOCALLS ARE AN ATTRACTIVE INVESTMENT

Our starting point is that vanilla defensive Autocalls are a very attractive asset. This can be supported by numerous articles evaluating the performance of a cash and short put strategy and our own analysis of the long term returns of Autocalls.

The chart below shows the performance of the basket of FTSE linked Autocalls that we monitor against the returns for UK Equities.



Source; Levendi Investment Management

The UK Equity Autocall Index illustrates the performance of a basket of equally weighted Autocalls linked to UK Equities where there is a daily closing price. Most of the products are “retail” and so include the costs and charges associated with this type of investment. Over the period since we have been calculating the value of the basket it has offered a better return than UK equities including dividends as

represented by the performance of the FTSE iShare (Acc) share class, with significantly better volatility and a much better risk/return as measured by the Sortino Ratio¹

	Last 3 years	Last 9 years	Since Inception
Autocall Basket Return	17.1%	63.9%	93.0%
UK Equity Return	23.8%	85.3%	72.3%
Autocall Basket Volatility	6.1%	9.9%	18.2%
UK Equity Volatility	11.2%	14.7%	18.9%
Autocall Basket Sortino	1.23	0.90	0.37
UK Equity Sortino	0.97	0.73	0.30

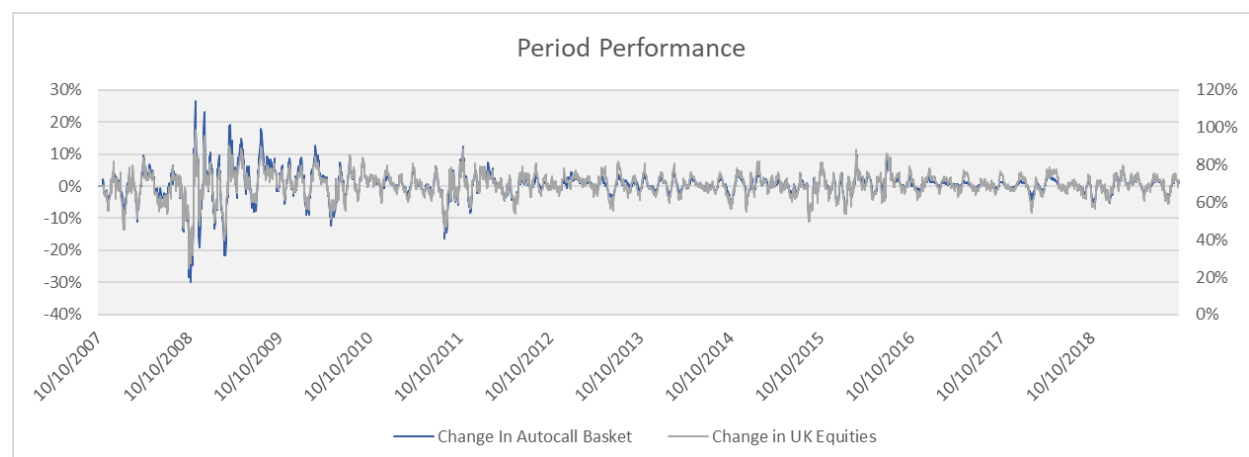
ANALYSIS OF RETURNS

The analysis of long term returns of Autocalls shows that they offer an attractive investment for investors. Depending on the product design, Autocalls can offer equity like returns with less volatility and lower drawdowns under normal market conditions. Our analysis is supported by other analysis of cash and short put strategies published on the [CBOE site](#).

Over recent periods the volatility of the Autocall basket is significantly lower than the volatility of UK equities. However, over the full period the volatility of the basket of Autocalls from inception is similar to the volatility of equities. The difference in volatility is because the full period includes the global financial crisis when equities fell, and volatility increased.

The additional volatility of the basket of Autocalls is shown by the chart below which compares the rolling 20-day performance of the Autocalls and UK Equities. Its noticeable that the Autocall returns are more volatile – rolling 20-day returns are both higher and lower than the return from UK equities through the period of the financial crisis.

ROLLING 20 DAY PERFORMANCE



Source; Levendi Investment Management

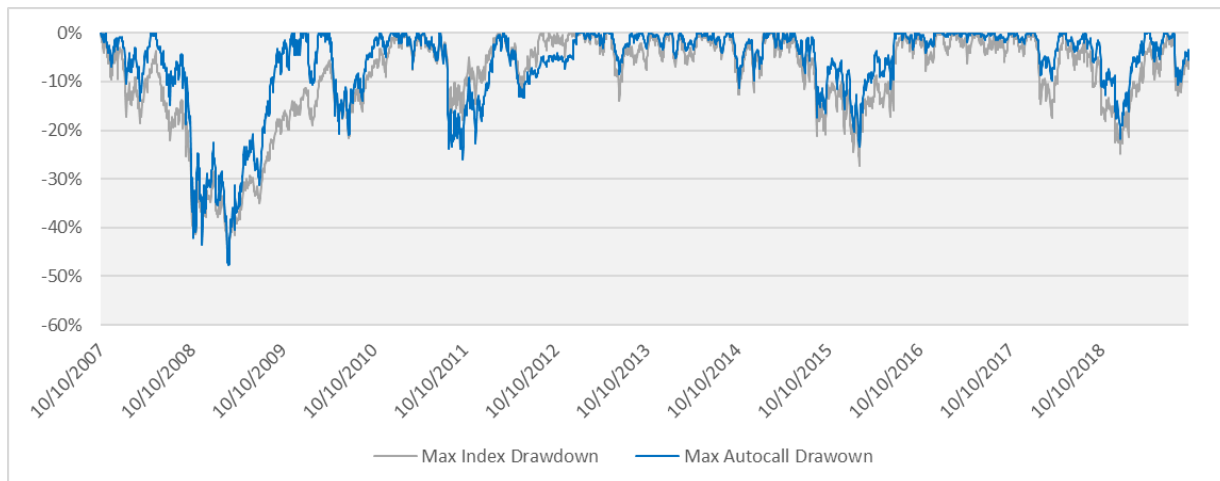
¹ Sortino Ratio; The Sortino ratio takes an asset or portfolio's return and subtracts the risk-free rate, and then divides that amount by the asset's downside deviation. <https://www.investopedia.com/terms/s/sortinoratio.asp>

LEARNING FROM THE PAST

At Levendi we are acutely aware of the benefits and risks of investing in Autocalls and try to plan for the worst. Understanding how Autocalls have performed under stressed market conditions in the past has been critical to the way that the Levendi fund is managed today. In our opinion, any fund that is intended for lower risk investors needs to include some modifications to the core strategy of holding defensive Autocalls so that it remains suitable and appropriate and does not expose investors to volatility or a risk to their capital that is too high.

DRAWDOWN

Although volatility is the most common metric of risk. In our opinion lower risk investors are primarily concerned with losing money, so “drawdown” is an important measure of risk. Comparing the drawdown of the Autocall Basket with UK equities illustrates how Autocalls have performed in the past and can be used to highlight the benefits and risks of investing in this type of asset.



Source; Levendi Investment Management

Most of the time, the drawdown for the Autocall basket is less than the drawdown of UK equities. However, when UK equities suffer a large drawdown, the Autocall basket tends to fall more. Over time, the Autocall basket tends to bounce back more quickly and the drawdown is eliminated faster, but this is a feature of Autocall returns that lower risk investors would rather avoid.

CORRELATED LOSSES

The fundamental problem of a basket of Autocalls for lower risk investors is that the mark to market value of Autocalls is likely to suffer most when the value of other assets is also falling. This pro-cyclical exposure may be unattractive for lower risk investors who are unable and unwilling to accept losses.

MITIGATING STRATEGIES

The Levendi Fund uses a range of strategies to mitigate these risks, while preserving the benefits of investing in Autocalls:

LONGER TERM

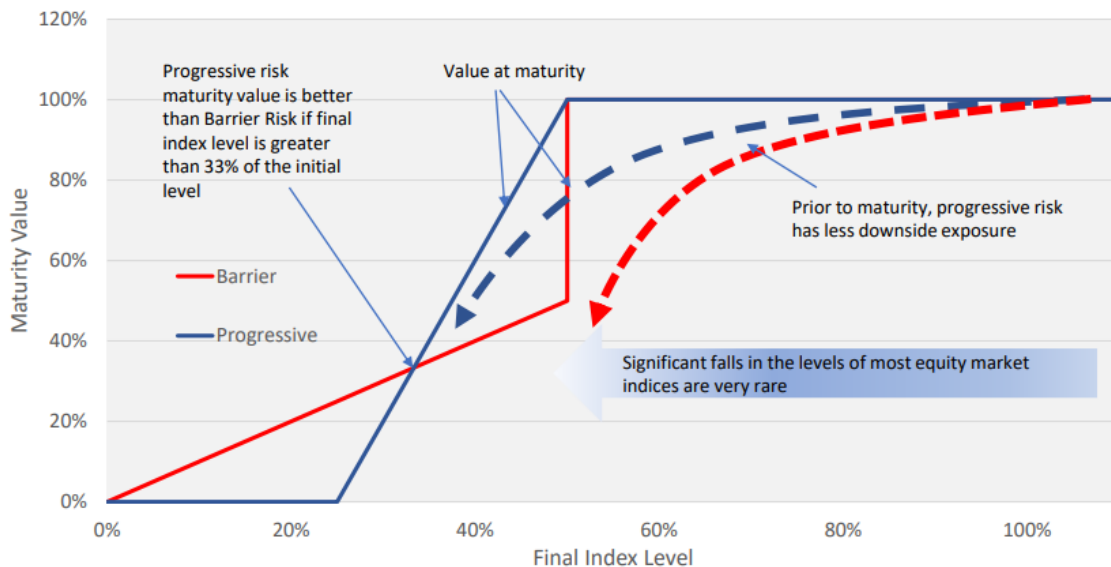
We have extended the term of the investments – giving more time for products to meet the conditions required to pay the return. Longer term investments can offer better headline returns and give the investor more optionality.

PROGRESSIVE RISK

We use put spreads instead of barriers. The chart below is taken from our institutional [presentation](#) and shows the use of progressive risk reduces risk in three ways

- Firstly, it means that if markets fall below the level required for maturity at 100%, there is no cliff-edge. Any reduction of capital value will be progressive from 100%, so reducing the scale of losses if markets fall slightly below the strike.
- Secondly, progressive risk reduces the initial sensitivity of the fund to changes in markets and so reduces volatility
- Thirdly, progressive risk reduces the rate at which exposure to market levels increases when markets fall.

PROGRESSIVE RISK BEFORE AND AT MATURITY



STEP DOWN TRIGGERS

Rather than use products where the level required to pay the return declines each year, we typically use products where the step-down is only at the maturity of the products. Typically markets need to be above 60% at the maturity of the product to pay the return. Compared to an annual step-down, the payoff is higher, but the average duration is longer.

RISK MANAGEMENT OVERLAY

We use a risk management overlay to limit our market exposure when the exposure we get through the core portfolio increases too much.

SWAPS

Investing through collateralised swaps instead of notes to eliminate volatility from changes in bank funding / CDS

COMPARISONS OF RETURN

Compared to a basket of Defensive Autocalls (Declining Autocall levels, barriers and similar headline return) and Vanilla Autocalls (barriers, flat Autocall levels and higher annual return) the trade-off from the risk mitigating strategies that Levendi use is that fund is expected to offer significantly more protection in stressed market conditions and less variation in volatility. But the returns from the Levendi strategy may be lower in some market conditions. The table below illustrates how we expect the performance of the Levendi Fund to compare with defensive and vanilla Autocalls under three market scenarios:

	STRESSED MARKETS (-25%)	MARKETS FLAT / SLIGHTLY DOWN	MARKETS UP
LEVENDI	Longer term products with progressive risk will lose value at a slower rate. Exposure to changes in market levels increases more slowly as markets fall. The risk management overlay mitigates market exposure and limits volatility	If markets are slightly down products may not mature early. Duration extends and products accrue value at a slower rate than the headline return	In rising markets returns are expected to be similar. Market levels will exceed the threshold for products to mature and pay the return. Both will offer a return close to the headline returns
DEFENSIVE AUTOCALLS	A combination of barrier options and defensive Autocall levels means that there can be a significant loss of value as markets fall towards the barrier / final Autocall level. Market exposure increases sharply as markets fall. Volatility increases significantly as a result of both increased exposure and higher market volatility.	Declining triggers mean that products are still likely to mature early and pay the return. Expected duration remains short and products accrue return that is close to the headline return	
PRODUCT RANKING	<ol style="list-style-type: none"> 1. Levendi 2. Defensive Autocalls 3. Vanilla Autocalls 	<ol style="list-style-type: none"> 1. Defensive Autocalls 2. Levendi 3. Vanilla Autocalls 	<ol style="list-style-type: none"> 1. Vanilla Autocalls 2. Levendi / Defensive Autocalls

SUMMARY

The long-term average returns from the Levendi Fund are likely to be similar to a basket of Autocalls that have similar headline returns and are equally likely to pay the return. In the shorter-term baskets of defensive Autocalls are more likely to realise a return close to the headline return if markets are flat or slightly down because of their shorter duration. But Autocalls with barriers are likely to be more volatile – and potentially MUCH more volatile with much larger drawdown in stressed market conditions.

Ultimately this is an investor choice. Defensive Autocalls are an attractive investment choice. However, investors must be prepared to accept a chance of a significant drawdown as other asset values fall, and periods where the volatility of the fund is very high. We have modified the strategy to make it appropriate for lower risk investors that want a smoother ride.

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