

## By Changing Nothing, Nothing Changes

*'The measure of intelligence is the ability to change.'* – Albert Einstein

*'The price of doing the same old thing is far higher than the price of change.'* – Bill Clinton

*'You're afraid of change. I don't know the future. I didn't come here to tell you how this is going to end. I came to tell you how it's going to begin'* – Neo, *The Matrix*

*'You miss 100% of the shots you never take.'* – Wayne Gretzky



Change is a funny thing.

Sudden and drastic change can challenge the human psyche's perception of self-determination and control. The importance of that perception is no better illustrated than by self-determination being a cardinal principal of modern international law, a *jus cogens* rule, from which no derogation is tolerated.

The world is currently experiencing its biggest change in a generation. Individuals' relationships with their surroundings, with governments, and with each other have changed immeasurably, and likely permanently. As far as democracies are concerned, curfews and lockdowns were previously the stuff of Orwellian myth; he continues to look prophetic.

The global economy, and the businesses operating within it, have been affected in ways that before this year would have been unimaginable. The hospitality, leisure and travel industries in particular, that rely on the free movement of people, have been significantly impacted. But, the human ability to adapt never fails to amaze, and those companies in the worst affected industries that have been able to pivot and change, in light of their new environment, are surviving, and in some cases flourishing. Those that shut up shop and are waiting for a return to normal, in many instances, will not be reopening.

It is this ability to pivot and make changes, often small, in order to make things work in new environments, that will surely be one of the good things to come from an otherwise miserable year, and it is something that can be applied in the relatively niche world of derivative finance also.

The pricing environment for autocallables has deteriorated significantly in recent years as rates have come down, credit spreads narrowed, volatility fallen to all time lows before a brief spike this year, and now even previously sacred dividend forwards have been slashed. It must be noted that this deterioration in pricing is not exclusive to autocallables, one only has to look at the bond market to see how little one can now expect to be paid relative to recent history.

However, investors can look to be similarly nimble and use slight changes to flourish in this new environment:

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### FTSE D30 Index

#### Index Methodology:

- ◆ Universe: FTSE 100
- ◆ Remove stocks with <£10m Average Daily Trading Volume
- ◆ Select 30 stocks with highest 12m dividend yield
- ◆ Weight stocks in proportion to 12m dividend yield
- ◆ Max weighting of each constituent 5%
- ◆ Index rebalanced quarterly

#### Risk & Return:

Index	Return	Annualised Vol
FTSE D30 PR	7.00%	18.60%
FTSE 100 PR	4.40%	16.50%

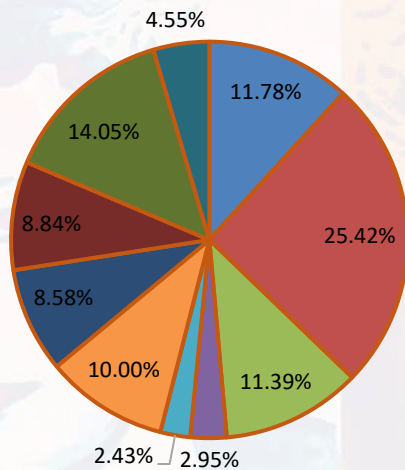
Index	Correlation
FTSE D30 PR	0.91
FTSE 100 PR	

Date range: 15.09.2010 – 04.09.2020

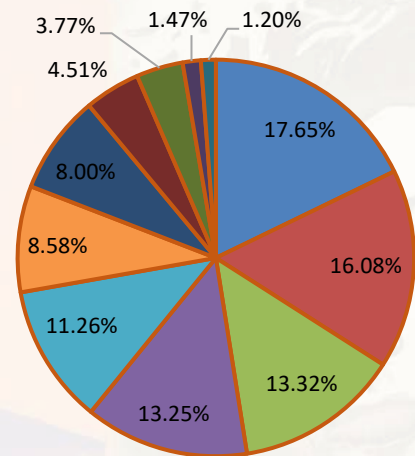
Source: GS Global Markets Division

#### Index Characteristics:

#### FTSE D30 Sector Exposure



#### FTSE 100 Sector Exposure



As one would expect, there is a higher weighting towards financials, utilities and energy, which tend to be higher dividend payers. Similarly, there is lower exposure to consumer staples, healthcare and industrials.

#### Market Cap:

The 30 stocks that currently comprise the index represent 40% of the total market cap of the FTSE 100 Index.

#### Rebalancing:

The FTSE D30 Index is weighted proportionally according to the constituents' dividend yields, with a maximum weighting of 5% to a single constituent. It will rebalance quarterly, both to update the constituents to include the 30 stocks with the highest 12m yield from the FTSE 100, and the index weightings to reflect the constituents' respective dividend yields.

This gives the index an attractive trait, in that a stock will enter the index upon its dividend yield increasing, which is either a function of the company increasing their dividend (positive), or from the stock price falling. Therefore, the index is likely to naturally increase weight towards cheaper stocks over time.

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## FTSE D30 Index

### Indicative Pricing:

Falling volatility and dividends have had a significant impact on the pricing environment for autocallables. The FTSE D30 Index has a significantly higher dividend yield and slightly higher volatility than the FTSE 100, giving a sizeable relative pick-up in coupon:

Shape	Term (Yrs)	Ccy	EKIP	Underlying	Payoff	Coupon
Defensive Autocall	6	GBP	65%	FTSE D30	100/95/90/85/80/75	7.3%
Defensive Autocall	6	GBP	65%	FTSE 100	100/95/90/85/80/75	5.7%
Flat Autocall	6	GBP	65%	FTSE D30	100/100/100/100/100/100	11.4%
Flat Autocall	6	GBP	65%	FTSE 100	100/100/100/100/100/100	8.8%

It's high correlation to the FTSE 100 means that investors are not dramatically changing the risk and return profile of any structure that would ordinarily have the FTSE 100 as its underlying in order to capture this excess return.

Turn and face the strange...

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