# Too good to be true

**Colm Fagan Diary of a Private Investor Update 17 10 September 2019**

***If something looks too good to be true, it usually is. That's the message from this month's diary update. It tells of a weird product, concocted to satisfy savers' hunger for security and return. That's an impossible combination in today's low-interest environment.***

A conversation with my friend Brian Woods almost four weeks ago started it all.

"Colm, I found an investment you might like. It's called Accelerator Bond 4. Google it and see what you make of it."

"OK, Brian, I'll have a look. While I'm looking, tell me more."

"It's a five-year lump sum investment. There are two options; I'll focus on the second. The return after five years is linked to a stock market index. If the index is at or above its starting level, the investment return is at least 40%. If the index is below its starting level, you lose 15% at most, less if the index has fallen by less than 15%."

"So, I'm guaranteed at least 85% of my initial investment after five years, come what may, and I'll get at least 140% if the index is above its current level. Is that what you're saying?"

"Yes, assuming of course that the bank backing the product hasn't gone bust."

"And who are they?"

"BNP Paribas. They're one of the world's top investment banks."

"Sounds great, but why do I get the feeling that you're not convinced?"

"The fact that it looks so good is precisely the problem, Colm. It's seems too good to be true, and you know what they say."

"Indeed. If there is a catch, it must be in the index. The brochure says the bond is linked to an index called the Solactive European Deep Value Select 50 Index. I never heard of it".

"It's exclusively for BNP Paribas."

"Brian, reading the brochure, this Solactive index is very peculiar. The most peculiar aspect is that up to 25 of the 50 stocks selected for inclusion each month are chosen specially because they're due to go ex-dividend within the month. As you know, the price falls when a share goes ex-dividend, because the seller, not the buyer, is entitled to the dividend."

"Colm, are you saying that stocks are chosen specially to depress the index?"

"Yes, that's what I think. I'll have to do some homework to estimate the extent of the drag. Talk to you tomorrow."

***********

"Brian, I've done the sums. I estimate that including in the index an above-average number of shares that are due to go ex-dividend cuts the return by around 2.3% a year. On top of that, the dividend yield on the Solactive index is at least 1.2% more than on the EURO STOXX 50, the main benchmark index for Eurozone stocks. So, if the shares in the two indices deliver identical total returns in future, the Solactive Index will lag the EURO STOXX (price only) index by at least 3.5% a year."

"Are you sure, Colm? That's a drag of almost 20% over five years. Putting it another way, are you saying that, if the EURO STOXX 50 Index increases by 20% over the next five years, the Solactive Index could still show a loss?"

"Yes, that's what I'm saying."

"Hold on now. If you're right, how do you explain the chart in the brochure showing the Solactive Index outperforming the EURO STOXX 50 over the last 14 years?"

"Brian, it's apples and oranges. The two indices are completely different, in terms of industry sectors, geographies, and even currencies. There is no logical reason for comparing them. The EURO STOXX 50 consists entirely of Eurozone stocks; the Solactive Index has a mishmash of currencies, including sterling, Swiss Franc and the three Scandinavian currencies. The UK and Switzerland have the highest weightings in the Solactive index. Neither is represented in the EURO STOXX. A cynic might claim that they compared the two indices simply because the comparison gave the "right" result (from their perspective), but I'm not a cynic."

"Colm, I still find what you're saying hard to believe, but it ties in with work I've been doing, based on the costs and charges on pages 18/19 of the brochure. The margins in the product indicate that there's about a one in six chance of the investor getting a profit of 40% (or more) at the end of five years. That's about the same as the chance of landing a six with one throw of a die. There's a five in six chance that they'll lose money. Those odds are reasonably consistent with your conclusion that the probability of making a profit is equivalent to the probability of the EURO STOXX Index (price only, excluding dividends) increasing by around 20% in the period."

"For a mathematician like yourself, Brian, it's nice to see the two approaches coming to similar conclusions. Not nice for investors, though."

"Indeed. Our conclusion that there's a small chance of investors making money also disagrees with the back-testing results on page 11 of the brochure. The Irish promoters (a company called MMPI Limited, trading as Broker Solutions) say that they back tested 1,304 5-year periods between 2 July 2009 and 1 July 2019 and that every single one of those 1,304 back-tests showed a profit. The worst return was +40% while the best was +81.27%."

"That sounds very impressive, Brian. How did they get 1,304 simulated past returns?"

"Good question! They assumed that someone could have invested in a five-year product each working day between 2 July 2009 and 1 July 2014 and seen it mature. But there were only two independent five-year periods in that time – the first between July 2009 and July 2014 and the second between July 2014 to July 2019 - not 1,304."

"Crazy. I'm surprised they didn't aim even higher. They could have got more than 15,000 successful past simulations by assuming people invested every half-hour rather than just once a day. They undersold themselves!"

"That's funny, Colm, but it's no joke for the people who bought the product. We should do something"

"Like write about it in my investment diary and hope someone in authority will read it?"