Structured Retail Products

Blue Bell PWM focuses on value for money

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Fee-based US investment adviser Blue Bell Private Wealth Management stands out for one simple fact: since it opened its doors on 15 April last year, 30% of its advisory business has focused on structured products.

Scott Miller runs the business with his son, Scott Miller Jr, and Justin Capetola, having set up the firm after thirty years in the business. Having most recently enjoyed a five-year stint with Morgan Stanley, Miller also had a 25-year run at what became Prudential Securities when Elkins Morris Stroud, where he was a general partner and board member, was sold to the Pru in 1982. Miller stayed until April 2000.

Such longevity in the investment advisory business makes an interesting juxtaposition to the relatively new world of structured financial products. “We recognised the advantages early and have modelled over 250 different investments and are familiar with most categories of index-based structured product from Earns to principal-protected notes to Smith Barney’s Tiers,” says Miller. Most of the issues are traded on the Amex, and most are index-linked, though he has also handled issues linked to gold, gold and silver, oil and an oil service index.

Miller first became involved in recommending structured products at the Pru, which at the time was one of the research departments covering structured products, but is not a fan of insurance-based products built on actuarial models, which, he says, are very expensive.

Now he finds himself at the forefront of a rapidly-growing market. “The reason structured products are growing so regularly is that the US investor is so much more conservative than seven or eight years ago,” says Scott Miller Jr. “This is why there has been such a huge influx, and why the most popular products are index-based: people want the diversification.”

Structured products caught on a lot quicker in Europe, notes Miller, where investors are mostly very conservative – they don’t have 80-90% of their wealth in individual stocks. “Since the market crash of 2000, US investors are also changing their attitude towards what has traditionally been seen as a negative feature of structured products – the cap,” he says. “In 2000 people laughed at the idea, but now they want the benefits of partial or total principal protection, and/or leverage, and they have become willing to give something up to get it.”

It is not just a product's inherent investment features that attract Miller, but the features they share with closed-end mutual funds that enable Blue Bell PWM to extract value for its clients.

Blue Bell PWM does not recommend new issues, but engages either in competitive bidding – a very new process in the US – or recommends publicly-listed products trading at a discount to their NAV in the secondary market. "As closed-end funds, ninety nine out of a hundred at some point can be purchased at a discount to their intrinsic value," says Miller.

The firm's process for competitive bidding to achieve good prices involves taking the same product concept to, perhaps, six banks, including Bear Stearns, Lehman, JP Morgan and BNP Paribas. The resulting products are SEC-listed with limited marketability.

Competitive bidding is in its infancy in the US, says Miller, but will become a force for change in the future as it considerably shifts the price pendulum towards the client. Three months ago, for example, the firm looked at a range accrual note paying 200% participation with a cap at 12.5%. The same week, Blue Bell PWM asked companies to bid on a similar product, and achieved a cap of 18% on a product that otherwise had the same terms. "It so happens we didn't do it, because we chose instead a buffered note through JPMorgan with downside protection and accelerated upside," says Miller.

The fifteen-month Buffered Return Enhanced Note pays twice the appreciation of the S&P500 with a 16% cap and 90% soft protection. Downside loss is 1.1111% for each 1% the index falls below the 10% buffer.

The level of expertise that enables such decisions to be made means a client can have a discerning portfolio, says Miller, avoiding bad-value products such as those that are launched to offset a bank's internal positions, for example. "The average client knows little to nothing, and cannot discern good value. But we're trying to get the word out that there are better values out there," says Miller, and with some success, given the 'tremendous interest' he is finding among registered investment advisors, accounting firms and the general public. "The business is growing nicely," he says.

The target audience for structured products in the US is changing. What were once the preserve of individuals with portfolios of $25m and above are open to the general public, 'thanks to Merrill Lynch', says Miller.

"Growth is good, but there's a long way to go," he adds. "They are priced like new-issue closed-end mutual funds, which I have never recommended in 35 years in the business. There are so many fees and expenses built into the IPO that unfortunately for mom and pop the costs are very high. Expenses are outrageous and they will have to come under control to expand among the retail client base."

Miller believes the influx of European investment banks might help make this shift. Competition in the sector is fierce he says, and BNP Paribas and Lehman in particular have been marketing rather aggressively. The firm also deals in issues from Citigroup, Merrill Lynch, Morgan Stanley, UBS and Wachovia.

The other crucial factor, and one you will hear mentioned time and again in the context of the US market, is education. Here, Blue Bell PWM looks as though it might have been aided in its mission by CNBC, which has mentioned structured products on a couple of episodes – after ten years of waiting by the patient Miller. “The world has just gotten slightly larger,” he says.

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