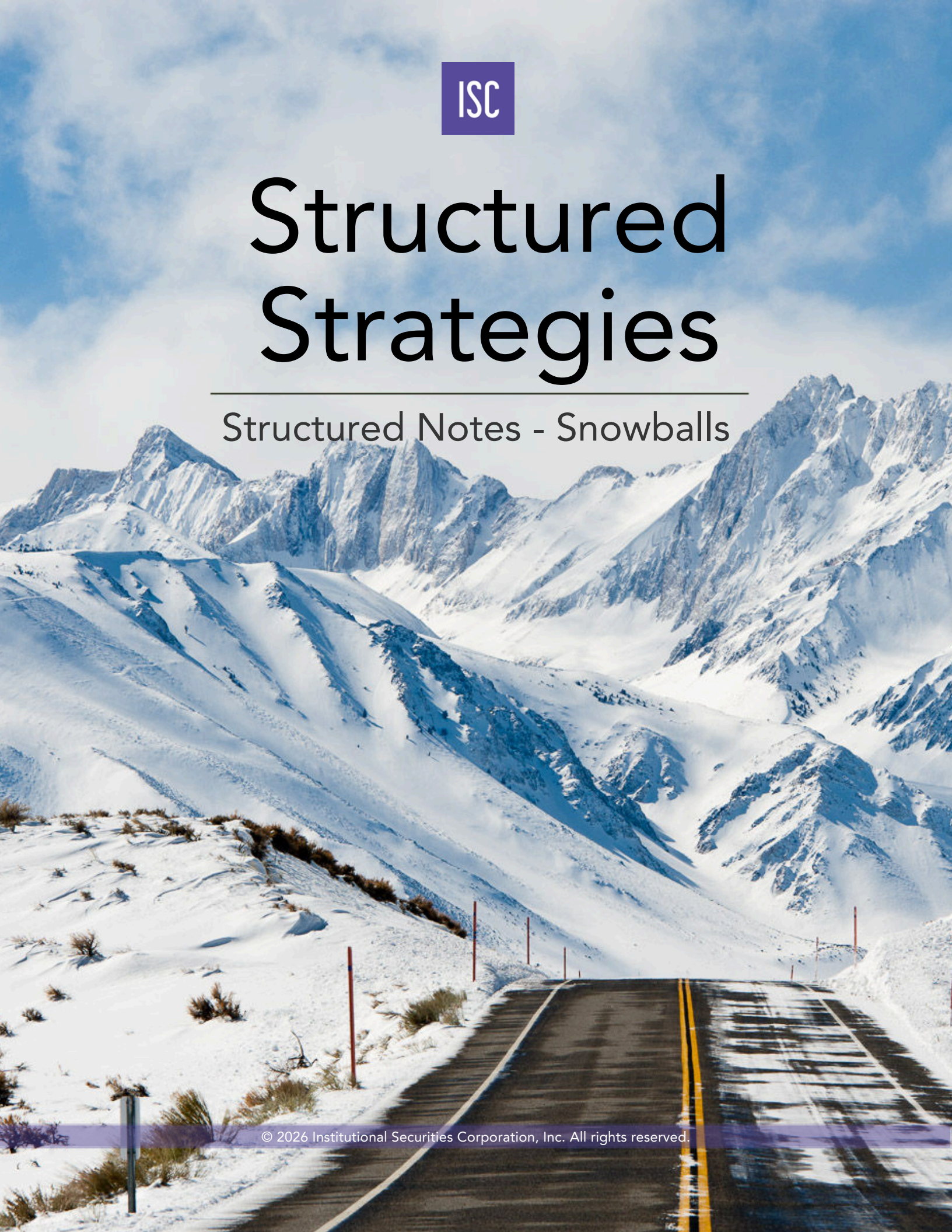

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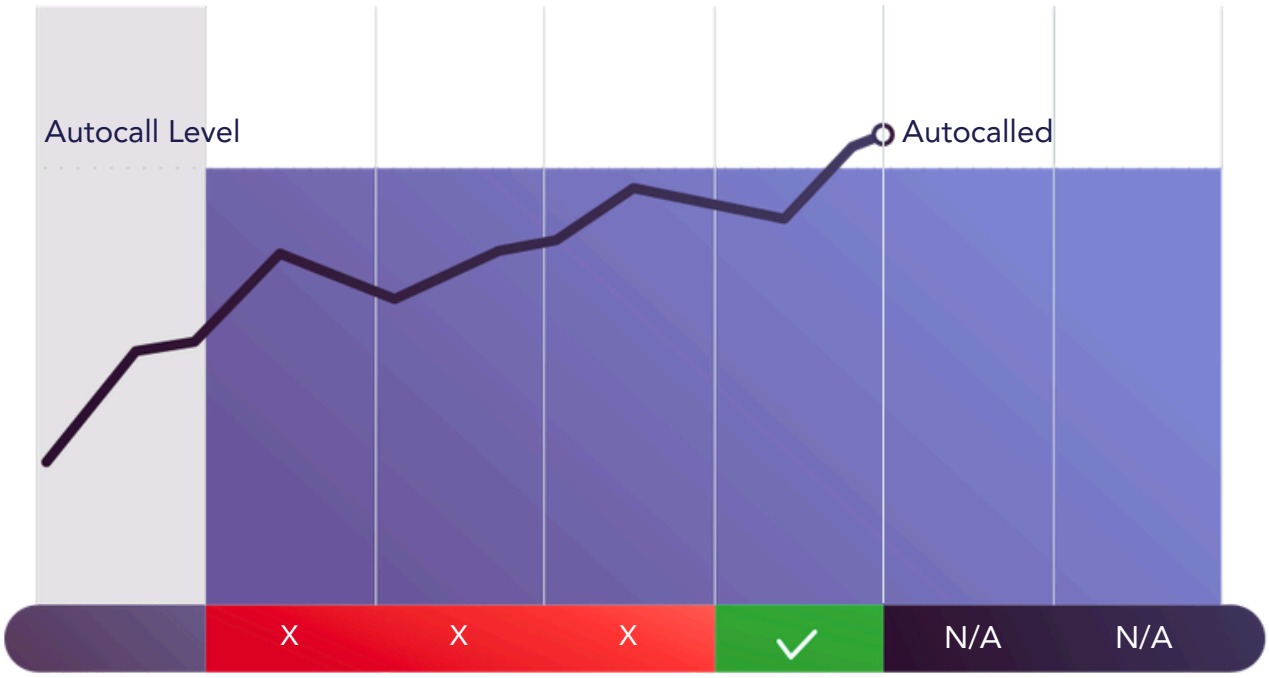
Structured notes, also known as "equity-linked notes", can be useful for a range of investors based on the various structures available in the marketplace. A structured note is a debt obligation, more commonly known as a bond, that has its return linked to the performance of an underlying asset using an option or package of derivatives, instead of a fixed rate of return. The return on a structured note is linked to an underlying asset, known as an "underlier", which could be a single stock, index, commodity, exchange traded fund (ETF), or a basket of stocks or indices.

A callable product is one that can be redeemed earlier at the issuer's discretion, known as "Issuer Callables," or automatically if a certain event occurs, such as the underlier's value being above its initial value, are known as "Autocallables". A product can be callable on a monthly, quarterly, or annual basis and typically an investor receives their initial principal and a premium payment if the product is called early. The initial value of the underlier is key because this value is used to determine if the underlier(s) is above the autocall level therefore triggering redemption and payment of the call premium; if the underlier(s) is below the autocall level then the product continues until the next valuation date.

If a product is not automatically called on any of the valuation dates and the underlier continues to decline, at maturity an investor may suffer a loss of their principal investment depending on the downside protection associated with the note. The call level is typically based on the initial value and can vary from product to product. For example, one could have an autocall level of 90% of the initial value, where as another product's autocall level could be 100% of the initial value. Take a look dat how an autocallable product works on the valuation dates.



A type of structure, called a "Snowball", has grown in popularity in recent years on callable products as it allows premium payouts to continue to grow until the product is called. The snowball feature is important because the premium payout increases each period the product is not called; therefore, like a snowball that gets larger as it rolls downhill, the call premium continues to grow the longer the product is not called.

Take a look at this example.



THE SNOWBALL FEATURE IS BENEFICIAL TO AN INVESTOR AS IT ALLOWS THE PREMIUM PAYOUT TO BUILD DURING THE LIFE OF THE PRODUCT UNTIL THE PRODUCT IS CALLED. IF THE LIFE OF THESE PRODUCTS IS LESS THAN ONE YEAR THAN THE TAX TREATMENT IS SHORT TERM CAPITAL GAINS, WHERE AS IF THE DURATION IS LONGER THAN A YEAR THE GAINS ARE TAXED AS LONG TERM CAPITAL GAINS.

Things to Consider When Investing in a Structured Note:

Credit Risk — Evaluate the risk associated with the issuer defaulting on the structured note.

Taxation Implications — Please consult a tax professional on the treatment of these products, as ISC Group does not provide tax advice.

Liquidity Risk — Structured notes do not have a traditional secondary market and are designed to be held to maturity; therefore, these products should be considered illiquid when purchased. However, if a structured note is repurchased by the issuer prior to maturity, the amount received may be less than the principal amount due to market factors and the time to maturity.

Performance Risk — Structured notes offer potential for greater upside, but there is no guarantee that the investment will outperform the risk-free rate of the return.

Principal Risk — If structured notes are repurchased by the issuer prior to maturity, principal can be lost as these investments are designed to be held to maturity.

Reinvestment Risk — if a product is auto called or redeemed early, there is no guarantee that the investor may be able to reinvest the cash flow into another investment with a comparable return or product with similar level of risk.

Market Risk — Structured notes are linked to the performance of an underlying asset. If the underlying asset does not go up, then the structured note may not create a return and may even generate a loss.

Disclosures

Structured notes are complex investments and may not be appropriate for all investors as they can be highly customized and present unique risks. Structured notes are not for investors who: do not understand the risks of being exposed to various underlying assets, such as equities, commodities, interest rates or foreign exchange rates; do not understand complex pay-out and the risks of losses; do not understand volatility, option premium and interest rates, and how they interact; do not want to take the credit risk of the issuer of the structured note; rely on current yield; do not want to risk losing all of their investment; investors should fully review the applicable offering documents or prospectus to fully understand the risks involved with purchasing a structured note.

Any promise to repay some or all of the money invested in a Principal Protected Note will depend on the creditworthiness of the issuer of the note. Also, some Principal Protected Notes have conditions to the protection or offer only partial protection, so an investor in this product could lose principal even if the issuer does not go bankrupt. Finally, a holder of a Principal Protected Note will receive principal protection only if that note is held until maturity—if a holder needs to sell a Principal Protected Note before maturity, there may not be secondary market for the note and the issuer may refuse to redeem it early. Even if a secondary market exists, the note may be quite illiquid and could be sold for substantially less than the purchase price.

While structured notes with principal protection have the potential to outperform the total fixed interest payments that would be paid on typical bonds, CDs or money market accounts, these notes could also underperform these investments and could earn no return for the entire term of the note, even if held to maturity. The terms and structures of Principal Protected Notes also can be more complex than traditional bonds, CDs or money market accounts making them more difficult for investors to evaluate. Finally, unlike CDs, Principal Protected Notes are not FDIC insured, and as with structured products generally, structured notes with principal protection may have hidden or imputed costs that can be relatively difficult to understand.

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