What could cause my S&L ETP to ‘knock out’ and become worthless?

‘Knock Out’ is a leveraged trading product which has a market move that is large enough to make the product worthless. Once this happens, the product ceases trading and is delisted.

Short Answer

The chances of a Short & Leverage (S&L) ETP being ‘knocked out’ and becoming worthless are remote and would need extreme daily volatility, such as a 33.3% move in a single day (including overnight moves).

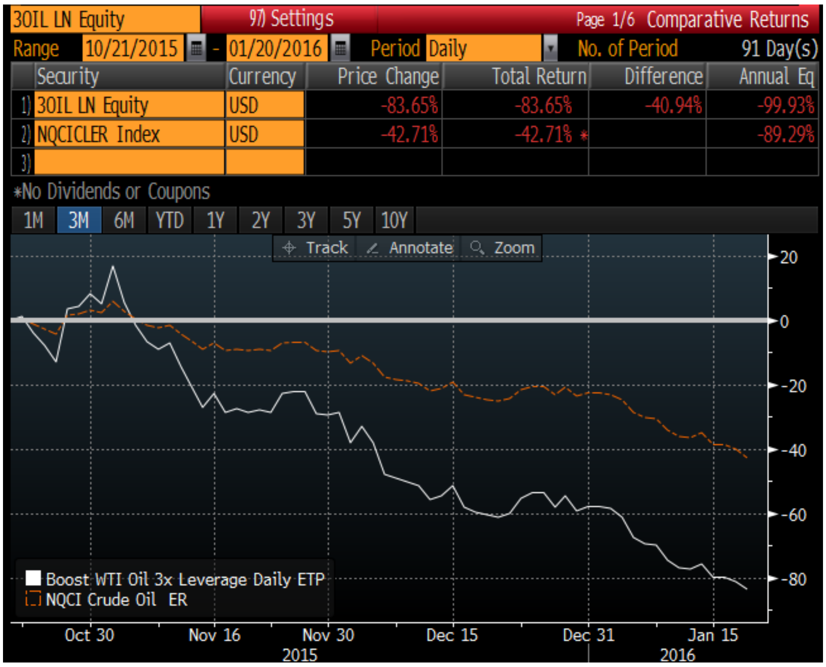
Long Answer

S&L ETPs rebalance daily. Theoretically, a Short & Leverage (S&L) ETP will knock out and become worthless if the underlying asset that is being tracked has price movements that are so extreme in a **single day** that the ETP’s movement exceeds the total value of the ETP. S&L ETPs tend to track assets and benchmarks that are very liquid where a daily move above 33.3% would be extremely rare[1]. To date, the biggest daily movement (price between relevant market open and close) in any asset underlying a Boost ETP was less than a 15%. However past performance may not be an accurate indicator of future performance.

The **daily rebalancing** structure is unique to S&L ETPs vs other leveraged products and protects the S&L ETP from knocking out over periods longer than one day. As S&L ETPs are rebased on a daily basis then the price movement impact would be isolated to that day. For example a 3x leverage factor ETP would need a daily move of 33.3% of the underlying price to knock out. However if the same ETP moved 20% on one day (60% if 3x leverage) and then 20% every day thereafter, this would still not knock out the product. Despite the ETP price moving towards zero very quickly, **it would not get to zero**. For example, if an S&L ETP was worth $10 on the opening of day 1, and the underlying investment fell by 20% (x3 leverage), the S&L ETP would be worth $4 at the end of the day. If the underlying fell another 20% (x3 leverage) on day 2, the S&L ETP would be worth $1.60 and so on.

Crude Oil (WTI) Example

In the three months preceding 20 January 2015, crude oil fell approximately 43% (see chart below). A leveraged position which wasn’t rebalanced daily would have been completely knocked out with a -129% return. Compare this to the Boost WTI Oil 3x Leverage Daily ETP (3OIL) which fell ‘just’ 83% due to the daily rebalancing mechanism.



Source: Bloomberg

Intra Day Crash Protection

It is important to note that volatility is real time and not restricted to the point between the start and the end of the day. Therefore there can be a price move that is greater during the day than the daily move. Boost S&L ETPs also have an intra-day crash protection mechanism which comes into play in extreme intra-day price moves and will rebalance the product if needed. The aim of that mechanism is to mitigate the possibility of a large intraday move 'knocking out' the product. Each Boost S&L ETP has a designated limit, normally a 15-20% move in the unlevered value of the underlying investment which forces the ETP to rebalance intra-day (as well as at the end of the day). This helps to cushion significant falls in the ETP price and to prevent the ETP from 'knocking out'. It will also mean that price rises will also be softened following the rebalance.

A low S&L ETP Price doesn't make it more or less likely to 'knock out'

The ETP price doesn't make a S&L ETP any more or less likely to knock out i.e a low price ETP isn't any more likely to knock out than a higher priced ETP – the probability of such an event remains exactly the same whether the ETP was priced at $0.01 per ETP, or $10,000 per ETP. For instance a 3x leverage ETP priced at $100 that has a market move of 2% will reduce by 6%, i.e. move to $94, while the same ETP priced at $10 also falls by exactly 6%, i.e. move to $9.40. The price of an ETP could fall to fractions of cents (in EUR or USD) or pence (GBP) without being knocked out. Stock Exchanges usually allow trading to several decimal points.

If an ETP price falls to a very low price or rises to a very high price over time the Issuer of the ETP can consider a consolidation or a sub division of the shares of the ETP. This is not necessary for the ETP to continue trading and does not affect the value of an investor's holding, but is potentially an action that could be taken to bring prices in line with what some investors might see as the 'normal level'. There is no reason that a very low price or a very high price would lead to the Issuer of the ETP delisting a product. Other S&L ETP providers have used this technique of sub-divisions and consolidations for their products, but this has not yet happened to any Boost ETPs.

1 For example, over the 26 years from 1/1/1990 to 1/1/2016 Natural Gas front-month futures, which are historically the most volatile assets underlying a Boost ETP, have only had 3 days where they moved greater than 30% in one day.