Portfolio Strategy

Understanding Structured Products

Overview

1. Structured Product Composition
2. Risk Factors
3. Credit & Market Risk
4. Investment Profile Considerations

The term "structured products" covers a wide range of complex investments created to address specific investment needs. Some structured products provide exposure to a specific security or asset class, while others are designed to hedge against existing assets or specific security exposure. Structured products typically have two components, a note and a derivative (i.e. option), and have a fixed maturity.

Structured products typically come in the form of a debt instrument with a maturity date, $1,000 par value or principal amount, and may or may not pay periodic interest. Each structured product is a debt obligation of the underwriter/issuer and will therefore carry both their name and respective debt rating. It's important to understand that maturing value of a structured products investment may differ from that of the actual underlying security or asset based on such investment factors as an averaging calculation, caps, floors, barriers, knock-in and outs, as well as others defined below.

In general, structured products available through LPL Financial are notes issued by an investment bank that offer an investor a potential return based on the performance of an underlying security(s) or index(s) while in some cases, providing a level of protection of principal. This protection is backed solely by the creditworthiness of the issuer unless purchased in the form of a Structured Product Certificate of Deposit (CD). In this case, protection includes standard Federal Deposit Insurance Corporation (FDIC) insurance but does not include protection against depreciation based on the underlying assets' negative performance or market value in the event of liquidation prior to maturity.

Structured product notes and structured product CDs may be derived from a single security, a basket of securities, one or more indices, commodities, debt securities, foreign currencies, or some combination there of. The issuing investment bank in certain cases combines a company issued and backed zero coupon bond along with options and/or futures to create the structured product. Structured products are not like owning a company's stock and carry different risks and rewards. Structured products also perform differently than traditional debt obligations.

Structured Product Composition

Before You Invest

Investors should carefully review the risks in the offering circular (i.e. prospectus) documents. Structured products are intended to be held to maturity and may not be liquid instruments prior to that. This investment's

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value prior to maturity will be influenced by many factors, including interest rates, the market values of the underlying asset(s), implied volatility and time remaining to maturity. Investors should contact their own accounting, legal or tax advisors for information about tax implications prior to investing.

Growing Number of Choices

Structured product types are available with a variety of features. Each of these products is designed to address a particular investment need, and each carries specific risks and complexity. Other material such as an offering circular will be provided at the time of investment which includes details of the specific investment you are purchasing.

Common Structured Product Types

There is no limit to the range of structured product types created, a few of these include:

- Principal Protected Notes (subject to creditworthiness of the issuer)– One type of structured investment is called a Principal Protected Note (PPN), used to gain exposure to an area of the market or security (equity or fixed income, commodity, currency, index, or a basket of indexes or asset classes) while providing principal protection when held to maturity. Principal protection may vary from partial, or less than 100% of the principal amount, up to 100%. It's important to understand, that this protection is backed solely by the creditworthiness of the issuer and not by any governmental agency. In addition, the underlying assets' rating quality has no bearing on the rating of the structured product itself.

  At the maturity of the PPN, if the options have no value, the zero coupon bond is worth the original amount invested. If the options turn out to be valuable, you can gain exposure to the upside of the security according to the terms of the PPN. That upside may be capped, which means your participation in this upside is limited to a particular level.

  When a structured product is sold prior to maturity, the amount returned may be less than originally invested. Principal Protected Notes are not bank deposits and depending on the investments included in the product, may not be insured by the FDIC or any other governmental agency, or be obligations of, or guaranteed by, a bank. These notes are not suitable for all investors. As a holder of a structured product note or CD you do not have ownership rights to the underlying investments, and do not have voting rights nor earn dividends.

- Return Enhanced Note– An investment vehicle that offers enhanced returns on a broad-based equity index or qualified basket of stocks. These notes may be suitable if you believe that returns on the underlying investment are likely to be flat or slightly up over the term of the note, typically one to three years. Such a note offers double or triple equity returns up to a cap limit in exchange for accepting full downside principal exposure. The return on the note is linked to the performance of the underlying investment, whether the return is positive or negative. Such notes do not guarantee any return of principal, and the investment, including principal, is fully exposed to any decline in the underlying security.

It's important to understand, that this protection is backed solely by the creditworthiness of the issuer and not by any governmental agency. In addition, the underlying assets' rating quality has no bearing on the rating of the structured product itself.

Reverse Convertibles based on a single security or stock may involve a high degree of risk.

- **Buffered Return Enhanced Notes**–These are similar to a Return Enhanced Note, but offer some limited downside protection using a buffer. A 10% buffer means that the underlying index would have to drop 10% before the investor starts to participate in the downside. For example, if a note has a 10% buffer on the S&P 500, the investor would lose 2% (represent the percentage above the 10% buffer) if the S&P 500 had dropped 12% at the maturity of the sale. The investment is fully exposed to any decline in the underlying investment principal below the buffer zone. Buffers are designed with different percentage rates. Investments in buffered return enhanced notes linked to indices may result in a loss of up to 90% of principal. Your maximum gain on the note is limited to the stated maximum return.
- **Reverse Convertibles**–These are securities that are linked to the performance of an individual equity, Exchange-Traded Fund (ETF) or index that pays a high rate of interest or coupon, but may return less than the full principal at maturity. These notes may be suitable if you believe that the underlying security will trade above the stated knock-in levels. If the knock-in level is breached, your principal may be reduced by the percentage decline in the underlying stock, ETF, or index. Please carefully read the offering circular for specifics on knock-in levels, receipt of securities in lieu of cash, and coupon payments. Reverse Convertibles based on a single security or stock may involve a high degree of risk.
- **Index Linked Brokered CDs (ILCDs)**– Index Linked Brokered CDs are structured products that include FDIC insurance. This FDIC coverage follows the same terms for CDs purchased directly through a bank, though certain restrictions apply. Investors must consider all deposits (bank and brokered CDs along with ILCDs) within any one financial institution when determining and ensuring FDIC coverage.

Risk Factors

An investment in Structured Notes involves significant risks. Investing in these notes is not equivalent to investing directly in the underlying indices, securities or asset(s). No assurance can be given that the investment strategy used to construct structured products will be successful or that the Structured Notes will outperform any alternative basket that might be constructed from the constituent sub-indices or securities.

Certain built-in costs are likely to adversely affect the value of the notes prior to maturity. The returns in the components of the underlying indices in the basket may offset each other. Prior to maturity, costs such as concessions and hedging, may affect the value of the notes.

Structured products are intended to be held to maturity and may not be liquid instruments prior to that. Many structured notes will make periodic interest payments (or pay only at maturity). Voting rights, rights to receive cash dividends or other distributions are not realized by the structured products investor. The investment value prior to maturity will fluctuate and be influenced by many economic and market factors that may either offset or magnify each other. These factors can include interest rates, the index or price level of the underlying, implied volatility, the time remaining to maturity, the dividend rate on the common stocks underlying the basket or indices, and a variety of economic, financial, political, regulatory, or judicial events.

Tax Implications Vary by Product

The income tax treatment depends on the specific terms of each product, and may be different from other investments held in your portfolio. You may be subject to the Ordinary Income Deduction (OID), also known as "phantom income", on interest realized but not paid until maturity, similar to the yearly taxes on accrued interest in a zero coupon bond which is reportable yearly but not generally paid out until maturity.

Structured Product CD programs and fully principally protected notes (backed solely by the creditworthiness of the issuer) are not tax efficient, so please refer to the tax section of the offering document before you make a purchase in a taxable (non-qualified retirement) account.

For a complete understanding of how a specific structured product may effect your tax situation, please review the prospectus (or offering document) and consult your tax professional.

Limited Liquidity

Due to the bond structure, structured products generally are traded over-the-counter (OTC) by fixed income dealers. A limited number of structured products are listed on the NYSE. The secondary market for a particular structured product varies and therefore, it should not be considered a liquid investment.

Tracking/Performance Differential

The difference between the return of the underlying securities or indices and the return on the structured product itself, when held to maturity, will differ. This tracking error arises due to the final security's return calculation formula, which includes averaging, barriers, caps, maximum cumulative percentage returns, knockouts, and the like. This tracking error may also be reflected in the structured product's fluctuating market value. Please refer to the averaging calculation definition for more detail.

Risk Considerations

- Credit Risk – The ability of the issuer to make both principal and interest payments (if applicable) through the term of the investment. An issuer's credit rating can vary during the term by improving and declining. These changes will impact the value of the investment with general price improvement upon rating upgrade(s) and price decline upon rating downgrade(s). Many other market factors will impact the market value as well.
- Market Risk – The potential for an investor to lose value in an investment based on various market factors such as, but not limited to; economic, industry, and issuer events, interest rate changes, illiquidity, and volatility.
- Value Dates – The initial/pricing date is the date on which the security is priced, as well as the final values for the specific percentage factors such as minimum and maximum returns, coupon and participation rates,

caps and floors are set. This pricing date is also the first trade date. Alternatively, the valuation date is the date on which the closing index level is determined and used to calculate the final potential return (using a predetermined formula). This date is typically several business days prior to maturity date.

- **Minimum Guaranteed Return (Cumulative)** – This is the cumulative return and/or rate earned over the term of the investment (does not depict an annualized return/rate).
- **Call Features** – The ability of the issuer to redeem the security prior to its maturity date.
- **Fees and Costs** – The charges applied to an investment which will impact your return. These charges may include, but are not limited to, sales charges and underwriting fees. Specific costs and fees by product may be obtained from your financial advisor.
- **Original Issue Discount (OID or Phantom Income)** – Reportable (within non-qualified or retirement accounts) income that is not paid out until maturity. U.S. holders are required to accrue interest income at the comparable yield in accordance with OID rules. OID rates are determined on the pricing date. This income is not paid out if the security is liquidated prior to maturity. Investors receive a 1099 tax reporting statement each year and are subject to capital gains and/or ordinary income taxes.
- **Averaging Calculation** – Return calculated as a mathematical average of the closing level of an index on each observation date. The potential return, only if held to maturity, is the sum of the closing levels minus the initial/pricing date closing level divided by the number of observation dates.
- **Cap** – The maximum payout percentage rate
  - **Floor** – The minimum payout percentage rate. In certain issues this may be a zero or negative percentage.
  - **Barriers (Knock In & Knock Out)** – An option that comes into existence (knock In) or ceases to exist (knock Out) if the underlying security(s) trades at a predetermined level on either a fixed date or during the term.
  - **Minimum/Maximum Rates** – The stated minimum or maximum rate of a security's performance, coupon rate, and/or return.
- Investment Profile Considerations

This feature is generally not available to irrevocable trust registrations. Certain restrictions and limitations may apply; therefore, refer to each securities' offering circular for details.

Talk to your advisor for more information, and to see if Structured Products might make sense for your investment portfolio.

IMPORTANT DISCLOSURES

Investing in structured products may not be suitable for all investors and involves special risks such as risk associated with leveraging the investment, potential adverse market forces, regulatory changes, and potential illiquidity. There is no assurance that the investment objective will be attainted.

The opinions voiced in this material are for general information only, and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) might be appropriate for you, consult your financial advisor prior to investing.

Investors should consider the investment objectives, risks, and charges and expenses of the investment company carefully before investing. The prospectus and offering document contains this and other information about the investment company. You can obtain a prospectus from you financial representative. **Read the prospectus carefully before investing.**

Structured notes may not be suitable for all investors and involve special risks such as risk associated with leveraging the investment, potential adverse market forces, regulatory changes, and potentially illiquidity. There is no assurance that the investment objective will be attained.

Neither LPL Financial nor any of its affiliates make a market in the investment being discussed nor does LPL Financial or its affiliates or its officers have a financial interest in any securities of the issuer whose investment is being recommended neither LPL Financial nor its affiliates have managed or co-managed a public offering of any securities of the issuer in the past 12 months.