FINANCIAL INSTRUMENTS AND ASSOCIATED RISKS

cpr asset management

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The aim of this document is to present an overview of the main financial instruments used by CPR AM when providing investment services and the risks associated with these instruments. This document is not intended to be an exhaustive list of all the risks to which you may be exposed when using CPR AM's investment services or when investing in one of its products.
Furthermore, this document is not intended to replace any regulatory documents which you may receive when investing in a specific type of financial transaction or instrument.

Our objective is therefore to provide investors with a reasonable amount of information in order to enable them to make informed investment decisions, by presenting the main categories of risks associated with each type of financial instrument or investment strategy.

Therefore, to ensure that its clients are well informed, CPR AM recommends that, before making any investment decision and/or using an investment service, they should familiarize themselves with the range of risks set out in this document.

This document begins with an overview of the general risks to which an in investor in any type of financial instrument may be exposed. We then map the main financial instruments by broad categories and their specific risks.

I- GENERAL RISKS

- **Capital-loss risk**

Capital-loss risk is the general risk that, for any investment, an investor may lose all or part of the capital invested. It is therefore the risk that an investor may not recover the full amount of the initial capital invested.

- **Currency risk**

Currency risk occurs when a financial instrument is priced in a currency other than that of the investor. This means, therefore, that a decrease or increase in the exchange rate, as the case may be, may cause the value of a financial instrument denominated in a foreign currency to move upwards or downwards.

- **Leverage risk**

This is the risk incurred when the exposure to a market or instrument exceeds the capital invested. The use of derivative instruments may increase market exposure beyond the amount of the initial capital investment. As a result, depending on the position taken, the effect of a fall (in the event of a long position) or a rise (in the event of a short position) in the value of the underlying asset may be amplified and thus increase the fall in value of the capital invested.

- **Liquidity risk**

Liquidity risk is the risk of not being able to buy or sell a sufficient volume of a financial instrument, sufficiently quickly and within a satisfactory price range. Therefore, the value of illiquid financial instruments may fall significantly between the time a sell order is placed and the execution date.

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- **Counterparty risk**

Counterparty risk is the risk of a counterparty defaulting on its payment obligation.

- **Foreign security risk**

Some financial instruments may be traded on foreign markets. All foreign investment will therefore be subject to the risks of the foreign market involved. For example, a financial instrument may be subject to a foreign jurisdiction that does not provide for permanent supervision by a supervisory authority to protect investors.

- **Emerging market risk**

Investments made in emerging countries or in issuers of securities that are registered in or do business in an emerging country are often speculative. Such investments are therefore riskier than those made in traditional markets. Accordingly, financial instruments traded in these countries may be less liquid than largecap equities traded in developed countries.Holding such securities may therefore increase the level of risk, since market prices may fall more sharply and more rapidly than in developed countries.

- **Settlement-delivery risk**

This is the risk that transactions in financial instruments may not be settled on the scheduled delivery date. In some markets, for example, settlement rules may mean that the market cannot process and absorb large volumes. Investors may therefore not be able to take full advantage of a market opportunity or, on the contrary, may be exposed to a greater loss if the price of a security falls between the scheduled and the actual delivery dates.

- **Arbitrage risk**

Arbitrage is a technique which consists in taking advantage of price differences noted (or anticipated) between markets and/or sectors and/or securities and/or currencies and/or instruments. An unsuccessful arbitrage trade (i.e. a short position rises and/or a long position falls) may generate a loss.

II- RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

Any type of financial instrument may be exposed to the abovementioned general risks. However, certain types of instruments are also subject to specific types of risk.

1- Money-market instruments and bonds

Money-market instruments are debt securities that generally have a maturity of less than one year. A bond is a security that represents a borrower’s commitment to a lender that, in consideration for the said commitment, makes funds available to the borrower. Therefore, bond investors lend a sum of money to the bond issuer and the latter must repay the amount in question on a specified maturity date. The borrower must also pay interest (coupons).

- **Credit risk**

This is the risk of a deterioration in the credit quality of a corporate issuer. Any such deterioration will increase the investor’s risk since there is a greater probability that the debt issuer will default on its obligation. Therefore, when the probability of default increases investors require a risk premium over the rate paid on government bonds (the“spread”).

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- **Interest-rate risk**

This is the risk that interest rates may go up and down. A debt instrument's exposure to interest-rate risk is measured in terms of "duration", which expresses the change in the instrument's yield-to-maturity for a given interest rate change. Thus, the higher an instrument's duration, the more its yield will be affected by a change in interest rates.

- **High-yield securities risk**

Fixed-income and money-market instruments and their issuers are rated by credit rating agencies. Depending on the rating of the instrument or the issuer, the risk associated with investments in these securities may vary.Therefore, investments in securities with a low or no credit rating or in securities issued by issuers with a low rating ("high-yield" securities), must be seen as speculative and therefore particularly risky.

2- Shares

Shares are securities that represent a fraction of the issuer's equity capital.
Each shareholder is entitled to a share of the company's profits in the form of annual dividend, the amount of which is proportional to the shareholder's participating interest in the company's capital.

- **Volatility risk**

Volatility risk is the risk associated with the instability of share prices. The more the price varies, the higher the volatility and the greater the investor's risk.

- **Small-cap and mid-cap risks**

The volume of listed small-and mid-cap shares is small. Therefore, prices on these markets may fall more sharply and quicker than in the case of large-caps.

3- UCI (UCITS and investment funds)

An undertaking for collective investment (UCI) is an investment vehicle that receives funds from investors that it generally invests in financial assets. Some UCI are said to be "coordinated"; i.e. they are considered as undertakings for collective investment in transferable securities (UCITS) within the meaning of European Directive 85/611, as amended.

- **Discretionary management risk**

The discretionary management of the management company of the UCITS or investment fund depends on expectations of the performance of various markets and/or on its selection of securities. There is therefore a risk that the UCITS may not always be invested in the best-performing markets or securities. The fund may therefore not meet its investment objective; in addition, the fund's net asset value may decline.

4- Derivative instruments

Derivatives are contracts that are used to buy or sell, at a fixed date and an agreed price, a specified quantity of a financial instrument, or to swap cash flows at a fixed date. These may be firm contracts or options and may be traded on a regulated market or over-thecounter. They are called derivatives because their value is derived from that of an underlying asset and varies in line with the said underlying asset's price. Such financial instruments may be used to gain specific exposure or, on the contrary, to hedge a risk of exposure. In the latter case there may be a risk that the hedge is imperfect. In addition, a counterparty risk exists in the case of overthe- counter derivatives.

- **Futures risks**

A futures contract involves an obligation to deliver an underlying asset on a specific date on predetermined terms. Quantities, delivery and payment dates are standardized in futures contracts.
The underlying asset is delivered at the price agreed when the contract is concluded. Consequently, investors are exposed to a significant risk of loss since they may be required to deliver an underlying asset whose price is higher than the value determined in the initial contract if they are the seller, or receive an asset whose value is lower than that determined in the initial contract if they are the buyer. As the price of the underlying asset may vary considerably (downwards and upwards) from the price determined when concluding the contract, the amount of any loss may be considerable.

- **Options risks**

The buyer of an option acquires the right to purchase (call option) or to sell (put option) a given quantity of an underlying asset at a predetermined price or to receive the difference between the option exercise price and the underlying price, either on a specified date (in the case of a European option) or any time up to the option's expiry date (in the case of an American option).
When a security has an option component, its value depends on a certain number of parameters, such as in particular volatility and the risk-free interest rate.
The buyer of a call or put option assumes a risk that is strictly limited to the amount of the premium, which is the price paid for the option. On the other hand, the seller of the option runs the risk that the buyer may exercise the option if the exercise price is less (call option) or greater (put option). If the=option is exercised by the buyer, the option seller is exposed to a significant capital-loss risk that cannot be quantified in advance, since it will correspond to the difference between the exercise price and the price of the underlying asset when the option is exercised.

- **Swap risks**

A swap is an over-the-counter contract between two parties that agree to swap streams of cash flows for a specified period.These flows may be linked to a variety of assets, including interest rate (interest-rate swap), currencies (currency swap) or to the performance of various benchmarks: market indices, inflation, volatility (performance swap). A credit default swap (CDS) is a special kind of swap designed to transfer the credit risk in respect of an underlying debt from the protection buyer to the protection seller.
The parties to a swap are exposed to counterparty risk and, depending on the type of swap, to credit, currency, volatility, interest rate risks, etc.

- **Risks associated with asset backed securities (ABS) and mortgage backed securities (MBS)**

The risk inherent in an investment in an ABSor an MBS is a credit risk (as defined in the above paragraph on money-market instruments and bonds). This risk depends mainly on the quality of the underlying asset which may be a bank loan, mortgage or another type of debt. These instruments are based on complex arrangements that may involve legal risks and specific risks related to the characteristics of the underlying assets.

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