

## 04 Keeping track of your investment



- ▶ Double check that you can transact in real time and have access to information on buy and sell positions and their volumes.
- ▶ A number of factors intervene in warrant pricing aside from the performance of the underlying instrument: volatility, interest rates, the course of time, dividend yield and, in some cases, exchange rates. And investors must learn to analyse the effects of all these factors together.
- ▶ An increase in volatility (the price variability of the underlying asset) will push up the price of traditional warrants. The reason is that if a security's price fluctuates sharply it is harder to predict what it will be worth on the expiry date. Hence there is more possibility that price movements will favour the buyer, and the seller will try to offset this by demanding a higher premium. If volatility dies down, the opposite will be the case.
- ▶ So even though you are right about the direction of the underlier's price, the value of your warrant can still be eroded by an adverse movement in some other factor, especially volatility.
- ▶ "Factors intervening in the price formation of regular warrants"

The higher the ...	Call warrant	Put warrant
Underlying asset price	▲	▼
Volatility	▲	▲
Interest rates	▲	▼
Dividends	▼	▲
Time to expiry	▲	▲

The particular characteristics of turbo warrants mean the way these factors act on price may vary in both size and direction (positively or negatively) as the underlier's price moves nearer to or further from the barrier.

## 05 Before you invest in warrants...



- ▶ Remember investing in these products calls for knowledge, a high risk tolerance and constant monitoring of your position (especially with turbo warrants).
- ▶ It is important to be familiar with their characteristics and the way they work before deciding on an investment. These are high-risk products if not carefully managed and movements in price can quickly turn a profit into a loss.
- ▶ If a regular warrant and turbo warrant are issued with the same characteristics (underlier, exercise price, term, etc.), the price of the turbo should be lower. This is because the barrier feature means an added risk for the investor.
- ▶ The market offers a wide choice of warrants with diverse profiles and underlying assets, so it is wise to compare terms before you invest. Information is available from issuers' websites, Sociedad de Bolsas (manager of the electronic trading system), the stock exchanges where they are traded and the CNMV.

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# WARRANTS AND TURBO WARRANTS



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## 01 What are warrants?



- Warrants and turbo warrants are **derivative products**, in that their price depends on the performance of another asset (*the underlier*).
- Warrants are tradeable securities whose holders pay a sum (the premium) giving them the right but not the obligation to buy (call warrant) or sell (put warrant) a given quantity of the underlying asset (the warrant ratio) at a specified price (the exercise price) during a preset time or on a preset date.
- Turbo or knock-out warrants are contingent in nature: **if the price of the underlying instrument touches a predefined point (*the barrier*) during the turbo's life, the warrant is terminated** ahead of time. The holder, in these circumstances, cannot exercise his or her right and will lose the premium paid.
  - They are issued at an exercise price lower (call turbo warrants) or higher (put turbo warrants) than the current market price of the underlier. In both call and put turbos, the barrier is usually set at the same level as the exercise price.
  - The early termination of a turbo warrant bars the investor from earning on favourable movements in underlier prices between then and the expiry date.

## 02 What are their main points in common...?



- Warrants and turbo warrants share certain basic features:
  - They are **leveraged products**: laying out just a small amount (the premium) can net the holder the same results as if he or she had bought or sold securities with a far higher market price. This also means a greater risk, since even small changes in the price of the underlying asset can end up magnified in warrant prices (in both up and down directions).
- Call warrants and, more so, call turbo warrants are a bet on a rising market, when the price of the underlying asset is expected to climb. Put warrants, conversely, are when the buyer's view is "bearish", i.e. he or she believes the value of the underlying asset will fall.
- Warrants are traded in a dedicated Stock Exchange segment through authorised financial intermediaries. They are bought and sold in a similar way to shares, with the difference that a specialist is on hand to provide them with liquidity under the terms set out in the prospectus.
- In general, warrant trades on Spanish markets are **settled by netting, i.e. in cash**, as described in the prospectus.

## 03 ...and their differences?

	WARRANTS	TURBO WARRANTS
Existence of barrier feature	NO. The right to buy or sell is conserved to expiry.	YES. When the underlying asset triggers the barrier, the turbo warrant expires, losing all its value.
Leverage	Extremely high	Generally less high than with regular warrants.
Exposure to underlying asset prices	One of the factors intervening in warrant valuation.	Very high, close to 100%.

- As leveraged products, warrants offer the **chance of a large percentage return on your investment**. In other words, you can earn a substantial profit for relatively little outlay.
- There is also the chance that you could lose some or all of the money invested (in the case of warrants, if they are valueless on the expiry date; in the case of turbos, if the barrier is triggered).

What kind of returns can I expect?

