Will duETS markets become one-sided?

Unlike other securities (e.g. ETFs) tied to indexes, Down/Up Equity Trust Securities (duETS) were specifically designed to allow for market forces to drive their prices on a daily basis. This prevents the markets for duETS from becoming one-sided. If the market prices were tied to the stale index values of the underlying real estate indexes, the markets would become one-sided and investors would be unable to trade.

Down and Up Prices Set by Market Supply and Demand

Unlike other index related securities (e.g. ETFs), the trading prices of Downs and Ups will be set by market supply and demand of the two securities. If there are more bids to buy one security over another (Downs vs Ups), the price of that security will increase until supply and demand equilibrate similar to any other equity. Likewise, the opposite security will decrease in price to reflect lack of demand until such time as the markets dictate what a fair value is for both.

duETS are not ETFs

Unlike ETFs, duETS are designed to be linked to a real estate index. Since real estate is a broad illiquid asset class, duETS cannot have a '40 Act ETF-style creation basket. What would you hold as the underlying securities replicating the index? Due to the nature of the asset class, duETS are designed with a cash create and the securities are issued in pairs of Downs and Ups.

This difference in the underlying asset class and security design means there is a difference in the securities arbitrage mechanism. An ETF price is tied to the fluctuating price of the underlying index. Down and Up market prices are set by supply and demand in the market place except on Valuation Date at the end of the Measurement Period. On that date, the prices are determined by a formula based on the change in the index over the Measurement Period.

Real Estate: Stale and Short Term Predictable Indexes

Since real estate is an illiquid asset class, private real estate indexes will typically have monthly or quarterly published index values. This means the last published index value includes prices at least three months old in its calculation.

Based on the last published index value and the tide of economic events happening during a quarter, economists and other forecasters have become good at anticipating the following quarter's index value. Those economists have a good idea of how the Downs and Ups will be valued on Valuation Date. This will change how they value the securities before Valuation Date.

Tying Price to Last Published Index – One-Sided Market

If the consensus of economists was for a very strong positive market between the current time and the Valuation Date of the Downs and Ups, then investors would want to buy an Up security tied to the last published index value, but there would be no sellers.

If the consensus of economists was for a significant market decline between the current time and the Valuation Date of the Downs and Ups, then investors would want to buy a Down security tied to the last published index value, but there would be no sellers.

If Down and Up prices were tied to the last published index value, there would be one-sided markets based on investors' forecasts of where the index would be on Valuation Date.

Recognition of this issue is why Down and Up security prices are tied to market supply and demand, not to the last published index value.

Down and Up prices will move in response to market demand. This price movement will always be in the direction of market clearing. For this reason, GIG believes the markets will not become one-sided for either security that makes up duETS.

By Kelly Haughton, Global Index Group, CEO

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