6. Warrants

Definition
Warrants are securities without interest and dividends attached, granting the owner the right to buy (call warrants) or sell (put warrants) a certain underlying asset (e.g. shares) at a previously fixed price (exercise price).

Return
The buyer of a call warrant has secured the purchase price of the underlying asset. A return can be obtained if the market price of the underlying asset exceeds the stipulated exercise price to the paid by the investor. The warrant holder may then buy the underlying instrument at the strike price and sell it immediately at the ruling market price.

An increase in the price of the underlying asset will usually lead to a proportionately higher percentage increase in the warrant price (leverage effect). Consequently, most warrant holders achieve a return through selling warrants.

The same applies, in the opposite direction, to put warrants. They usually rise in value if the price of the underlying asset decreases.

The return on warrant transactions cannot be established in advance.
The maximum loss is limited to the amount of capital invested.

Price risk
The risk inherent in warrant transactions is the possibility that, between purchase and expiration of the warrant, the underlying asset develops differently than expected at the time of purchase. In the worst case, the entire capital invested may be lost.

The price of a warrant depends also on the following factors:
- Volatility of the underlying asset (a measure of the fluctuation margin anticipated at the time of purchase and, simultaneously, the most important input for determining the fairness of the warrant price). High volatility generally implies a higher price for the warrant.
- Remaining time to maturity (the longer the maturity of a warrant, the higher the price).

A decrease of volatility or diminishing time to maturity may cause the price of a warrant to remain unchanged or fall - even though the expectations in respect of the price trend of the underlying asset are met.

We generally advise against the purchase of warrants which are close to expiry. Buying warrants with high volatility makes your investment more expensive and is therefore highly speculative.

Liquidity risk
Warrants are usually issued only in small quantities, which increases the liquidity risk for investors. Because of this, individual warrants may be subject to particularly heavy price fluctuations.

Warrant trading
Warrants are traded on stock exchanges as well as over the counter (OTC). In many cases, the gap between the purchase price and selling price is larger for warrants traded OTC. This difference is for your account.

With respect to stock exchange trading, it is important to remember that the market has very low liquidity.

Warrant terms
Warrants do not have standardised terms. It is therefore imperative to obtain full information on the exact terms and conditions of a warrant, in particular:

Style of exercise:	Is the warrant exercisable at any time during its life (American option) or only at expiry (European option)?
Subscription ratio:	How many warrants are needed to obtain the underlying asset?
Exercise:	Delivery of the underlying asset or cash settlement
Expiry:	When does the option right expire? Please note that your bank will not exercise a warrant unless specifically instructed to do so!
Last trading day:	This date is often a bit earlier than the expiry date, so that it cannot be taken for granted that the option can be sold at any time up to the expiry date.