



# Want to efficiently generate incremental returns over the long term?

## CHALLENGES

- > Pension plans are on the hook to meet difficult return targets
- > Options strategies can help, but can be difficult to implement

## RESULTS

- > Designed to generate incremental, uncorrelated returns with a modest increase in risk
- > Efficient and transparent use of capital

## Investor Challenge

Pension plans are continually striving to meet challenging return targets. Properly implemented options strategies can offer transparency, liquidity and lower average costs—but they can be difficult to execute for many investors.

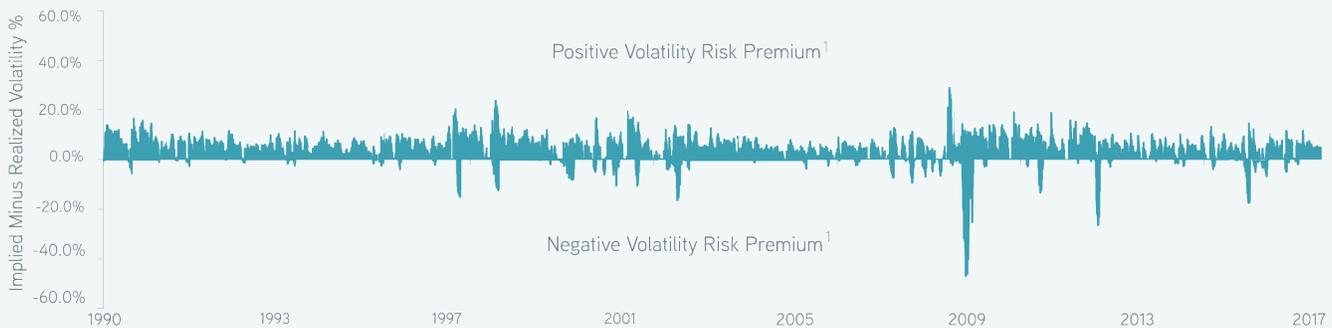
## The Research

We've found that an embedded risk premium—the volatility risk premium (VRP)—creates opportunity to enhance return through option selling. Our investment thesis has three primary pillars . . .

- Options may be thought of as financial insurance contracts, and insurance is not free
- Option prices contain a VRP paid by option buyers to option sellers
- This VRP is meaningful and likely to persist . . . and is supported by empirical data:

Equity Index options have historically traded with an embedded volatility risk premium and we expect this to continue.

Since 1990, S&P 500® Index options have traded with a positive volatility risk premium over 85% of the time.



This embedded risk premium creates an opportunity to enhance returns through option selling.

Source: Parametric, 12/31/2017.

<sup>1</sup>1990 to the present represents the longest period from which reliable data is available for the S&P 500® Index implied volatility. S&P 500 Index options relative valuation was measured by taking daily observations of implied volatility (as measured by the VIX Index) and subtracting the subsequent realized volatility of the S&P 500 Index over the following 30 days. Options have historically traded about 4.3 volatility points above subsequent realized volatility. Said another way, the option market tends to overestimate future volatility, which translates directly into higher prices for both puts and calls. VIX is the Chicago Board Options Exchange Volatility Index. VIX is calculated constantly throughout each trading day by observing the implied volatility derived from actual market prices of a wide array of put and call options with an average maturity of 30 days to expiration. For informational purposes only.



## Parametric's Solution

Parametric's Defensive Equity solution can be implemented as an options-only mandate on top of a client's chosen base portfolio. This allows investors to maintain their existing allocations rather than swapping out a portion of their equity exposure (as is done for a fully-funded implementation).

Our Defensive Equity – Options Only strategy sells out-of-the-money index put and call options against a base portfolio. It is designed to:

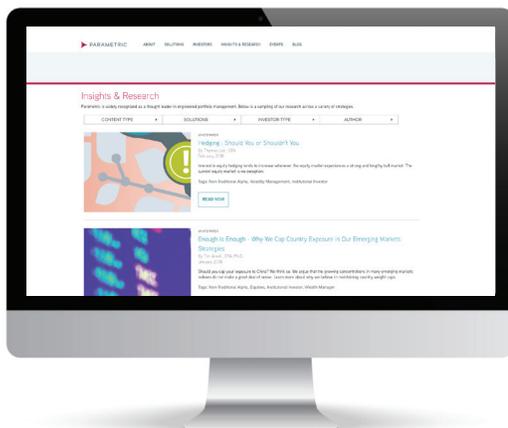
- Enhance returns with systematic option selling
- Improve the risk/return profile of a long-only portfolio by accessing the volatility risk premium, a diversifying risk premium

Parametric's Defensive Equity – Options Only strategy seeks to enhance performance and provide attractive risk-adjusted returns over the long term when compared to equity-only portfolios. This capital efficient, transparent method can be reasonably expected to help plan sponsors add expected return with a relatively modest increase in risk at the total plan level.

## The Results

Over the long run, Parametric's Defensive Equity – Options Only strategy aims to deliver more attractive risk/return characteristics than equities alone. Its balanced blend of short index puts and short index calls is designed to produce profitable outcomes.

- > Designed to generate incremental, uncorrelated returns with a modest increase in risk
- > Efficient and transparent use of capital



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