

# Parametric Defensive Equity

## Strategy overview

### Liquid alternative, with favorable risk-adjusted results

Defensive Equity (DE) is a systematic investment strategy that seeks to provide favorable risk-adjusted return streams compared to equity.

The strategy's model-driven investment approach is designed to remove the emotions and guesswork from the investment decision-making process. A lower volatility portfolio is created by structurally reducing equity market risk, while systematically selling fully collateralized equity index options to enhance returns. When compared to a fully invested equity portfolio, it is expected that DE's combination of reduced equity exposure and the Volatility Risk Premium (VRP) results in a smoother ride over the long term, reducing the magnitude of drawdowns and recovering more quickly from stress events.

The strategy is expected to deliver the best relative performance in moderately down and sideways markets while trailing equities in strong rallies. DE is best suited for investors with a heightened sensitivity to equity risk, who are seeking increased yield, or who are dissatisfied with high fees and low realized alpha from traditional hedge funds.

### Intended Benefits

#### Systematic investment process

- Disciplined and rules-based investment process that is designed to result in repeatable and more formulaic results without the use of market forecasts or interference from behavioral biases.

#### Faster recovery

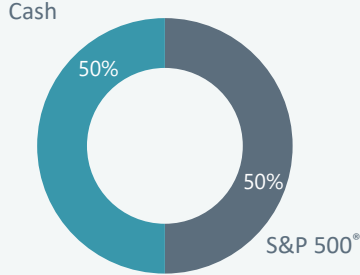
- The defensively structured base portfolio is designed to reduce drawdowns during stress events, and consistent exposure to the VRP aims to deliver faster recovery to peak valuation compared to a long-only equity portfolio.

#### Portfolio diversification

- Places investors in the path of a diversifying VRP, delivering favorable risk-adjusted returns without sacrificing liquidity. May be used as a complement or replacement for hedge fund or low volatility equity allocations.

### Portfolio Construction

Parametric DE creates implicit downside protection through a core position in the S&P 500® Index and US Treasury bills, combined with fully collateralized short equity index call and put options. No leverage is used in the portfolio. To achieve these long-term investment objectives, multiple layers of diversification are incorporated into the portfolio construction process to meaningfully reduce risk.

Base Portfolio (defensive)	Option Overlay (VRP)	Systematic Implementation
<p>50% allocation to cash helps reduce downside participation, but also reduces long-term expected return.</p>  <p>The donut chart is divided into two equal halves. The left half is teal and labeled 'Cash' with '50%' below it. The right half is dark grey and labeled 'S&amp;P 500®' with '50%' below it.</p>	<p>Sell put and call options against the base portfolio to help enhance returns (capture the “Volatility Risk Premium”).</p> <p><b>Option Characteristics</b></p> <ul style="list-style-type: none"><li>&gt; Fully-collateralized (no leverage)</li><li>&gt; Exchange-traded &amp; cash-settled</li><li>&gt; “Out of the money” at initiation</li><li>&gt; Fixed initial delta allows strike prices to adjust dynamically</li><li>&gt; 1-month or less initial tenor</li></ul>	<p>Systematic approach to portfolio management aims to deliver more predictable outcomes.</p> <p><b>Rules-based Implementation</b></p> <ul style="list-style-type: none"><li>&gt; Disciplined rebalancing back to 50/50 blend – no market timing</li><li>&gt; Laddered option portfolio with options sales occurring multiple times per week</li><li>&gt; At expiration, simultaneously sell new pair with the same initial characteristics</li></ul>

Cash component includes investment in US Treasury Bills. Certain statements contained herein represent the subjective views of Parametric and as such may not be independently verified. All investments are subject to loss. Investing in an options strategy involves risk. Please refer to the disclosures for additional information.

## Investment thesis

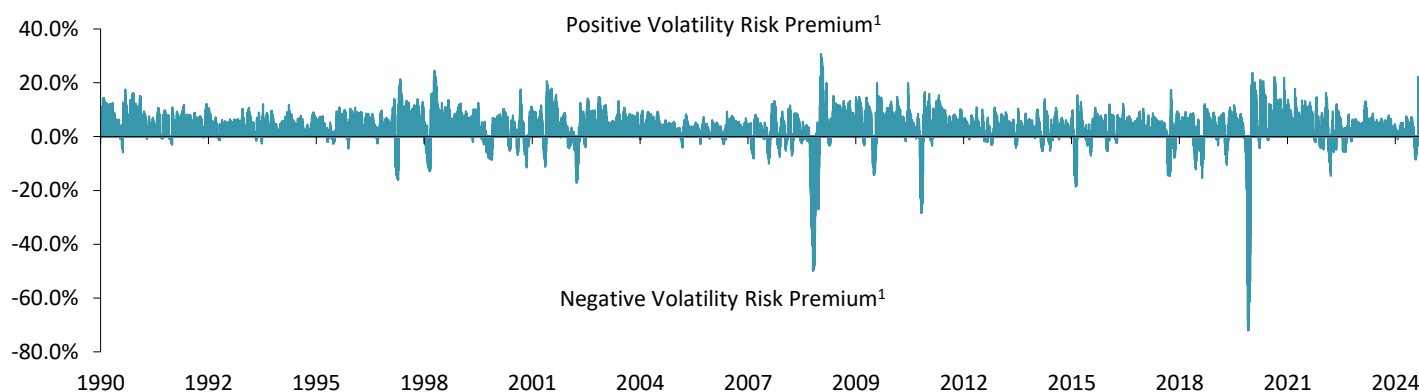
As one of Parametric's VRP strategies, it is designed to capitalize on the tendency of implied volatility to exceed subsequent realized volatility. Through the systematic sale of equity index options, investors can harvest the volatility risk premium—a distinct, persistent, and diversifying return stream—without the use of leverage or market forecasts. These strategies are designed to increase portfolio diversification at a lower cost than traditional alternative investments, without sacrificing liquidity.

## Investment objectives

Defensive Equity seeks to outperform the S&P 500® Index and long/short hedge funds over a full market cycle on both an absolute and risk-adjusted basis, while also reducing volatility versus the equity index by at least 40% across all stages of the market cycle. Additionally, it seeks to reduce the magnitude of drawdowns and recover faster from stress events. Since the portfolio holds an average 50% allocation to Treasury Bills, shorter-term results should be evaluated versus the 50% S&P 500®/50% T-Bill blended benchmark.

## Empirical data supports our investment thesis

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



<sup>1</sup>1990 to present represents longest period from which reliable data is available and accessible for S&P 500® Volatility Index. S&P 500® Index options relative valuation measured by taking daily observations of Implied Volatility (as measured by VIX® Index) and subtracting the subsequent Realized Volatility of the S&P 500® over the subsequent 1 month (assuming 21 trading days). Options have historically traded about 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. It is not possible to invest directly in an index. All investments are subject to loss. Source: Parametric, Bloomberg; Date: 9/30/24.

## Team leadership

**Alex Zweber, CFA, CAIA**  
Managing Director,  
Investment Strategy

**Yuepeng "Perry" Li, CFA, FRM**  
Senior Investment Strategist

**Michael Zaslavsky, CFA, CAIA**  
Senior Investment Strategist

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## Parametric

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There is no assurance that the investment objective(s) will be achieved. All investments are subject to the risk of loss.

The effectiveness of the option strategy depends on a general imbalance of natural buyers over natural sellers of index options. This imbalance could decrease or be eliminated, which could have an adverse effect. A decision as to whether, when and how to use options involves the exercise of skill and judgment, and even a well-conceived and well-executed options programs may be adversely affected by market behavior or unexpected events. Successful options strategies may require the anticipation of future movements in securities prices, interest rates and other economic factors. No assurances can be given that the judgment of Parametric in this respect will be correct.

Options are not suitable for all investors and carry additional risks. Investors must ensure that they have read and understood the current options risk disclosure document before entering into any options transactions. The options risk disclosure document can be accessed at the following web address: <http://www.optionsclearing.com/about/bulications/character-risks.jsp>. In addition, investors should consult with tax, legal and/or financial advisor prior to contemplating any derivative transactions.

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