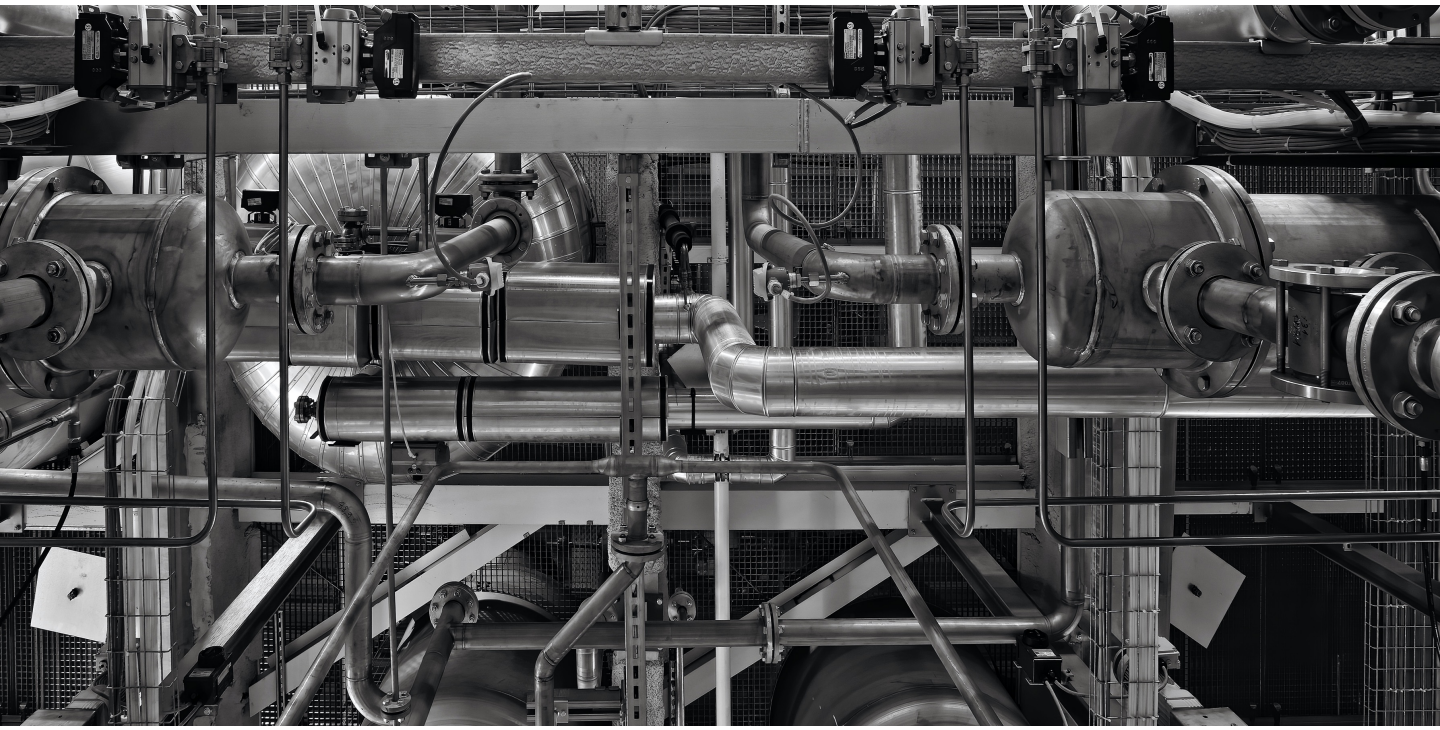
METAURUS

DIVIDEND MULTIPLIER STRATEGY



How to Reallocate Dividend Cash Flows

*For decades the fixed income markets have changed a bond's duration by reallocating its cashflows. Now the **Metaurus Dividend Multiplier Strategy** seeks to do the same for the equity markets. The Strategy reallocates a portion of an equity index's cash flows from potential longer-term future dividends to more near-term distributions. This reallocation can change an equity index's duration and its risk/return profile including volatility level and yield.*

Metaurus Dividend Multiplier Strategy

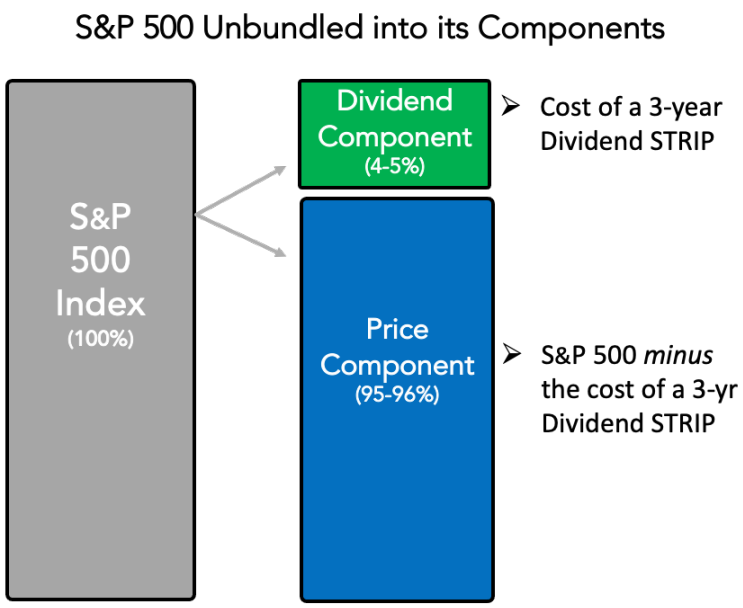
"How the Strategy Reallocates Dividend Cash Flows"

The Metaurus Dividend Multiplier Strategy separates an equity index into its core components of return – dividend cash flow (the Dividend Component) and index price exposure (the Price Component) – and seeks to provide a multiple of an index's dividend yield in exchange for a reduction in index price exposure. The Strategy reallocates a portion of an equity index's cash flows from potential longer-term future dividends to more near-term distributions. This reallocation can change an equity index's duration and be a useful customization tool for equity fund managers.

Strategy "Components"

The Dividend Multiplier Strategy's **Dividend Component** represents the market value of the next three years of expected dividends on the S&P 500 Index® – also called a 3-year dividend strip.[1]

To illustrate, if we assume the market value of the next three years of expected dividends is $180 ($59, $60, and $61 respectively), and the S&P 500 is at 4,200, then the **Dividend Component** would be worth approximately 4-5% of the value of the S&P 500 ($180 / $4,200)



The **Price Component** represents the S&P 500 stripped of the market value of those next three years of expected dividends. So, the value of the S&P 500 Index, less the Dividend Component (~4-5%) yields the value of the Price Component at ~95-96%.

When held in a 1:1 ratio, meaning one Dividend Component for every one Price Component, the aggregate value of the two components replicates the total return of the S&P 500, designed to deliver 100% of the dividend payout and 100% of any price appreciation / depreciation of an index.

The Dividend Multiplier Strategy modifies the two Components' relative initial weightings, by, for example, holding multiple units of the Dividend Component and less than one full unit of the Price Component instead. This design enables the Strategy to deliver a multiple of the S&P 500 dividend yield, with potentially better tax efficiency, in exchange for slightly less than 100% participation in the price appreciation / depreciation of the index.

The Dividend Component

The Dividend Component is created by holding long positions in the first three maturities of futures contracts of an index, in our case, of S&P 500 Annual Dividend Futures contracts. These contracts are then fully collateralized with a portfolio of short-term US Treasuries ("USTs") and cash to offset any embedded leverage. Together, the cash and USTs are the "Collateral". While futures contracts, in general, are instruments that provide leverage, the Strategy

[1] This white paper uses the S&P 500 Index to illustrate the operation of the Strategy. However, it is equally applicable to other indices. Unless otherwise noted, references to dividends are to ordinary dividends, and not special dividends.

effectively has no leverage as it is designed to neutralize any inherent leverage of the long futures positions by securing their full notional value with the Collateral.

Another core element of the Strategy is that dividends (and thus the Dividend Component) are themselves, risk-assets, meaning the Strategy can expect to derive a return from the Dividend Component – it is not "dead money." Of course, this return can be positive or negative.

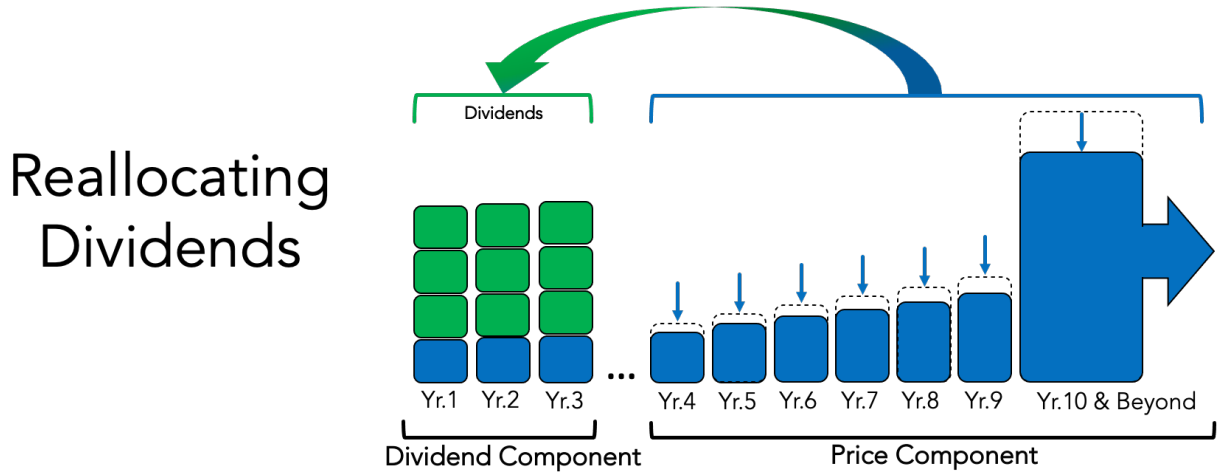
The Price Component

Understanding the Price Component is very straightforward – again, it is the index value less the value of one unit of the Dividend Component. So, in the current example it is the stocks of the S&P 500 Index (SPX) held in their appropriate weightings, less one unit of the S&P 500's Dividend Component. (Note: as the Price Component holds a portfolio of the S&P 500 stocks, it will itself generate a fraction of a full S&P 500 Index dividend payment. These dividend payments are considered when determining the size of the relative Component weightings)

Reallocating Capital Between the Components

Key to the design of the Dividend Multiplier Strategy is the re-allocation of capital by overweighting the Dividend Component and under-weighting the Price Component to achieve its investment objective. This re-weighting creates the Strategy's fundamental trade-off: distributing a multiple of the index's dividend yield in exchange for a modest reduction in index price exposure. As illustrated in Figure 1 below, the Strategy essentially harvests early a portion of potential future dividend payments beyond three years (*i.e.*, from the Price Component) and reallocates that cash flow to near-term distributions (*i.e.*, the Dividend Component).

Figure 1



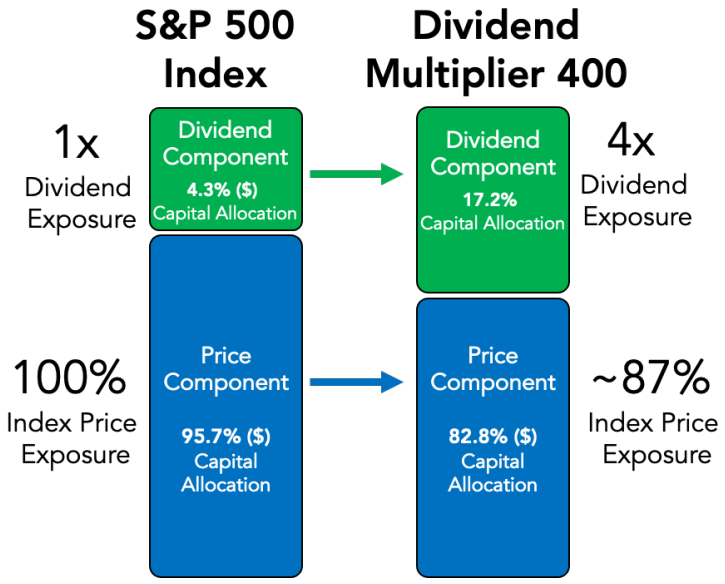
The Dividend Multiplier 400 – Hypothetical Example:

1) Value of One Dividend Component (*ex. 4.3%)*

Restating our example, assuming the next three years of S&P 500 dividend futures (2022, 2023 and 2024 maturities) are trading at $59, $60, and $61 respectively and the S&P 500 Index is at 4,200, then the **value of one Dividend Component** is worth $180 or **4.3%** of the overall S&P 500 Index value ($180 dividends / 4,200 = 4.3%).

2) Value of Four Dividend Components *(ex. 17.2%)*

If one Dividend Component unit requires ~4.3% of the portfolio's capital, then four Dividend Component units require ~**17.2%** (4 x 4.3%). Here the Strategy is designed to provide 4x the dividend yield of the index. So, 17.2% of the capital is used to purchase Collateral for the necessary number of futures contracts.



3) Resulting Decreased Allocation to the Price Component *(ex. 82.8%)*

Next, if 17.2% of the Strategy's capital is allocated to the Dividend Components, then **82.8%** will remain to be allocated to the Price Component. The Strategy uses 82.8% of the capital to purchase the S&P 500 Index stocks or another form of Index replication.

4) Reduced Index Price Exposure *(ex. ~87%)*

Overall, allocating less capital to the Price Component means less Index price exposure. Recall that if full, unadjusted, 100% S&P 500 Index price exposure requires a **95.7%** capital allocation to the Price Component, then the Strategy's reduced **82.8%** capital allocation would provide comparatively less, that is, **~87% Index price exposure**.[2] This is the fundamental trade-off when reengineering the Index's capital allocation – increased Index dividend exposure means reduced Index price exposure.

5) Strategy Results: The Dividend Multiplier 400 *(ex. 4x Dividends & ~87% Price Exposure)*

The Strategy's reallocation process is designed to produce **4x** the Index dividend yield in exchange for an **~87%** Index price exposure in our example. The Strategy allocates 17.2% of the capital to the Dividend Component (4 units), and the balance of 82.8% to the Price Component.

Note, the combination of dividend yield multiple and index price exposure can be periodically re-established, i.e., the capital required to establish the Dividend Component (target dividend multiple) will determine the remaining capital allocated to the Price Component and thus index price exposure.

Importantly, this reallocation of capital can have the effect of changing the underlying index's risk/return profile including its yield, price sensitivity, equity duration, volatility, and other metrics.

Freeing up Collateral as Dividend Points are "Locked-In"

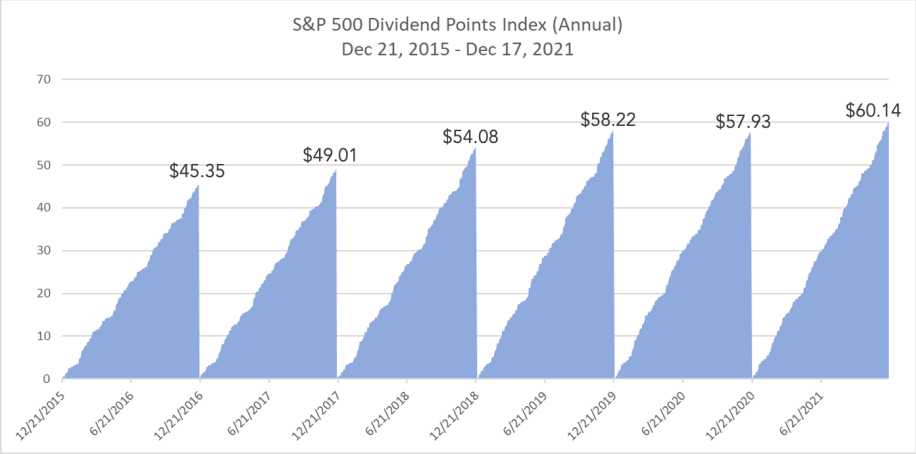
The Strategy is designed to replicate a multiple of an index's dividend yield by being long dividend futures and, importantly, holding the Collateral needed to distribute the required multiple of dividend-related cash flow.

How is this tracked? Over the course of a year, the intrinsic value of that year's dividend futures contract will be gradually "locked-in" as actual dividends are paid by S&P 500 companies. This running tally is measured by the S&P 500 Annual Dividend Points Index ("Dividend Points Index," Ticker: SPXDIVAN). Once a dividend has been paid, the Dividend Point Index increases commensurately (see Figure 2 below). The value of the Dividend Points Index acts as a floor for dividend futures prices as those dividends have already been paid. That portion of locked-

[2] Again, the Price Component's holdings of index constituents produce fractional dividends as well and are accounted for in the Strategy's dividend replication process. See Metaurus' Dividend Futures Primer for further details. (Link)

in dividends is no longer at risk and thus the Collateral supporting the locked-in dividends can be distributed to investors.

Figure 2: The Dividend Points Index – a Running Tally



Source: Bloomberg

To illustrate: assume the starting price for the current year's annual dividend futures contract was **$60** (supported by $60 in Collateral), and by the end of September the **Dividend Points Index is at $44** – meaning through September, $44 of dividends have been actually paid by the companies and "locked-in" over the first nine months. As a result, futures cannot drop below this $44 floor and thus $44 worth of Collateral can be freed up and paid to investors while still maintaining sufficient Collateral to fully collateralize the at-risk portion of this futures contract.

Said differently, of the original $60, only **$16** of expected dividends **remain at-risk** over the final three months until expiration, so only $16 of Collateral needs to be held for the balance of the year.

The virtue of the Strategy is its design to always hold the Collateral needed to make distributions corresponding to the actual Index dividends paid.

Summary:

The Dividend Multiplier Strategy reallocates capital between an index's dividend cash flow and potential price appreciation/depreciation. This process is designed to provide a multiple of the index yield and moderately reduced index price exposure. The Strategy uses the following progression:

1. ***Value one Dividend Component*** *(3-yr dividend strip)*
2. ***Value one Price Component*** *(S&P minus one Dividend Component)*
3. ***Apply Dividend Multiplier*** *(4x)*
4. ***Reallocate capital between the two Components***
5. ***Increase allocation to the Dividend Component*** *to achieve ~400% index yield*
6. ***Use remaining capital to purchase reduce allocation to the Price Component***

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