

DIVIDEND MULTIPLIER STRATEGY



Increasing Yield in Portfolio Construction

Increasing yield is an ongoing portfolio challenge. The Dividend Multiplier Strategy is designed to provide broad-based equity exposure while still delivering a multiple of the index's dividend yield. Its beneficial features make it an alternative to popular income-oriented strategies such as Dividend-Focused Funds, Covered Call Strategies, Sector Funds, and other Hybrid Assets. We highlight the potential trade-offs and drawbacks of each and show how including the Dividend Multiplier Strategy in a portfolio can be an attractive investment path to follow.

The Metaurus Dividend Multiplier Strategy

“Increasing Yield in Portfolio Construction”



It can be challenging for investors to generate yield in a historically low interest rate environment. The traditional 60/40 portfolio may no longer provide the income it produced in the past leaving investors to search for yield from other sources. Increasingly, those sources include equity- and option-based strategies that may come with considerable risks and drawbacks. The *Metaurus Dividend Multiplier Strategy* may provide a better approach.

Dividend Multiplier Strategy Overview

The Dividend Multiplier Strategy is designed to offer equity index exposure and dividend distributions that are notably higher than the index's ordinary dividend yield.¹ It separates an index into its two components of return, a Dividend Component and Price Component, and then reallocates their relative weightings to yield a multiple of the initial, ordinary dividend yield in exchange for modestly reduced exposure to the price return of the index². We see several key benefits of the Strategy:

Key Benefits:

- ✓ Increased dividend exposure – historically effective hedge against inflation
- ✓ Index-based diversification
- ✓ Uncapped upside equity potential
- ✓ Expand the efficient frontier
- ✓ Exposure to isolated dividends
- ✓ No leverage. No embedded options
- ✓ No stock-picking or sector concentration
- ✓ Strategy doesn't introduce credit risk

How to Use in a Portfolio

The many benefits of the Dividend Multiplier Strategy may make it an excellent alternative to many popular equity income-generating strategies including those listed below. Here we provide reasons why the Dividend Multiplier Strategy may be an appropriate investment alternative while also highlight some key differences.³

Other Popular Strategies:

- Dividend funds
- Covered call strategies
- Sector funds
- Hybrid asset classes
- Traditional 60/40 portfolio

¹ Unless otherwise noted, references to dividends are to ordinary dividends, and not special dividends.

² The Strategy uses dividend futures contracts. More information about their use is located [here](#).

³ Note: this analysis is not intended to discuss all differences from these other approaches. It highlights some of those that, in Metaurus' opinion, are significant. Please see the Terms and Conditions below for further information.

Dividend Funds (e.g., Dividend Achievers, Aristocrats, and “focused” funds)

- *May lack exposure to growth stocks*
- *May exclude recent dividend-paying stocks*

These strategies select individual stocks based on the quality and/or quantity of their earnings and dividends. Generally, they include companies that have demonstrated a track record of growing their dividend over a sustained period of years. As a result of this filtering approach, these strategies tend to skew heavily toward value stocks and concentrate in certain sectors such as consumer staples, industrials, financials, and energy — traditional dividend-paying sectors. These strategies may offer little exposure to growth stocks and growth sectors like technology, communications, and healthcare. In addition, a dividend-paying company typically needs to pay its dividend for several years before it becomes eligible for inclusion in some strategies. A company like Cisco (CSCO), for example, even though it has an excellent track record of growing its dividend, might have to wait years before it satisfies the eligibility tests and can be included, which in some cases, like the Dividend Aristocrats, require up to 25 years of sustained dividend increases. CSCO only first declared a dividend in 2011.

✓ **The Dividend Multiplier Strategy**, by comparison, has no such style tilt. The Strategy offers full, index-weighted exposure to all of an index components’ various sectors to provide more balance between growth stocks and value stocks. In addition, the Strategy participates in all ordinary dividends paid by companies, including any from first-time dividend payers. And importantly, by its design, the Dividend Multiplier Strategy can generate a significantly higher level of current cash distributions, as much as 2x to 3x the dividend yield of the Dividend Achievers / Dividend Aristocrats.

Covered Call Strategies

- *Capped upside potential*
- *May not participate in market rallies following selloffs*
- *Relatively low betas*

For decades, investors have turned to writing covered calls on their equity portfolio to enhance cash flow. The Cboe S&P 500 Monthly BuyWrite Index (“BXM”) is a very popular benchmark for these types of strategies. While the BXM, and these strategies in general, have a track record of producing relatively attractive, long-term risk-adjusted returns, the approach nonetheless forces investors to make significant tradeoffs, in our view. Covered calls written to generate the option premium impose a hard price cap on potential capital appreciation during their term, opening the portfolios up to significant underperformance during periods of high equity market growth.

In addition, when markets sell off, the new call options (price caps) that must be written to maintain the portfolios’ cash flow profile can limit the ability of the portfolio to participate in a subsequent market recovery, especially during a strong, V-shaped recovery. Importantly, the market sensitivity of these strategies to short-term moves in the market (as measured by CAPM Beta or option Delta) are approximately 60%. This means for every \$1 move in the broad market, these strategies are expected to only reflect ~\$0.60 of that move. This may seem desirable when considering the downside risk mitigation benefits, however, it may also leave investors lacking long-term growth by not fully participating in short- and medium-term market rallies.

✓ **The Dividend Multiplier Strategy**, by comparison, provides current cash distributions in line with covered-call strategies *without being subject to a hard price cap on potential capital appreciation*. To be sure, the Dividend Multiplier Strategy *does* require some trade-off in potential price appreciation – in exchange for a higher current cash distribution rate, there is a modestly reduced market participation rate. But, in addition to that give-up being linear in nature (*i.e.*, no hard price cap), it allows for an enhanced allocation to the Dividend Component, which itself can be expected to earn a return while producing the higher level of distributable cash.

The combination of the modest, linear reduction and the enhanced allocation to the Dividend Component produces a market Beta of ~90% as compared to a Beta of ~60% for a typical covered call strategy. This provides greater participation in short- and medium-term market moves. *E.g.*, in 2019, a year in which the S&P 500 produced a ~31.5% total return, the back-tested Dividend Multiplier Strategy outperformed the BXM Index with a total return of ~26.5% relative to the BXM’s ~15.7% return. In 2020, which included the COVID pandemic’s sharp, V-shaped

market recovery, the back-tested Dividend Multiplier Strategy again outperformed the BXM Index ~14.9% to ~(negative) 2.8% on the year.⁴

Sector Strategies

■ *Sector and stock concentration*

Investors often accept significant portfolio concentration risk when investing in individual sectors such as REITS, Utilities and Financials in search of current cash flow. One must be comfortable with this actively managed investment approach and the corresponding cash flow profile associated with stock/sector selection. We see concentration in a specific sector (or sectors) for the primary purpose of harvesting cash flow akin to letting the proverbial tail wag the dog.

✓ **The Dividend Multiplier Strategy**, by comparison, provides diversified exposure to all sectors in an index and simultaneously offers a level of current cash flow greater than any individual sector, including utilities, real estate, financials, and energy⁵.

Hybrid Assets (*i.e.*, Structured Notes, Convertible, Preferreds)

- *Potentially illiquid securities*
- *May include complex embedded derivatives*
- *Possible credit and counter-party risk*

Hybrid assets, or securities that are structured to have both equity and bond-like characteristics, are another source investors turn to for the combination of significant cash flow with capital appreciation potential. Unfortunately, in many cases these assets can experience periods of prolonged illiquidity. And, due to their complex embedded derivatives (options), pricing these assets can prove to be complex and substantially less transparent than exchange-traded instruments. Hybrid assets also introduce the credit-risk of the issuer into the investment decision and profile. And finally, the issuance of these types of securities can be idiosyncratic, either as measured by the types (or scarcity) of companies that issue them and/or the frequency (or infrequency) with which they are issued.

✓ **The Dividend Multiplier Strategy** by comparison, is highly diversified and utilizes only exchange-traded instruments. There are no options, no leverage, and no credit-risk in the Strategy. As with covered call strategies, by avoiding the use of options the Dividend Multiplier Strategy does not introduce an asymmetric return profile. This generally results in a higher and more stable degree of equity sensitivity (growth potential), while still providing equivalent or greater distributable cash flow than covered call strategies.

Traditional 60/40 Portfolio

■ *Lacks exposure to “Isolated Dividends”*

The Strategy is an alternative approach to income generation. Taking a broader view, the Dividend Multiplier Strategy may also enhance a traditional 60/40 portfolio by adding *Isolated Dividends* as a “Third Prong” to asset allocation. Isolated Dividends (cash flow derived from dividend payments) have several unique features including how they can be an attractive investment addition by maintaining equity exposure, providing more income, and improving the efficient frontier⁶.

⁴ Source: Bloomberg.

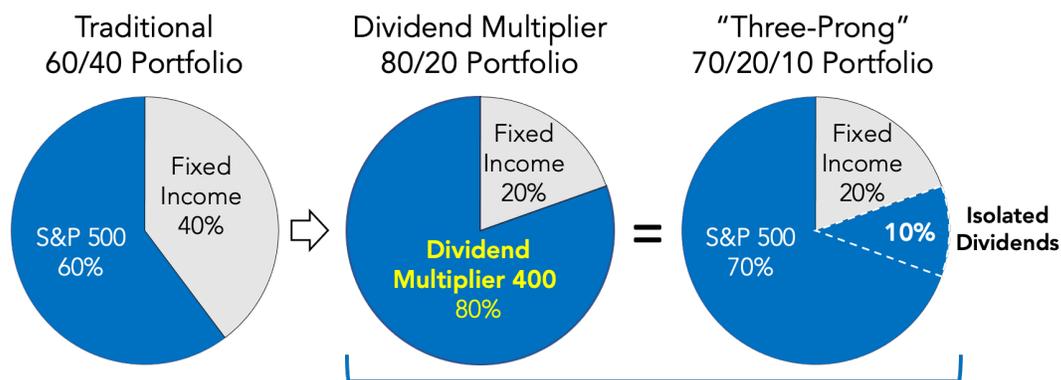
⁵ Source: Bloomberg (analyzing current dividend yields of 11 Select Sector SPDRs as of 3/4/22).

⁶ “The Term Structure of Returns: Facts and Theory”, Van Binsbergen and Koijen, Journal of Financial Economics, 2017. ([Link](#))

Adding “Isolated Dividends” to a 60/40 Portfolio

Figure 1 below shows how a traditional 60/40 portfolio can be transformed into a three-pronged, 70% equity / 20% fixed income / 10% Isolated Dividend portfolio. Here the Dividend Multiplier Strategy is substituted for all of the S&P 500 exposure and half of the fixed income exposure. The result is a portfolio that increases equity-based cash flow and introduces the unique characteristics of Isolated Dividends, an important one being cash flows positively correlated with interest rates.

Figure 1



Conclusion

The Dividend Multiplier Strategy can be an effective, equity-based income producing alternative that avoids the potential drawbacks of other popular income strategies:

- **Dividend Funds** – Tend to lack exposure to growth stocks and companies new to paying dividends
- **Covered Call Strategies** – Capped upside, may not participate in recovery rallies, lower betas
- **Sector Funds** – Sector and/or stock concentration
- **Hybrid Securities** – Can be illiquid, contain embedded derivatives, possible credit risk
- **Traditional 60/40 Portfolio** – Lacks exposure to the Isolated Dividend “Third-Prong” (70/20/10)

APPENDIX: Performance of the Metaurus Dividend Multiplier Indices (YLDX300 & YLDX400)

The graph and table below show the back-tested total return performance of the Metaurus Dividend Multiplier Indices over the 5-year period ending June 15, 2021 as compared to a group of popular income-oriented strategies' 5ndices. The Metaurus Dividend Multiplier Indices are published and maintained by S&P Dow Jones Indices. The underlying historical data is publicly available through the S&P Dow Jones website at <https://www.spglobal.com/spdji/en/custom-indices/solutions/> as well as on Bloomberg and other sources. The Metaurus Dividend Multiplier Indices have a back-tested start date of December 18, 2015.⁷



Index Performance Comparison

	S&P 500 TR (SPXT)	S&P 500 Div Aristocrats TR Index (SPDAUDT)	CBOE Buy-write Monthly Index (BXM)	S&P Preferred Stock TR Index (SPTREFTR)	BBG US EQ:FI 60:40 Index (TR) (BMA6040)	MET Div Multiplier Index - 300 (YLDX300T)	MET Div Multiplier Index - 400 (YLDX400T)
<i>June 2016 - Dec. 2021</i>							
Cumulative Return	151.67%	108.03%	52.45%	37.24%	90.21%	132.99%	123.89%
Annualized Return	15.91%	12.43%	6.98%	5.20%	10.83%	14.49%	13.76%
Standard Deviation	18.43%	17.94%	13.98%	12.85%	10.67%	16.92%	16.20%
Information Ratio (IR)	0.86	0.69	0.50	0.40	1.02	0.86	0.85
Beta	1.00	0.91	0.69	0.42	0.57	0.91	0.87
Indicative Yield*	1.3%	2.3%	N/A*	5.7%	1.5%	3.8%	5.1%

* Indicative Yield is the dividend yield if the most recent dividend is annualized. Used for comparison purposes only. You cannot invest directly in an index. The Cboe Monthly BuyWrite Index does not list an indicative yield.

⁷ Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Index returns are for illustrative purposes only.

Alternative Investment Strategies – Our View

S&P 500 Dividend Aristocrats Strategy

EQUITY STOCK SELECTION

Ticker: SPDAUDT Index

Description: Tracks companies in the S&P 500 that have increased dividends every year for the last 25 consecutive years.

Drawbacks: Can be concentrated in old economy sectors. May lack appreciable exposure to growth sectors (Tech/HC). Embedded value tilt. A company must wait 25yrs from first dividend payment to become eligible for inclusion (e.g., CSCO, 2011 first dividend). Current distribution rate is approximately 2.8%.

Cboe Monthly Buy-write Strategy

EQUITY with OPTIONS-OVERLAY

Ticker: BXM Index

Description: A benchmark index designed to track the performance of a hypothetical buy-write strategy on the S&P 500 Index.

Drawbacks: Hard price cap limits the index's ability to participate in large price gains and to participate during periods of sharp recoveries following a drawdown. Recently, has a market beta of approximately 0.60 and negative convexity – i.e., in any given month, if market rallies, strategy beta approaches zero, whereas if market sells off, beta approaches 1.0.

Bloomberg Generic US 60/40 (EQ/FI) Portfolio

EQUITY / FIXED-INCOME BLEND

Ticker: BMA6040 Index

Description: Measures cross-asset market performance in the U.S. Rebalances monthly to 60% equities, 40% fixed income. Equity allocation represented by Bloomberg US Large Cap Index. Fixed Income represented by Bloomberg Barclays US Agg Index.

Drawbacks: Majority of distribution sourced from the equity allocation (60%). Significant exposure (40%) to long-duration fixed-income with yields near historic lows.

S&P Preferred Stock Total Return Index

HYBRID SECURITIES

Ticker: SPTRETFR Index

Description: An investible benchmark representing the U.S. preferred stock market. Index includes both traditional preferred and convertible preferred structures.

Drawbacks: Potentially low equity sensitivity and may have low growth potential. Not all companies typically issue a preferred class of shares. Over 60% of the index concentrated in the financial sector.

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