

BUFFER ETFs EXPLAINED

Script:

Equity markets are known for their upside potential, making them essential for growing investor portfolios, if appropriate for your risk tolerance, even amidst market volatility. In today's uncertain environment, many investors are seeking ways to capture market gains while managing risks. This is where buffer exchange-traded funds, or buffer ETFs, come into play.

Buffer ETFs are also known as defined-outcome ETFs. Unlike traditional long-only equity investments, buffer ETF investors can experience stock market gains up to a specified cap. They also do not experience losses down to a specified buffer, although they can have losses below that buffer. This trade-off leads to a narrower range of outcomes over a full target outcome time period, increasing certainty surrounding what an investor can expect versus traditional long-only equity market exposure.

Although nobody can reliably predict stock market performance, buffer ETFs can offer investors a narrower range of outcomes. By adding in buffer ETFs, you increase your probability of not experiencing a loss on your investment. This strategy can be effective through most market environments, particularly periods of volatility and drawdowns. Looking at the 1-year rolling returns of the S&P 500 since 1957, a buffer ETF with a 20% buffer would have protected investors from incurring any losses in 96% of these periods, while a 12% buffer would have provided protection 89% of the time. Stocks have shown an average gain of 15.8% in positive years, which occurred 73% of the time, highlighting the upside bias of equities. However, in negative years, the average loss was 11.8%. Buffer ETFs can help cushion investors against many of these losses.

Now, consider a hypothetical buffer ETF with a 16% cap and a 12% buffer compared to the S&P 500 across various market conditions. In a 'Bear Market,' where the S&P 500 plummeted 20%, the ETF dropped only 8% because the buffer cushioned the first 12% of losses. During a 'Market Correction,' with a 10% decline, the ETF avoided losses entirely as the decline was within the buffer. In a 'Positive' scenario, the ETF matched the S&P 500's 10% rise, staying within the cap limit. However, in a 'Very Positive' scenario, where the S&P 500 rose 20%, the ETF's gain was capped at 16%. This example assumes the investor held the buffer ETF shares for the entire outcome period.

In summary, the buffer ETF performed better than the S&P 500 in both scenarios when the market fell, matched S&P performance when the market rose modestly, and trailed S&P performance only during the "Very Positive" environment. As this example demonstrates, buffer ETFs are effective through most market environments.

Equity investors strategically position their portfolios with buffer ETFs for a variety of reasons. These are some of the most common: There is a significant amount of investor cash sitting on the sidelines currently, taking advantage of what have been

attractive rates. However, with the potential for a decreasing interest rate environment, investors are looking to step out of cash and participate in the equity upside while having some protection against downside risk. For investors who are concerned about stretched equity valuations, or worried about a correction, but also don't want to miss out on potential upside, buffer ETFs offer an attractive solution. Historically, investors have allocated to bonds as a hedge to equity market volatility. Since buffer ETFs participate in the market upside, while offering protection to limit the downside, they can be complementary to bond allocations as a hedge to equities.

A broad range of investors may find buffer ETFs attractive. Let's meet some of them:

- Risk-Averse Investors seeking modest growth with reduced downside exposure can benefit from the risk-mitigation characteristics of buffer ETFs.
- Goal-Based Investors who want to use investment proceeds for known expenses can benefit from positive buffer ETF returns along with some downside protection.
- Fixed income horizon Investors using traditional defined-outcome annuity strategies may benefit from the enhanced liquidity of buffer ETFs.
- Retirees and Pre-Retirees who do not have time to recover from significant market losses can benefit from buffer ETFs' downside protection.

The two most common strategies for investing in buffer ETFs are buffer ETFs and ladder buffer ETFs. Let's take a closer look at each one.

Buffer ETFs – like we mentioned earlier – offer investors upside participation in the stock market up to a specific cap while limiting losses down to a specific buffer. Again, investors can experience losses below that buffer. Providers typically roll out these strategies monthly over a predetermined time. In this hypothetical example, buffer ETFs are launched once a month with a 20% downside buffer and a 1-year outcome period.

A ladder buffer ETF is a single ticker fund of funds solution that comprises multiple buffer ETFs. In this example, the ladder fund invests equally in all 12 of the monthly buffer ETFs in the series. While ladder funds do not directly offer their own caps and buffers, they allow investors to benefit from exposure to the varying caps, buffers, and outcome period end dates of their individual buffer ETF components. One of the standout advantages of a ladder buffer ETF is the efficiency of a single ticker solution. Instead of purchasing multiple individual buffer ETFs, each with its own ticker, investors can access a diverse set of buffer ETFs through a single investment. This approach simplifies participation and reduces the timing risk associated with selecting a specific monthly buffer, offering a more consistent investment experience across different market conditions.

Visit PGIM's Buffer ETF Hub to learn how buffer ETFs can enhance predictability and deliver more consistent outcomes in uncertain markets.