



CASE STUDY

A CUSTOMIZED OPTION FOR EQUITY REPLACEMENT

OVERVIEW

A US-based fund advisor sought an equity replacement offering with a uniquely differentiated option to create a custom return profile that complemented its existing product lineup. Operating primarily as a single manager advisor with robust core funds offerings, the client sought a partner to manage a defensive equity fund as part of its model portfolio.

KEY PARTNERS

- Advisor investment & sales teams
- PGIM Quant sales & client service teams
- PGIM Quant investment team
- PGIM Quant operations team

CHALLENGE

The advisor sought an equity replacement strategy that would provide increased upside participation when the US equity market advanced, while reducing the largest market drawdowns. Constraints on notional exposure of futures investments in the advisor's mutual fund family limited the use of traditional liquid alternative strategies, necessitating a novel approach to achieve the advisor's investment goals. Furthermore, the advisor's flex-fee-based model for both its funds platform and wealth management channel resonated strongly with its client base, requiring any solution to integrate this approach.

APPROACH

To understand the advisor's unique challenges and goals, PGIM Quant collaborated closely with their investment team. We proposed customizing our standard Market Participation Strategy (MPS) to provide a convex return profile solution with increased equity market exposure. We performed comprehensive simulations using the live, 30+ year track record of our MPS (.60 Delta) S&P 500 strategy applied to a model with a greater equity delta to meet the advisor's volatility and risk requirements.

SOLUTION

Through partnership with the advisor, we created a customized equity alternative option that met the advisor's unique investment requirements and provided ongoing education and training to its salesforce. To do this, we:

- Created a new MPS Delta 1 fund designed to capture approximately 100% of the S&P 500 Index on the upside, while participating in only 65% of the downside, to take the place of the advisor's legacy equity alternative fund.
- Utilized long-term FLEX call options in combination with US Treasuries/US Treasury futures to achieve ~3x leveraged equity exposure while maintaining the liquidity and convex return profile of the .60 Delta MPS.
- Met the objective of increased market participation, but with lower volatility and the ability to dynamically adjust equity exposure to mitigate risk.
- Delivered a customized solution based on the existing proven, long-term track record of MPS, aligning with the advisor's performance-based fee structure.
- Arranged initial training for advisor's sales team prior to fund launch and provide ongoing support to wholesalers and financial advisors via quarterly update calls and in-person educational seminars at annual client conference.
- Since launch, delivered superior upside participation and successfully managed to stated risk and return targets. While markets have not experienced a down cycle since inception, the fund is positioned to reduce downside risk during an equity drawdown.

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