A DIFFERENT APPROACH TO INCOME
Autocallable ETFs

What is an autocallable ETF?

An autocallable ETF provides exposure to a portfolio of autocallable investments linked to the performance of a reference index.

These investments are designed to generate:

- Enhanced income potential
- Conditional downside protection above a predefined barrier

The ETF structure allows investors to access a diversified laddered portfolio of autocallable investments through a single publicly traded vehicle, which may offer tax advantages relative to purchasing individual autocallable investments directly.

How does an autocallable work?

An autocallable is generally issued with:

- A starting reference level (quoted as 100%)
- A predefined barrier level
- A predefined autocall level
- A maturity date
- A contingent coupon

Autocallables are reassessed on a regular basis, known as "observation dates". *On scheduled observation dates:*

- If the reference index is at or above the **autocall level**, the position is called early, or "autocalled," and the investor receives the return of principal.
- If the reference index is below the **autocall level but at or above the coupon barrier**, the autocallable continues and the coupon is paid.
- If the reference index is **below the coupon barrier**, the coupon is not paid for that observation period.

How does an autocallable ETF differ from an individual autocallable?

An individual autocallable typically:

- Has a single issuance date and a fixed maturity date
- Is tied to a single structured payoff
- Delivers one point-to-point outcome determined by the index's path over that specific period

An autocallable ETF generally:

- Provides exposure to a portfolio of autocallable investments with laddered issuance dates
- Continuously adds or replaces autocallables, including reinvesting principal when positions are autocalled
- Does not have a single maturity date or predefined outcome
- Trades daily on an exchange
- Staggered observation schedules

ETF autocallable structures vary.

How do autocallable strategies seek to generate income?

Autocallable strategies generate coupon income in exchange for capped upside potential and exposure to downside risk. Investors do not participate in gains of the reference index beyond the coupons received, and the return of principal is contingent on the reference index remaining at or above the barrier at maturity. If the reference index closes below the barrier, investors participate one-for-one in its decline from the initial level and may lose principal.

What is the difference between a barrier and a buffer?

A coupon barrier is a threshold that determines whether downside protection applies. It works more like a cliff than a cushion.

For example, assume an autocallable has a 70% coupon barrier level:

- If the reference index finishes at 75% of its starting reference level—a 25% decline—it is still above the 70% barrier and the autocallable principal is protected. ETF shares are not principal protected.
- If the index finishes at 65% of its starting level—a 35% decline—it is below the 70% barrier and the position will potentially become exposed to the full reference index decline.

Barrier and autocall levels are quoted as a percentage of the initial reference level, not as the percentage change in the index.

A buffer works differently: it absorbs a specified portion of a loss. With a barrier, once the barrier condition is not met, the full decline may apply:

- A 20% buffer protects against the first 20% of an underlying index decline. If the underlying index falls 25%, the investor experiences a 5% loss.

What is the coupon memory feature?

Some autocallables may include a coupon memory feature. The coupon memory feature determines what happens to coupons that are missed while the reference index is below its barrier. Rather than being permanently forfeited, missed coupons are stored. If the reference index recovers above the barrier level on a later observation date, the position may pay the current coupon plus any previously skipped coupons.

- For example, if a position accumulates 12 coupons while the reference index is below the barrier, and the reference index is back above the barrier on the next observation date, the investor may receive all 13 coupons at that time. If the reference index does not recover above the barrier, missed coupons may never be paid.

Terms of the coupon memory features may vary.

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Why can autocallable ETFs offer enhanced income potential than traditional income investments?

Autocallable ETFs offer a unique source of income tied to equity market performance. Unlike covered call ETFs, dividend strategies, or traditional bonds, their coupons compensate investors for accepting downside risk beyond a defined barrier and capped upside potential. These coupons may exceed the income available from dividends or traditional bonds, providing a differentiated, equity-linked income source that may complement traditional income investments.

What happens in different market environments?

Autocallable strategies may perform differently from traditional equity and fixed income investments across market environments.

Historically, market environments that have favored autocallable strategies include:

- Range-bound markets
- Moderately rising markets
- Markets with stable or moderate volatility

In these environments, autocallable ETFs may be well positioned to generate enhanced income.

Historically, autocallable strategies have faced challenges in the following market environments:

- Strong, sustained bull markets
- Sharp market declines
- Highly volatile or rapidly changing markets

Because upside participation is capped, autocallable strategies may lag in comparison to traditional equities during strong market rallies.

What types of investors may consider autocallable ETFs?

Autocallable ETFs may appeal to investors seeking enhanced income potential from an alternative, equity-linked source that may behave differently from traditional income investments. Investors should understand and be willing to accept downside risk and capped upside potential. Like all investments, autocallable ETFs involve risk, including the potential loss of principal if the reference index falls below a predefined barrier.

What are the primary risks associated with autocallable ETFs?

Autocallable ETFs involve substantial risks, including:

- Downside equity market risk
- Capped upside participation
- Structural complexity
- Volatility and barrier risk
- Income risk

If barriers are breached, investors may experience significant losses. ETF shares are not principal protected. Conditional protection applies only to specified underlying autocallable positions and only if their stated conditions are satisfied.

Key Takeaways

- Autocallable ETFs seek to provide enhanced income through structured investment techniques.
- Conditional downside protection generally applies only if specific barrier conditions are maintained.
- Strong market rallies may result in lower returns than traditional equity investments due to capped upside participation or early redemption features.
- Outcomes can vary significantly depending on market conditions and the behavior of the reference index.
- These strategies involve meaningful risks and complexity and may not be appropriate for all investors.

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