

Upgrading Your S&P 500 Investments: The Case for a Strategic ETF Model

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The S&P 500, representing 500 of the largest publicly traded companies in the U.S., is widely recognized as a benchmark for the U.S. stock market. It serves as a key indicator of the overall health and performance of large-cap companies, with insights into market trends and economic conditions.

Many mutual funds and ETFs aim to replicate the S&P 500's performance. As of 10/31/2024, approximately \$2.1 trillion in ETF assets are dedicated to tracking the S&P 500, with the largest ETFs by assets under management (AUM) being SPDR S&P 500 ETF Trust (SPY), iShares Core S&P 500 ETF (IVV), and Vanguard S&P 500 ETF (VOO).

The S&P 500 has a long history of delivering robust returns, averaging around 11% annually over the past three decades. This has made it a popular choice for long-term investors looking to build wealth steadily.

A key advantage of the S&P 500 is its broad exposure to the U.S. economy. The index includes companies from various sectors, such as technology, healthcare, financials, and consumer goods, offering diversified access to the country's most influential corporations. The diversity helps to reduce the risk associated with investing in individual stocks.

Additionally, many S&P 500 Index funds and ETFs typically have low expense ratios, making them an affordable option for investors seeking broad market exposure without the high fees associated with actively managed funds.

The index's consistent returns, broad diversification, and low fees, make it challenging for active strategies to beat the market. As a result, many investors prefer to invest passively in S&P 500 Index funds, and investors typically allocate a decent proportion of their portfolio to the S&P 500 exposure. For example, State Street's all equity model places 42% weight on their S&P 500 ETF.

However, despite the benefits and popularity, investing in the S&P 500 carries substantial equity risk due to its exclusive focus on stocks, which tend to be more volatile than other asset classes. This risk arises from several factors:

- 1. Economic Sensitivity:** The S&P 500 is closely tied to U.S. and global economic conditions, often experiencing steep declines during downturns, such as during the 2008 financial crisis and the COVID-19 pandemic.
- 2. Overvaluation Risk:** The S&P 500 can experience periods of overvaluation, increasing the likelihood of corrections. High investor expectations can lead to sharp declines with any negative economic news, as seen during previous market bubbles.
- 3. Market-Cap Weighting:** The index's performance is dominated by large companies, particularly tech giants like Apple, Microsoft, and NVIDIA. This concentration may amplify risk, especially when the tech sector underperforms, as was evident during the dot-com bubble.

- 4. Global Exposure:** Although the S&P 500 focuses on U.S.-based companies, many have significant global operations, making the index vulnerable to international risks like trade tensions and supply chain disruptions. For example, during the U.S.-China trade war, volatility increased due to uncertainty for globally exposed companies.

The S&P 500's lack of built-in defensive mechanisms makes it particularly vulnerable during market downturns. The drawdowns highlight the risk of substantial price fluctuations, which may be unsettling for investors, especially those who may need to access their funds during periods of significant market stress.

S&P 500 Index (Price Return) performance with more than 20% drawdowns

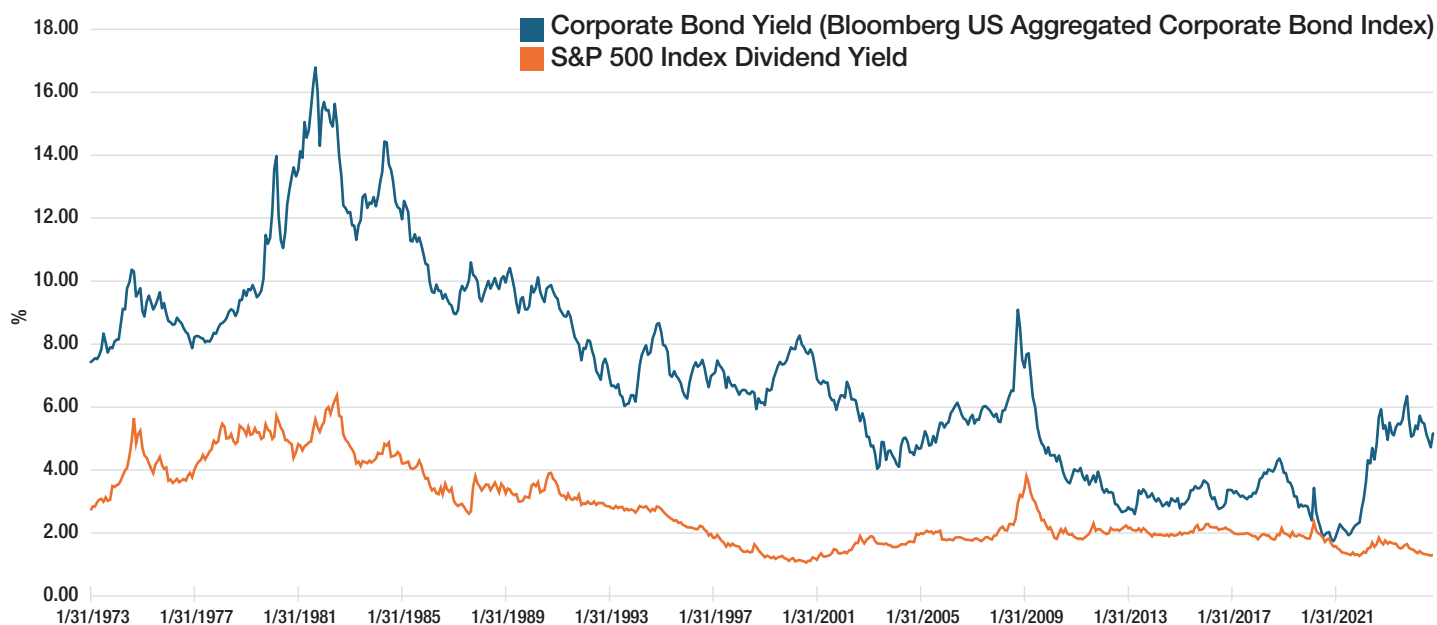
Peak Date	Trough Date	Max Drawdown (Peak to Trough)
9/16/1929	6/1/1932	-86.19%
8/2/1956	10/22/1957	-21.63%
12/12/1961	6/26/1962	-27.97%
2/9/1966	10/7/1966	-22.18%
11/29/1968	5/26/1970	-36.06%
1/11/1973	10/3/1974	-48.20%
11/28/1980	8/12/1982	-27.11%
8/25/1987	12/4/1987	-33.51%
7/16/1990	10/11/1990	-19.92%
7/17/1998	8/31/1998	-19.34%
3/24/2000	10/9/2002	-49.15%
10/9/2007	3/9/2009	-56.78%
9/20/2018	12/24/2018	-19.78%
2/19/2020	3/23/2020	-33.92%
1/3/2022	10/12/2022	-25.43%

Source: Pacer Advisors, Bloomberg

Furthermore, while many companies in the S&P 500 Index pay dividends, the overall yield of the index is lower than other income-focused investments, such as dividend-focused funds, bonds, or real estate. Over the past decade, the S&P 500 Index dividend yield has remained about 1.8% on average, below its historical average. Recently, market rallies have compressed yields further to approximately 1.3%, which may not satisfy investors seeking higher income without adding other yield-focused investments.

S&P 500 Index Dividend Yield vs Corporate Bond Yield

1/31/1973 to 10/31/2024



Source: Bloomberg, Pacer Advisors

Though the S&P 500 has been a cornerstone of many investment portfolios, the challenges and limitation motivate investors to consider alternatives that may offer similar market exposure while potentially addressing the concerns associated with traditional S&P 500 investments. Pacer ETFs offers numerous options that could serve as effective complements or substitutes to direct investment in the S&P 500 by focusing on risk mitigation and income enhancement.

The Pacer Trendpilot US Large Cap ETF (PTLC) uses the “trend-following strategy” on the S&P 500 Index to alternate exposure between equities and T-Bills. When the S&P 500 Index falls below its 200-day Simple Moving Average (SMA), signaling a negative trend, PTLC shifts to short-term Treasuries. This approach aims to reduce market exposure during bearish time and protect against prolonged downturns.

The Pacer Swan Structured Outcome Strategies (SOS) ETFs utilizes the “buffer strategy” to match the performance of the S&P 500 up to a cap while offering downside risk mitigation buffer. For instance, with a set buffer level ranging from 0% to -20%, the strategy effectively shields investors against the first 20% of losses over a one-year period. This strategy provides a known level of downside protection, helping investors navigate market volatility. Currently, the SOS Series contains 12 funds with different defined risk levels, and one fund of funds (The Pacer Swan SOS Fund of Funds ETF, ticker: PSFF) utilizing an active approach, investing in Pacer Swan SOS ETFs.

Using both the buffer strategy and trend-following strategy together may help smooth out market fluctuations. The buffer strategy offers protection in moderate market declines, while the trend-following approach can mitigate losses during more severe downturns by switching to safer assets¹.

On the other hand, the Pacer Metaurus US Large Cap Dividend Multiplier 400 ETF (QDPL) focuses on boosting dividend income while tracking the S&P 500 Index. By using dividend futures contracts and long stock positions, QDPL generates cash distributions up to four times the S&P 500's dividend yield. As of 10/31/2024, the fund's dividend 12-month yield was 5.5%, compared to just 1.30% from the S&P 500. (Fund 30-day SEC Yield: 0.95%)^{2,3}.

⁽¹⁾See more details in Pacer Perspective January 2024: The Investment Case of Effective Risk Management

⁽²⁾See more details in Pacer Perspective November 2024: Dividend Multiplier: An Innovative Way to Enhance Dividend Income Part 1: Dividends and Dividend Futures; Dividend Multiplier: An Innovative Way to Enhance Dividend Income Part 2: Application - Dividend Strips and Multipliers

⁽³⁾See more details in Pacer Perspective September 2024: Dividend Multiplier Series: How Dividend Multipliers Stand Out

By incorporating PTLC, PSFF, and QDPL, a new S&P 500-centric model portfolio could be structured, providing a compelling alternative for investors looking to maintain the broad market exposure while addressing its key limitations. The combined use of PTLC and PSFF provides multiple layers of protection against market corrections and prolonged downturns. The higher cash distribution from QDPL makes it suitable for investors seeking higher income.

By default, we propose a model with equal weight allocations among PTLC, PSFF, and QDPL (the model 1).

Model 1

	Weight
PTLC	33.33%
PSFF	33.33%
QDPL	33.33%

Source: Bloomberg, Pacer Advisors

Model 1 vs S&P 500 Index

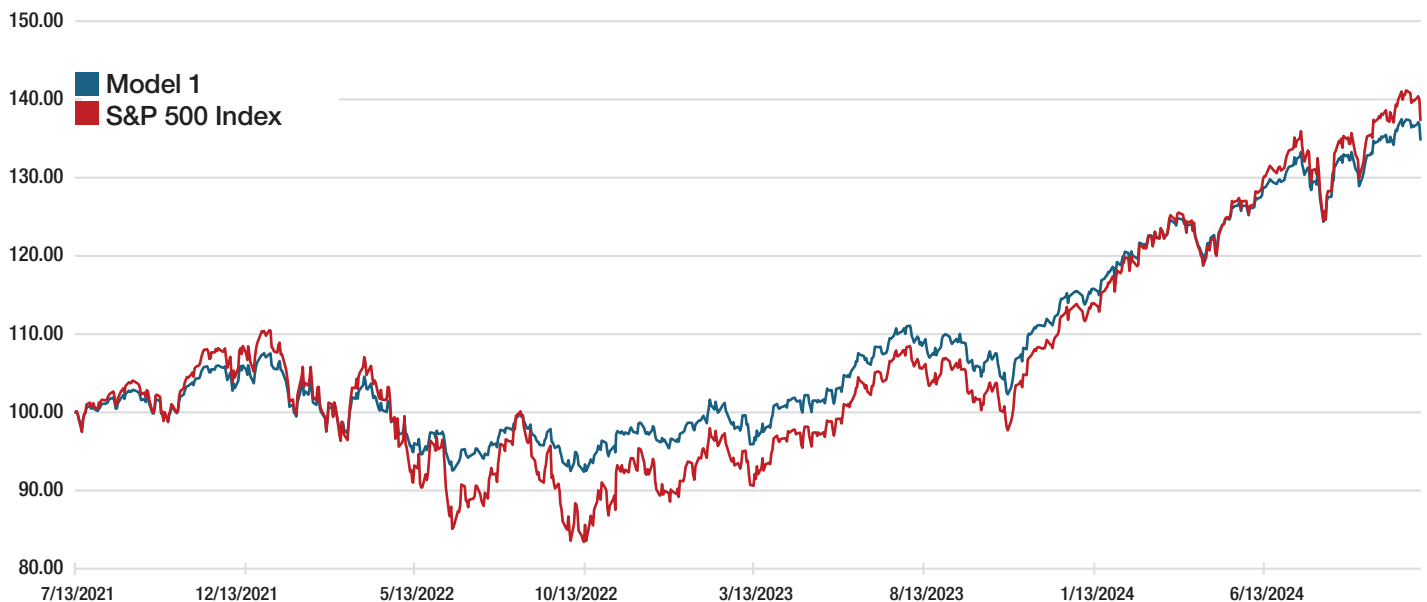
7/13/2021 to 10/31/2024

	Model 1	S&P 500 Index
Returns (Annualized)	9.47%	10.08%
Volatility	10.61%	17.08%
Max Drawdown	-14.12%	-24.49%
Dividend 12 Month Yield (10/31/24)	2.16%	1.30%

Source: Bloomberg, Pacer Advisors

Model 1 Performance vs S&P 500 Index

7/13/2021 to 10/31/2024



Source: Bloomberg, Pacer Advisors

Since common inception (7/13/2021), the model portfolio has a slightly lower annual return compared to the S&P 500, trailing by 0.61 percentage points. However, this difference is relatively modest and can be justified given the improved risk management and yield level.

The portfolio's volatility is significantly lower, with a standard deviation of 10.61% versus 17.08% for the S&P 500. Its maximum drawdown stands at -14.12%, considerably less than the S&P 500's -24.49%. Those indicate that the model is less vulnerable to sharp market fluctuations and downturn. PTLC's ability to shift into T-Bills during bearish trends, along with PSFF's downside buffer, effectively limits losses, making the model particularly suitable for risk-averse investors. Meanwhile, the fact that QDPL is constructed with approximately 88% exposure to S&P 500 stocks also lowers the model's risk profile.

Furthermore, the model portfolio offers a higher dividend yield of 2.16%, compared to the S&P 500's 1.30%. The primary driver of this increased yield is QDPL, which uses dividend futures to boost cash distributions.

The combination of PTLC, PSFF and QDPL serves as an adaptable alternative or complement to investors' core S&P 500 allocation, catering to investors who want a more balanced approach with enhanced income and risk control. The allocation across PTLC, PSFF, and QDPL can further be customized to suit different investor objectives.

- **Income Enhancement:** Investors seeking higher cash flows can increase the allocation to QDPL, which focuses on maximizing dividend income, thereby enhancing the overall yield of the portfolio.
- **Risk Management:** Investors concerned about market volatility and risks might prefer increasing exposure to PTLC and PSFF to further mitigate potential losses during market downturns.

For example, by allocating 50% PTLC and 50% QDPL, the alternative model portfolio (Model 2) has a similar return compared to the S&P 500 Index while still demonstrating significantly lower volatility and drawdown numbers. The higher weighting on QDPL pushes the yield level even higher to more than 3%.

Model 2

	Weight
PTLC	50.00%
QDPL	50.00%

Source: Bloomberg, Pacer Advisors

Model 2 vs S&P 500 Index

7/13/2021 to 10/31/2024

	Model 2	S&P 500 Index
Returns (Annualized)	10.07%	10.08%
Volatility	11.92%	17.08%
Max Drawdown	-16.12%	-24.49%
Dividend 12 Month Yield (10/31/24)	3.24%	1.30%

Source: Bloomberg, Pacer Advisors

Model 2 Performance vs S&P 500 Index

7/13/2021 to 10/31/2024



Source: Bloomberg, Pacer Advisors

In summary, incorporating innovative ETFs like PTLC, PSFF, and QDPL into a traditional S&P 500 portfolio may offer a well-rounded investment approach. These ETFs provide unique strategies for managing risk and enhancing income, making them valuable tools for investors seeking to build a more resilient and adaptable portfolio. By diversifying beyond a traditional S&P 500 allocation, investors may better navigate market fluctuations and position themselves for long-term success.

Annualized returns are the average returns an investment earns per year over a specific period, adjusted to show what the yearly return would be if it were steady each year.

Volatility measures how much an asset's price fluctuates over time, indicating the level of risk or uncertainty in its value. High volatility means large price swings, while low volatility suggests more stable prices.

Max drawdown is the largest decline in an investment's value from its peak to its lowest point over a specific period. It measures the potential downside risk by showing how much an asset could lose before recovering.

Dividends Risk: There can be no assurance that a dividend-paying company will continue to make regular dividend payments. The ability for a company to pay dividends is dependent on the economic climate and the companies' current earnings and capital resources. Changes in economic conditions or a company's earnings or financial resources could cause a company to reduce its dividend payments or suspend the payment of dividends altogether. The possibility that such companies could reduce or eliminate the payment of dividends in the future, especially if the companies are facing an economic downturn, could negatively affect the Fund's performance

SPDR S&P 500 ETF Trust (SPY): The SPDR S&P 500 ETF Trust is an exchange-traded fund under the symbol SPY. The ETF is designed to track the S&P 500 index.

iShares Core S&P 500 ETF (IVV): The iShares Core S&P 500 ETF is an exchange-traded fund under the symbol IVV. The ETF is designed to track the S&P 500 index.

Vanguard S&P 500 ETF (VOO): The Vanguard S&P 500 ETF is an exchange-traded fund under the symbol VOO. The ETF is designed to track the S&P 500 index.

Bloomberg US Aggregated Corporate Bond Index: a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.

Dividend Yield: The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its stock price

Bond Yield: The bond yield is the return an investor expects to receive each year over its term to maturity.

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Fund shareholders are subject to an upside return cap that represents the maximum percentage return an investor can achieve from an investment in a Fund for an Investment Period. Therefore, even though the Funds' returns are based upon the Underlying ETF, if the Underlying ETF experiences returns for an Investment Period in excess of the Cap, an investor will not experience those excess gains. The Cap is set on the first day of a Funds' Investment Period and does not take into account any management fees, transaction costs or expenses charged to shareholders. The Cap will be reduced by these when taken into account.

Each single Buffer Fund only seeks to provide shareholders that hold shares for an entire Investment Period with a buffer against a pre-determined percentage of Underlying ETF losses (based upon the value of the Underlying ETF at the time the Fund entered into the FLEX Options on the first day of its Investment Period) during an Investment Period. You will bear all Underlying ETF losses beyond that pre-determined percentage. The buffer is provided prior to taking into account annual Fund management fees, operating expenses, transaction fees, and any extraordinary expenses incurred by a Fund. A shareholder that purchases shares at the beginning of an Investment Period may lose their entire investment. While each Fund seeks to limit losses for shareholders who hold shares for the entire Investment Period, there is no guarantee it will successfully do so.

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