

Dividend Multiplier: An Innovative Way to Enhance Dividend Income-Potential

Part 2: Application - Dividend Strips and Multipliers

– Danke Wang, Portfolio Manager

With a fundamental knowledge of dividend futures, we can dig deeper into how to utilize dividend futures contracts to enhance an investor's income-potential through the Dividend Multiplier Strategy.

Key Takeaways

- With long positions in the S&P 500's dividend futures contracts, investors can isolate the index's dividend into a separate "investment asset" — a Dividend Strip.
- By holding multiple dividend strips, investors can construct a portfolio producing a multiple of the initial, ordinary dividend yield of the S&P 500 Index.
- The Dividend Risk Premium exists because of the market's mispricing of the S&P 500's future dividend. Realization of the Dividend Risk Premium drives the return of the dividend strip, which further enhances the portfolio's performance-potential.

Dividend Component Creation

Combining a long position in dividend futures and the corresponding full collateral creates a synthetic holding replicating the S&P 500's dividend payment (dividends are not guaranteed). As a result, the S&P 500's dividend becomes an isolated "investment asset," like a stock or bond, so that an investor could purchase it for certain prices.

For example, taking a long dividend futures contract position for \$60 and holding \$60 in cash collateral is the theoretical equivalent of investing in the S&P 500's dividend for a price of \$60.

Here are some potential scenarios:

- If over the period, the actual dividends paid are \$65, the value of the dividend position will also be worth \$65. Because \$5 was received from the settlement of the futures position (the investor received \$65, while paying \$60), and that plus \$60 of cash collateral equals \$65.
- On the other hand, if the actual dividends paid are \$55, the value of the position will be worth \$55: \$60 of cash collateral minus a \$5 "loss" from the futures position ($\$55 - \$60 = -\$5$).

The ending value of the dividend component will equal the actual dividends paid during that period.

Dividend Multiplier Construction

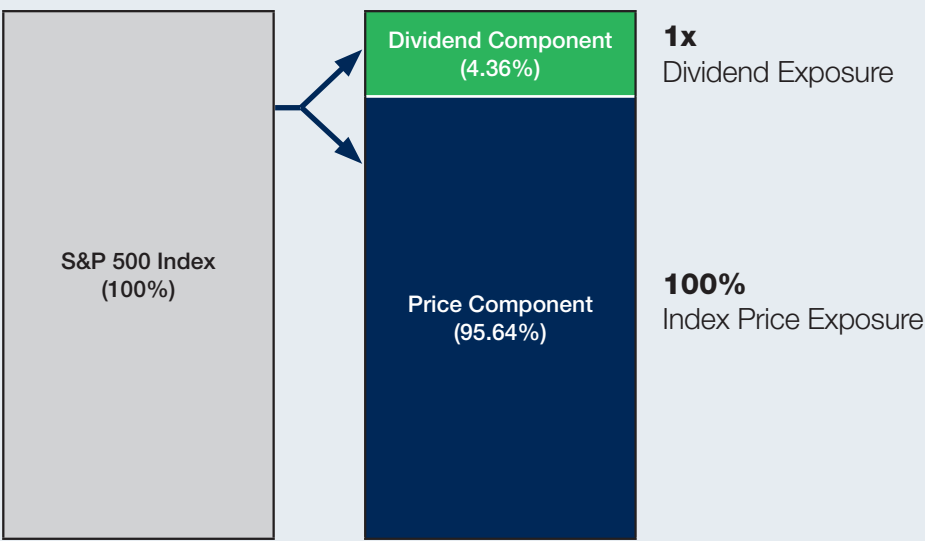
The next step is a simple one: combining the price and dividend components like “asset” allocation.

To create a portfolio mimicking the S&P 500’s return for a year while utilizing the dividend and price component, an investor can allocate 1 unit of the one-year dividend component along with 1 unit of the one-year price component (the dividend component and price component should have the same maturity to meet the 1:1 ratio requirement).

Assuming S&P 500 dividend futures for 2022 are trading at \$60 and, the S&P 500 Index is at \$4,200, the value of the 1-year dividend strip is worth \$60 or 1.43% of the S&P 500 Index value. Furthermore, to take advantage of the dividend risk premium (more on this later), an investor can also allocate to a longer-term dividend strip. A 3-year dividend strip, for instance, can be used to match the price component of the same time length.

Hypothetically, if the S&P 500’s dividend futures for 2022, 2023 and 2024 are trading at \$60, \$61 and \$62, respectively, then the 3-year dividend strip would be approximately 4.36% of the value of the S&P 500 (\$183/\$4,200).

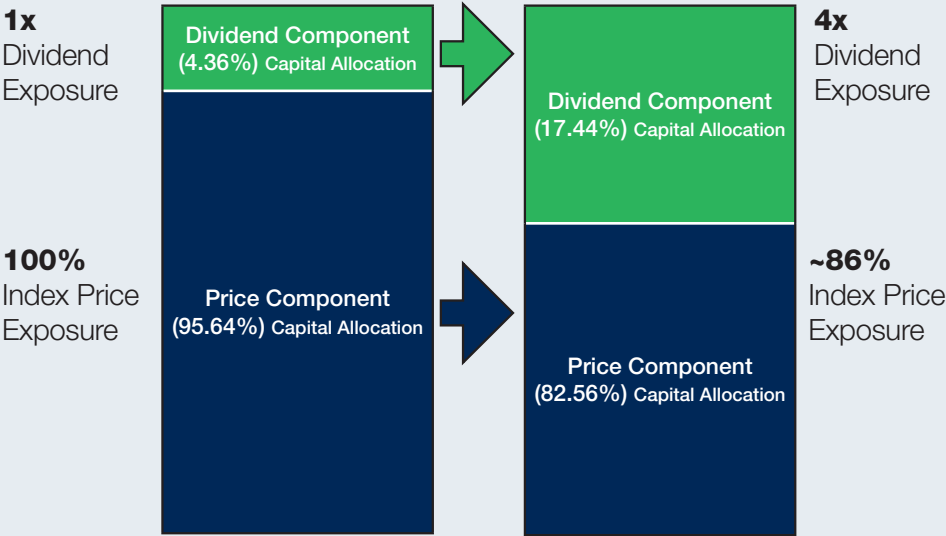
Then the allocation to the price component will be 95.64% (see chart to the right).



The chart above shows the realization of 1x dividends by allocating 1 unit of the dividend strip. By multiplying the dividend strip allocation, a dividend multiplier strategy emerges.

A quadruple dividend multiplier strategy is designed to provide 4x the dividend yield of the S&P 500. In the previous example, if 1 dividend component accounts for ~4.36% of the portfolio, then 4 dividend component units mean 17.44% (4 x 4.36%) of the capital is allocated to the S&P 500 dividend futures contracts, while 82.56% is on the price component.

Due to reduced allocation to the price exposure (82.56% vs. 95.64%), the quadruple dividend multiplier should demonstrate an estimated beta of 0.86 (see chart to the right).



The dividend multiplier strategy involves overweighting the dividend component and subsequently under-weighting the price component to enhance the overall dividend level. Here's the trade-off: to get a multiple of the index's dividend yield, an investor must give up some of the S&P 500's price exposure, thereby reducing the portfolio's beta. Which is why in the above example the beta is 0.86.

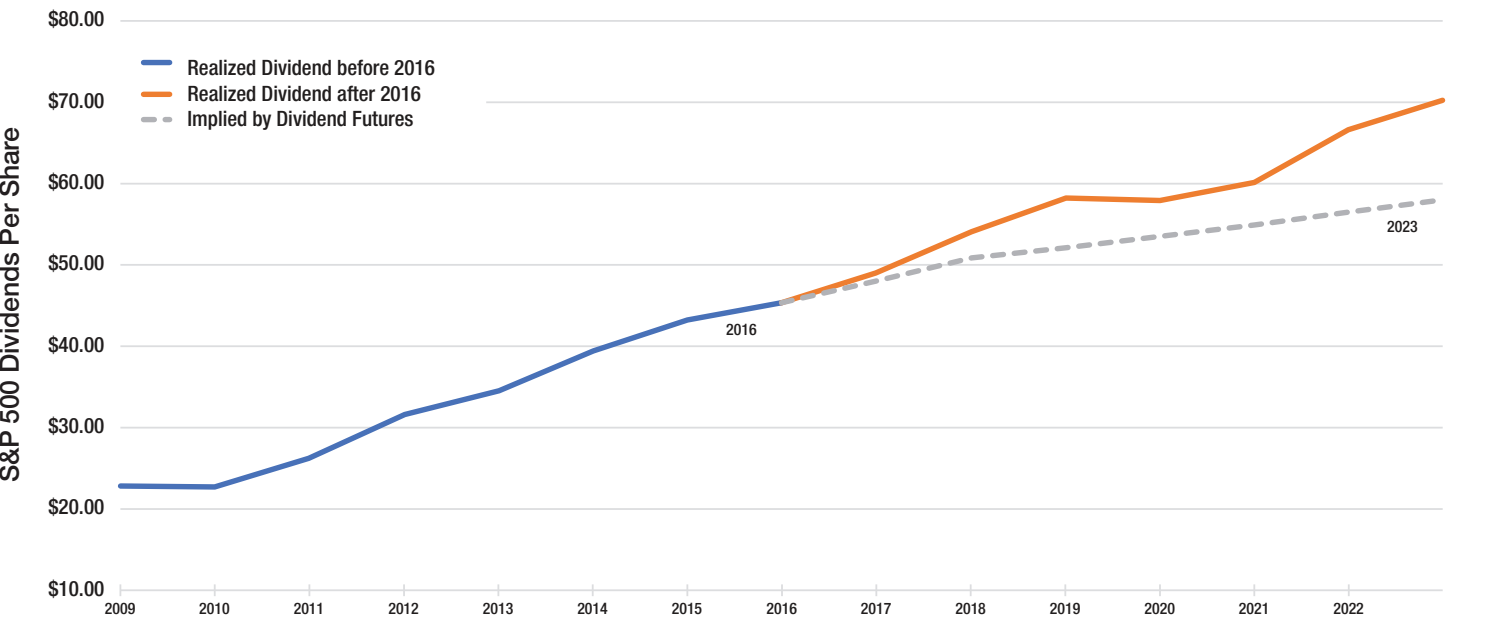
PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. YOU CANNOT INVEST IN AN INDEX.

Dividend risk premium

Finally, let's talk about what's driving the excess returns of dividend futures contracts.

Historically, forward dividend expectations of the S&P 500 index (the dividend futures price) have been substantially lower than the realized dividend (the settlement value of the dividend futures contract).

S&P 500 Dividend Implied vs Realized
2009 - 2023



Source: Bloomberg

For example, as of December 2016 based on the dividend futures price, the implied 1-year and 3-year dividend growth was 5.84% and 14.88%, respectively.

However, the actual 1-year dividend growth in 2017 was 8.07%, while the S&P 500 dividend grew 28.36% from 2016 to 2019. Both numbers indicate that market expectation on the S&P 500 dividend was lower than the actual amount.

The discount between implied and realized dividends translates to investment returns on dividend futures contracts (because investors pay the price based on expectation while receiving the value of the actual dividend amount).

The table to the lower right shows the cumulative and annualized return when investing in the N –period dividend futures at the end of 2016. The annualized return is referred to as the **realized dividend risk premium**.

	Implied Dividend Growth vs. 2015	Realized Dividend Growth vs. 2015
2017	5.84%	8.07%
2018	12.12%	19.23%
2019	14.88%	28.36%
2020	17.97%	27.73%
2021	21.05%	32.60%
2022	24.58%	46.87%
2023	27.89%	54.88%

Source: Bloomberg

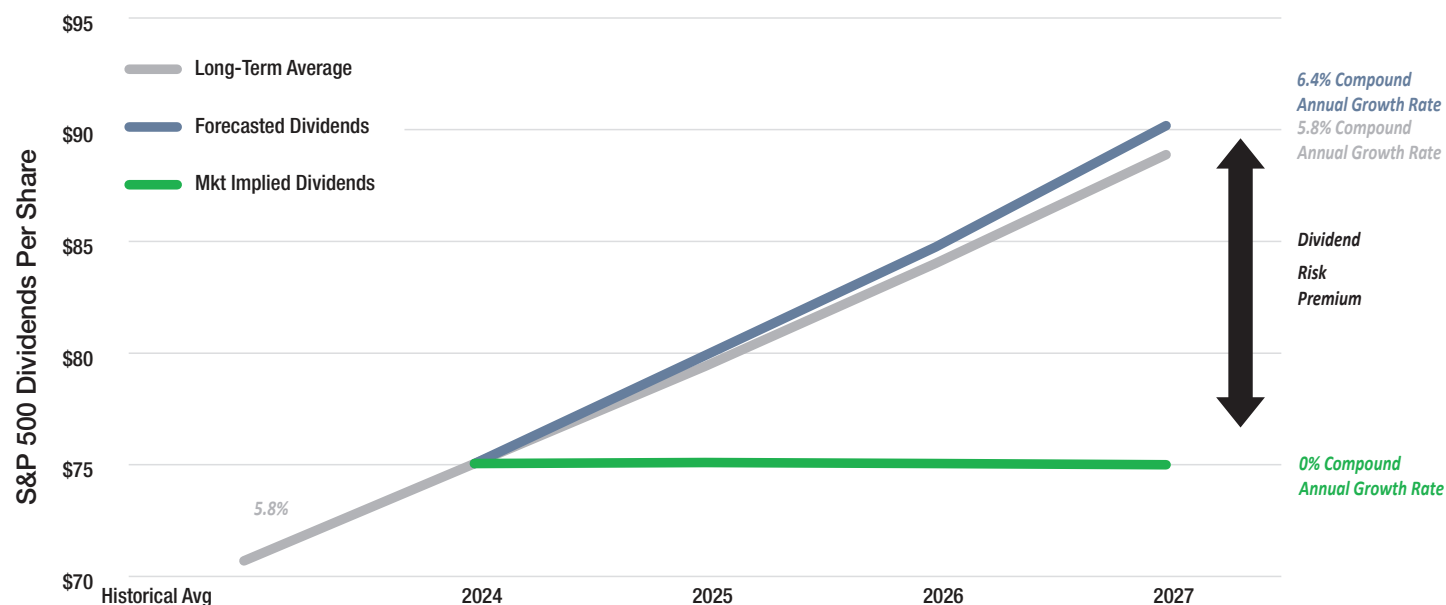
	N –period	Annualized Return (Realized Risk Premium)	Cumulative Return
Year 1	2017	2.11%	2.11%
Year 2	2018	3.12%	6.34%
Year 3	2019	3.77%	11.74%
Year 4	2020	2.01%	8.28%
Year 5	2021	1.84%	9.54%
Year 6	2022	2.78%	17.89%
Year 7	2023	2.77%	21.10%

Source: Bloomberg

The dividend risk premium is what investors demand to compensate them for the risk of actual dividends coming short of market expectations. Like a risk premium, the dividend risk premium indicates that investing in the dividend strip comes with certain risks, but it also has the potential for rewards.

On a forward-looking basis, the dividend risk premium can be measured using the difference between dividend futures prices and analyst dividend forecasts. As of 9/30/2024, equity analysts expect the S&P 500 index to grow its dividend by 6.4% annually for the next 3 years, while the current futures market implies a 0% dividend growth per year till 2027.

S&P 500 Dividend Futures trade at a discount to analyst expectations as of 9/30/2024



Source: Bloomberg

The disagreement between the futures price and consensus estimates indicates that investors can take advantage of a decent risk premium to enhance investment return-potential.

The Pacer Metaurus Dividend Multiplier Strategy extends the dividend strip to a 3-year period (dividend futures contracts maturing in 1, 2 and 3 years), seeking compensation with higher premiums.



Pacer Metaurus US Large Cap Dividend Multiplier 400 ETF

Utilizes the dividend multiplier strategy to reallocate capital between an index's dividend cash flow and potential price appreciation/depreciation. By holding 4 times the dividend component, including dividend futures and equity investment, the fund aims to provide cash distributions equal to 400% of the S&P 500's ordinary yield in exchange for modestly lower exposure (approximately 90%) to the S&P 500 Index performance.

As of 10/31/2024, the fund's indicated yield is 5.46% vs. only 1.3% from S&P 500. At the same time, the 1-year beta is 0.91.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. YOU CANNOT INVEST IN AN INDEX.

Pacer Metaurus US Large Cap Dividend Multiplier 400 ETF
Fund Details as of 9/30/24

30-Day SEC Yield*	1.00%
Indicated Yield	5.45%

30-Day SEC Yield is the Fund's annualized total net investment income per share for the 30-day period ended on the last day of the month. Indicated Yield is the most recently announced dividend amount, annualized based on the payment frequency, then divided by the last price. *Does not include the dividend futures.

					Total Returns (%) as of 10/31/24			Total Returns (%) as of 9/30/24			
	Ticker	Total Expenses	Fund Inception		1 Month	3 Month	YTD	1 Year	3 Year	5 Year	Since Fund Inception
Pacer Metaurus US Large Cap Dividend Multiplier 400 ETF	QDPL	0.79%	7/12/21	NAV	-0.66	3.18	19.02	32.49	10.80	N/A	9.57
				Market Price	-0.11	3.60	19.66	32.20	10.66	N/A	9.55
Metaurus US Large Cap Dividend Multiplier Index - Series 400					-0.69	3.22	19.19	32.83	11.32	N/A	10.11
S&P 500 Index					-0.91	3.66	20.97	36.35	11.91	15.98	10.54

Returns less than 1 year are cumulative. Returns greater than 1 year are annualized.
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Market Price is the price investors can buy and sell ETF shares for in the stock market and is used to calculate market return. It is based on the price at the listed exchange market close. This is when NAV is determined for most ETFs. If shares trade at another time, the return may differ. Market and NAV returns assume that dividends and capital gain distributions have been reinvested in the Fund at Market Price and NAV respectively.

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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.

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Beta is a concept that measures the expected move in a stock relative to movements in the overall market. A beta greater than 1.0 suggests that the stock is more volatile than the broader market, and a beta less than 1.0 indicates a stock with lower volatility.

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