A Compelling Short-Term Investment Opportunity in Buffer ETFs

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Key Takeaways:
* While Buffer ETFs are generally considered long-term investments, there are times when they offer very attractive short-term opportunities, intra-outcome period.
* It is rare to see a market decline of greater than 7% or 9% over a two- or three-month period.
* There is not an increased chance of a sharp decline during election years. 2008 is the only election year since 1960 that experienced a three-month return of worse than -3.6% leading up to the election.

For those of you who are new to Buffer ETFs, they are one of the fastest growing corners of the ETF marketplace and have attracted nearly $50 billion over the past 6 years. Buffer ETFs are sometimes referred to as Defined Outcome ETFs, Target Outcome ETFs, or Buffered ETFs, but they are all essentially the same investment vehicles. Buffer ETFs allow investors to track a well-known stock index (e.g. S&P 500) over a defined outcome period (typically one year), with built-in protection against initial losses. The level of protection will vary depending on the Buffer series purchased.

The cost of the downside protection in Buffer ETFs is the investor's upside profit potential is capped over the outcome period. For example, a Buffer ETF offering 15% downside protection could have gains capped at 13%. The investor will forego any profits of the underlying asset that exceed the cap at the end of the 12-month outcome period. At the end of the outcome period, on the reset date, the investor receives new protection and a new upside cap, so Buffer ETFs can be held for the long term.

Yes, Buffer ETFs are generally considered long-term investments, but there are times when they offer very attractive short-term opportunities, intra-outcome period.

This past week we reviewed over 200 Buffer ETFs that currently trade on U.S. markets. We'd like to highlight two Buffer ETFs that are extremely attractive short-term investments in the current volatile environment. POCT (Innovator U.S. Equity Power Buffer – October) and PNOV (Innovator U.S. Equity Power Buffer - November) have short-term outcome parameters that offer annualized returns of 9% and 8.2% to the next reset dates, even if the underlying asset (S&P 500 "SPY") declines by 7% or 9% respectively.

POCT (Innovator U.S. Equity Power Buffer – October)

By utilizing *Innovator's* Potential Outcome Analyzer Tool (www.innovatoretfs.com), we can determine how much protection an investor has prior to experiencing a loss in POCT.

During the remainder of the outcome period (49 days), as long as SPY's return is positive, flat, or declines by no more than 7%, POCT will return approximately 1.2% net. On the next reset date POCT will receive fresh 15% downside protection and a new upside cap for the next 12 months.

PNOV (Innovator U.S. Equity Power Buffer – November)

PNOV currently offers approximately 9% protection before it will show a loss during the remainder of its outcome period. The net remaining upside for PNOV is 1.8% over the 80 days that remain in the outcome period. If the return of the reference asset (SPY) is positive, flat, or does not decline by more than approximately 9%, an investor who purchases PNOV today will earn 1.8%. Note, if SPY declines by more than 9%, PNOV will experience a 1-to-1 loss with the reference asset loss.

How can an investor earn a profit in POCT and PNOV even if the reference asset declines?

Both POCT and PNOV have lagged the return of the underlying reference asset (SPY) since the last reset dates, but they will likely close the performance gap somewhat as the ETFs approach their upcoming reset dates. SPY has returned close to 30% since the last reset dates for both POCT and PNOV, but PNOV is only up approximately 13.17%. It had an initial cap of 14.97% net, which means it is poised to gain another 1.8% to the next reset date.

POCT had an initial net cap of 14.70% on its last reset date and it has returned close to 13.50%. It has remaining upside of 1.2% which will likely be realized over the next 49 days.

Because of the way the four option contracts on SPY are currently priced within POCT and PNOV, and the time value remaining on the options, there is an opportunity for investors to make a decent annualized return, even if the underlying asset (SPY) declines by quite a bit leading up to the reset dates. Again, POCT would still show a 1.2% net gain over the next 49 days if SPY doesn't decline more than 7%, and PNOV will show a gain of 1.8% if SPY doesn't decline more than 9%. Note, the remaining outcome parameters are updated throughout each trading day on *Innovator's* website.

How do the annualized returns of POCT and PNOV compare to the risk-free return of Treasury bills?

POCT offers a return of approximately 1.2% over the next 49 days. This equates to an annualized return of nearly 9%.

PNOV offers a return of approximately 1.8% over the next 80 days. This equates to an annualized return of 8.2%.

At the time of this writing (August 12, 2024), 13-week Treasury bills yield 5.07% annualized. POCT offers a potential annualized return that is 77% higher than T-bills and PNOV offers a potential annualized return that is 61% higher. Still, there is obviously a risk of loss in the Buffer ETFs if the reference asset declines by more than the remaining protection. So, it's important to consider the risk of loss vs. the extra return received above the risk-free rate of T-bills. Is it worth the risk, and what is the probability of a loss in the Buffer ETFs to the next reset dates?

What is the probability of a 7% or 9% decline in the S&P 500 over any two or three-month period?

The table below shows the probability of a drop of more than 7% over two consecutive months and a drop of more than 9% over three consecutive months in the S&P 500.

<u>POCT - Drop of More Than 7% Over Two Consecutive Months</u>

Time Period	**Number of Times the S&P 500 Has Declined by More Than 7%**	**Outcome Periods**	**Probability**
Since 1957	65	799	8.1%
Last 20 Years	18	240	7.5%
Last 10 Years	9	120	7.5%

<u>PNOV - Drop of More Than 9% Over Three Consecutive Months</u>

Time Period	**Number of Times the S&P 500 Has Declined by More Than 9%**	**Outcome Periods**	**Probability**
Since 1957	52	799	6.5%
Last 20 Years	15	240	6.2%
Last 10 Years	3	120	2.5%

** Ideally, we would look at 49-day returns and 80-day returns (49-day outcome period for POCT and 80-day outcome period for PNOV), but the data are not easily accessible. In addition, the data are calculated using calendar month returns, but for the most accurate results we would look at any 49-day period and 80-day period regardless of the calendar month.*

What's the probability of a decline of more than 9% over the three months leading up to a U.S. presidential election?

Below is a list of election years, the Democratic and Republican candidates, the monthly returns leading up to the election (August, September, October), and the total three month return since 1960 (the first election year after the inception of the S&P 500 in 1957). The winner of the election is in bold.

Year	Democratic Candidate	Republican Candidate	August	September	October	3-Month Total Return
2024	Kamala Harris	Donald Trump	1.70%			
2020	**Joe Biden**	Donald Trump	7.01%	-3.92%	-2.77%	0.32%
2016	Hillary Clinton	**Donald Trump**	-0.12%	-0.12%	-1.94%	-2.18%
2012	**Barack Obama**	Mitt Romney	-1.98%	2.42%	1.98%	2.42%
2008	**Barack Obama**	John McCain	1.22%	-9.08%	-16.94%	-24.8%
2004	John Kerry	**George W. Bush**	0.23%	0.94%	1.40%	2.57%
2000	Al Gore	**George W. Bush**	6.10%	-5.4%	-0.5%	0.20%
1996	**Bill Clinton**	Bob Dole	1.90%	5.40%	2.60%	9.9%
1992	**Bill Clinton**	George H.W. Bush	-2.40%	0.90%	0.20%	-1.3%
1988	Michael Dukakis	**George H.W. Bush**	-3.90%	4.00%	2.60%	2.7%
1984	Walter Mondale	**Ronald Reagan**	10.60%	-0.4%	0.00%	10.2%
1980	Jimmy Carter	**Ronald Reagan**	0.60%	2.50%	1.60%	4.7%
1976	**Jimmy Carter**	Gerald Ford	-0.50%	2.20%	-2.20%	-0.5%
1972	George McGovern	**Richard Nixon**	3.50%	-0.50%	0.90%	3.9%
1968	Hubert Humphrey	**Richard Nixon**	1.20%	3.80%	0.70%	5.7%
1964	**Lyndon B. Johnson**	Barry Goldwater	-1.70%	2.90%	0.80%	2%
1960	**John F. Kennedy**	Richard Nixon	2.70%	-6.10%	-0.20%	-3.6%

There have been 16 elections since 1960 (excluding 2024) and only one three-month return of worse than -9% (6.25% probability). 2008 is the only year that experienced a greater than

9% drop in the S&P 500 (-24.8%). The data are similar to our broader sample and would suggest there is not an increased risk of a greater than 9% drop during an election year.

Summary

Conservative or moderate-risk investors should find *Innovator's* two U.S. Equity Power Buffer ETFs, POCT and PNOV, attractive short-term investments. Both POCT and PNOV have remaining outcome periods of less than three months and offer potential annualized returns approximately 77% and 61% higher than Treasury bills. However, unlike T-bills, there is risk of loss with both POCT and PNOV in the event the underlying asset (SPY) declines by more than 7% or 9%, respectively.

If you're looking for a short-term investment that offers a compelling annualized return, with a high historical probability of success, consider POCT and PNOV.

At the time of publication, Stuart Chaussée, Henry Chaussée, and/or clients of Stuart Chaussée & Associates, Inc., held positions in POCT, PNOV and SPY. Holdings can change at any time. Under no circumstances does the information in this article represent investment advice or a recommendation to buy or sell securities.