TRUESHARES

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Balancing Risk Management and Growth Potential in Equity Investments

BALANCING RISK MANAGEMENT AND GROWTH POTENTIAL IN EQUITY INVESTMENTS

The abrupt return of equity market volatility has been a major investment consideration in 2020. Among the ten largest one-day increases in the CBOE Volatility Index over the last 30 years, 4 have happened (so far) this year.[1] With ongoing uncertainty surrounding the timing of a coronavirus vaccine, employment concerns impacting consumer behavior and overall corporate profitability, not to mention potential election fallout, catalysts remain for significant market swings in the near- to mid-term.

Against this backdrop, investors are faced with additional challenges related to traditional choices for managing equity volatility. Diversifying further into fixed income is an option, but increased demand for this asset class would dampen return potential in an already historically low-interest rate environment. Shifting to cash is an extreme and short-sighted plan, particularly given that many investors need long-term growth and that the U.S. markets have shown notable resiliency in 2020. Furthermore, neither minimum volatility equity portfolios nor preferred stocks have provided the panacea.

Can Structured Outcome ETFs represent the missing portfolio ingredient? Let's examine.

How Returns are Generated Matters

As we know from historical equity market performance, *returns don't happen in a linear fashion*. Even though there has been a long-term positive return profile for equities, there are peaks and valleys, leading to what we often describe as a "lumpy" return experience. As part of that experience, the longer-term impacts of downside volatility can strongly influence overall performance results, especially as retiring investors begin drawing down their accounts.

To demonstrate this, the hypothetical illustration on the next page looks at two portfolios with identical annual rates of return but with different volatility characteristics. As we look at the results, we see the that impact of higher standard deviation on the first portfolio led to a complete drawdown of the account value, while the lower volatility profile of the second portfolio led to an ending value over $1 million dollars over the same time period.

Hypothetical Illustration: Volatility's Impact on Portfolios[2]

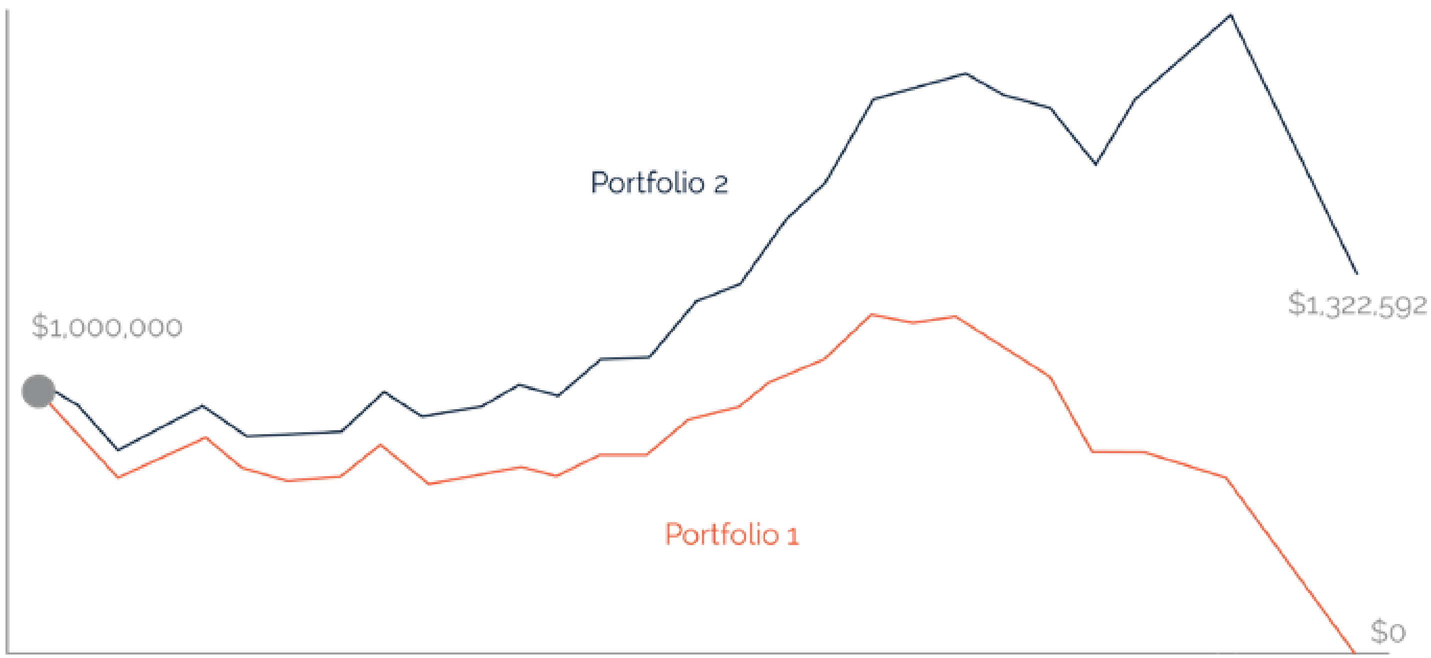


Illustration Assumptions[2]

	Portfolio 1	Portfolio 2
Annual rate of return	9.97%	9.97%
Annual std. deviation	16.32%	11.82%
Initial annual withdrawal	$50,000	$50,000
Annual cost-of-living adjustment	5%	5%
Total Income	$3,317,632	$3,321,942
Starting account value	$1,000,000	$1,000,000
Ending account value	$0	$1,332,592

2. Source: SpiderRock Advisors. For illustrative and discussion purposes only. Performance shown is hypothetical and based on certain assumptions. It does not represent the performance of any TrueShares fund. The illustration is meant to illustrate the impact of higher vs. lower volatility on overall account results when clients are making withdrawals. Performance shown is hypothetical and based on assumptions. As illustrated above, the key assumptions utilized in the analysis above include a.) holding equal geometric mean returns, initial annual withdrawal amounts, and annual cost-of-living adjustments to the annual withdrawals, and b.) the stated differences in the annual volatility (as represented by annual standard deviation) between the two investors' portfolios. The returns streams used in this analysis are hypothetical and are not tied to, or meant to represent, any index or security. They are intended to solely represent a mathematical exercise. Results may vary with each use and over time. IMPORTANT: The projections or other information regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. There is no guarantee that the goal to seek less volatility would be achieved in any time frame. Market Risk is still present and investors may still be susceptible to general stock market fluctuations and to volatile increases and decreases in value as market confidence in and perceptions of their issuers change. These investor perceptions are based on various and unpredictable factors including: expectations regarding government, economic, monetary and fiscal policies; inflation and interest rates; economic expansion or contraction; and global or regional political, economic and banking crises.

The exercise above further supports exploring ways to lower portfolio equity volatility for investors that are utilizing their portfolio for income-generation purposes. These investors traditionally maintain growth components in their portfolios to help support cost-of-living standards but at the same time generally have lower risk appetites. Add in the income-dampening effect of an ongoing low-rate environment and there emerges a case for exploring alternative sources of risk-managed returns.

Buffering Downside Exposure

Structured outcome strategies have been available in various structures for decades but have only recently started to arrive in lower-cost, higher-liquidity ETF structures. These products often offer a form of downside risk mitigation or "buffer", seeking to protect investors against the first losses of a specific equity benchmark (ex. S&P 500, Nasdaq 100, Russell 2000) while offering upside participation to a specified level. This is achieved through a series of option sales and purchases to provide market exposure and establish both downside buffer and upside participation levels.

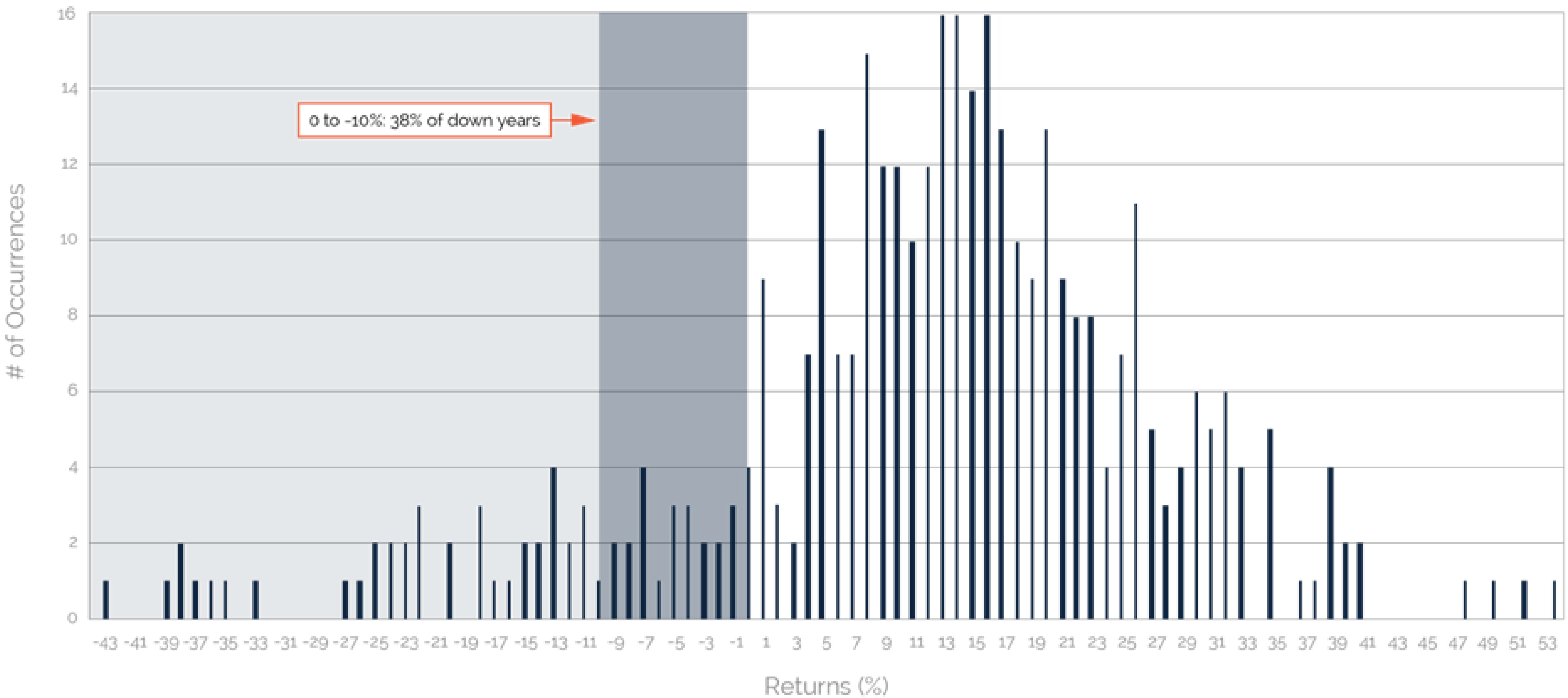
The concept is relatively simple but elegant: investors can choose a desired buffer level with the understanding that increased downside protection potential comes with the tradeoff of less upside participation. The availability of multiple buffer levels enables a variety of investors with different risk appetites the potential to find a strategy that fits their needs.

How We View Downside Buffers and Our Approach

At TrueShares, we've established a targeted 10% buffer (within a range of 8-12%) on the first losses of the S&P 500 Price Index in our Structured Outcome ETFs. This buffer level reflects our belief in a long-term, positive return bias for U.S. equity markets, and as a result, a need to maximize upside participation should markets enter a period of significant outperformance (keep an eye out for a related future post on upside participation strategies in buffered products). These "right-tail" events play an important role in the long-term performance advantage that equities have historically had when compared to many other asset classes.

Focusing in on U.S. large-cap equities (represented by the S&P 500 Index), we chart a historical distribution of rolling 1-year returns on the following page. As we shift the lens onto down years, we see negative return periods occurred roughly 20% of the time. When negative years happened, approximately 40% of the time the annual decline ranged between 0 and -10%. For buffered strategies that cover that range, investors should expect they would avoid any of that selloff on a gross of fees basis. For negative returns beyond that level, investors would begin experiencing declines in their investment, but could anticipate still seeing overall performance benefits based on not participating in the initial selloff of the underlying benchmark.

S&P 500 Index Rolling 1-Year Return Periods (1/31/1998 – 9/30/2020)[3]



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Why a 10% Buffer Level?

With an understanding of this historical market behavior and augmented by empirical performance aggregation from our sub-advisor, SpiderRock Advisors (an asset management company focused on custom option overlay strategies), we believe that the 10% buffer level over a one-year period represents an ideal risk-return tradeoff point, striking a balance between providing a degree of downside risk mitigation and seeking to maximize upside participation for our uncapped Structured Outcome strategy. For example, expanding the buffer level to 15% would lower upside participation potential to a degree that would offset any marginal benefit that came with the additional risk mitigation. With that said, we understand that additional buffer levels will be attractive to some investors who are more risk averse.

Additionally, as we look at institutional ownership of put options, the 10% out-of-the-money price level is a heavily traded area of the options market, resulting in opportunities for better liquidity and pricing for options transactions. While these are more nuanced reasons, they do potentially offer extra benefits to investors in products that are trading options in that strike price range.

Conclusion

Exposure to equities is a must-have for most investors seeking a growth component in portfolios. We believe that group of investors has grown in size due to the challenges of a low-interest rate environment. Yet expanding equity allocations can be stressful to more conservative investors. It's our view that in those cases, advisors and investors should explore structured or defined outcome strategies, with a focus on identifying a comfortable tradeoff point between adding risk mitigation and still allowing for a significant level of upside participation

Footnotes
1. Source: Bloomberg, as of 9/30/2020. It is not possible to invest directly in an index.
3. For illustrative and discussion purposes only. Source: Bloomberg, as of 9/30/2020. Rolling returns shown in the chart represent 1-year returns measured on a monthly basis for the previous 1-year period, with the first return measured 01/31/1989. The lines in the chart represent the total number of occurrences for a given return percentage over the full date range noted. Index performance shown is for the S&P 500 Total Return Index and does not represent TrueShares fund performance. It is not possible to invest directly in an index. Values in the chart are rounded to the nearest whole percent. **Performance data quoted above represents past performance and does not guarantee future results.**

Important Information
The content herein includes the views, opinions and analysis of the investment manager as of the date of publication. These views and information are subject to change without notice, and are not meant to be a complete analysis of any market, industry, country, or company.

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All investments involve risk including possible loss of principal.

Before investing, carefully consider the True- Shares ETFs investment objectives, risks, charges and expenses. Specific information about the True-Shares is contained in the prospectus and a summary prospectus, copies of which may be obtained by visiting true-shares.com. Read the prospectus carefully before you invest. Foreside Fund Services, LLC, distributor.

The Fund has characteristics unlike many other traditional investment products and may not be suitable for all investors. You should only consider an investment in the Fund if you fully understand the inherent risks, which can be found in the prospectus.

RISK CONDISDERATIONS

An investment in an ETF is subject to risks and you can lose money on your investment in an ETF. There can be no assurance that the ETF will achieve its investment objective.

The Fund is recently organized with no operating history for prospective investors to base their investment decision which may increase risks. The Fund employs a buffered strategy in an attempt to buffer against losses in the S&P 500 Price Index over the course of a 1-year period. There is no guarantee the Fund will be successful in this strategy, and investors may experience losses beyond targeted levels.

The Fund invests in options, which involves leverage, meaning that a small investment in options could have a substantial impact on the performance of the Fund. The Fund may invest in FLEX Options issued and guaranteed for settlement by the OCC. The Fund bears the risk that the OCC will be unable or unwilling to perform its obligations under the FLEX Options contracts. Additionally, FLEX Options may be illiquid, and in such cases, the Fund may have difficulty closing out certain FLEX Options positions at desired times and prices. As the options the Fund invests in derive their performance from the S&P 500 Price Index, the Fund is subject to the equity market risk associated with the index.

Additional risks of investing include management, non-diversification, portfolio turnover and tax risks. Detailed information regarding the specific risks of the funds can be found in their prospectuses.

The ETF's portfolio is more volatile than broad market averages. Shares of ETFs are bought and sold at market price (not NAV) and are not individually redeemed from the ETF. ETF shares may only be redeemed directly with the ETF at NAV by Authorized Participants, in very large creation units. There can be no guarantee that an active trading market for ETF shares will develop or be maintained, or that their listing will continue or remain unchanged. Buying or selling ETF shares on an exchange may require the payment of brokerage commissions and frequent trading may incur brokerage costs that detract significantly from investment returns.

The Fund is designed to seek to achieve its strategy for investments made on the Initial Investment Day and held until the last day of the Investment Period. Investors purchasing shares in the fund after its 12-month investment period has begun or selling shares prior to the end of the investment period, may experience very different results than the fund's stated investment objective. These periods begin at either the fund's inception date or at each subsequent "Initial Investment Day". Following the initial investment period after fund inception, each subsequent investment period will begin each year on the first day of the month the fund was incepted (subsequent "Initial Investment Days"). Fund management will target a 10% downside buffer, with expectations that it will generally fall between 8-12%. The Fund is not designed to protect against declines of more than 8-12% in the level of the S&P 500 Price Index, and there can be no guarantee that the Fund will be successful in implementing the buffer protect options strategy to avoid the first 8-12% decline.

Index Description: The S&P 500® Index is a widely recognized capitalization-weighted index that measures the performance of the large-capitalization sector of the U.S. stock market. The S&P 500 Price Index does not include reinvestment of dividends. Securities in the ETF's portfolio will not match those in any index. **The ETF is benchmark agnostic and corresponding portfolios may have significant non-correlation to any index**. Index returns are generally provided as an overall market indicator. You cannot invest directly in an index. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction.

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