Pursuing Yield and Capital Growth with Derivative Income Instruments

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- *Investors can aim to create income while maintaining the potential for capital appreciation through a "buy-write" strategy, an options program that is the equivalent of buying an index or stock (long position) while simultaneously selling a call option on that index or stock.*
- *Morningstar created the "derivative income" category for these types of strategies, and the popular category attracted $22 billion in new inflows during 2023[1].*
- *Amundi US's process is differentiated by a focus on single stock options, which can potentially deliver additional incremental yield and more consistent income than an index-based approach.*

As markets have evolved, investors have used a variety of instruments to meet a diverse range of investment objectives. Quantitative easing severely and artificially compressed interest rates caused income to become particularly scarce, resulting in a flourishing "structured products" market focused on meeting the income challenge. Structured notes evolved to combine the characteristics of a variety of instruments, which can include equity, credit, currencies, interest rates, and commodities, into a security with a specific return and yield profile.

One of the more popular methods for creating potential income while maintaining the potential for capital appreciation is the structuring of a "buy-write" equity-linked note (ELN). This is a bullish options program equivalent to buying an index or stock (long position) while simultaneously selling a call option on that same index or stock. The selling of an "out of the money" covered call option allows the seller to collect a premium wrapped into a bond-like security with a monthly coupon. Repayment of principal occurs at the agreed maturity date +/- the underlying stock performance.

According to Morningstar, these types of funds have become increasingly attractive, and in 2021, Morningstar created the Derivative Income category for these types of strategies. Their popularity has continued, with the category attracting approximately $22 billion in new inflows during 2023[1].

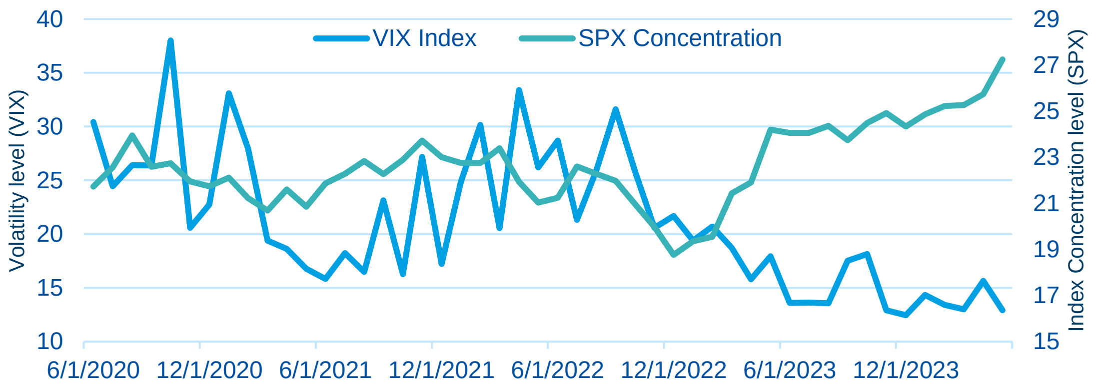
Potential Income opportunity: There is no (passive) free lunch

Over the last two years, market conditions have changed in a variety of ways, including interest rate levels, inflation, equity valuations and credit spreads. An additional market phenomenon includes the extraordinary level of concentration in equity market performance. Strong earnings growth and speculation on technology-related stocks has led to the substantial narrowing in market breadth and changes to the composition of major benchmark indices such as the S&P 500.

As Exhibit 1 demonstrates, the five stocks that make up almost 30% of the market have overwhelmed the performance of the remainder of the index. This has led to a steady but significant reduction in market volatility (shown by the VIX Index) at the index level, which has typically led to lower yields on indexed structured products.

[1] Source: Bloomberg, Aug 31, 2024.

Exhibit 1: Volatility vs index concentration

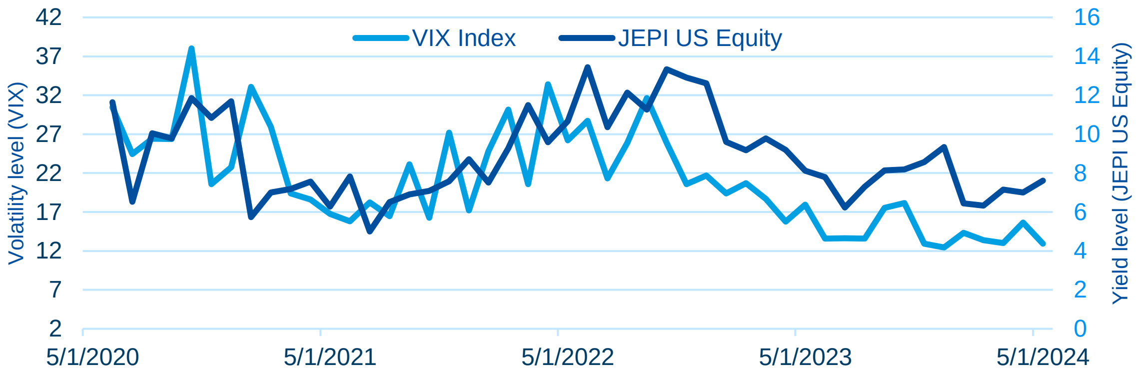


Source: Bloomberg, Aug 30, 2024. Volatility as depicted by Chicago Board Options Exchange's CBOE Volatility Index (VIX). Index concentration is represented by the five stocks referenced in paragraph above, depicted by S&P 500 Equal Weight Index (SPW). See Terms & Indices section for more information.

This trend has important implications for derivative income portfolios that utilize an index-based strategy. As Exhibit 2 demonstrates, as volatility dropped historically, so did yield.

Derivative income strategies can use options to pursue income while maintaining significant exposure to equity market risk.

Exhibit 2: Lower volatility typically leads to lower yield



Source: Bloomberg, Aug 30, 2024. Volatility as depicted by Chicago Board Options Exchange's CBOE Volatility Index (VIX). Yield depicted by JPMorgan Equity Premium Income ETF (JEPI). See Terms & Indices section for more information.

To compensate for the compressed index-level volatility and lower yield generation, many investment firms compensate by using leverage within their note structures. This forces them to keep note terms short and strike prices tight to spot rates in an effort to maximize premium. It effectively ensures that portfolios' net asset value (NAV) depletes in pursuit of yield.

Challenges of an index-based approach

While this approach is popular, an index-based approach presents challenges, including:

- Compressed index-level volatility
- Decrease in yield generation
- Use of leverage
- Notes structures with shorter terms and strike prices tighter to spot
- Degradation of NAV

In contrast, a stock-specific strategy enables the portfolio to avoid the use of leverage, lengthen the term (which can result in enhanced tax efficiency), and set strike prices far enough above the prevailing spot rate that the portfolio has room to generate a desirable level of potential capital appreciation.

Single-stock equity-linked notes

To avoid some of these challenges, we employ a process differentiated by its focus on writing single stock equity-linked notes. We believe these can potentially deliver higher incremental yields than an index-based approach. In our view, the focus on idiosyncratic opportunities helps lower the risk of a reduction in overall market volatility, which has been exacerbated by the large amount of call options on equity indices. Therefore, the process can seek consistent income generation despite prevailing market conditions.

In addition, through our process implementation and the mechanics of selecting the underlying securities, we aim to produce an enhanced total return profile, as a large proportion of this return may come in the form of committed income. After careful study of the category composition and the evolution of buy-write strategies over the past five years in response to changing market conditions, we believe our structure is uniquely positioned to pursue strong returns for the long-term investor.

Exhibit 3: Performance of the Equity-Linked Note (ELN) Carveout* as of August 31, 2024

	ELN Carveout Return (Gross)*	ELN Carveout Return (Net)*	ELN Carveout Yield (Net)*	S&P 500 Index (SPX)	Russell 1000 Value Index (RLV)
1 Year	14.47%	13.67%	15.07%	27.12%	21.12%
3 Year	10.45%	9.68%	14.94%	9.36%	7.22%
5 Year	11.85%	11.07%	14.17%	15.88%	11.12%
Since Inception (Dec. 31, 2016)	10.81%	10.04%	12.82%	14.80%	9.53%

*The Equity-Linked Note Carveout is a subset of the equity-linked note assets from the representative account within Amundi US's Multi-Asset Income composite. The performance inception of ELN Carveout is 12/31/16. Please see the GIPS Report for more information. The performance results of the total portfolio from which the ELN carveout has been extracted is available upon request.

Gross of fee returns are presented before management and custodial fees, but after all transaction costs. Net of fee returns are net of model fees and calculated in the same manner as gross of fee returns using the Time Weighted Rate of Return method. On July 3, 2017, Amundi Asset Management acquired Pioneer Investments (the "prior firm", now Amundi US). Performance prior to July 3, 2017 occurred while members of the portfolio management team were affiliated with the prior firm. Such members of the portfolio management team were responsible for investment decisions at the prior firm and the decision-making process has remained intact.
Source: Amundi US. See Terms & Indices section for more information. **Past performance is no guarantee of future results.**

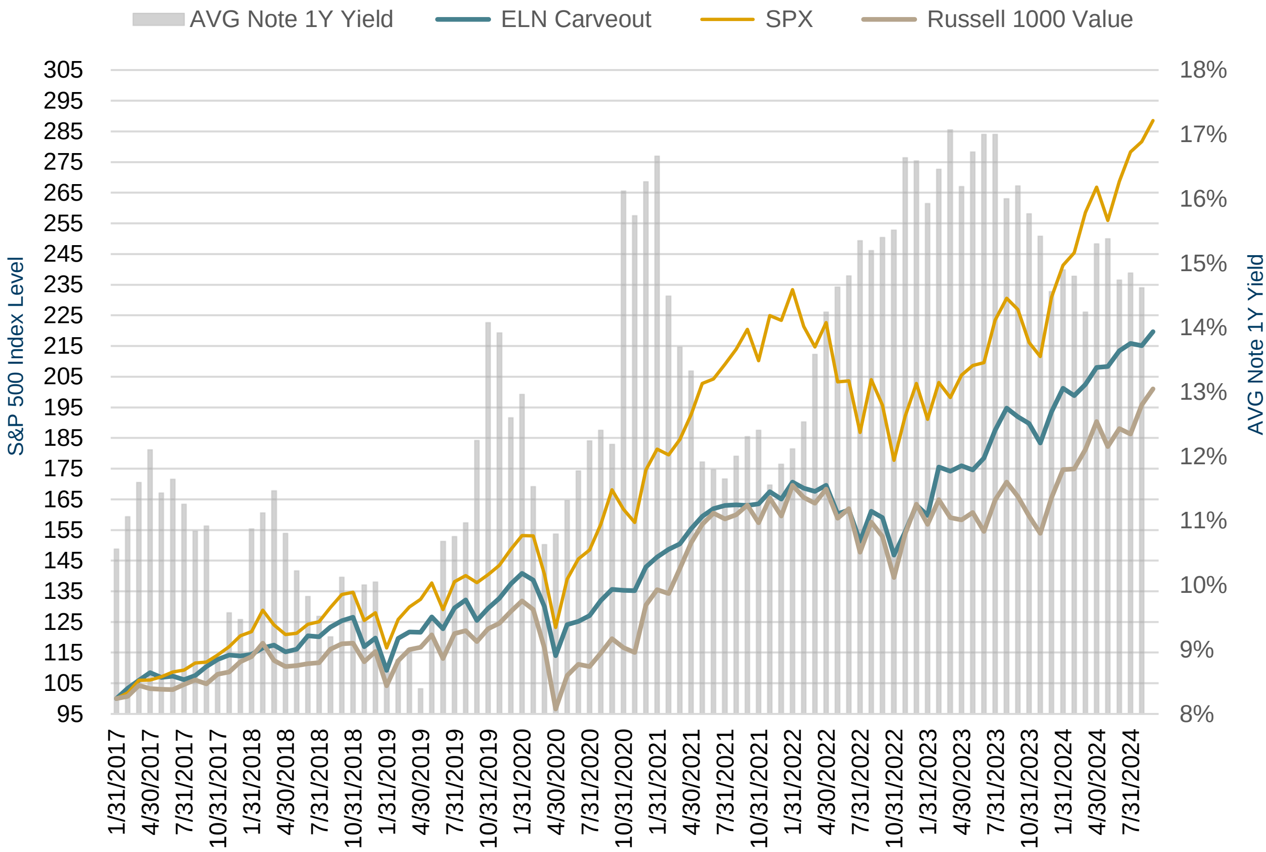
Selecting the underlying security is an important part of our process. We create equity-linked notes based on the stocks of individual companies with strong fundamentals including free cashflow generation, the reasonable valuation of any growth elements, and a volatility level that can potentially enhance total return in a buy-write structure.

By writing on individual companies, we seek to generate yield from individual stocks that may not have a dividend, and therefore would not otherwise be bought for income. We may also select stocks with higher levels of volatility to provide enhanced potential yield. We aim to mitigate their greater unpredictability through diversification[2] across multiple individual underliers.

As shown in Exhibit 4, which compares our ELN composite with the S&P 500 and Russell 1000 Value Index, this approach has historically generated an attractive total return solidly anchored by the income generated. By pairing the attractive equity return profile with a high level of income, an investor's total return was smoothed over time.

[2] Diversification does not assure a profit or protect against loss.

Exhibit 4: Equity-Linked Note (ELN) Carveout* growth over time



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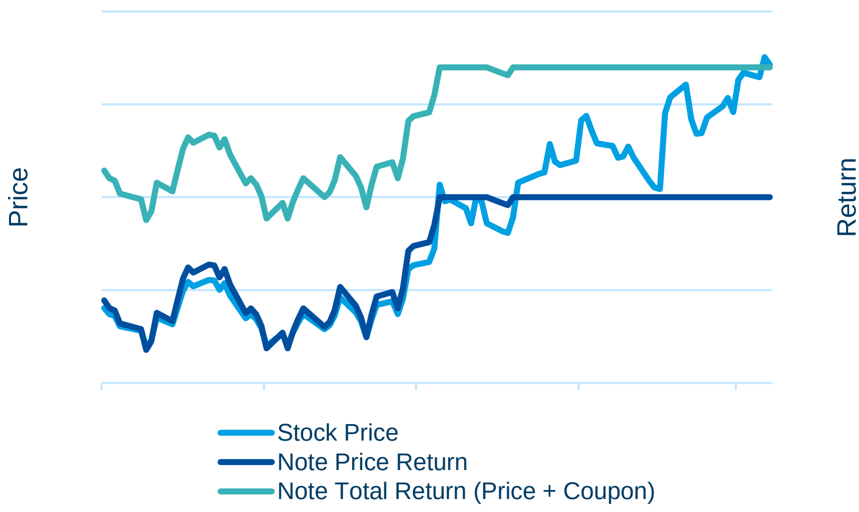
Source: Amundi US, and Bloomberg as of August 31, 2024. Last data point August 31, 2024. **Past performance is no guarantee of future results.**

Examples of equity-linked notes

As shown in Exhibit 5, investors participate in the first 10% of equity return upside from the security. Additionally, they receive a premium from the sale of the call option, which we believe smooths the volatility typically associated with equity ownership, provides a steady return stream, and supplies some insulation against drawdowns.

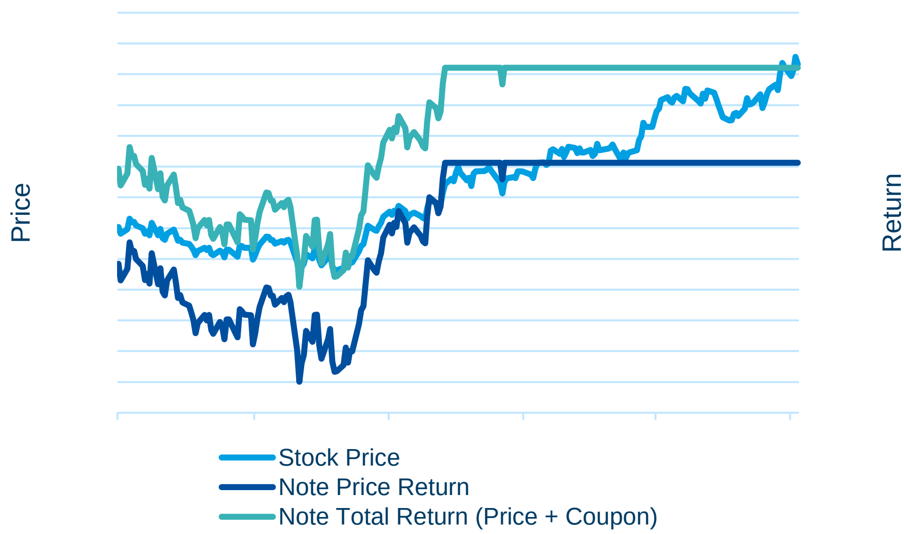
Exhibit 5: Example of equity-linked note with 110% equity cap



Source: Amundi, Bloomberg, Aug 31, 2024. For illustrative purposes only. Securities listed are not meant to represent any current or future holding of an Amundi US portfolio, and should not be considered recommendations to buy or sell any security.

Exhibit 6 demonstrates an equity-linked note based on an underlying security in the tech sector. Again, the addition of income from the sale of the call option smoothed out the volatility of the investment while providing some exposure to upside from the equity.

Exhibit 6: Additional example of equity-linked note with 110% equity cap



Source: Amundi, Bloomberg, Aug 31, 2024. For illustrative purposes only. Securities listed are not meant to represent any current or future holding of an Amundi US portfolio, and should not be considered recommendations to buy or sell any security.

Conclusion

Due to their unique combination of providing equity upside potential while also supplying income, derivative income strategies such as equity-linked notes have become popular vehicles for investors.

Index and Term Definitions

- Call option: Gives an investor the right, but not the requirement, to purchase a stock at a specific price (known as the strike price) by a specific date, at the option's expiration.
- Covered call: An investment strategy in which an investor holds a long stock position and sells call options on that same stock with the aim of generating income.
- Chicago Board Options Exchange's Volatility Index (VIX Index): The Chicago Board Options Exchange's CBOE Volatility Index (often referred to as the VIX), a popular measure of the stock market's expectation of volatility based on S&P 500 index options.
- Derivatives: Financial contracts that derive their value from an underlying asset, index, or security. They can be used to manage risk, speculate, and obtain leverage.
- Derivative income: The premium collected by investors when they sell options.
- Equity-linked note: A type of debt instrument structured to pay out based on the performance of an underlying equity investment. ELNs are different from traditional bonds because they do not offer a fixed interest rate; instead, the returns are tied to the performance of the underlying equity, which can be a single stock, a collection of stocks, or an equity index.
- JPMorgan Equity Premium Income Index (JEPI): Tracks returns associated with the S&P 500 Index.
- Net Asset Value (NAV): The value of an investment fund, determined by subtracting its liabilities from its assets.
- Stock/equity option: A contract which gives the buyer (the owner or holder of the option) the right, but not the obligation, to buy or sell an underlying asset or instrument at a specified strike price prior to or on a specified date.

Composite Name: Multi-Asset Income

Benchmark: 65.0% BLOOMBERG US AGGREGATE, 35.0% MSCI ACWI

Reporting Period:	*1 January 2014 to 31 December 2023*	**Composite Creation Date:**	*31 December 2011*
Reporting Currency:	*USD*	**Composite Inception Date:**	*1 January 2012*

Period	Composite Gross Return (%)	Composite Net Actual Fee Return (%)	Composite Net Model Fee Return (%) **	Benchmark Return (%)	Composite 3-Yr Standard Deviation (%)	Benchmark 3-Yr Standard Deviation (%)	Number of Portfolios	Internal Dispersion (%)	Composite Assets (Millions)	Firm Assets (Millions)
2023	9.91	N/A	9.15	11.21	9.71	9.82	≤ 5	N/A	3,954	1,345,186
2022	0.99	N/A	0.28	-14.69	13.24	9.59	≤ 5	N/A	2,838	1,191,419
2021	12.61	11.70	11.83	5.20	11.63	6.49	≤ 5	N/A	2,148	1,264,636
2020	6.16	5.33	5.42	11.25	11.89	6.89	≤ 5	N/A	1,994	1,255,960
2019	11.67	N/A	10.90	14.91	6.62	4.14	≤ 5	N/A	2,304	1,104,104
2018	-4.99	N/A	-5.65	-3.17	6.42	4.02	≤ 5	N/A	1,516	1,051,994
2017	18.08	N/A	17.26	10.31	6.77	3.98	≤ 5	N/A	1,028	911,366
2016	13.66	N/A	12.87	4.61	7.28	4.32	≤ 5	N/A	719	706,043
2015	-2.07	N/A	-2.75	-0.24	7.14	4.44	≤ 5	N/A	828	610,461
2014	2.23	N/A	1.52	5.41	6.15	4.26	≤ 5	N/A	830	654,151

** Composite Net Model Fee Returns are presented as supplemental information, effective 1 January 2020 on a prospective basis. See the Performance Calculation disclosure for more information.

Compliance Statement: Amundi claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Amundi has been independently verified for the periods 1 January 1994 to 31 December 2022. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

Firm: For the purpose of GIPS® compliance, effective 1 January 2021, the Firm is defined as "Amundi" and includes the following: Amundi Asset Management, Société Générale Gestion, Amundi (UK) Ltd, Amundi Ireland Limited, Amundi SGR SpA, Amundi Deutschland GmbH, Amundi Austria GmbH, Amundi Japan Ltd, Amundi Hong Kong Ltd, Amundi Singapore Ltd, Amundi Malaysia Sdn Bhd, and Amundi Asset Management US, Inc. With respect to the Amundi firm history, on 1 October 2013, Amundi Asset Management acquired Smith Breeden Associates, Inc. and renamed it Amundi Smith Breeden LLC. On 1 January 2014, the Firm was expanded to include Amundi Japan Ltd and Amundi Singapore Ltd. On 3 July 2017, Amundi Asset Management acquired Pioneer Investments and renamed it Amundi Pioneer. Following the acquisition, on 1 January 2018, the Firm was redefined to include Amundi Pioneer. Amundi Smith Breeden LLC merged with and into Amundi Pioneer Institutional Asset Management, Inc. with the latter entity surviving the merger. The Firm expanded to include Amundi SGR SpA, Amundi Deutschland GmbH, and Amundi Austria GmbH. On 1 January 2021, Pioneer Investment Management, Inc. merged with and into its affiliate, Amundi Pioneer Asset Management. Inc. and the surviving entity changed its name to Amundi Asset Management US, Inc. With respect to the Pioneer Investments firm history, between 1 January 2010 and 31 December 2015, Pioneer Investments was redefined to only include assets managed exclusively by Pioneer Investment Management, Inc., Pioneer Institutional Asset Management, Inc., and Pioneer Investment Management Limited, and on 1 January 2016 reintegrated the assets of Pioneer Investment Management Sgr p.A. On 1 January 2022, Lyxor Asset Management merged with Amundi Asset Management with the latter entity surviving the merger.

Composite Description: The Strategy seeks a high-level of current income with a secondary objective of capital appreciation. The Strategy pursues its objective by being flexible and tactically allocating among a diversified portfolio of dividend-paying stocks and bonds. Important risks materially relevant to strategy include Market risk: risk of price fluctuation in the investment portfolios due to variations in market parameters: interest rates, exchange rates, securities prices, credit spreads, etc. Liquidity risk: in case of low trading volume on financial markets, any buy or sell trade on these markets may lead to important market variations/fluctuations that may impact your portfolio valuation. Counterparty risk: risk of default of a market participant to fulfil its contractual obligations vis-à-vis your portfolio. Operational risk: risk of default or error within the different service providers involved in managing and valuing your portfolio. Emerging Markets risk: Some of the countries invested in may carry higher political, legal, economic and liquidity risks than investments in more developed countries.
On 3 July 2017, Amundi Asset Management acquired Pioneer Investments ("the Prior Firm") and renamed it Amundi Pioneer. Following the acquisition, on 1 January 2018, the Firm was redefined to include the former Amundi Pioneer (now Amundi US, a legal entity within "the Firm"). Performance prior to January 2018 occurred while members of the portfolio management team were affiliated with the Prior Firm. Such members of the portfolio management team were responsible for investment decisions at the Prior Firm and the decision making process has remained intact within the Firm. Performance results presented from 2011 to 2017 occurred while these assets were not part of the Firm. In the Firm's opinion, such performance track record conforms to the GIPS standards with respect to the portability of investment performance results. Performance records of the Prior Firm are available upon request.

Minimum Account Size: There is no minimum asset level for inclusion in this composite.

Performance Calculation: Gross-of-fees returns are presented before management and custodial fees but after all transaction costs. Composite Net Actual Returns are net of actual fees, starting from composite gross returns, by subtracting fixed and variable management fees of all of the underlying portfolios. Composite Net Model Returns are net of model fees and are calculated, starting from composite gross returns, by geometrically subtracting the highest tier model fee for institutional segregated accounts. The Composite Net Model Returns are presented as supplemental information.
Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request.

Fee Schedule: The current standard annual investment management fee schedule for institutional separate accounts is 0.70% on the first 100 million; 0.60% on the next 100 million; 0.50% thereafter.

Internal Dispersion: Dispersion is defined as the standard deviation of the annual gross returns of all portfolios that were included in the composite for the entire year. For those years when five or fewer portfolios were included in the composite for the full year, no dispersion measure is presented.

Three-Year Annualized Standard Deviation: The Three-year Annualized Ex-Post Standard Deviation measures the volatility of gross returns for the composite and benchmark over the preceding 36-month period, and is not applicable for performance periods with less than 36 months of returns based on the composite's performance inception date.

Benchmark Description: The benchmark of the composite is 65.0% BLOOMBERG US AGGREGATE, 35.0% MSCI ACWI rebalanced monthly, calculated by weighting the respective index returns on a monthly basis

Past performance is not indicative of future results.