Defined outcome strategies: comparing defined return autocallables and buffer ETFs

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Key Takeaways

- Buffer ETFs typically cap gains and absorb an initial portion of losses over a one-year outcome period, so they generally need markets to rise to deliver a positive return.
- Autocallables can deliver a predefined return when markets rise, stay flat or, in defensive structures, fall moderately. Their longer potential term, often six years, gives markets more time to recover from interim declines.
- Autocallables tend to have greater exposure to the volatility and skew risk premia. Investors are exposed to the full decline from the initial index level if the market finishes below the capital barrier.

Buffer ETFs and Defined Return Autocallable ETFs both give investors a way to change the returns they receive from equity markets, but their approaches and roles within a portfolio differ.

Buffer ETFs typically offer participation in equity market appreciation up to a specified cap, while absorbing an initial portion of losses over an outcome period, usually one year. Investors bear losses beyond the buffer, while gains are limited to the cap even if the market rises further. Buffer ETFs, therefore, generally require markets to rise over the outcome period for a positive return to be generated.

Autocallables offer a predefined return if the underlying market meets specified conditions on observation dates, allowing returns to be generated when markets rise or remain flat and, in defensive implementations, even when markets fall moderately. They generally have a longer potential term, often six years, although they can mature early if conditions are met, hence the name autocallable. The capital barrier is generally assessed only at final maturity, giving markets time to recover from interim declines if equity performance is poor in the short term.

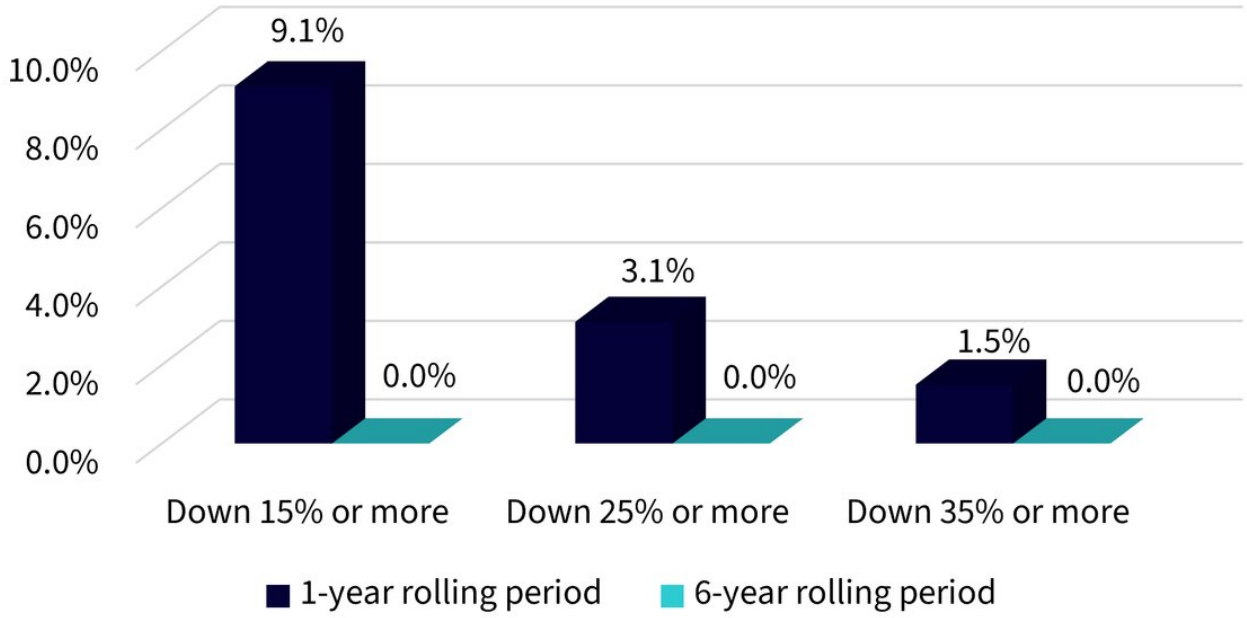
Alongside the maximum term, another meaningful difference between the strategies is the level and form of downside protection: a buffer absorbs the first portion of a market decline, while an autocallable may use a capital barrier that allows for a larger fall before capital repayment is affected. However, if the market finishes below that autocallable capital barrier, investors are exposed to the full decline from the initial index level.

How effectively do these strategies harvest risk premiums?

Both strategies take advantage of the equity, volatility, and skew risk premiums, although to different extents because of how their payoffs are constructed.

The **equity risk premium** is the additional return investors expect above risk-free rates for accepting equity market risk. Buffers generally assess outcomes over one year, whereas autocallables often have longer maximum terms, commonly six years. This can give markets more time to recover from interim declines in the short term, allowing longer-term equity growth and recovery to support the autocallable investment's outcome.

Figure 1: Historical frequency of global equity declines



Source: WisdomTree, Bloomberg. Calculations using MSCI World Index (MXWO Index), USD price-return data. 31 December 1969 to 30 September 2026. Overlapping rolling returns calculated at monthly intervals. **Historical performance is not an indication of future performance and any investments may go down in value.**

Figure 1 uses the full available history of the MSCI World Index, spanning more than 50 years. Over this period, global equities fell by 15% or more in 9.1% of one-year periods, reaching or exceeding the protection provided by a 15% buffer, while no declines of that magnitude were observed over six-year periods. An autocallable with a final return barrier 25% below its initial index level could deliver its predefined return even if markets performed worse than any six-year outcome in the historical sample. A capital barrier 35% below the initial level would provide further room for declines before capital repayment was affected. The findings help to illustrate why prolonged exposure to the equity risk premium and an autocallable's longer potential term may lead to improved outcomes.

The **volatility risk premium** reflects the difference between the volatility priced into options (implied volatility) and the volatility markets subsequently experience (realised volatility). Historically, implied volatility has on average exceeded realised volatility, providing compensation to option sellers, although

during periods of market stress, realised volatility can exceed what was priced in and lead to substantial losses.

Harvesting the volatility risk premium is akin to selling insurance, where premiums are generally set above expected claims to compensate the insurer for accepting risk. Both autocallables and buffers sell downside protection to the market, but they have different upside profiles to provide their respective returns. In a buffer, the investment participates in equity market appreciation up to a predefined cap. This upside participation offsets part of the short-volatility exposure from a buffer's downside exposure. An autocallable's predefined return does not generally require market appreciation, and its payoff construction typically results in greater net short-volatility exposure at inception. Autocallables, therefore, tend to have more exposure to the volatility risk premium as a potential source of return.

Autocallables can also benefit from greater volatility skew, where protection against larger declines tends to command higher implied volatility. A buffer might absorb the first 15% of a market decline, while an autocallable might repay capital in full provided the index finishes no more than 35% below its initial level at maturity. If it finishes below that barrier, however, investors are exposed to the full decline from the initial index level. This barrier structure allows autocallables to monetise the relatively expensive protection against deeper declines differently from buffers, generally enhancing potential returns through a **skew risk premium**.

Considering the strategies in multi-asset portfolios

For investors who expect equity markets to perform reasonably well over the coming year, buffer ETFs may be a useful way to participate in that growth while absorbing an initial portion of any decline. Positive returns remain dependent on market appreciation, but the buffer can make it more comfortable for investors to retain equity exposure when they are also concerned about moderate potential losses.

Autocallables offer a different return profile within a portfolio, with predefined returns often in the region of 6% to 10% per annum, achievable in flat or, depending on the structure, moderately falling markets. This can complement investments that require appreciation to perform well, offering scope to generate returns comparable to those of equities over the long term and to outperform when markets make limited progress. However, returns are capped at the predefined level, and investors remain exposed to the full decline in the underlying market if capital repayment conditions are not met.

Both buffers and autocallables can be implemented as diversified, laddered portfolios, spreading investments across starting dates and maturities to help reduce reliance on a single market entry point. However, the generally longer potential term of autocallables can allow for additional diversification through a wider spread of entry points over time.

Actively managed portfolios of autocallables can diversify exposure across underlying equity indices, capital barriers, maturities and counterparties. Through exposure to equity, volatility and skew risk premia, the Defined Return Autocallable strategies aim to increase the likelihood of achieving their target returns across a wider range of equity market conditions. These funds and ETFs can therefore provide a source

of diversification that supports portfolio returns without necessarily relying on sustained equity market appreciation.

Key characteristics	Buffer ETFs	Defined Return Autocallable ETFs
Return profile	Participate in equity market gains up to a specified cap	Offer a predefined return if specified market conditions are met
Conditions for a positive return	Generally require equity markets to rise over the outcome period	Can generate returns in rising or flat markets and, depending on the structure, moderately falling markets
Typical timeframe	Usually a one-year outcome period	Often a maximum term of six years, with potential for early maturity if autocall conditions are met
Downside protection	Absorb an initial portion of market losses, such as the first 15% of a decline	May repay capital in full provided the underlying index finishes at or above a capital barrier, such as 35% below its initial level
Losses beyond protection	Investors bear losses beyond the buffer	If the index finishes below the capital barrier, investors are exposed to the full decline from its initial level
Assessment of protection	The buffer applies to performance over the specified outcome period	The capital barrier is generally assessed only at final maturity, allowing time for recovery from interim declines
Upside limitation	Gains are limited to the specified cap	Returns are limited to the predefined level, even if equity markets rise substantially
Exposure to risk premiums	Access equity, volatility and skew risk premiums, with upside participation offsetting part of the short-volatility exposure	Access the same risk premiums, typically with greater net short-volatility exposure at inception and a different approach to monetising downside skew
Potential portfolio role	Retain participation in equity market growth while cushioning an initial portion of losses	Complement investments that depend on market appreciation, with scope to generate returns when markets make limited progress
Diversification across entry points	Can be laddered across different starting dates and maturities	Can also be laddered, with longer potential terms allowing a wider spread of entry points over time

For Illustrative purposes only. Actual caps, buffers, predefined returns, barriers and maturities vary by strategy and structure.

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