

SIMPLIFY TREASURY OPTION INCOME ETF (BUCK)

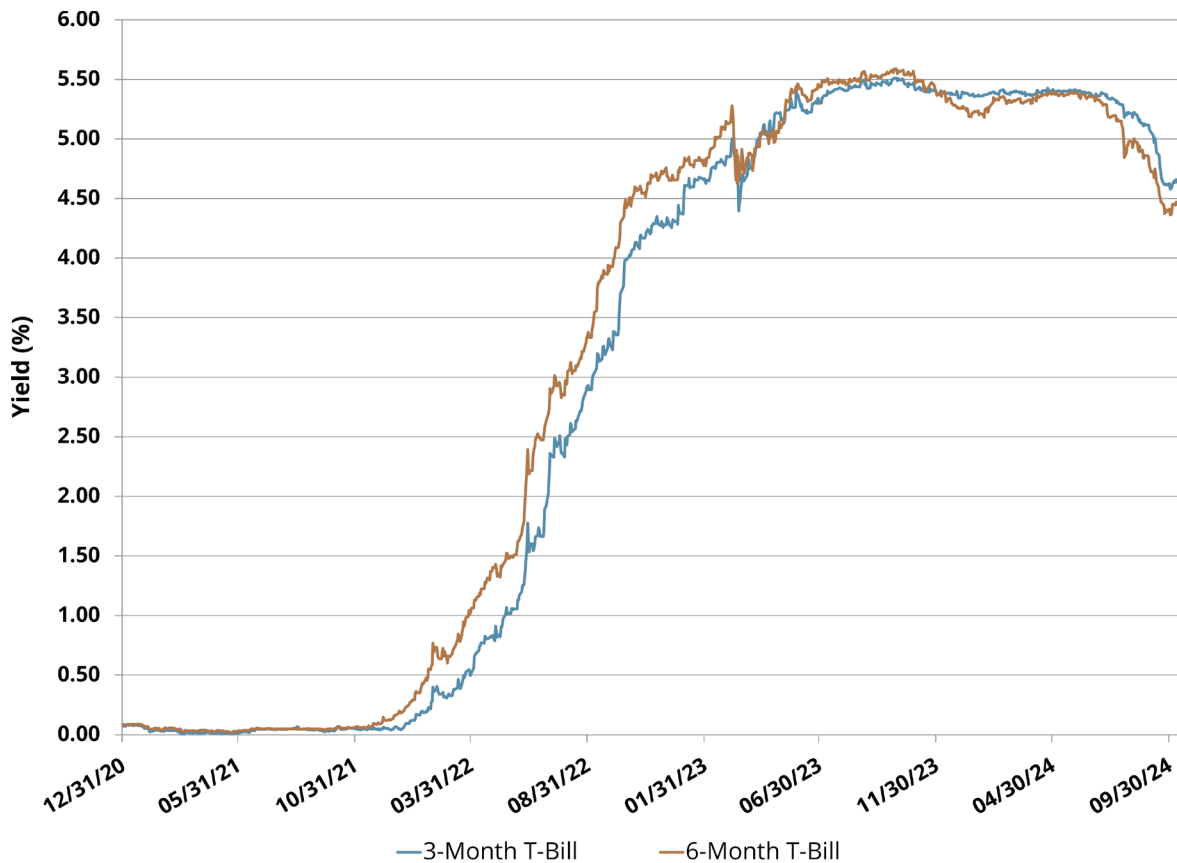
BUCK the Trend: Seek Attractive Income without Chasing Credit Risk

By: Jason England, Managing Director, Portfolio Manager, Fixed Income Strategist

INTRODUCTION

Treasury Bill yields have been trending lower since late July as interest rate cuts started to be priced into the market. Yields eventually dropped below the psychologically important 5.00% level (see Figure 1) that had many investors hanging out in money market funds for the past couple of years. Then the Federal Reserve Bank (FED) cut the Federal Funds Rate by 50 basis points (bps) — or 0.50% — at their September meeting, beginning the start of an easing cycle that sent Treasury Bill yields even lower. The expected path forward is a series of interest rate cuts, to bring down the Federal Funds Rate to a more neutral level, and thus Treasury Bill yields should continue to decline. Over \$6 Trillion invested in money markets are now searching for a new home and will suffer reinvestment risk the longer an investor waits. In this Fund Insight, we introduce an income-enhanced Treasury Bill strategy as a cash alternative for those investors still looking for attractive income without credit risk now that front-end yields are falling.

Figure 1: U.S. Treasury Bill Yields



Source: Bloomberg

ENHANCED TREASURY BILL FUND

The [Simplify Treasury Option Income ETF \(BUCK\)](#) is an enhanced Treasury Bill fund. This ETF looks to maximize Treasury Bill total returns while targeting a duration of one year or less and additionally looks to enhance income via structural alpha by selling options on Treasuries. The potential distribution target is 2.00% to 3.00% higher than the Bloomberg U.S. Treasury Bill: 1-3 Months Index. The fund is actively managed, investing at least 80% of its net assets in U.S. Treasury securities, and enhancing income through a risk-managed option selling strategy. The risk-managed options writing strategy is designed to provide additional income as well as add to the ETF's total returns.

RISK-MANAGED OPTIONS WRITING STRATEGY

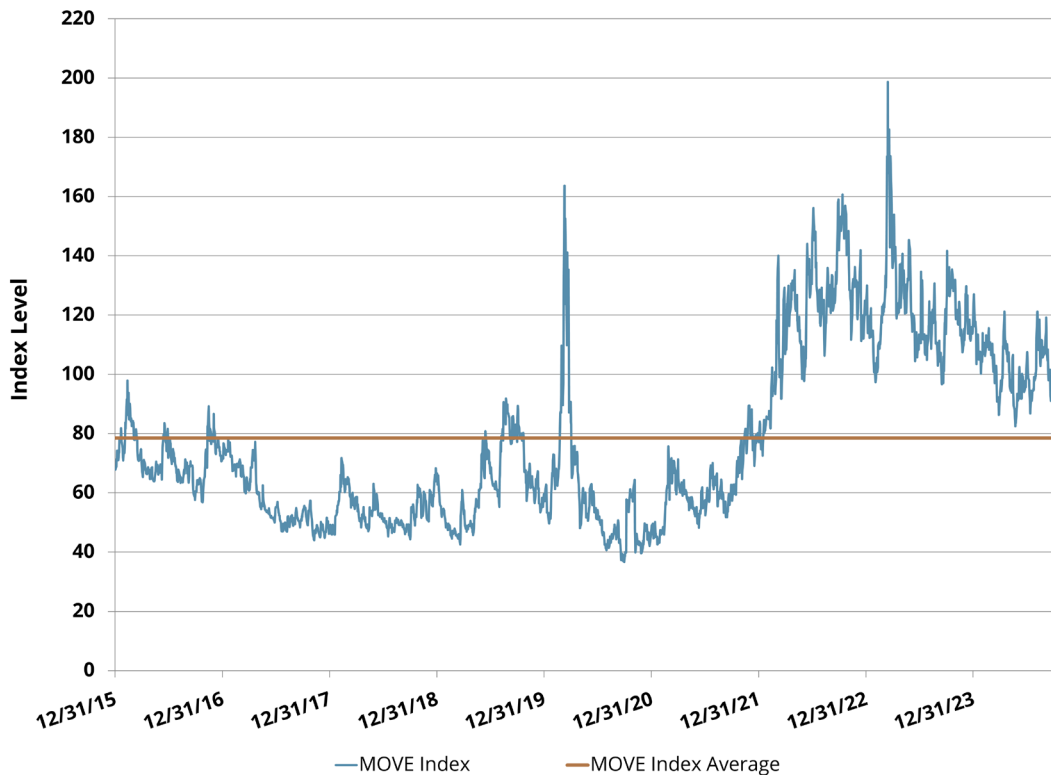
Treasury options are consistently in high demand for broker-dealers – especially those involved with Mortgage-Backed Securities (MBS) – to hedge out interest rate risk. This strong structural demand to buy options naturally increases option premiums, adding to the potential profitability of option-selling strategies. By selling out of the money options at key rate levels, BUCK generates additional income while positioning for adding or reducing risk at high reward-to-risk junctures.

Strike prices in BUCK are typically selected with about a 90%-to-95%-win probability that the options expire worthless. Additionally, option durations are short, typically one to two months to expiration. And finally, our risk management procedures will typically close an option early if the position goes in the money because once an option price goes through the strike price, the move in the option price accelerates rapidly.

FAVORING TREASURY VOLATILITY OVER CREDIT

In our view, option-based convexity risk is much more compelling than credit risk right now given that the MOVE Index, is extremely elevated (see Figure 2) and credit spreads are very tight (see Figure 3).

Figure 2: MOVE Index Remains Elevated, Ripe for Harvesting Volatility



Source: Bloomberg

Figure 3: 5-Year IG CDX Index Credit Spreads



Source: Bloomberg

CONCLUSION

After both a strong jobs report and inflation report for September, the market has repriced interest rate cuts to be more in line with the FED's September Dot Plot, forecasting 150bps (1.50%) of cuts by the end of 2025. This should lead to a more gradual reduction of front-end rates, potentially keeping rates range-bound. However, rates are expected to be volatile within the range, as we have seen over the past month, creating opportunities to optimize convexity risk premium via option selling.

Most ultrashort duration strategies will enhance yield via credit risk; however, that is not very compelling right now given that credit spreads are very tight. Convexity risk is more compelling, and BUCK seeks to monetize the premium in an optimal way. Investors looking for a cash alternative and willing to accept a small amount of volatility while seeking the highest total returns with enhanced income without credit risk should consider an investment in BUCK.

GLOSSARY

Basis Points (bps): A common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

Convexity: A measure of how the duration of a bond changes as interest rates change. The greater the convexity of a bond, the greater that change will be for a specific interest rate shift.

Credit Spread: The difference in yield between two debt securities of the same maturity but different credit quality.

Duration: A measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

In the Money: An option that possesses intrinsic value. An option that's in the money is an option that presents a profit opportunity due to the relationship between the strike price and the prevailing market price of the underlying asset.

Option: An option is a contract that gives the buyer the right to either buy (in the case of a call option) or sell (in the case of a put option) an underlying asset at a pre-determined price ("strike") by a specific date ("expiry"). An "outright" is another name for a single option leg. A "spread" is when options are bought at one strike and an equal amount of options are sold at a different strike, all at the same expiry.

Out of the Money: An option has no intrinsic value, only extrinsic or time value.

Mortgage-Backed Securities (MBS): Investment products similar to bonds. Each MBS consists of a bundle of home loans and other real estate debt bought from the banks that issued them. Investors in mortgage-backed securities receive periodic payments similar to bond coupon payments.

Important Information

Investors should carefully consider the investment objectives, risks, charges, and expenses of Exchange Traded Funds (ETFs) before investing. To obtain an ETF's prospectus or Summary prospectus containing this and other important information, please call (855) 772-8488, or visit SimplifyETFs.com. Please read the prospectus carefully before you invest.

An investment in the fund involves risk, including possible loss of principal.

The fund is actively-managed is subject to the risk that the strategy may not produce the intended results. The Fund invests in ETFs (Exchange-Traded Funds) and entails higher expenses than if invested into the underlying ETF directly. The lower the credit quality, the more volatile performance will be. When junk bonds sell off, the lowest-rated bonds are typically hit hardest known as blow up risk. Likewise, the riskiest bonds typically rise fastest in a bull market however these investments that don't have a credit rating are typically the most volatile, hard to price and the least liquid.

The use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments. These risks include (i) the risk that the counterparty to a derivative transaction may not fulfill its contractual obligations; (ii) risk of mispricing or improper valuation; and (iii) the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate, or index. Derivative prices are highly volatile and may fluctuate substantially during a short period of time. The use of leverage by the Fund, such as borrowing money to purchase securities or the use of options, will cause the Fund to incur additional expenses and magnify the Fund's gains or losses. The Fund's investment in fixed income securities is subject to credit risk (the debtor may default) and prepayment risk (an obligation paid early) which could cause its share price and total return to be reduced. Typically, as interest rates rise the value of bond prices will decline and the fund could lose value.

While the option overlay is intended to improve the Fund's performance, there is no guarantee that it will do so. Utilizing an option overlay strategy involves the risk that as the buyer of a put or call option, the Fund risks losing the entire premium invested in the option if the Fund does not exercise the option. Also, securities and options traded in over-the-counter markets may trade less frequently and in limited volumes and thus exhibit more volatility and liquidity risk.

Simplify ETFs are distributed by Foreside Financial Services, LLC. Foreside and Simplify are not related.

© 2024 Simplify. All rights reserved.