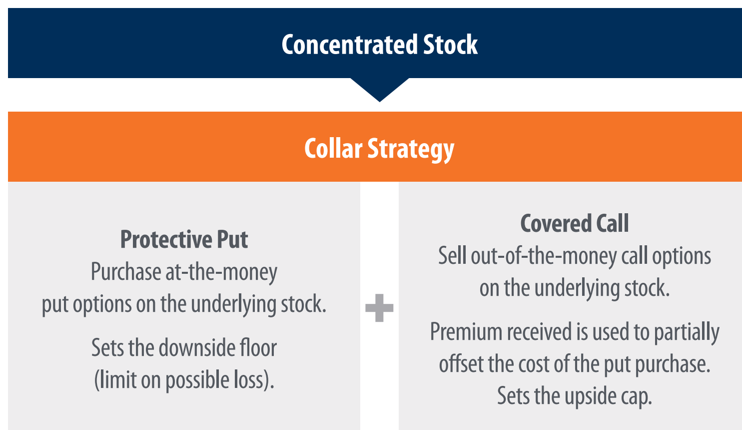
First Trust

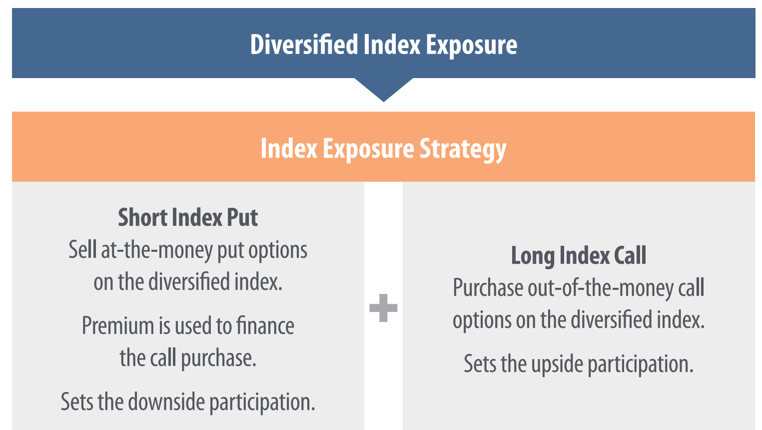
Hedged Equity Exchange

Strategy

Hedged Equity Exchange allows holders of a concentrated stock position to substitute their single-name security risk with the risk of a diversified index. The investor will continue to own their stock and will not have to realize the tax consequences of selling their security at initiation of the strategy to gain diversified exposure. Additionally, since the investor will continue to hold their underlying stock, they will receive any future dividends. The Hedged Equity Exchange uses both a equity collar strategy to hedge the risk of a concentrated position and a synthetic index exposure strategy to seek diversified market exposure.

Investment Process





Options trading strategies have characteristics unlike many other traditional investments and may not be appropriate for all investors. You could lose money by investing in the strategy. There can be no assurance that the strategy will achieve its investment objectives.

Hedged Equity Exchange vs. Exchange Fund

Exchange funds have been traditionally used to diversify concentrated equity positions, but this technique has several important limitations. The Hedged Equity Exchange improves on many of the drawbacks of traditional exchange funds.

	Hedged Equity Exchange	Exchange Fund
Universe	Potential for any stock with options	Limited to an authorized list
Eligible Participants	No accreditation requirements	Qualified Purchaser; $5 mm+ liquid investments
Tax Reporting	1099	K-1
Dividend	Retained	Not eligible; fund retains
Liquidity	Daily	7-year lock-up
Customization	Tailored approached	None
Index Exposure	Index with viable options market	Set by fund and subject to securities within fund

Hedged Equity Exchange

Potential Return Scenarios

Collar Strategy

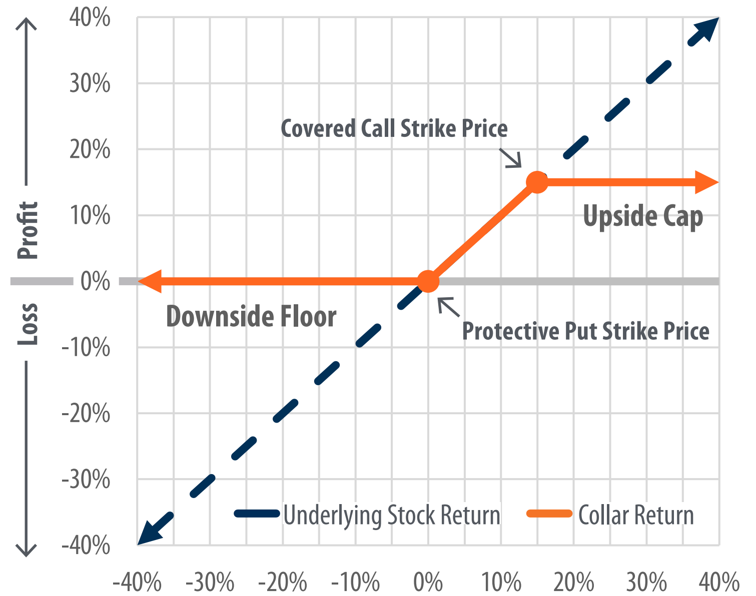
Stock Price Moves Higher But Below Call Strike
The investor will participate in gains to the upside cap.

Stock Price Moves Higher Above Call Strike
The investor will participate in gains to the upside cap, but not above the upside cap.

Stock Price Moves Lower But Above Put Strike
The investor will participate in losses to the downside floor.

Stock Price Moves Lower Below Put Strike
The investor will participate in losses to the downside floor and will be protected against further losses.

Protective Put + Covered Call = Collar Strategy



Index Exposure Strategy

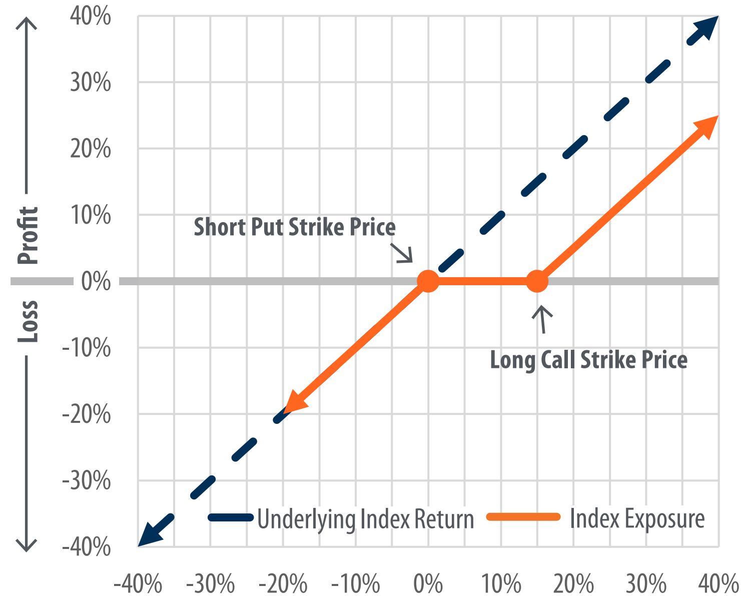
Index Price Moves Higher But Below Call Strike
The investor does not participate in any index price appreciation.

Index Price Moves Higher Above Call Strike
The investor participates in all index price appreciation above the long call strike price.

Index Price Moves Lower But Above Put Strike
The investor does not participate in any index price declines.

Index Price Moves Lower Below Put Strike
The investor participates in all index price declines below the short put strike price.

Short Index Put + Long Index Call = Index Exposure Strategy

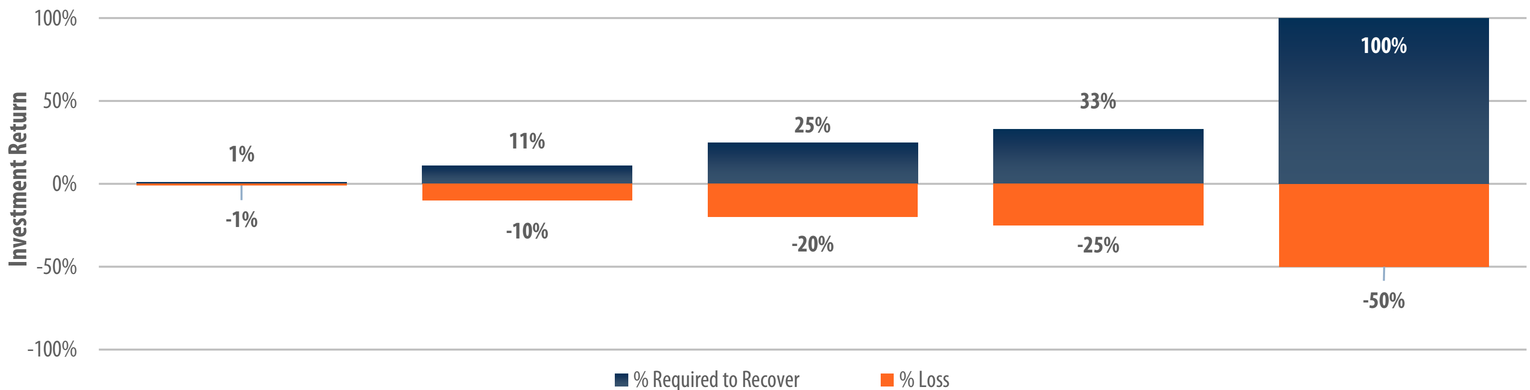


The examples are for illustrative purposes only and are not based on an actual portfolio. The above scenarios assume the options are exercised or assigned if the underlying securities price exceeds the options strike price. Outcomes from the Hedged Equity Exchange Strategy will vary depending on actual portfolio positions, option premiums received, individual stock price volatility, and general stock market volatility. Positions covered by call or put options may be called away, creating realized capital gains or losses. There can be no guarantee that the owner of the call or put option will not exercise the call or put options prior to FTA's attempt to repurchase a sold option. Cash flow is not guaranteed over any period. More information may be found on FTA's Form ADV. Commissions and fees will adversely affect the strategy.

Hedged Equity Exchange

Minimizing Losses Can Significantly Impact the Value of a Portfolio

Overall, the Hedged Equity Exchange strategy limits the investor's downside risk by providing a floor price for the asset through the protective puts while allowing them to partially offset the cost of the put purchase. While this strategy may limit potential gains if the price of the asset appreciates significantly, it provides a level of protection against losses if the price declines. This is significant because losses can have a greater impact on investments than gains. The math of percentages shows that as losses get larger, the return necessary to recover to the break-even point increases at a much faster rate. A loss of 10% necessitates an 11% gain to recover. Increase that loss to 25%, and it takes a 33% gain to get back to break-even. A 50% loss requires a 100% gain to get back to where the investment value started. The Hedged Equity Exchange strategy may minimize losses and encourage investors to stay invested by providing a defined level of protection against potential losses.



In a hedged equity exchange, an investor's upside return potential is limited by a defined cap which is based on the terms of the combined collar strategies and will vary with market conditions.

Why Hedge a Concentrated Position?

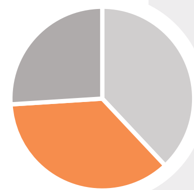
The risk of incurring losses significantly increases when a large portion of an investment portfolio is concentrated in a single stock or small number of stocks. If that particular stock performs poorly, your entire portfolio may suffer. Because individual stocks often underperform the overall market, it is important to have a proper risk management strategy in place.

Historical Return Breakdown of the S&P 500® Index Constituents[1]

Since 1990, approximately 35% (or about a third) of the stocks in the S&P 500® Index went down by at least 50% and remain below that level.

65% of the S&P 500® Index constituents underperformed the Index.

For stocks in the S&P 500® Index since 1990, the average volatility has measured 29.81% compared to 18.08% for the index itself.



26% Underperformed and lost money

39% Underperformed the Index

34% Outperformed the Index

[1]Data from 1/31/1990 to 12/31/2024. Sources: Capital IQ and Bloomberg. Returns are measured from the date added to the index (or start of the study period) to the date removed (or end of the study period) for all companies included in the index during the study period, using month-end prices. **Past performance is no guarantee of future results.**

Charts are for illustrative purposes only and not indicative of any actual investment.

First Trust

Hedged Equity Exchange

Why Choose First Trust?

- We work with financial professionals and their clients to help manage their concentrated stock positions and potentially improve outcomes.
- Our suite of custom solutions offer the potential for yield enhancement, hedging, diversification and tax-mitigating strategies.
- We utilize best-in-class option analytics tools taking into account an option's delta, skew, and moneyness.
- We customize strategies to each client blending options analysis and client expectations.
- We draft and adhere to a tailored Investment Policy Statement for each client based on their needs, goals, tax budget, risk tolerance and timeline.

For additional information, please refer to First Trust Advisor L.P.'s Form ADV Part 2A.

This is not an offer to buy or sell any security and does not include a complete list of all securities purchased or sold in the period or for all clients. Actual holdings will vary and there is no guarantee that any client will hold any mentioned positions. No security or discipline is profitable all the time and there is always the possibility of loss.

There is no assurance that a separately managed account ("SMA") will achieve its investment objective. Accordingly, you can lose money investing in an SMA. SMAs are subject to market risk, which is the possibility that the market values of the securities in an account will decline and that the value of the securities may therefore be less than what you paid for them. The value of investments held by the strategy may increase or decrease in response to economic, financial, and political events (whether real, expected, or perceived) in the U.S. and global markets. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events.

An SMA strategy with significant exposure to a single asset class, country, region, industry, or sector may be more affected by an adverse economic or political development than a broadly diversified strategy.

High portfolio turnover may result in higher levels of transaction costs and may generate greater tax liabilities for shareholders.

While SMAs can be customized, accounts with smaller balances may struggle to achieve optimal diversification across multiple asset classes due to the higher cost of individual securities.

Fees associated with SMAs can be higher than mutual funds and ETFs that include manager, service, and advisory fees. Being able to withdraw cash from an SMA may be delayed due to the amount and type of positions to be sold. Withdrawals may negatively impact the SMA's performance.

This summary is not intended to be tax or legal advice. This summary cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. This summary is being used to support the promotion or marketing of the transactions herein. The taxpayer should consult an independent tax advisor.

Investors or financial professionals should consult with a tax professional regarding the potential application of loss deferral regimes, such as wash sales and straddles, to these securities and potential transactions along with other securities and transactions in the broader portfolio.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Key Options Risks: Writing and buying options are speculative activities and entail investment exposures that are greater than their cost would suggest, meaning that a small investment in an option could have a substantial impact on performance. The use of call and put options can lead to losses because of adverse movements in the price or value of the underlying stock, index, or other asset, which may be magnified by certain features of the options. These risks are heightened when options are used to enhance a client's return or as a substitute for a position or security. When selling a call or put option, a client will receive a premium; however, this premium may not be enough to offset a loss incurred by the client if the price of the underlying asset is above or below, the strike price, respectively, by an amount equal to or greater than the premium. The value of an option may be adversely affected if the market for the option becomes less liquid or smaller and will be affected by changes in the value or yield of the option's underlying asset, an increase in interest rates, a change in the actual or perceived volatility of the stock market or the underlying asset and the remaining time to expiration.

Writing a call or put option can lead to an assignment upon an exercise of a call or put option. In the case of a short call, an assignment can lead to a forced sale of the underlying security being held as collateral. Being short a put can lead to a forced purchase of the underlying security for which additional capital may have to be contributed by the account holder (i.e., "margin call"). Such involuntary sale and purchase transaction may occur at inopportune market times, which could result in losses to an account.

In the case of an option purchase (long call or long put), a client's entire initial investment of premium can be lost. In the case of a covered option short sale (short call or short put), upside gains can be limited by the sale of a short call against an underlying stock position and a forced purchase of stock can occur in the case of a short cash covered put sale. In the case of a naked call or put sale (a call with no underlying stock position and a put with no cash to cover the possibility of a forced stock purchase) there is the risk of unlimited loss in the call position and substantial loss in the put position.

Options trading is not appropriate for all investors. Please refer to Characteristics and Risks of Standardized Options, also known as the options disclosure document (ODD), which discusses potential risks of options issued by the Options Clearing Corporation (OCC), which are typically listed on an exchange. Visit https://www.theocc.com/Company-Information/Documents-and-Archives/Options-Disclosure-Document.

The strategy was previously managed by First Trust Investment Solutions (FTIS). Effective October 31, 2024, FTIS merged into First Trust Advisors L.P. ("FTA"). All business activities, including portfolio management and business records are now performed under FTA.

Kevin Erndl is the portfolio manager for the First Trust Advisors L.P. custom options investment strategies. Mr. Erndl is also registered with an unaffiliated investment advisor, CWA Asset Management Group, LLC ("CWA"). Mr. Erndl is allowed to remain an investment adviser representative with CWA in order to service his current CWA client accounts ("CWA clients") during a transition period of up to 20 months beginning August 31, 2023 ("transition period"). Mr. Erndl receives compensation from CWA in exchange for providing his CWA clients advisory services through CWA during the transition period. Mr. Erndl will not seek any new CWA clients. In addition, during this transition period, Mr. Erndl's activities, as they relate to his CWA clients, will be limited to providing financial planning and guidance on asset allocation. He will not make any investment decisions on behalf of his CWA clients. The assets of Mr. Erndl's CWA clients invested in a custom options investment strategy managed by Mr. Erndl will be deducted from strategy assets under management when calculating advisory fees so that CWA clients will not be charged twice for advisory services.

Definitions

An **option** is a contractual obligation between a buyer and a seller. There are two types of options known as "calls" and "puts." The buyer of a **call option** has the right, but not the obligation, to purchase an agreed upon quantity of an underlying asset from the writer (seller) of the option at a predetermined price (the strike price) within a certain window of time (until the option's expiration), creating a long position.

A **put option** gives the holder the right to sell the underlying asset at the strike price within a specified time period.

An option is **out-of-the-money** when the current price of the underlying asset (for a call option) is below the strike price or (for a put option) is above the strike price.

An **option** is at-the-money when the current price of the underlying asset is equal to the strike price.

The **S&P 500® Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance.

A **collar strategy** is a risk management strategy whereby an investor sells an out-of-the-money covered call option and uses the premium received to partially offset the cost of purchasing an at-the-money put option, providing the investor with a predetermined level of downside protection and upside potential to a cap.

An **Index Exposure Strategy** is a synthetic long strategy whereby an investor buys an out-of-the-money call option to gain exposure to price performance of an index while selling an at-the-money put option to finance the cost of buying the call option (which will expose the client to downside risk in the index).

Downside floor is a limit on a possible loss during the collar implementation.

A **covered call** is an option strategy where the investor sells a call option while also owning the underlying security.

A **protective put** is an option strategy that investors employ to potentially guard against a loss in a stock or other asset.

Delta measures an option's price movement for every $1 change in the price of the underlying security or index.

An **option skew** refers to the level of implied volatility for options with different strike prices.

Moneyness refers to the relationship between the current price of the underlying asset and the strike price of the option.

Scan to view ODD