First Trust
Investment Solutions

Covered Call Direct Indexing

High Income Potential

Limited Downside Protection

Growth Potential

Diversification Potential

STRATEGY

The Covered Call Direct Indexing strategy may be attractive for investors seeking a systematic way to diversify their holdings while setting time and price limits for the disposition of their stock. The strategy provides a disciplined approach to selling concentrated stock positions in a tax-efficient manner while allowing investors to participate in potential stock gains and accrue cash premiums from the sale of call options. The cash premiums are paired with direct indexing, via a separately managed account ("SMA"), for potential tax benefits and diversification.

INVESTMENT PROCESS

Growth Potential | Concentrated Stock and Equity Holdings in the Direct Indexing SMA

Covered Call Transition

Sell call options on underlying stock while setting time and price limits for the disposition of the stock.

Call option premium, dividends (if any), and called-away stock proceeds are invested in a diversified basket of securities through a Direct Indexing SMA.

Direct Indexing

Track a diversified equity index.

Employ tax-loss harvesting strategies that utilize losses to offset capital gains.

Allows for individual account customization based on personal values or client specific needs.

Potential to offset gains with realized losses.

HOW COVERED CALLS WORK

- For investors interested in enhancing income, the strategy sells a call on the underlying stock.
- The investor receives a premium for the call option sold and participates in potential price gains up to the call strike price.
- Investors may customize their desired income levels and risk of call exercise.

POTENTIAL RETURN SCENARIOS OF THE COVERED CALL DIRECT INDEXING STRATEGY

Stock Price Moves Higher

If the price of the underlying stock increases, the strategy will participate in gains up to the strike price. The profit potential is equal to the strike price plus call option premium and dividends paid on the underlying stock.

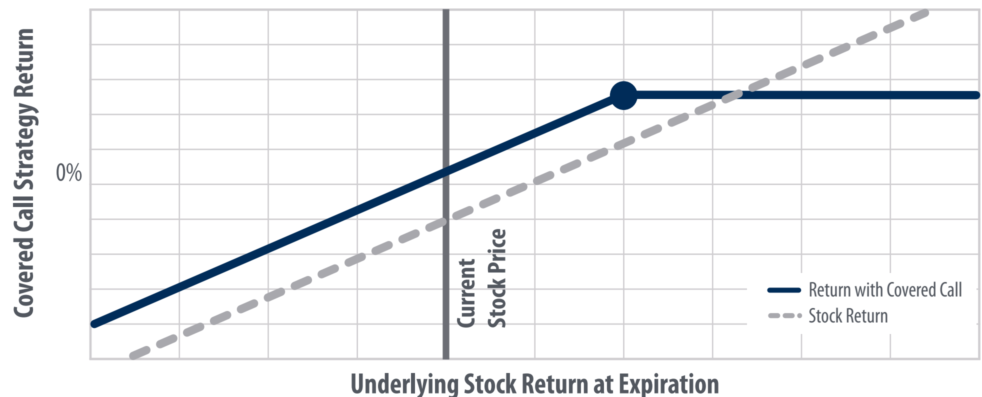
Stock Price Remains Stable

If the underlying stock remains stable, the profit potential is equal to the option premium received plus any stock dividends.

Stock Price Declines

If the stock price declines, loss potential is equal to the stock price. However, the call option premium received from the written call and any dividends received may offset some of the loss.

COVERED CALL ILLUSTRATION



The chart is for illustrative purposes only and not indicative of any actual investment. You could lose money by investing in the strategy. Options trading is not appropriate for all investors. There can be no assurance that the strategy will achieve its investment objectives. Diversification does not guarantee a profit or protect against loss.

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What is Direct Indexing?

Direct indexing seeks to closely track the performance of a market index while creating tax savings to increase after-tax returns. Investors own individual securities in a portfolio via an SMA. Holding individual securities rather than a single fund allows investors to customize their exposure to the initial index according to their needs while allowing for greater tax efficiency.

Direct indexing seeks to:

- Mimic the exposures of a benchmark while seeking to keep tracking error in line with a specified target.
- Employ tax-loss harvesting strategies that utilize losses to offset potential capital gains realized anywhere in a taxable portfolio.
- Allow individual account customization for personal values or client-specific needs.

Tax-Advantaged Investing

Enhanced After-Tax Returns

Direct indexing utilizes tax-loss harvesting to generate tax alpha, which increases after-tax returns. While **alpha** is a measure used to evaluate portfolio returns in excess of a benchmark index, **tax alpha** is a measure of after-tax account return that exceeds pre-tax return in excess of a benchmark. The example below illustrates the tax alpha that may be achieved by the growth of an initial investment over a 25-year period.

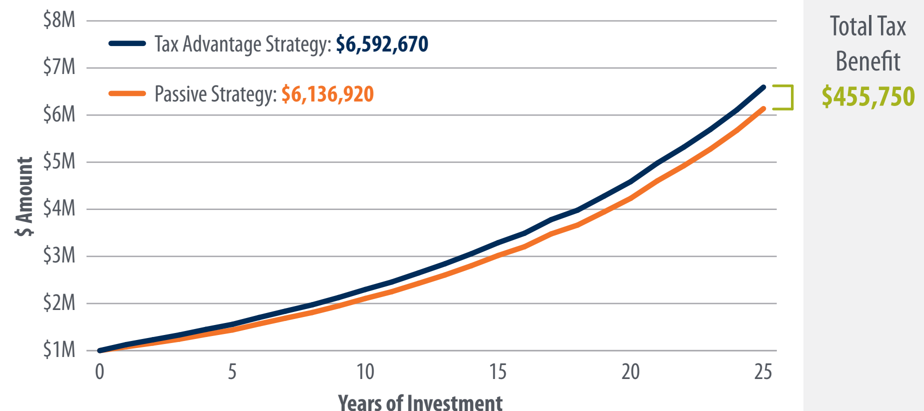
EXCESS AFTER-TAX RETURN – EXCESS PRE-TAX RETURN = TAX ALPHA

Tax-Efficient Transitions

Proper tax management is especially important when exiting securities with appreciated gains. When transitioning securities into a Direct Index SMA, the account can be funded in-kind without creating a taxable event. The tax management tools available through direct indexing can be used to achieve a tax-efficient portfolio transition and potentially minimize, delay, or avoid net taxes.

LIQUIDATION VS. TRANSITION TAX SAVINGS = TRANSITION ALPHA

Assumptions: Initial Investment Amount: $1 Million | Annualized Equity Market Return: 8% | Dividend Tax Rate: 23.80% Long-Term Capital Gains Tax Rate: 23.80% | Short-Term Capital Gains Tax Rate: 40.80%



This sample provided does not reflect the investment results of actual securities and is not a guarantee of future results. Changes to the assumptions will drastically change the results. See complete methodology on the last page.

Personalization

Whether prioritizing traditional factors, risk management strategies, thematic positioning, or values-based investing, financial professionals can completely customize their clients' exposure to selected benchmarks based on their investment goals and personal values.

The personalization and customization screens shown above are examples. The First Trust Direct Indexing platform provides a menu of 70 levels of customization from which to choose.

First Trust Tax-Advantaged Strategy Simulator

Use this tool to run a simulation that illustrates the potential tax benefit of a tax-advantaged strategy versus a passive strategy.

Mutual Funds, ETFs, and Direct Indexing - What's the Difference?

There are many similarities among mutual funds, exchange-traded funds (ETFs) and direct indexing. Typically, investors use ETFs and mutual funds to gain indirect exposure to the securities in a benchmark. Although ETFs and mutual funds can deliver broad market exposure, direct indexing does so with a key difference: a portfolio can be tailored to an investor's specific needs and tax loss harvesting strategies. This portfolio of the optimal component stocks of a benchmark, held directly in a direct index SMA, can be funded with either cash or with an existing portfolio of securities (in-kind), including appreciated stock, which provides the potential to create tax alpha beyond what ETFs and mutual funds may offer.

Potential Benefits	Mutual Funds	ETFs	Direct Indexing
Seeks to match (or exceed) the returns of a benchmark index	✓	✓	✓
Tax efficiency	X	✓	✓
Potential to create tax alpha	X	X	✓
Potential to create transition alpha	X	X	✓
Portfolio customization	X	X	✓
Ability to fund in-kind	X	X	✓

WHY CHOOSE FIRST TRUST INVESTMENT SOLUTIONS?

- 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.
- Based on volatility surface, expected premiums and relative volatility, we provide an optimized strategy.
- We draft and adhere to a tailored Investment Policy Statement for each client based on their needs, goals, tax budget, risk tolerance and timeline.

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Transition Alpha Chart Methodology: The sample provided assumes a starting basket of 300 equally-weighted hypothetical securities. Returns are randomly simulated monthly with the annualized mean chosen above and annualized standard deviation of 30%. The sample portfolio has an assumed 2% annualized dividend yield which is subject to income tax and is reinvested monthly into a new tax lot. The "Passive" strategy simulates a buy-and-hold strategy over the investment horizon. The "Tax-Advantaged" strategy simulates a tax-loss harvesting strategy. In any period that a tax lot's cumulative loss exceeds 5%, the tax lot is sold, and the proceeds are immediately reinvested, plus any tax benefit, into a new tax lot. Tax benefit calculations assume that the capital gains offset by the harvested loss are 50% short-term and 50% long-term. The Monte Carlo simulation takes an average across 2,000 iterations for each set of return, risk, and tax assumptions. The sample presented does not represent actual trading of securities and is not indicative of actual investment strategy performance. The impact of market factors is not included in this simulation which may cause the results to be over-or-under stated. This should not be construed as a representation that any account will, or is likely to, achieve profits, losses or tax savings similar to those reflected in this example.

First Trust Investment Solutions L.P. ("FTIS") is an investment advisor registered with the U.S. Securities and Exchange Commission. FTIS is an affiliate of First Trust Portfolios L.P., a FINRA-registered broker-dealer, and First Trust Advisors L.P., a U.S. registered investment advisor, and is responsible for the day-to-day management of the SMAs. First Trust Portfolios L.P. is the marketing agent for the SMAs.

FTIS has entered into a contractual agreement with First Trust Portfolios L.P. ("First Trust") to refer investment advisory services provided by FTIS. Since FTIS management fees are based upon a percentage of assets under management, the more assets under management, the higher fee income to FTIS. In addition, since First Trust is under common control with FTIS, First Trust will indirectly benefit from an increase in fees received by FTIS. Due to such compensation, First Trust has an incentive to recommend advisory services of FTIS, resulting in a material conflict of interest which should be considered when deciding to engage FTIS. First Trust will not be involved in the provision of services by FTIS. Please read FTIS' Form ADV Part 2 for a description of services and fees offered.

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.

There are no guarantees to the effectiveness of tax alpha in minimizing an investor's overall tax liabilities or to the tax results of any given transaction and the performance of an account may be negatively affected by tax gain/loss harvesting. Financial professionals should consult with a tax professional regarding the potential application of loss deferral regimes, such as wash sales and straddles, to any securities and potential transactions along with other securities and transactions in a 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.

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.