

## Buffer ETFs: An Honest Look at Protection at a Cost

September 09, 2025

**Looking for a way to grow your portfolio, while minimizing how much you can lose in the market? Who would say no? A growing number of financial products have been designed and adopted by investors over the last few years to do just that.**

The pitch is simple, powerful, and especially resonant after stocks and bonds dropped in tandem in 2022. The financial data and research company Morningstar calls these products “Defined Outcome” funds and the category has grown by 11% per year going back to January 2020. One such type of fund that has seen expanded interest is called buffer ETFs. But buffer ETFs, despite the compelling story, can come with hidden costs.

It may sound strange, but I am reminded of the story of Rumpelstiltskin. In the classic Brothers Grimm tale, a poor miller’s daughter is thrust into a dire situation when her father claims she can spin straw into gold. The intrigued king demands she prove it—promising marriage if she succeeds, and death if she fails. The problem (aside from terrible parenting. What was the father’s plan here?) is that she has no ability to spin straw into gold. Enter Rumpelstiltskin, a mysterious trickster who offers to perform the impossible and spin straw into gold, in exchange for increasingly steep payments. Ultimately, he demands her firstborn child as payment.

The story of Rumpelstiltskin (which thankfully ends happily) reminds us that if something is too good to be true, there’s often a trickster behind the curtain. The straw may have been spun into gold, but only by accepting a hidden cost. Likewise, buffer ETFs may seem to conjure a balance between growth and safety, but investors who do not look closely risk giving up more than they bargained for.

### How Buffer ETFs Work

At their core, buffer ETFs are linked to an underlying index, often the S&P 500. But rather than simply owning all the 500 stocks in the S&P 500 index, a buffer ETF will use options (calls and puts) to narrow the range of returns an investor can enjoy, typically offering less potential for growth in exchange for less risk of declining. The typical return characteristics include:

**1. Puts for Protection:** A buffer ETF will typically buy puts on the underlying index to shield the fund against losses. The put options may be structured to protect investors from an initial drawdown (for example, the first 10% of losses) or from losses above a threshold (the investor bears the first 10% of losses and is then protected from additional loss). But buying puts is expensive. To fund the downside protection, the fund may sell out-of-the-money calls, which leads us to our next return characteristic...

**2. Calls Cap Upside and Generate Income:** To generate income and help offset the costs of buying puts, a buffer ETF will sell calls on the underlying index. While everyone enjoys some extra income, it’s important to remember that selling calls also caps how much your underlying investment can increase in value. For instance, if the fund sells a call at 10% above the value of the S&P 500, then the index rises 15%, the fund’s return is capped at 10%.

Most options—including these puts and calls—are designed for very specific outcomes. They are in effect against specific price levels, for specific periods of time. Leading to a final characteristic...

**3. Defined Timeline:** These ETFs are designed for a specific outcome period, usually one year. Entering late or exiting early can lead to different results.

## Understanding the Value

Buffer ETFs have surged in popularity, and it is not hard to understand the appeal.

Beyond their protective features, buffer ETFs offer transparency and liquidity, making them an appealing option for certain investors. They are rule-based and offer the same holdings transparency with intraday pricing that investors prefer. They trade on public exchanges like standard ETFs, avoiding the lock-up periods often associated with structured products. These characteristics make buffer ETFs particularly suitable for risk-averse investors who prioritize capital preservation, as well as for short-term strategies ahead of known liquidity events—such as retirement or tax obligations—where safeguarding principal is essential.

Buffer ETFs give investors access to a professionally managed options portfolio, a structure that has not always been available to retail investors. They provide predictability, and an allocation to buffer products can reduce portfolio volatility. There is a behavioral benefit to this decision, as investors who feel protected are more likely to stay invested through volatility. If there is a client who is contemplating leaving the market entirely, then a buffer ETF might be a product that can keep them invested as they reevaluate their risk tolerance and make a new long-term investment plan.

## Understanding the Costs

Let's develop an understanding of the costs associated with buffer ETFs, and not make the same mistake as the poor miller's daughter who didn't understand her trade with Rumpelstiltskin (as a dad myself, I feel obligated to repeat that the fault lies entirely with the father).

I believe the costs can be summarized in three groups:

- 1. Higher explicit fees:** Expense ratios are meaningfully above index ETFs. The average expense ratio for Defined Outcome Funds is 78 basis points. The most popular strategies, as determined by assets, are more expensive than this.
- 2. Dividend shortfall:** Typically, these products are benchmarked against the price-only return of underlying indexes. The overlaid options may reflect the value of expected dividends but depending on the type of option, these are not paid as actual cashflow. For large cap indexes such as the S&P 500, the dividend yield has been about 1.5-2.0% in recent history. Investors may need to manage around or replace that lack of portfolio income.
- 3. Long-term compounding:** This is the largest and most important cost to understand. For long-term investors, giving up equity upside participation has a staggering impact on the growth of wealth.

To understand the cost of lost compounding, compare the S&P 500 (as proxied by the SPDR S&P 500 ETF "SPY") to the FT Vest Laddered Buffer ETF ("BUFR"), the largest in its category since launching in August 2020. Over the five years ending August 31, 2025, SPY returned 15.5% annually, while BUFR delivered 10.3%. That gap compounds over time, potentially leading to significantly lower wealth accumulation. For investors in the accumulation phase of their investment horizon, giving up this growth of wealth is one of the biggest long-term tradeoffs with buffer ETFs.

## A Brief Comment on "The Right Benchmark"

When comparing the returns to buffer products against an underlying equity index we have heard that investors think equities are not the right benchmark for this product. Many investors chose an allocation to defined outcome funds as a replacement to some or all of their fixed income allocation, giving themselves upside that bonds do not offer while still getting the benefit of capital preservation.

Proper benchmarking should reflect the opportunity set of the investment. Buffer ETFs offer some equity upside and the underlying exposure is equities. The fact that an investor sold bonds to buy the buffer does not make bonds the benchmark—it makes bonds the opportunity cost.

The FT Vest Laddered Buffer ETF (BUFR) has a 96% correlation with SPY since BUFR's inception. This makes sense, because these portfolios provide exposure to the same underlying index—they are supposed to be highly correlated. While buffer products may offer some capital preservation, they behave like equities and not like bonds. In contrast to BUFR's high correlation to equities, the iShares Core Total Bond Market ETF has a 25% correlation to the S&P 500 over the same period. Bonds still offer compelling diversification benefits that are rooted in economic intuition that is supported by economic evidence. And if investors don't want bonds yet still want a meaningful reduction in risk, [then they can just own fewer equities](#) and get a similar outcome as owning buffered products.

## Conclusion

Buffer ETFs offer investors something that feels like spinning straw into gold—equity exposure with downside protection. But, as in the tale of Rumpelstiltskin, the promise of magic comes at a cost.

While they can serve a purpose for investors facing near-term liquidity needs or those who might otherwise abandon the market altogether, their long-term opportunity cost is substantial. Higher fees, dividend exclusion, and capped upside all work against the compounding that fuels equity wealth creation.

For advisors and investors alike, the key is recognizing buffer ETFs for what they are—insurance against volatility—and use them purposefully and with intent. In many cases, simpler and more cost-effective strategies, whether through asset allocation or traditional hedging tools, will leave investors better off over time. That said, these products may appeal to conservative investors focused on preserving capital, especially in the lead-up to known liquidity needs where protecting the principal takes precedence. But the protection they provide is not free, and over time the costs can be more damaging than the risks they are meant to guard against.

*The opinions expressed in this commentary are those of the author and may not necessarily reflect those held by Kestra Advisor Services Holdings C, Inc., d/b/a Kestra Holdings, and its subsidiaries, including, but not limited to, Kestra Advisory Services, LLC, Kestra Investment Services, LLC, Kestra Private Wealth Services, and Bluespring Wealth Partners, LLC. The material is for informational purposes only. It represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. It is not guaranteed by any entity for accuracy, does not purport to be complete and is not intended to be used as a primary basis for investment decisions. It should also not be construed as advice meeting the particular investment needs of any investor. Neither the information presented nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. This material was created to provide accurate and reliable information on the subjects covered but should not be regarded as a complete analysis of these subjects. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation. Kestra Advisor Services Holdings C, Inc., d/b/a Kestra Holdings, and its subsidiaries, including, but not limited to, Kestra Advisory Services, LLC, Kestra Investment Services, LLC, Kestra Private Wealth Services, and Bluespring Wealth Partners, LLC, do not offer tax or legal advice.*