



# Derivative Strategies ETF Report

December 2023

# Main Principles Behind Global X's Classification System for Derivative-Based Strategies

## Principle 1

The product must utilize derivatives as a core component of its investment strategy. This does not necessarily mean that derivatives must make up the majority of the ETF's portfolio. However, derivatives must serve a key purpose in achieving the investment objective stated in the ETF's prospectus.

## Principle 2

The derivative-based strategy can be utilized over a long-term period from the standpoint that it is able to be used tactically, for temporary exposure to express a market view, or within a strategic allocation. Strategies whose core objective is to be a daily trading tool will most likely not be considered for inclusion.

## Principle 3

The strategy must use derivatives as a means to achieve 1 or more of the 3 main use cases of derivatives by either buying or selling short a specific type of derivative:

- a. Risk Management
- b. Derivative Income
- c. Performance Enhancement

## The Four Layers of the Global X Classification System for Derivative-Based Strategies

### Layer 1 – Derivative Objective

Representing the broadest layer, this gives an understanding as to the core objective of the fund, utilizing the 3 derivative use cases of either Risk Management, Derivative Income, or Performance Enhancement.

### Layer 2 – Derivative Strategy

This layer will provide investors the means by which the investment objective is being pursued. For example, an ETF that utilizes derivatives with a risk management objective can be generated using either a tail risk strategy to provide a level of downside protection or a collar strategy to provide a range-bound return outcome.

### Layer 3 – Derivative Overlay

This layer describes the specific types of options positions or options packages being used to achieve the stated strategy. For example, an equity tail risk strategy on the S&P 500 may potentially be achieved by either purchasing a protective put option on this index or with a long position on VIX options.

### Layer 4 – Derivative Tactic

This final layer helps to communicate to investors any unique considerations regarding the options overlay being used. For example, a strategy offering synthetic exposure may be access vehicles to a type of option or options strategy that is meant to offer investors the ability to implement their own hedges within a portfolio allocation.

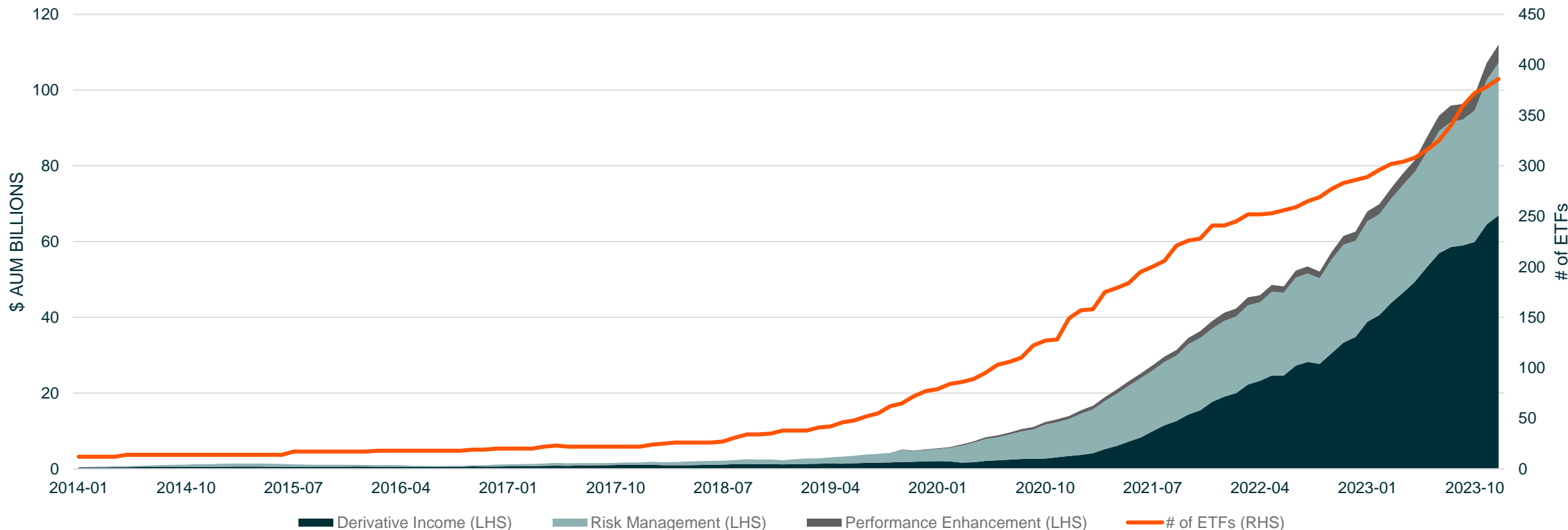
## Defining & Categorizing Derivative-Based Strategies: Global X's Classification System

All strategies within the Global X classification system have a Derivative Objective (Layer 1). However, it should be noted that some strategies may not have additional layer classifications, dependent on the usage of options within the ETF's strategy.

Derivative Objective (Layer 1)	Derivative Strategy (Layer 2)	Derivative Overlay (Layer 3)	Derivative Tactic (Layer 4)
Derivative Income	BuyWrite	Covered Call	
		Covered Call & Growth	
	PutWrite	Barrier Options	
	Futures-Based Income	Index Dividend Futures	
		VIX Futures Premium	
	Risk Managed Income	Net-Credit Collar	
Performance Enhancement	Spread Strategy	Bear Call Spread	
		Bull Put Spread	
		Long Call Options	
	Economic Leverage	Futures	
		Total Return Swap	
		Bull Call Spread	>100% Notional Coverage
Risk Management	Collar Strategy	Bull Put Spread	
		Put Spread Collar	Defined-Outcome
		Protective Collar	Defined-Outcome
	Credit Hedge	OTC Credit Derivatives	
	Inflation Hedge	Inflation Swaps	
		Yield Curve Options	
	Interest Rate Hedge	Interest Rate Swaps	
		Swaptions	Synthetic Exposure
	Spread Strategy	Bull Call Spread	
	Tail Risk	PutWrite	Fixed Income + Synthetic Equity
Long Put Options			
Protective Put			
Protective Put Spread			
VIX Hedge			

## Derivative Strategy ETF Landscape

At the end of December 2023, there were a total of 389 Derivative Strategy ETFs with roughly \$112B in assets under management (AUM), representing 79% year over year growth. Derivative Income strategies led the way, taking in new assets totaling approximately \$31B throughout the entirety of 2023.

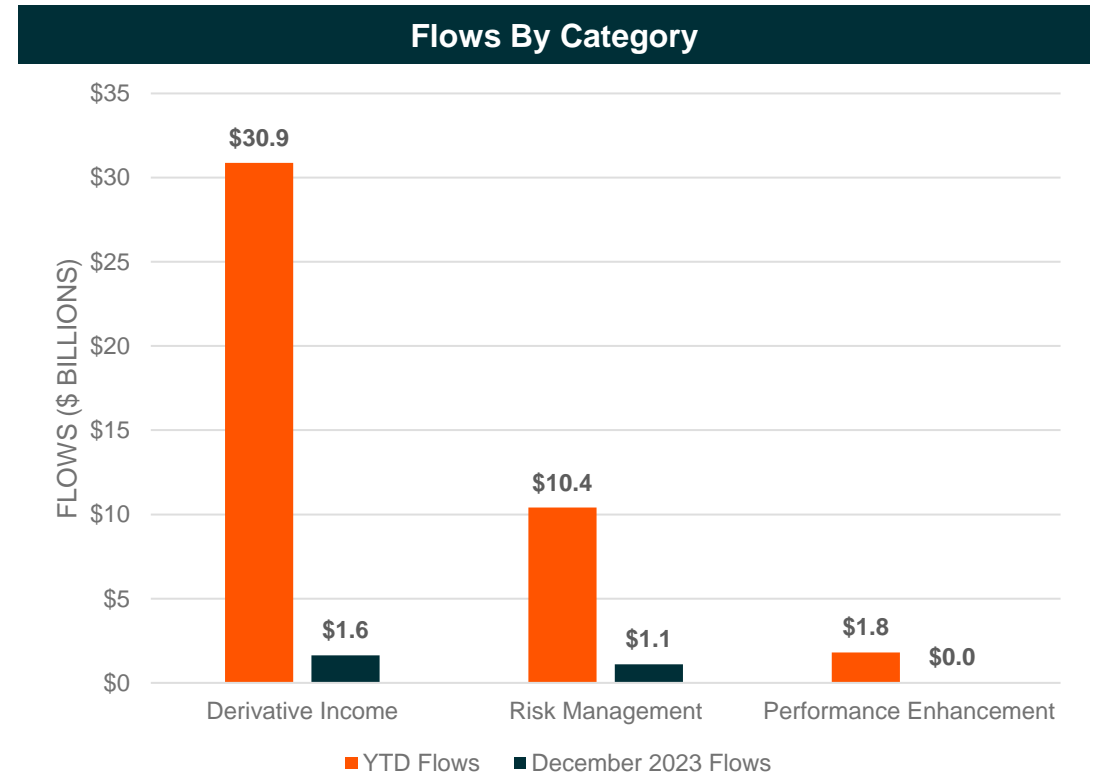
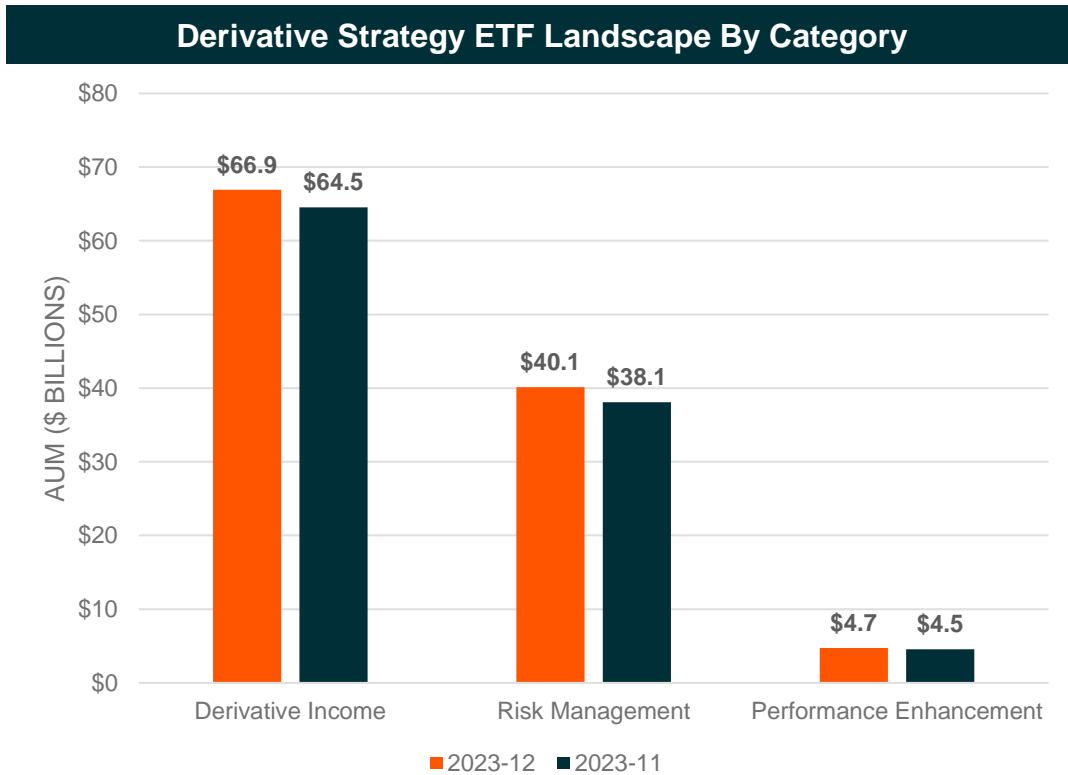


Source: Global X ETFs, Morningstar Direct. Data measured from December 31st, 2013 to December 31st, 2023.

Note: AUM includes assets of funds closed until the last month of trading activity

## Derivative Income ETFs Continue To See Exceptional Demand

Within the Derivative ETF ecosystem, Derivative Income represents the largest category. That said, all objective categories experienced positive inflows during the month of December. With the bulk of the fund flows targeted towards Derivative Income and Risk Management, investors may be preparing income and core portfolio sleeves for a potential slowdown in global economic growth.

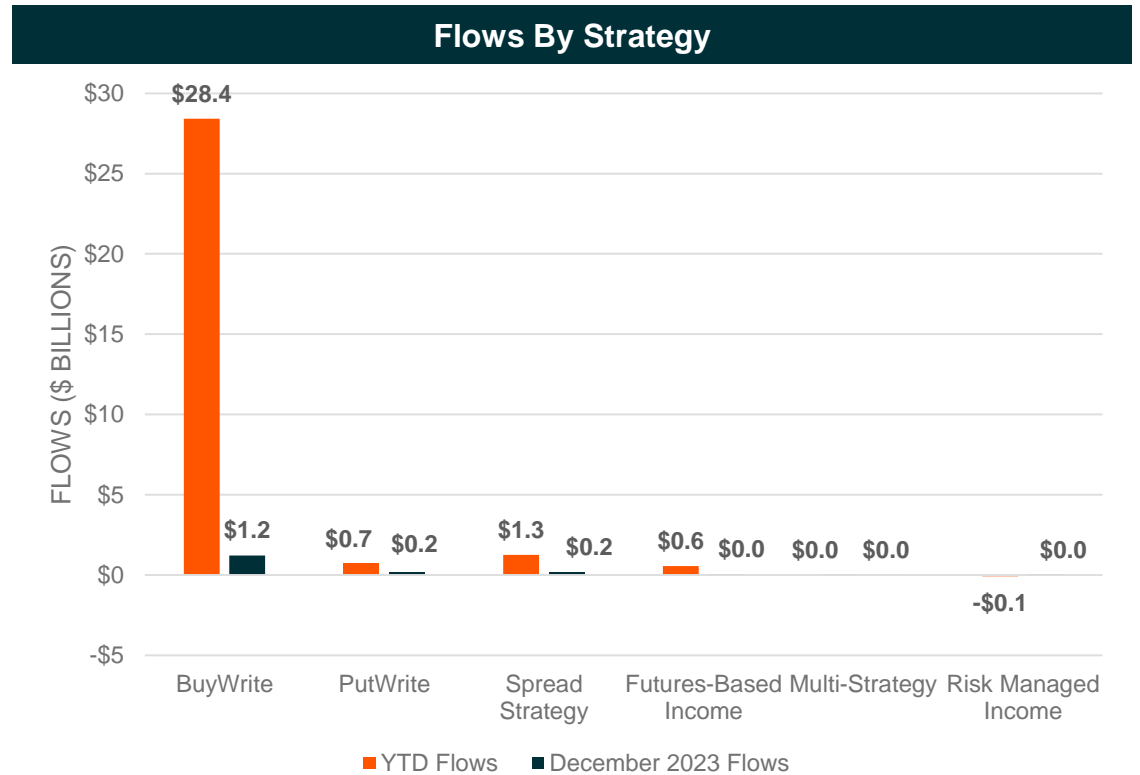
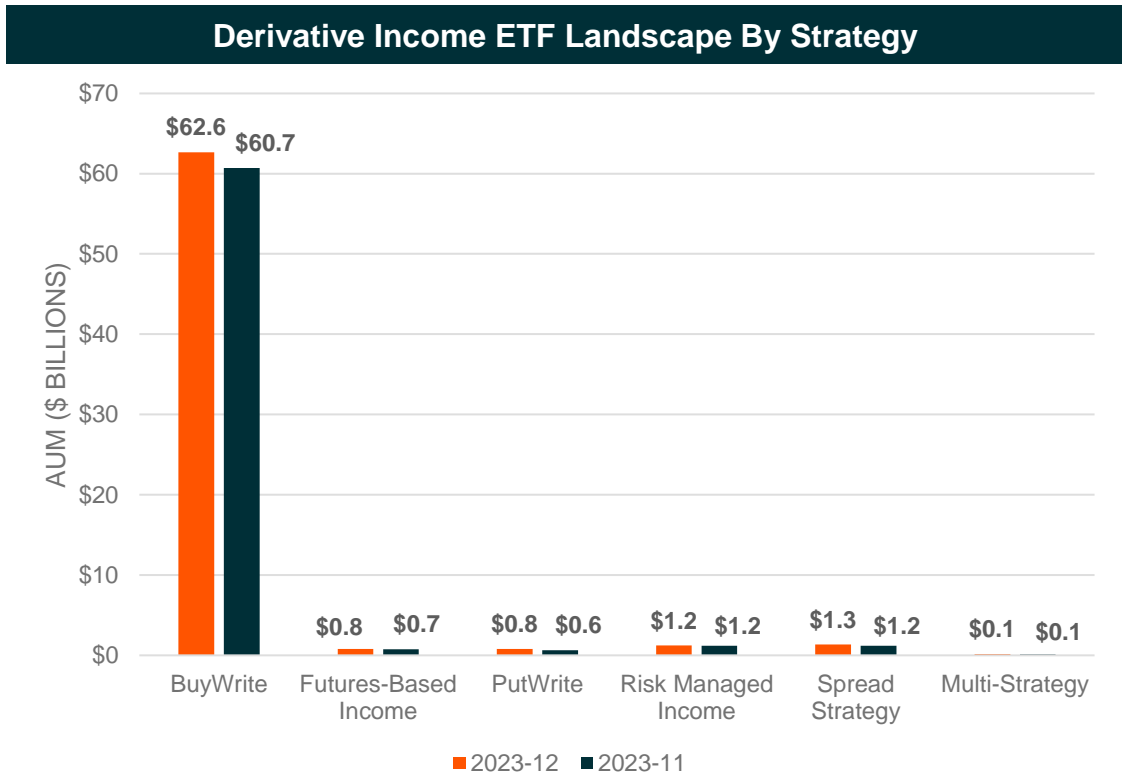


Source: Global X ETFs, Morningstar Direct. As of December 31st, 2023.

Note: AUM includes assets of funds closed until the last month of trading activity

## Derivative Income Landscape Update

Buywrite strategies accounted for the broad majority of assets under management within the Derivative Income category and they continued to lead in flows in December with some \$1.2B in net new assets. Notably, putwrite and spread strategies experienced modest flows over the course of the month as differentiated derivative income strategies continue to come to market.

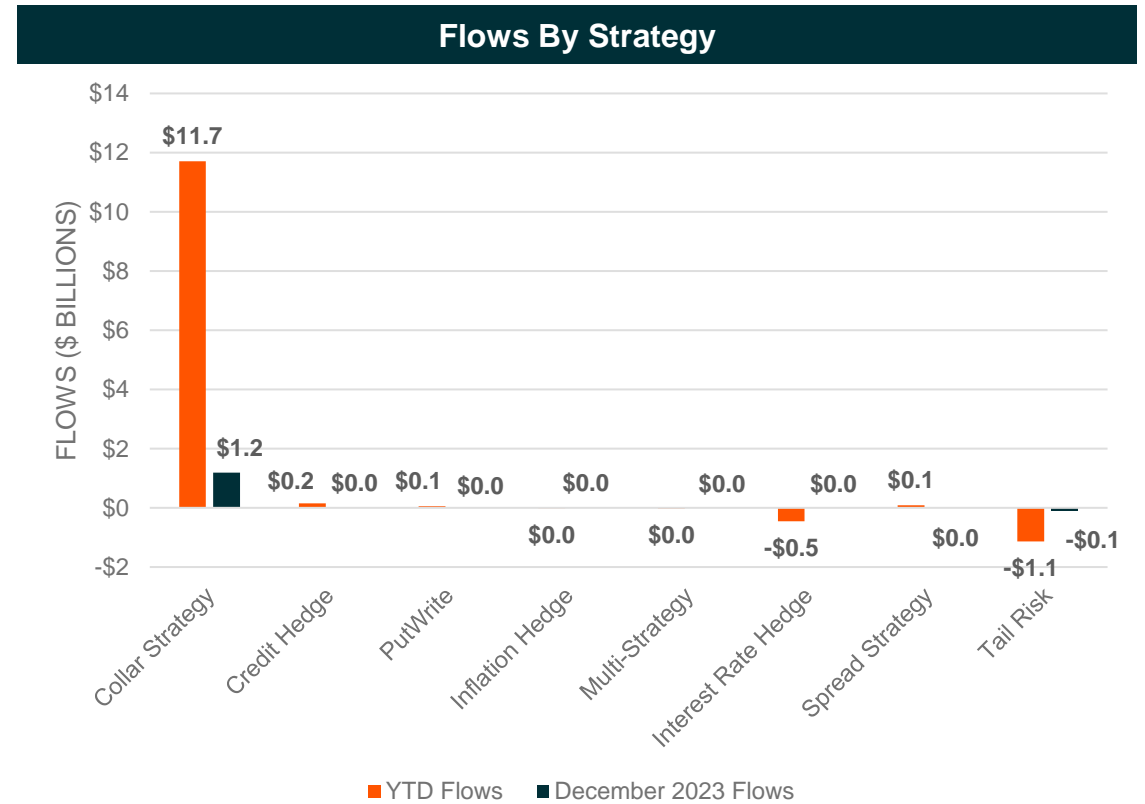
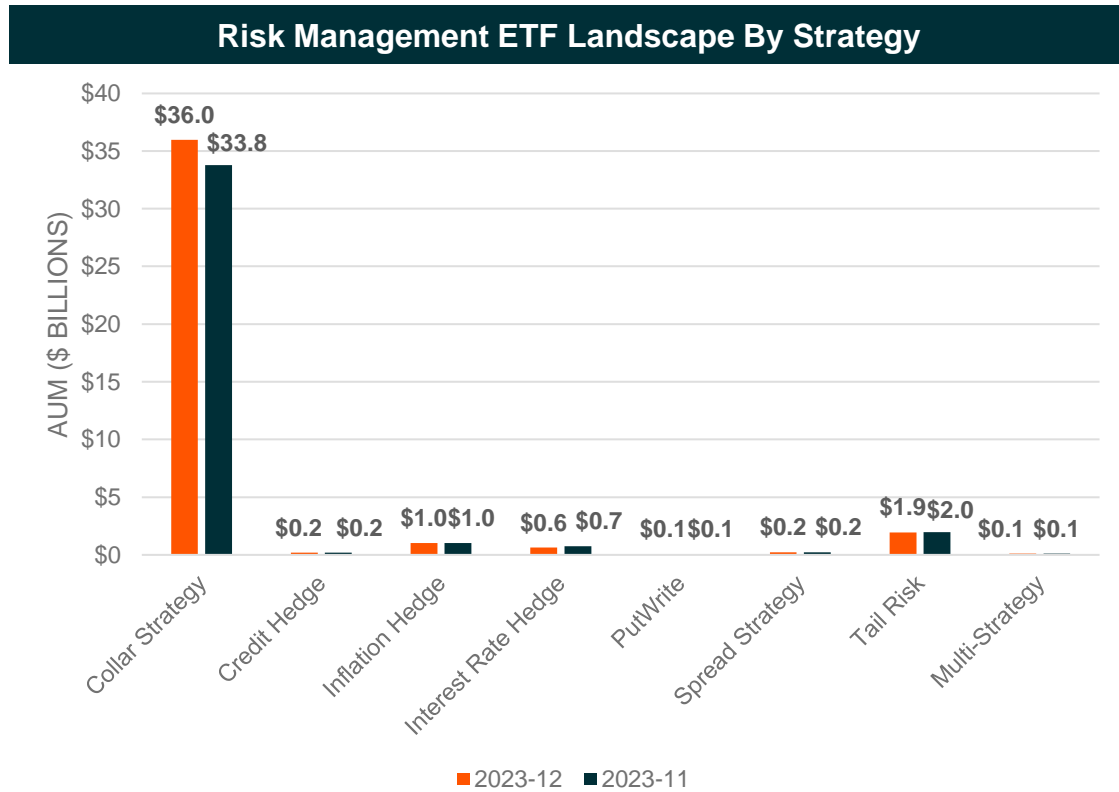


Source: Global X ETFs, Morningstar Direct. As of December 31st, 2023.

Note: AUM includes assets of funds closed until the last month of trading activity

## Risk Management Landscape Update

Collar strategies remained the most prominently implemented derivative-based ETF strategy within the Risk Management objective, driving new assets of roughly \$1.2 billion in the month of December. With the new year turning the corner, some investors may be seeking to play defense as traditional equity benchmarks in the U.S. have become more concentrated.



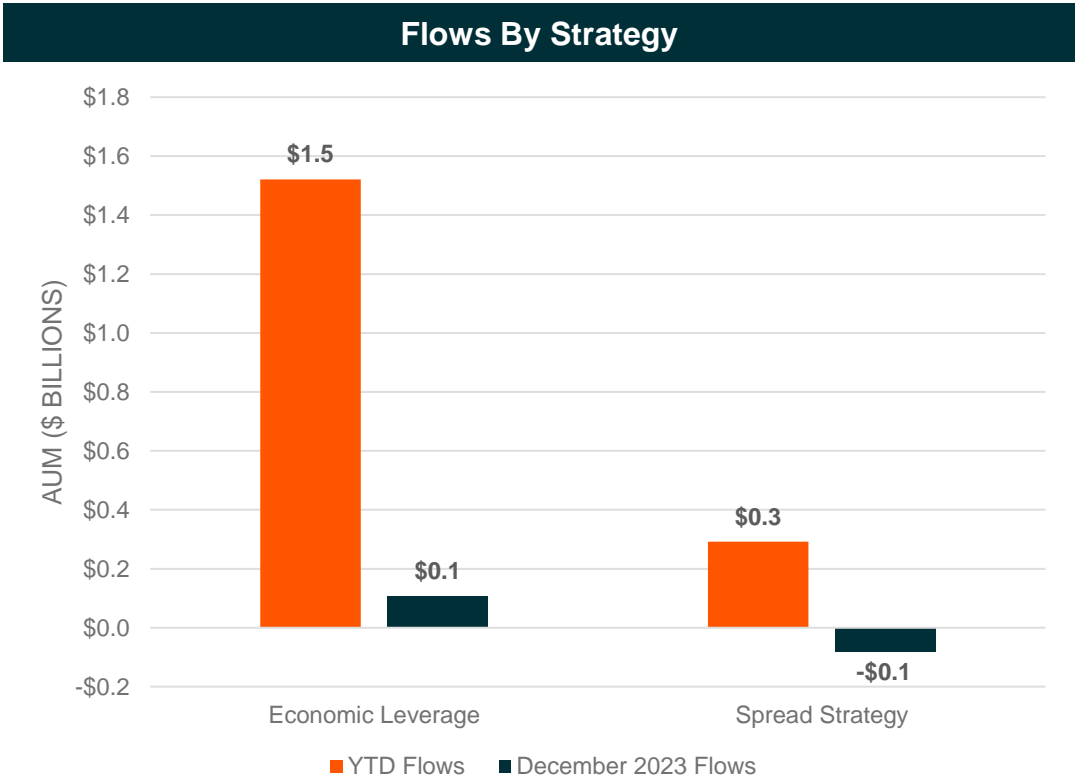
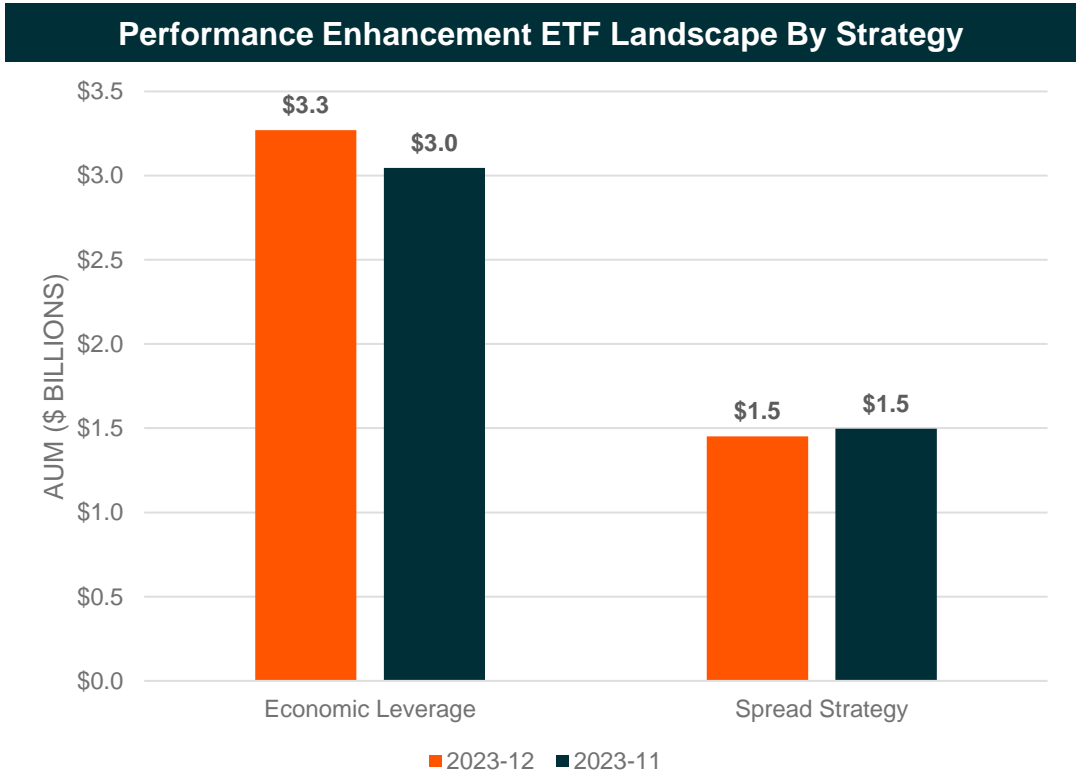
Source: Global X ETFs, Morningstar Direct. As of December 31st, 2023.

Note: AUM includes assets of funds closed until the last month of trading activity



# Performance Enhancement Landscape Update

Flows were flat within this category for the month of December, potentially reflecting the need for more income amid the potential for future rate cuts as well as the need for downside volatility reduction via a risk management oriented derivative strategy in anticipation of a year of slower economic growth.



Source: Global X ETFs, Morningstar Direct. As of December 31st, 2023.

Note: AUM includes assets of funds closed until the last month of trading activity

## Key Takeaways

### Takeaway 1 – Derivative ETF Landscape Outlook

Finishing the year off strong, derivative strategy ETFs took in roughly \$43B in net new assets for the entirety of 2023.<sup>1</sup> This growth saw total assets increase to \$112B, from \$63B in assets at the beginning of the year.<sup>2</sup> Derivative Income strategies were responsible for much of the advance as investor demand for income stayed consistent throughout the year. With 115 new ETFs coming to market in 2023, the market remains strong as issuers seek to differentiate from existing payoff structures.<sup>3</sup>

### Takeaway 2 – Risk Management ETF Outlook

Risk Management Strategies brought in a total of \$10B in net new assets in 2023, driven by the continued expansion of defined outcome and collar strategy lineups.<sup>4</sup> With a significant amount of annual, semi-annual, and quarterly collar strategy resets occurring at the end of December, investors may be preparing for the new year to have a level of turbulence with a slowing economy as a possible scenario.

### Takeaway 3 – Derivative Income ETF Outlook

Ending the year with \$28B in net new assets, Buywrite strategies accounted for 65% of all flows into all Derivative ETFs.<sup>1</sup> Outpacing other overlays significantly, it's likely that other income-oriented strategies outside of the Buywrite landscape will continue to come to market for landscape differentiation. With interest rates likely peaking, investors may be well equipped to maintain portfolio income streams with the enhancement of selling optionality via the ETF wrapper.

<sup>1</sup>Source: Global X ETFs with data from Morningstar Direct measured from 01/01/2023 to 12/31/2023. <sup>2</sup>Ibid. <sup>3</sup>Ibid. <sup>4</sup>Ibid.



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# Important Information

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The Global X Derivative Strategy Classification System is based on the expertise, views, and opinions of the Global X Derivative Strategy Classification Committee and are subject to change.

Global X defines thematic investing as the process of identifying powerful disruptive macro-level trends and the underlying investments that stand to benefit from the materialization of those trends. By nature, thematic investing is a long term, growth-oriented strategy, that is typically unconstrained geographically or by traditional sector/industry classifications, has low correlation to other growth strategies, and invests in relatable concepts.

The process to identify a derivative-based strategy incorporates three main principles:

1. The product must utilize derivatives as a core component of its investment strategy. This does not necessarily mean that derivatives must make up the majority of the ETF's portfolio. However, derivatives must serve a key purpose in achieving the investment objective stated in the ETF's prospectus.
2. The derivative-based strategy can be utilized over a long-term period from the standpoint that it is able to be used tactically, for temporary exposure to express a market view, or within a strategic allocation. Strategies whose core objective is to be a daily trading tool will most likely not be considered for inclusion.
3. The strategy must use derivatives as a means to achieve 1 or more of the 3 main use cases of derivatives by either buying or selling short a specific type of derivative:
  - Risk Management – These are strategies with an objective of achieving higher risk-adjusted returns by lowering overall portfolio volatility with the usage of derivatives.
  - Income – Strategies that utilize derivatives as a core investment to potentially achieve high income for its investors.
  - Performance Enhancement - Strategies that use derivatives to enhance the upside potential for capital appreciation, typically increasing the economic leverage used within a portfolio.

Taking the above principles into account, it should be noted that the derivative-based classification system does not consist of leveraged/inverse ETFs whose core objective is to track an index that rebalances daily. This goes against the 2nd principle stated above regarding the strategy being a long-term investment.

Based on the definitions and principles described above, the derivative-based classification system is organized into multiple layers for a more refined understanding as to the objective of each strategy. Note that some options strategies can be utilized for multiple purposes, whether that be for Income, Risk Management, or Performance Enhancement, resulting in some categories appearing more than one time. The system consists of four layers of classification: (1) Derivative Objective (2) Derivative Strategy (3) Derivative Overlay and; (4) Derivative Tactic.

'Derivative Objective' is the broadest layer and this gives an understanding as to the core objective of the fund, utilizing the 3 derivative use cases defined in the Principles section: (1) Risk Management, (2) Derivative Income, and (3) Performance Enhancement. One layer down is 'Derivative Strategy,' which will provide investors the means by which the investment objective is being pursued. For example, an ETF that utilizes derivatives with a Risk Management objective can be generated using either a Tail Risk Strategy to provide a level of downside protection or a Collar Strategy to provide a range-bound return outcome. Although slightly different, the commonality between these two overlays are the fact that their core purpose is to provide Risk Management.

## Important Information (Continued)

Further down, we identify 'Derivative Overlay' as a layer describes the specific derivatives being used and the manner in which they are being used (Long or Short, Bull or Bear). For example, a Tail Risk overlay can obtain a level of downside protection using many kinds of derivatives. Some overlays include either "going-long" with put options via a Protective Put or harnessing VIX Futures as an overlay on an existing stock portfolio. Lastly, 'Derivative Tactic' help to communicate to investors any unique considerations regarding the options overlay being used. For example, a strategy offering a Synthetic Exposure are primarily meant to be exposure vehicles to. Another example is a Defined-Outcome ETF, which utilizes put spread collars to offer a specific level of downside protection with capped upside potential if held over the course of the stated "outcome-period", making each iteration different from one another.

The number of derivative objectives, derivative strategies, derivative overlays, and derivative tactics are expected to change as new derivative-based strategies come to market. These updates will be made by the Global X Derivative Strategy Classification Committee ("the committee") and take into account official fund prospectus filings as well as fund company materials.

The ETF industry is continually innovating to provide unique derivative exposures to investors. The Global X Derivative Strategy Classification Committee evaluates these innovations by first investigating if a fund aligns with the core three principles of what it believes a derivative strategy to be. Then, once a fund is deemed a "Derivative Strategy", the committee identifies what the core objective is, how this objective is being achieved, and what types of derivative positions are being utilized within the strategy by reviewing prospectuses, index methodologies (if applicable), stated objectives by the fund company, as well as underlying holdings. Once per month, the committee will review all new U.S.-Listed ETF launches to determine if the fund should be added and how it should be classified. In addition, the committee will also review any strategy changes that have occurred amongst existing ETFs within the Classification System that might merit reporting in the next monthly Derivative Strategy ETF Report.

While an ETF may engage in multiple objectives or strategies utilizing derivatives, the committee will determine the classification based on the true nature of the ETF.

While an ETF may be classified within a certain objective, strategy, overlay, or tactic, Global X does not give any assurances that the ETF provides good and accurate exposure to the specific exposure it is targeting. For example, an ETF may convey or market itself in a specific manner but still utilize a specific derivative trading strategy that has its own nomenclature.

The derivative classification system is reviewed monthly by the Global X Derivative Strategy Classification Committee to consider new changes and/or additions to the layers (categories) stated above. In addition, the committee will also seek to add newly launched, U.S.-listed ETFs that fit the 3 main principles of a derivative-based strategy.

In the event that an ETF changes its investment objective to another one that goes against the 3 principles of a derivative-based strategy, the strategy will be removed from the classification system and its historical assets under management data will be maintained within the monthly report. On the other hand, if an ETF changes its investment objective to something that fits within the parameters of the 3 principles, it will be considered for inclusion in the classification system where its AUM will start to be reflected in the report.

***Global X accepts requests for reviews or appeals for any ETFs. Please contact Global X at [research@globalxetfs.com](mailto:research@globalxetfs.com), and the appeal will be considered in a timely manner. There are no guarantees that an appeal will result in a change in the ETF's classification.***

## Important Information (Continued)

The Derivative-based ETF Report, including the classification system, falls under the supervision of the Global X Derivative-Based Strategy Classification Committee. The Committee consists of members from Global X's research and product teams who have extensive knowledge of the strategies themselves and the ETF industry. The goal of the committee is to properly identify and classify ETFs that fit the 3 principles. The Committee meets at least monthly to review the classification system, as well as on an ad-hoc basis to review new ETF launches or ETFs that change their strategy.

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