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## GLOBAL X ETFs RESEARCH

# Inflection Points: The Summer Vol Stew Recipe

## Inflection Points

Advisor-Focused Monthly  
Insights by Global X ETFs

### Ingredient List:

¼ cup geopolitical risk tied to the first-ever incumbent withdrawing from a presidential race after the primary

¼ cup monetary policy risk with the Fed holding rates at 5.5%

1 tablespoon of economic slowdown fears after the weak job report

A pinch of liquidity crunch from a global carry trade unwind on a stronger yen

### Instructions:

Mix and let simmer on medium for two weeks...

The market rout on Monday, August 5, was the product of volatility ingredients boiling up at a time of mounting concern that valuations were too high. Prior to the selloff, U.S. equity volatility had been quite low for much of the year.<sup>1</sup> We believed that the market was undergoing a regime shift where monetary policy and related data releases would play a smaller part in driving uncertainty and that the complicated geopolitical backdrop would cause volatility to rise.<sup>2</sup> Both factors played a role in the recent volatility spike, along with economic concerns and tightening liquidity.

By Friday, August 9, the market had some footing. The irony of this episode is that earnings growth continues to shape up nicely and the S&P 500's long streak of 12% or better quarterly profit margins remains intact.<sup>3</sup> The selloff could simply reflect a small air pocket in the economy that proves to be a blip, or it could prove to be the canary in the coal mine signaling a bigger downturn. Either way, this type of volatility is a reminder that there's value in a long-term perspective and that investors do have opportunities to add recipes to their cookbooks that can calm nerves.

### Key Takeaways

- Increased volatility does not necessarily impede market returns over a longer time frame.
- Some themes can hold up better in volatile environments given their stable revenue streams, including U.S. Infrastructure and Defense Tech.
- Alternative income strategies can help reduce volatility by moving the capital structure with preferreds or hedging equity risk with covered calls.

## Good Things Come to Those Who Wait

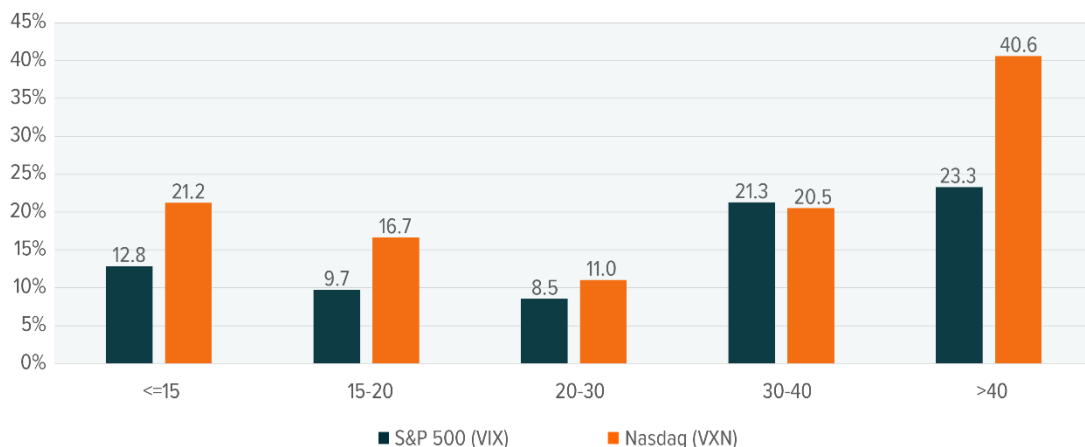
Whether we're talking about gumbo, chicken soup, beef stew, or ramen, they all need time to simmer. Bouts of volatility typically arise due to a confluence of events—some predictable and some not—that increase uncertainty. These rollercoaster rides can be unsettling for investors, but they often pass with few lasting effects. When the VIX, a commonly used measure of equity volatility, is in the 25–30 range, it signals the potential for high volatility.<sup>4</sup> Since 1990, the VIX has been above 25 about 18% of the time. One year after the VIX exceeds that threshold, the S&P 500 is only down in 21% of those instances and in just 4% of all trading days. In other words, most volatility spikes are not associated with major selloffs and are false positives.

Volatility spikes typically do not impact long-term investors. The 12-month rolling returns around volatility spikes show that equity markets often recover quite fast. Comparing prices one month before the elevated volatility with prices 11 months after shows that the markets often charge higher after turbulent periods.<sup>5</sup> This trend may prove the case yet again given the continued strength in corporate fundamentals, which includes S&P 500 companies delivering almost 5% sales growth and 12% earnings growth for second quarter of 2024.<sup>6</sup>



### ONE MONTH BEFORE, 11 MONTHS AFTER ROLLING RETURNS AFTER VOLATILITY SPIKE

Source: Bloomberg, measured daily using vol levels from 7/31/2002-7/31/20XX (XX depends on rolling return period).



## Thematic Ingredients for Uncertain Times

One way that investors can manage short-term volatility is by focusing on long-term trends. This approach might not eliminate or even reduce drawdowns in the short run, but the extended time frame and emphasis on the future can help contextualize the bumps. While high growth themes may have higher beta and swing more than the broad market, they also tend to recover quickly.

Several themes display fairly strong performance 12 months after a volatility spike. Given our view that geopolitics continues to be an important catalyst for volatility, two themes that look particularly interesting are U.S. Infrastructure and Defense Technology.<sup>7</sup> As we've written in the past, both themes have bipartisan support and there is a good deal of funding already pledged. U.S. Infrastructure is buttressed by the combined \$1.8 trillion from the Infrastructure Investment and Jobs Act and the CHIPS Act, and U.S. defense spending is approved for almost \$900 billion in fiscal year 2024.<sup>8</sup> Consistent with our long-term view of continued automation and digitalization, the Artificial Intelligence and Robotics themes have also performed reasonably well across different volatility regimes.



## THEMATIC SUMMARY

Source: Bloomberg, measured from 07/08/2011 (SOLIT Index Inception) to 07/31/2023.

Start Date	VIX Closing Level	<=15	15-20	20-30	30-40	>40
5/2/18	AI & Big Data	23.0	7.5	21.8	31.4	83.5
8/29/16	Robotics & AI	17.0	-0.5	14.5	29.2	87.9
3/29/19	Cloud Computing	37.2	-2.1	9.3	19.6	77.8
10/7/19	Cybersecurity	39.4	4.8	13.8	19.8	79.9
10/12/20	Data Centers & Digital Infrastructure	14.1	-6.3	0.4	-3.2	21.3
8/29/16	5G & IoT	11.9	4.6	17.8	30.4	82.7
10/15/19	Video Games & Esports	58.8	-13.6	-0.6	20.1	96.4
11/9/11	Social Media	18.9	7.2	11.7	28.2	125.1
7/21/23	Defense Tech	36.2	33.2	23.5	24.3	-
3/14/18	Electric/Autonomous Vehicles	10.5	0.5	20.7	45.5	136.9
7/9/10	Lithium & Battery Tech	8.6	-2.8	15.5	28.7	122.7
8/29/16	FinTech	27.5	-2.6	3.5	14.7	84.6
6/29/21	PropTech	17.1	18.5	7.6	0.7	-
3/9/23	Blockchain Equities	72.3	-12.6	22.6	-33.2	-
10/31/18	E-Commerce	38.2	-1.2	5.1	25.1	122.3
4/19/16	Millennial Consumer	19.1	2.5	15.6	28.2	98.8
3/26/19	Genomics	23.2	-15.2	-7.0	11.7	77.0
7/16/20	Telemedicine & Digital Health	-21.9	-28.6	-12.8	-9.1	9.3
4/19/16	Aging Population	12.9	4.8	8.2	15.1	38.4
4/17/17	U.S. Infrastructure Dev	4.7	8.1	27.4	43.8	102.0
6/29/21	AgTech & Food Innovation	-17.8	-26.9	-26.1	-20.4	-
10/12/20	CleanTech	-41.2	-28.2	-16.2	-1.8	39.9
8/22/18	Renewable Energy Producers	10.8	-1.8	-5.3	0.8	32.0
3/23/21	Clean Water	14.6	-3.6	6.4	8.5	-
8/16/21	Solar	-42.0	-26.8	-22.4	-9.8	-
8/16/21	Wind Energy	-21.2	-25.9	-21.9	-16.1	-
6/29/21	Hydrogen	-40.6	-45.6	-38.2	-30.9	-

## Serving Up Alternative Income

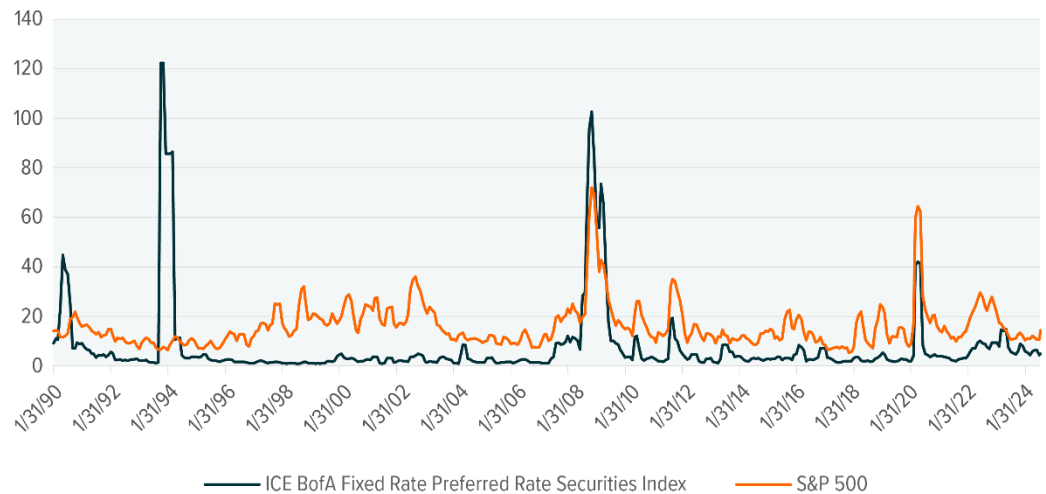
Another approach to consider in turbulent markets are strategies that help lower portfolio volatility. One method to preserving principle is moving up the capital structure. Preferred equities have equity and



bond-like characteristics with modest correlation to the broader market.<sup>9</sup> The segment is concentrated in the financial sector but historically displays much lower volatility than the S&P 500.

### 60-DAY VOLATILITY ON PREFERRED VS. S&P 500

Source: Bloomberg as of 7/31/2024.



Hedged equity can also be an option. Covered call strategies sell options on underlying exposures to generate income. Typically, option premiums increase as volatility rises.<sup>10</sup> These equity strategies can help generate income and reduce volatility at the same time. Investors focused on yield may want to look at strategies that sell calls on 100% of the underlying index, whereas investors interested in hedging equity upside might find a strategy that sells options on 50% more appealing.

#### Footnotes

1. Global X analysis with information derived from: Bloomberg L.P. (n.d.) [Data set]. Retrieved on August 9, 2024.
2. Helfstein, S. (2024, June 18). Inflection Points at Mid-Year: Favorable Winds, Choppy Seas. Global X. <https://www.globalxetfs.com/inflection-points-at-mid-year-favorable-winds-choppy-seas/>
3. Global X analysis with information derived from: Bloomberg L.P. (n.d.) [Data set]. Retrieved on August 9, 2024.
4. Ibid.
5. Ibid.
6. Ibid.
7. Ibid.
8. Helfstein, S. (2024, June 18). Inflection Points at Mid-Year: Favorable Winds, Choppy Seas. Global X. <https://www.globalxetfs.com/inflection-points-at-mid-year-favorable-winds-choppy-seas/>
9. Global X analysis with information derived from: Bloomberg L.P. (n.d.) [Data set]. Retrieved on August 9, 2024.
10. Ibid.



**Theme Reference index:**

Blockchain – Solactive Blockchain Index  
Disruptive Materials – Solactive Disruptive Materials Index  
Lithium & Battery Technology – Solactive Global Lithium Index.  
FinTech – Indxx Global FinTech Thematic Index  
Cloud Computing – Indxx Global Cloud Computing Index  
Robotics & AI – Indxx Global Robotics & Artificial Intelligence Thematic Index  
Artificial Intelligence – Indxx Artificial Intelligence & Big Data Index  
Cybersecurity – Indxx Cybersecurity Index  
Millennial Consumer – Indxx Millennials Thematic Index  
E-commerce – Solactive E-commerce Index  
Genomics & Biotechnology – Solactive Genomics Index  
Data Centers & Digital Infrastructure – Solactive Data Center REITs & Digital Infrastructure Index  
Defense Technology – Global X Defense Technology Index  
Social Media – Solactive Social Media Total Return Index  
Solar – Solactive Solar Index  
Autonomous & Electric Vehicles – Solactive Autonomous & Electric Vehicles Index  
Education – Indxx Global Education Thematic Index  
Telemedicine & Digital Health – Solactive Telemedicine & Digital Health Index  
Hydrogen – Solactive Global Hydrogen Index  
Internet of Things – Indxx Global Internet of Things Thematic Index  
U.S. Infrastructure Development – Indxx U.S. Infrastructure Development Index  
CleanTech – Indxx Global CleanTech Index  
AgTech & Food Innovation – Solactive AgTech & Food Innovation Index  
Renewable Energy Producers – Indxx Renewable Energy Producers Index  
Aging Population – Indxx Aging Population Thematic Index  
Clean Water – Solactive Global Clean Water Industry Index  
Wind Energy – Solactive Wind Energy Index  
Video Games & Esports – Solactive Video Games & Esports Index  
Green Building - Solactive Green Building Index

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