QYLD - Exploring the Case for a Nasdaq 100 Covered Call Strategy

Robert J. Scrudato
rscrudato@globalxetfs.com

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At the onset of 2023, a combination of factors dampened investor sentiment as it pertained to U.S. equities. Among them were rising interest rates and recessionary concerns that dented consumer confidence. As the first half unfolded, however, markets found support in the form of decelerating inflation, resilience in jobs reports, and strong positive revenue revisions for major players in the tech space. The breadth of this rally was narrow, driven by a small constituency of mega-cap names in the Nasdaq 100 Index. However, now that share gains have grown more broad based, where markets may go from here and what investors can do in them represent some big questions. In this environment that features higher valuations, covered call option strategies can provide opportunities to hedge positions and generate returns from call premiums. Among them is the Global X Nasdaq 100 Covered Call ETF (QYLD).

Key Takeaways

- The Nasdaq 100 Index has increased precipitously in value so far this year, but momentum has slowed in recent months, and investors may be looking for a way to hedge their positions.
- The Global X Nasdaq 100 Covered Call ETF (QYLD) is a fully covered buy-write strategy that uses the Nasdaq 100 as its reference asset. Providing a potential stream of premiums, the fund acts as a competitive total return solution.
- Covered call investment strategies can bring visibility, a variety of diversification benefits, and risk mitigation potential to a portfolio.

Finding Current Income in the Nasdaq 100

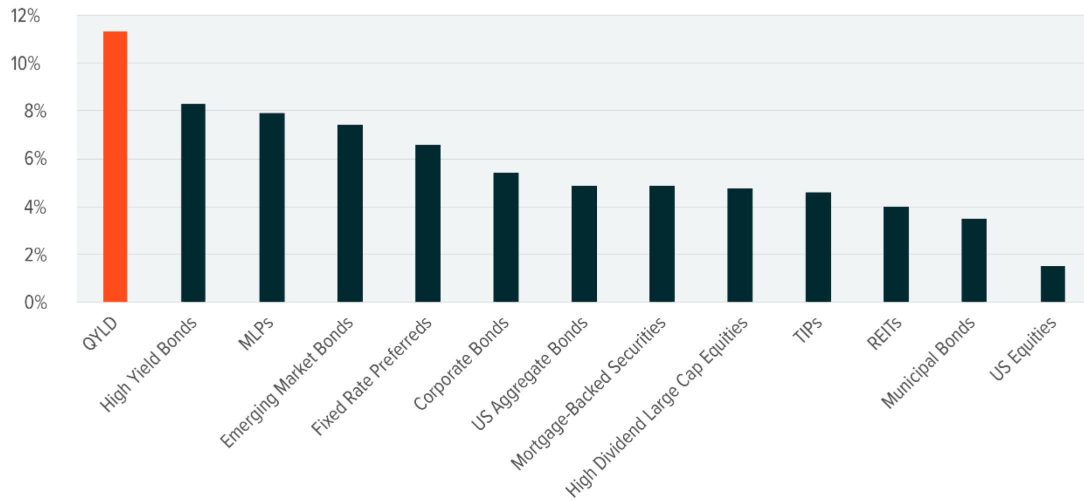
Accounts that maintained a healthy exposure to Nasdaq 100 Index constituents despite all the market uncertainty in early 2023 were well rewarded in the first half. The Communication Services, Consumer Discretionary, and Information Technology sectors, which make up the lion's share of the index, represented some of the strongest performing segments of the market. In fact, a few participants in these growth focused arenas performed so well that it led to overconcentration in the index and a special rebalance in July, though the Nasdaq 100's composition is largely the same.

Major advancements in artificial intelligence, cloud computing, and the internet of things offer the potential to push valuations even higher. That said, some investors may be interested in hedging their positions, and they can potentially do so through a covered call strategy. In the chart below, we highlight some of the more conventional asset classes that investors use to find current yield. We also include the 12-month trailing distributions provided by the Global X Nasdaq 100 Covered Call ETF (QYLD). Discounting the stream of premium distributions that it has provided, the fund also offers exposure to the Nasdaq 100.

Duplicating exposures to Nasdaq 100 constituents might seem counterintuitive at first glance when trying to mitigate risk. However, an at-the-money covered call strategy like QYLD seeks to monetize the index's volatility to create returns that can act as somewhat of a hedge. Those potential premiums can also supplement an existing growth strategy while offering a portfolio a positive relationship with volatility that other investment vehicles may not provide.

ASSET CLASS YIELD VS. GLOBAL X NASDAQ 100 COVERED CALL ETF (QYLD) DISTRIBUTIONS

Source: Global X ETFs & Bloomberg as of 07/31/2023. Asset class representations are as follows: High Yield Bonds, Bloomberg U.S. Corporate High Yield Total Return Index; Fixed-Rate Preferreds, ICE BofA Fixed Rate Preferred Securities Index; Emerging Market Bonds, Bloomberg EM USD Aggregate Total Return Index; Corporate Bonds, Bloomberg U.S. Corporate Total Return Index; High Dividend Large Cap Equities, S&P 500 High Dividend Total Return Index; REITs, FTSE NAREIT All Equity REITs Total Return Index; U.S. Equities, S&P 500 Total Return Index; U.S. Aggregate Bonds, Bloomberg U.S. Aggregate Index; TIPS, Bloomberg US Treasury Inflation Notes TR Index; Mortgage-Backed Securities, Bloomberg U.S. Mortgage-Backed Securities Index; Municipal Bonds, Bloomberg U.S. Municipal Index; MLPs, S&P MLP Index. High Dividend and U.S. Equity yields are indicated by their 12-month yields. Fixed income yields are indicated by yield-to-worst. QYLD indicated by its trailing 12-month distributions relative to fund Net Asset value and capital gains.



A portion of QYLD's distributions is estimated to include a return of capital. For information on the breakdown of the most recent distribution, please see QYLD's 19a notice.

Performance data quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted. For performance data current to the most recent month- or quarter-end, 30-Day SEC Yield, and a copy of the fund prospectus, please click here.

Breaking Down QYLD's Basics

The Global X Nasdaq 100 Covered Call ETF is an index fund that operates a rules-based investment policy, including a covered call option overlay. QYLD's covered call strategy works in the same way that it might for an individual investor that wants to maintain holdings on a single equity and then write calls on that position. QYLD simply uses the broader Nasdaq 100 index as its reference asset and writes its call options against the broader index in exchange for the options' premiums.

COVERED CALL STRATEGY IN PRACTICE

Sources: Global X ETFs.

QYLD is an ETF that implements a covered call strategy on the Nasdaq 100

Owns the Nasdaq 100 Index Components

Components:	As per Nasdaq 100 Index
Weighting Scheme:	As per Nasdaq 100 Index

+

Writes monthly call options on the Nasdaq 100 Index

Style:	European
Strike Price (SP):	Closest listed SP above last value
Options Strategy:	Written Monthly

Additional Info

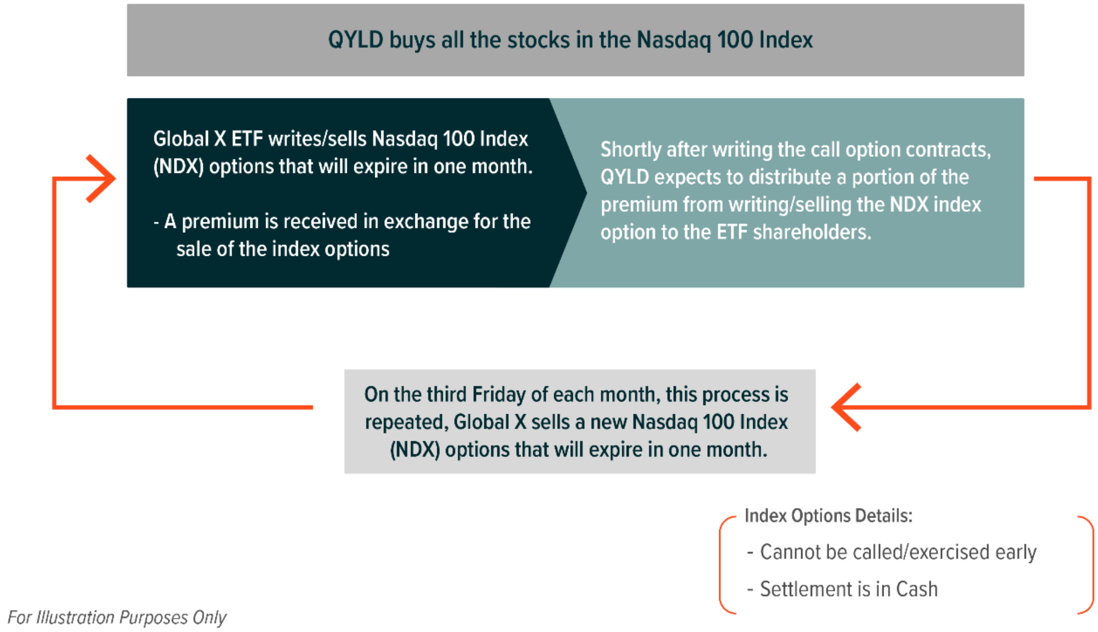
Ticker:	QYLD
Inception Date:	12/11/2013
Expense Ratio:	0.60%
Distributions:	Paid Monthly

Rather than purchase an ETF that tracks the Nasdaq 100, QYLD purchases the many components that comprise the index. As a result, the fund can maintain a high level of liquidity and it is not subjecting itself to the additional expenses that might be associated with purchasing another ETF. Also, the strategy keeps the fund flexible in that it can purchase or sell the stock of individual companies in order to maintain an overall weighting that is as close as possible to its equity index, the Nasdaq 100. QYLD seeks to provide investment results that correspond generally to the price and yield performance, before fees and expenses, of the Cboe Nasdaq 100 BuyWrite V2 Index.

QYLD operates a call-write strategy to cover 100% of its notional portfolio by selling Nasdaq 100 (NDX) call options that cover the entire Nasdaq 100, as opposed to writing call options on all the stocks that make up the index individually. The fund uses European style options that cannot be executed by the purchaser until the contract reaches its expiration date. These contracts are cash settled, so the fund maintains its systematic approach, writing at-the-money options monthly, and investors do not need to be concerned with how the fund can maintain its holdings at a similar weight to that of the index.

COVERED CALL STRATEGY PROCESS EXPLAINED

Sources: Global X ETFs.



Each month, the Global X Nasdaq 100 Covered Call ETF writes call options with strike prices that are at the money, which means that at initiation the strike price of the calls written is equal to the value of the underlying index. If a contract with a strike price that is precisely at-the-money is not available to be sold, the fund will write its call options at the closest possible strike price to the reference index's value that is out of the money. The strategy allows the fund to attract the highest possible premiums for its written calls without selling contracts that are already in a position to potentially be exercised. From there, the fund proceeds to implement its distribution policy of distributing half of the premiums it has received or 1% of the fund's net asset value, whichever is lower. The balance of the premium is reinvested back into the fund.

MONTHLY DISTRIBUTION CALCULATION – COVERED CALLS

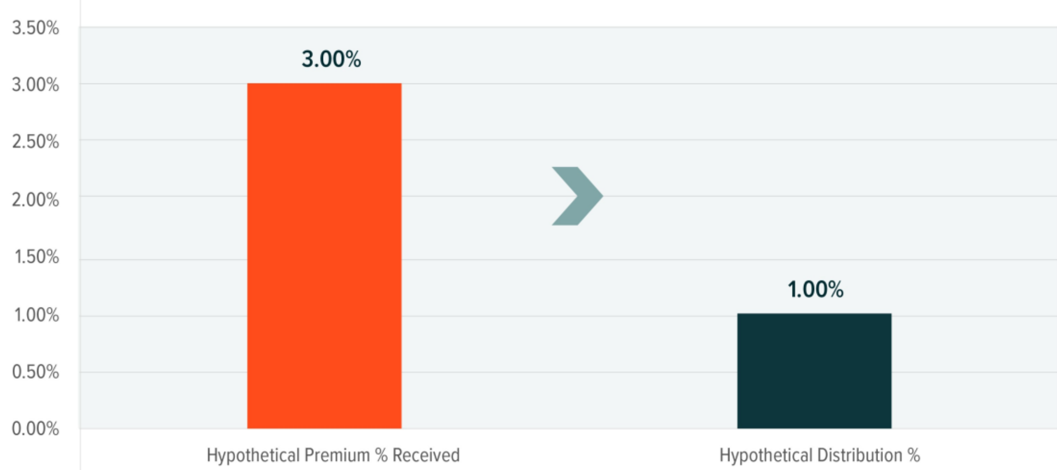
Source: Global X ETFs. For illustrative purposes only.

The monthly distribution of Global X's covered call strategies is calculated as the lower of:

a) half the premiums received and b) 1% of the net asset value (NAV).

The excess of options premiums received, if applicable, is reinvested into the fund.

Hypothetical Example # 1



Even though half of the premiums received in the above example is equal to 1.50%, the distribution would be capped at 1%. The excess 2% in premium would be reinvested into the Net Asset Value of the covered call ETF.

Hypothetical Example #2

Since half of the premiums received in the above example equals 75bps, which is less than 1%, the covered call ETF would distribute only 75bps. The excess 75bps of premium would be reinvested into the Net Asset Value of the ETF.

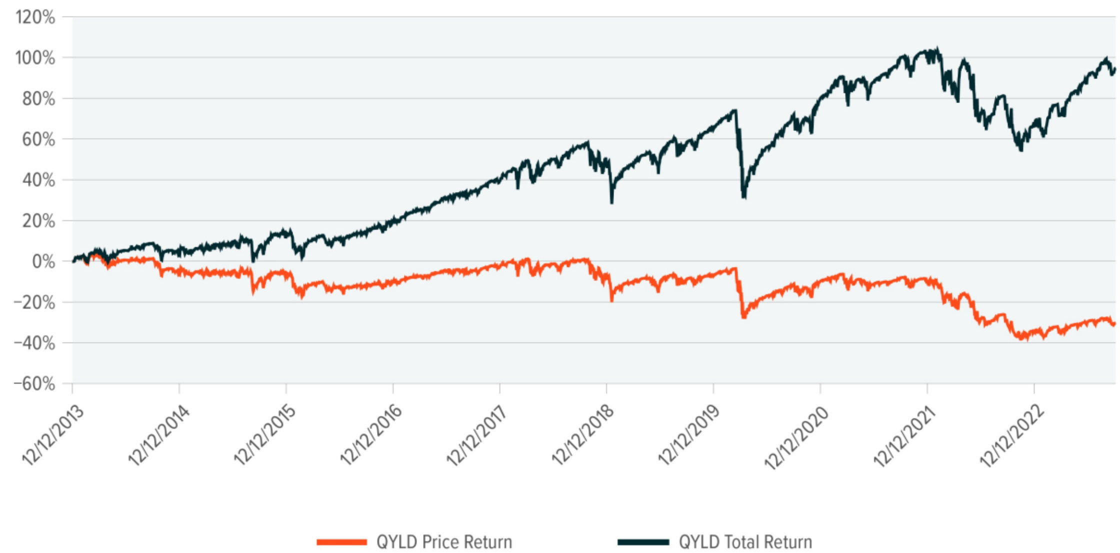
QYLD Represents a Total Return Solution

Writing index call options against 100% of the value of its portfolio, QYLD forgoes the possibility of realizing the capital appreciation generated by the Nasdaq 100 Index. The fund operates this way so that it can attract the highest possible premiums in exchange for calls written.

Investors can use the income that may be generated by a position in QYLD at their discretion. That said, the premiums that are distributed to investors are oftentimes absent from the fund's price chart when displayed across various investment research platforms. This undertaking results in QYLD displaying a negative price trend since its inception, as shown in the chart below. However, depending on their needs, we encourage investors to consider the opportunity for reinvestment that exists here. Indeed, we view QYLD as a total return solution and submit that its performance should be assessed as such. If held since inception and with all distributions reinvested into the fund, an investor's cumulative total return for QYLD would have been about 95% as of August 31st.[1]

QYLD PRICE RETURN VS. TOTAL RETURN

Sources: Global X ETFs with information derived from Bloomberg L.P. [Global X Nasdaq 100 Covered Call ETF Price vs. Total Return data from December 11, 2013 (QYLD inception) to August 31, 2023]



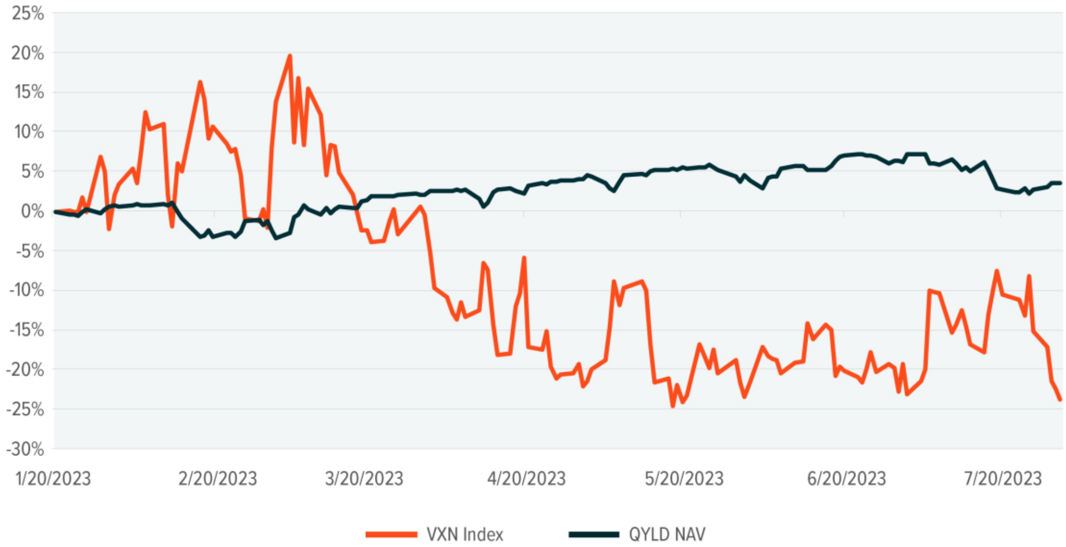
Past performance is not a guarantee of future results.

A natural question is how the fund can maintain recent price levels or recuperate its NAV after distributions. First, the fund reinvests the balance of the premiums that are not distributed to its shareholders. Second, new shareholders can help buoy the fund's stockpile of assets. Third, the fund can derive value from the options that it writes, benefiting from changes in underlying time value.

For instance, when QYLD commences a monthly roll period, it writes a call contract that will fluctuate in value until expiration. These fluctuations take moneyness, volatility, and supply and demand into account. If the initial contract was written when volatility was elevated, and then volatility declined, the value of the call option written generally decreases in similar fashion over the course of the roll period. Writing this call option for a value that was higher than its realized value at expiration benefits the fund, as the option expires unexercised, creating an inverse relationship between NAV and volatility.

QYLD RECOVERED NAV IN A PERIOD OF DECLINING VOLATILITY

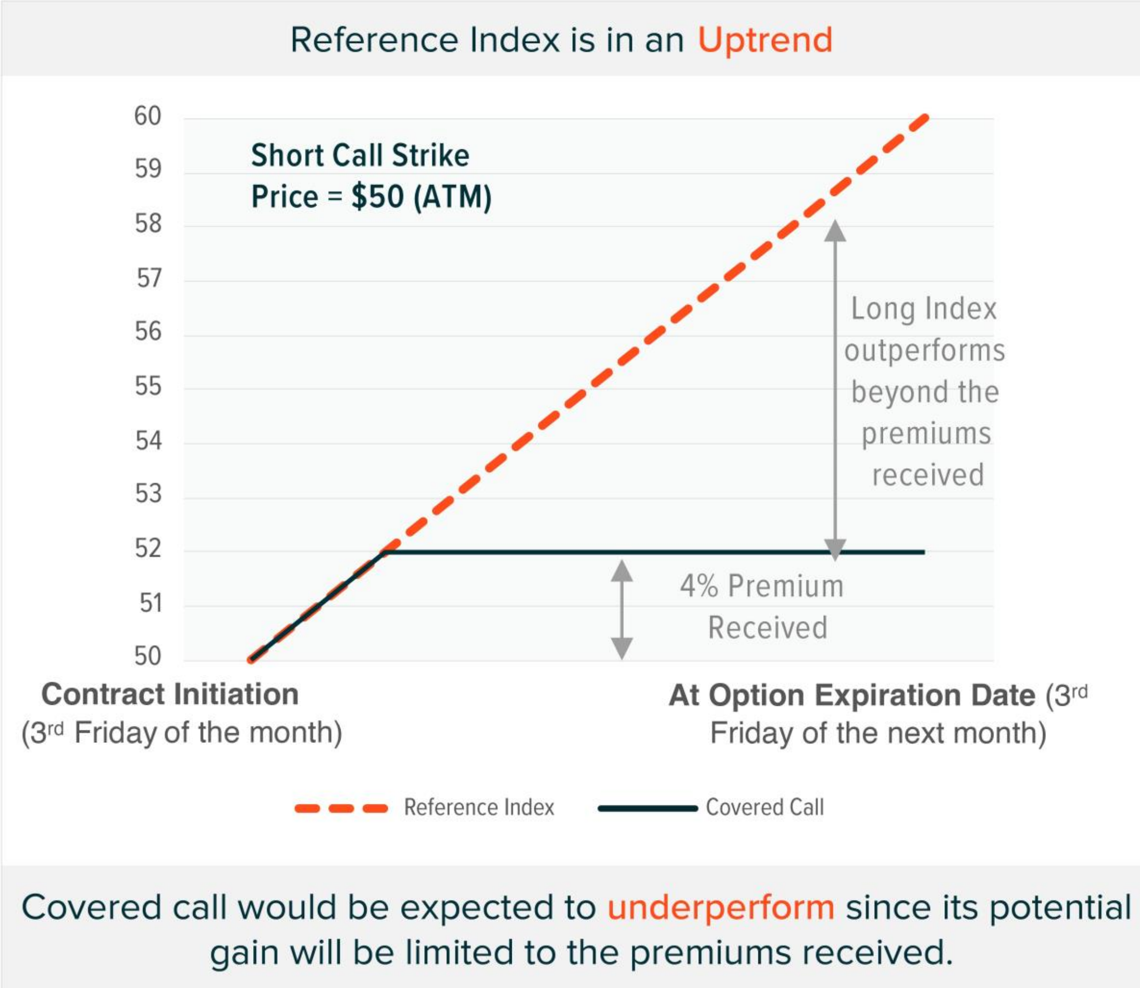
Source: Global X ETFs with information derived from Bloomberg L.P. (n.d.) [Global X Nasdaq 100 Covered Call ETF NAV Price Return vs. Cboe Nasdaq 100 Volatility Index (VXN) January 20th, 2023 (first contract roll date of 2023) to August 31, 2023] [Data set]



Based on the fund's trailing 12-month distribution of 11.89%, QYLD has shown it can remain competitive versus other asset classes even amid a period of declining volatility such as this.[2] The premium component may suit the needs of various accounts. That said, writing call options against 100% of an underlying portfolio can affect a fund's performance in varying market scenarios. In theory, the premiums that QYLD receives position it to outperform the Nasdaq 100 most effectively when the index trades in choppy, flat, and declining directions.

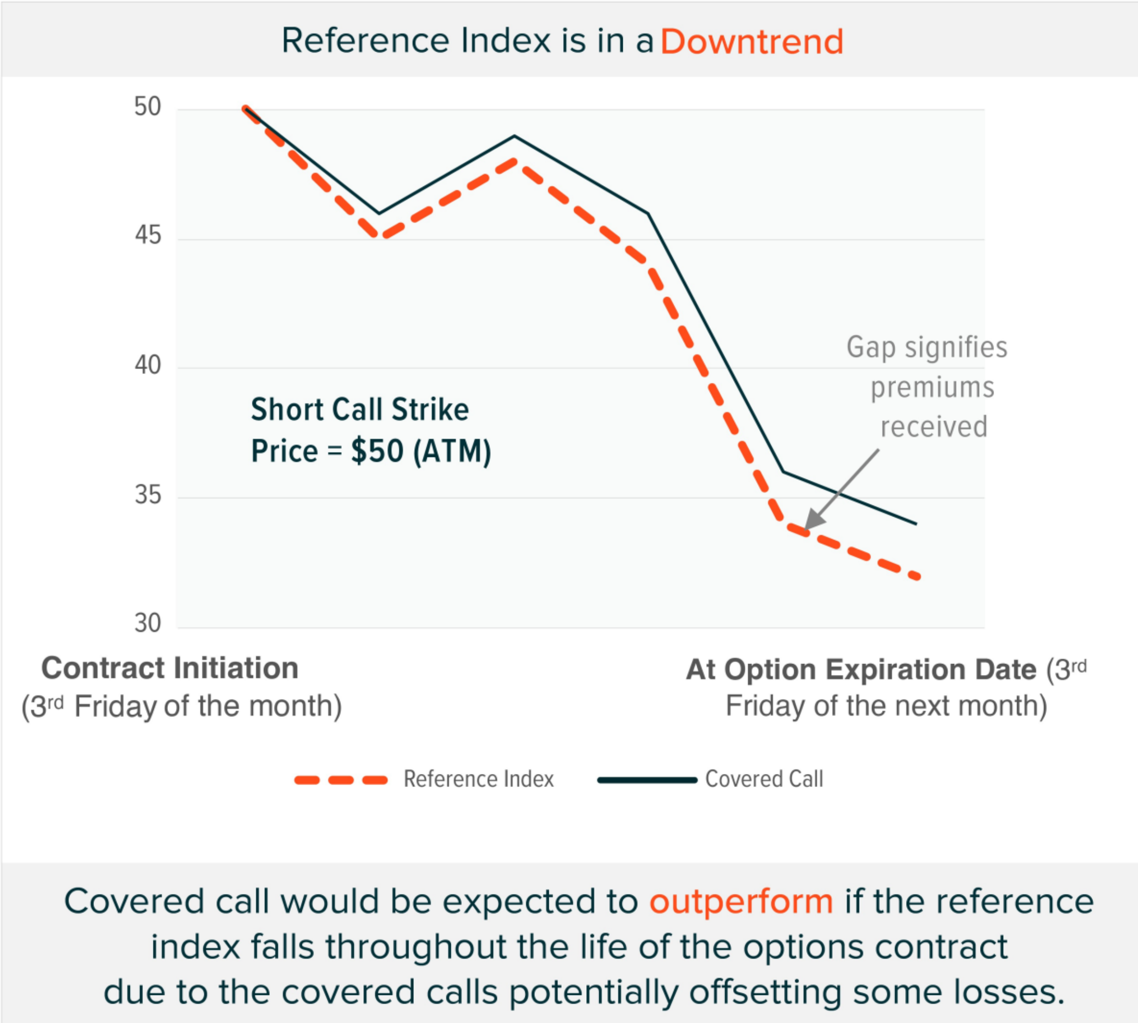
COVERED CALL PERFORMANCE SCENARIOS

Sources: Global X ETFs. For illustrative purposes only. Flat/choppy market assumes no fluctuation below the strike price.



Reference Index is Flat/Choppy

Covered call would be expected to outperform if the reference index price at contract initiation ends at the same price upon contract expiration since its performance will be supported by the premium income collected from selling monthly index calls.



Covered Call Strategies Can Help Investors Round Out Their Portfolios

Investors can pursue wealth generation in many ways, beyond traditional allocations like the 60/40 equity and fixed income structure. A strategy like QYLD can offer investors a potential stream of current income and a diverse group of holdings on which to base its risk-adjusted returns. With a portfolio that follows the rules set forth by the Cboe Nasdaq 100 BuyWrite v2 Index and daily disclosure of portfolio holdings, QYLD also allows investors to be fully aware of the fund's exposures. The fund trades the upside potential associated with its reference equity index to create premiums, so it may also act as a functional portfolio diversifier and hedged equity solution on multiple levels.

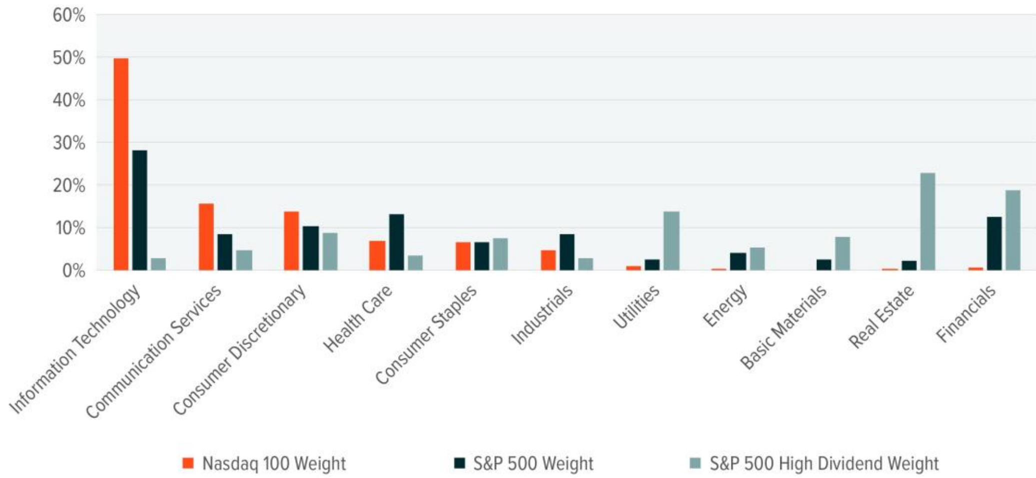
Diversification Potential

Operating within the ETF sleeve, covered call option strategies like QYLD have the potential to reduce the beta coefficient associated with a basket of investments like the Nasdaq 100. Index funds can inherently provide this because they typically take positions on a broad base of assets. With more than $327 billion in global ETF and mutual fund assets that can be linked to it, the Nasdaq 100 is a popular destination for investors pursuing this exposure.[3]

When it comes to conventional income accounts that have more of a tendency to seek out high dividend-paying stocks, as the chart below shows, QYLD offers allocations toward sectors that they might have deemed unsuitable. By seeking to monetize the volatility associated with these sectors, QYLD's ability to acquire premiums creates an opportunity to pursue these underexposed positions.

SECTOR BREAKDOWN – S&P 500 VS. NASDAQ-100 VS. S&P 500 HIGH DIVIDEND WEIGHT

Sources: S&P, Bloomberg L.P. data as of July 31, 2023.

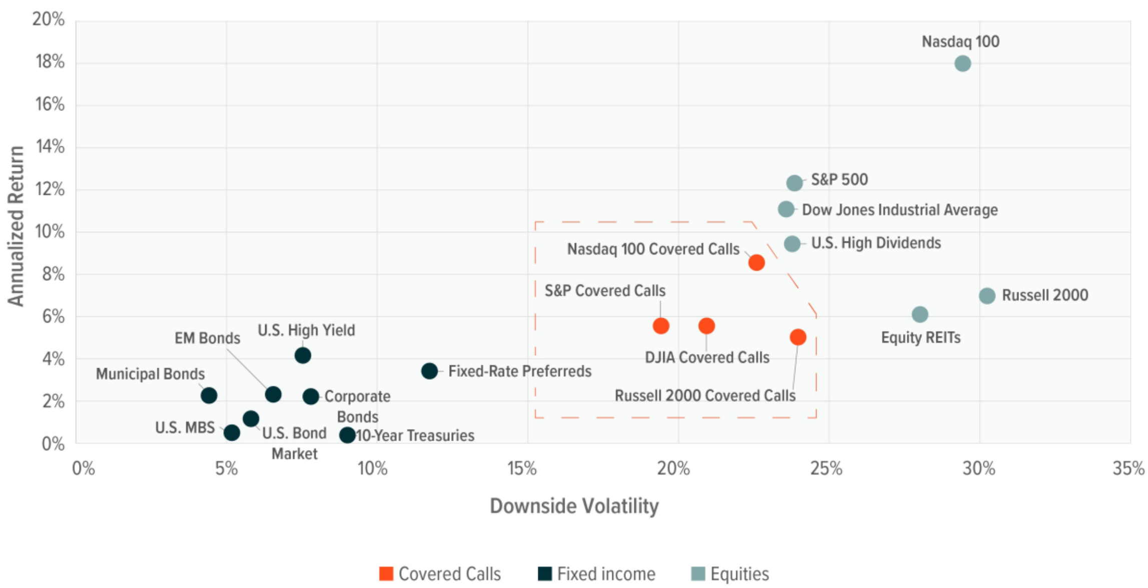


Visibility and Risk Mitigation Potential

Another key attribute associated with systematic covered call funds like QYLD is their straightforward, rules-based nature. Passively managed products typically follow a strict set of rules that establish specific exposures over an explicit time frame. Relative to a strategy that employs active management without daily holdings disclosure, this might empower investors to gain a better understanding of precisely where fund allocations are being made. The uniformity of a rules-based investment strategy can allow for seamless implementation into a broader portfolio, where risk-adjusted return metrics can be considered and weighed accordingly. It can also help to save the time that researching more complex strategies can require.

QYLD'S HEDGED EQUITY EXPOSURE CAN MITIGATE THE IMPACT OF DOWNSIDE MOVEMENTS WITHIN AN EQUITY PORTFOLIO

Source: Global X ETFs utilizing data from Morningstar Direct measured from 6/22/2015 (Cboe Nasdaq-100 BuyWrite V2 Index (BXNT) inception) to 07/31/2023. Asset class representation are as follows: U.S. High Dividends, Dow Jones US Select Dividend Index; Nasdaq 100 Covered Calls, Cboe Nasdaq 100 BuyWrite v2 Index; S&P 500 Covered Calls, Cboe S&P 500 BuyWrite Index; DJIA (Dow Jones Industrial Average) Covered Calls, Cboe DJIA BuyWrite Index; Russell 2000 Covered Calls, Cboe Russell 2000 BuyWrite Index; U.S. Bond Market, Bloomberg US Agg Bond Index; Municipal Bonds, Bloomberg U.S. Municipal Index; U.S. High Yield, Bloomberg US Corporate High Yield Bond Index; Corporate Bonds, Bloomberg US Corporate Bond Index; U.S. MBS, Bloomberg US Mortgage Backed Securities Index; Fixed-Rate Preferreds, ICE BofA Fixed Rate Preferred Securities Index; EM Bonds, Bloomberg EM USD Aggregate Index; 10-Year U.S. Treasury, USTREAS T-Bill Constant Maturity Rate 10-Year; Equity REITs, FTSE NAREITS All Equity REITs Index. Index returns are for illustrative purposes only and do not represent actual Fund performance. Past performance does not guarantee future results.



Ability to Work Within an Equity Growth Portfolio

Because QYLD seeks a minimal level of capital appreciation in exchange for option premiums, the fund offers a value proposition that can be utilized through various allocation combinations. For example, an investor may be able to implement QYLD within a broader growth portfolio as a means to target a growth and income blend, depending on their risk and yield appetite. The ability to be this nimble within an index tracking strategy that maintains a 100% coverage ratio with NDX call options can support an investors ablity to modify their respective portfolios in a variety of different ways. Some examples of equity portfolio breakdowns that harness QYLD are illustrated below.

DIAL-UP AND DIAL-DOWN EQUITY RISK, POTENTIAL REWARD, AND INCOME POTENTIAL WITH QYLD

Source: Global X ETFs utilizing return data from Morningstar Direct measured from December 11th 2013 (QYLD Inception) to July 31st, 2023.

100% Equity Tracking Index | 50% Equity Tracking Index 50% Global X Covered Call ETF | 100% Global X Covered Call ETF

Name	100% Nasdaq 100 Index (NDX)	50% NDX/50% QYLD	100% QYLD
12-Month Yield/12-Month Trailing Month Distributions[1]	0.81%	6.47%	12.12%
Total Return Annualized	18.22%	12.92%	7.22%
Sortino Ratio	1.16	0.96	0.62
Beta	-	0.81	0.65
Downside Volatility	19.95%	16.85%	15.12%

QYLD returns are represented by NAV returns. Beta is measured against the Nasdaq-100 Index. [1]Nasdaq 100 Index represented by index 12-month yield. QYLD represented by the ETF's 12 trailing month distributions relative to the fund's most recent NAV and capital gains over the 12-month period. A portion of the fund's distribution is estimated to contain a return of capital. For information on the breakdown of the most recent distribution, please see QYLD's 19a notice.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. Performance current to the most recent quarter- and month-end is available here.

Conclusion: A Multipurpose Premium-Seeking Solution Amid Uncertainty

Mixed economic signals, including those from corporate earnings and treasury yields, make speculating on future market movements particularly difficult. This year's rapid run-up in value for the Nasdaq 100 and its subsequent slowing doesn't make it any easier. In this environment, covered call options strategies can bring a multitude of benefits to investor portfolios, particularly when volatility ramps up and uncertainties linger. As a core competency of the passively managed ETFs that Global X provides, we believe that QYLD's systematic approach makes it a compelling diversification tool for a broad range of accounts.

Related ETFs

QYLD – Global X Nasdaq 100 Covered Call ETF

Click the fund name above to view current performance and holdings. Holdings are subject to change. Current and future holdings are subject to risk.

Footnotes

1. Bloomberg L.P. (n.d.) [Global X Nasdaq 100 Covered Call ETF (QYLD) total returns from December 12, 2013 to August 31, 2023] [Data Set]. Retrieved on September 12, 2023 from Global X Bloomberg terminal.
2. Global X ETFs. (2023, July 31). Global X Nasdaq 100 Covered Call ETF (QYLD) Fact Sheet.
3. Morningstar Direct. Measured June 30th, 2023 through Global X's Morningstar Direct License.

Glossary

Call Option: A call option gives the buyer the right, but not the obligation to buy a security at a pre-determined strike price within a given time frame or on a specific date.

Covered Call: A covered call (call write) strategy involves purchasing securities, such as equities, and then simultaneously selling a call option on those securities.
12-Trailing Month Distributions: The distribution rate an investor would have received if they had held the fund over the last twelve months, assuming the most recent NAV. The 12-Trailing Month distribution is calculated by summing any income, capital gains, and return of capital distributions over the past twelve months and dividing by the sum of the most recent NAV and any capital gain distributions made over the same time period.
Yield to Worst: A measure of the lowest possible yield that can be received by a bond that could potentially possess an early retirement provision.
Out of the Money (OTM): An option is considered to be out-of-the-money when the price of its underlying asset has not yet surpassed the strike price necessary for it to become exercisable.
S&P 500 Index: The S&P 500 Index includes 500 of the largest public companies listed on the stock market.
Downside Volatility: A measure of downside risk that focuses on returns that fall below the average annual return related to an associated investment. Calculated by taking the standard deviation of returns that are below the mean return of a broader portfolio.
Nasdaq 100 Index: The NASDAQ 100 index includes 100 of the largest non-financial companies listed on its stock market.
Beta: Measures the volatility of a fund's price relative to the volatility in the market index and can also be identified as the percentage change in the price of the fund given a 1% change in the market index. A beta below one suggests that the fund was less volatile than the market benchmark.
At-the-money: An option contract is considered to be "At the Money" when its strike price is equivalent to the current price value of its underlying asset.
