Using Nasdaq Pure-Tech Exposure to Boost Traditional 60/40 Canada Portfolios

August 2024

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Executive Summary

The NASDAQ-100 Technology Sector Market-Cap Weighted™ Index (NDXT10™) gives investors exposure to Nasdaq-100® constituents that are considered pure Technology companies (per the Industry Classification Benchmark system). It provides a more concentrated approach to investing in the innovation-driven growth of the Nasdaq-100. The emergence of artificial intelligence (AI) as a new secular growth theme has boosted the returns of most of the Nasdaq-100's biggest holdings in recent years, extending a long-running streak of outperformance vs. the rest of the US equity market. With much of investor interest now focused on the nature, length, and fundamental underpinnings of the AI-driven rally, it is worthwhile to examine the return and risk profile of adding technology exposure by way of the NDXT10 to a traditional 60/40 portfolio offered to investors in Canada, using the Vanguard Balanced ETF Portfolio (VBAL) as a proxy.

The report highlights the return profiles of two modified 60/40 portfolios that reallocate some of its US equity exposure to NDXT10, at hypothetical weights of 5% and 10%. All data are calculated using the underlying indexes tracked by VBAL's ETF holdings.

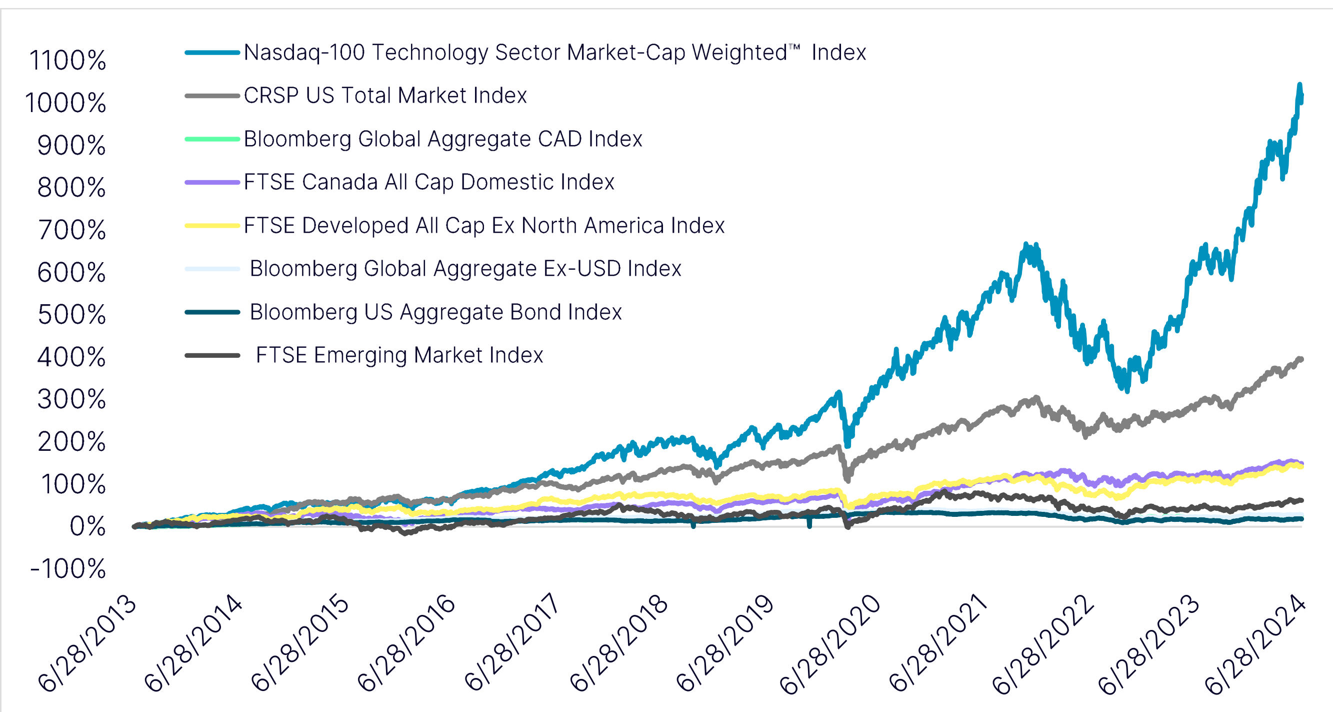
Investors are likely to be encouraged that the modified 60/40 portfolios with exposure to NDXT10 generate higher returns, increase portfolio Sharpe ratio and lower downside deviation when compared to a traditional 60/40 portfolio. Additionally, they offer added benefits of exposure to secular growth stories in technology and mitigation of home bias.

NDXT10 Exposure Added to a Traditional 60/40 Portfolio

The table below details the weights of the traditional 60/40 portfolio and modified 60/40 portfolios with 5%/10% exposure to NDXT10. The weights are as of June 30th 2024.

Index Name	Index Ticker	Traditional 60/40	5% Exposure to NDXT10	10% Exposure to NDXT10
NASDAQ-100 Technology Sector Market-Cap Weighted™ Index	NDXT10™ Index	0%	5%	10%
CRSP US Total Market Index	CRSPTMCT Index	28%	23%	18%
Bloomberg Global Aggregate CAD Index	BCFATRDU Index	24%	24%	24%
FTSE Canada All Cap Domestic Index	ACCANXF Index	18%	18%	18%
FTSE Developed All Cap Ex North America Index	ACDXNAN Index	11%	11%	11%
Bloomberg Global Aggregate Ex-USD Index	BGRCTRDH Index	8%	8%	8%
Bloomberg US Aggregate Bond Index	LBUFTRDH Index	8%	8%	8%
FTSE Emerging Markets Index	FQEACRCA Index	4%	4%	4%

Cumulative Total Returns of NDXT10 vs. Indexes Tracked by 60/40 Portfolio (VBAL ETF) Holdings*



* Performance data based on the period from July 5, 2013 (earliest date with index history across the entire portfolio) to June 28, 2024. Data presented on a total return basis in CAD, other than NDXT10 and FQEACRCA which are in USD.
Source: Nasdaq Global Indexes, Bloomberg

Cumulative Total Returns of Original vs. Modified 60/40 Portfolios with 5%/10% Exposure to NDXT10

The chart below illustrates that the cumulative returns of modified 60/40 portfolios are much higher than that of a traditional 60/40 portfolio. As seen above, the original 60/40 portfolio generated cumulative returns of 163.9% over the course of an 11-year period ending June 28, 2024, while the modified portfolio with 5% exposure to NDXT10 generated returns of 195.0%, increasing to 226.2% with a 10% exposure to NDXT10. Investors are likely to be encouraged by the high value add from the modified portfolios. These modified portfolios with 5% and 10% exposure to NDXT10 generated an impressive value add of 31 and 62 percentage points, respectively.

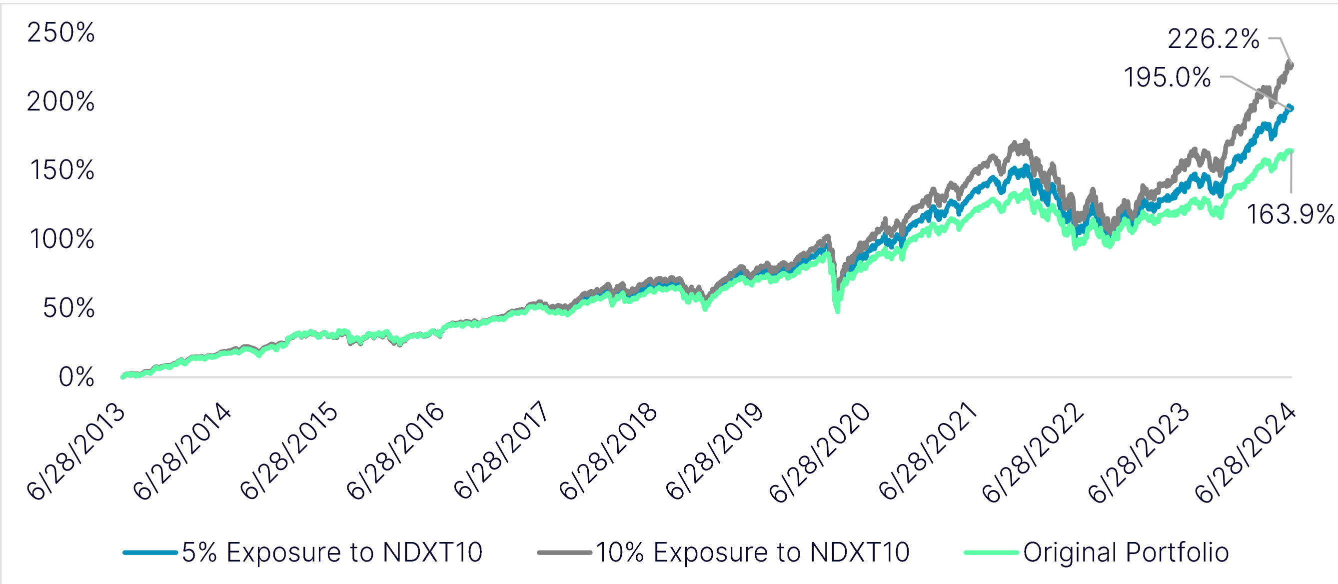


Table 2: Annual Total Returns of Original vs. Modified 60/40 Portfolios with 5%/10% Exposure to NDXT10

Table 2 illustrates that the modified 60/40 portfolios generated higher returns than the original portfolio in all but three time periods, pointing to the benefit of adding NDXT10 to the original portfolio across varying market dynamics. The years 2018 and 2022 were particularly challenging for the technology sector, although even in those cases, the portfolio drag was minimal and more than offset by the benefit in the following year.

Years	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024*
60/40 Portfolio	9.5%	12.2%	6.6%	7.5%	9.6%	(1.7%)	16.0%	10.5%	11.5%	(11.6%)	13.1%	6.8%
5% Exposure to NDXT10	9.8%	12.3%	5.9%	7.8%	11.0%	(2.0%)	17.2%	11.7%	12.2%	(12.8%)	16.3%	7.6%
10% Exposure to NDXT10	10.2%	12.5%	5.3%	8.2%	12.4%	(2.3%)	18.4%	12.9%	13.1%	(14.1%)	19.5%	8.4%

* Performance data based on the period from July 5, 2013 (earliest date with index history across the entire portfolio) to June 28, 2024. Data presented on a total return basis in CAD, other than NDXT10 and FQEACRCA which are in USD.
Source: Nasdaq Global Indexes, Bloomberg

Table 3: Total Return Performance Metrics, 60/40 Portfolios vs. NDXT10 vs. CRSP US Total Market Index

Table 3 provides risk and return metrics including cumulative returns, annualized returns and volatility, Sharpe ratio, Sortino ratio, and downside deviation. As seen above, the modified portfolios with 5% and 10% exposure to NDXT10 generated strong annualized returns of 10.3% and 11.4% respectively, over the period July 5th 2013 to June 28th 2024, versus 9.2% for a traditional 60/40 portfolio. Despite elevated volatility, the modified portfolios boast higher Sharpe and Sortino ratios than the traditional 60/40 portfolios, signalling a favorable risk/return tradeoff. What is also particularly encouraging is that the modified portfolios generated lower downside deviation when compared to the traditional 60/40 portfolio, despite the peculiarity of the technology sector to exhibit higher volatility than other sectors.

It also provides details of risk and return metrics for the NDXT10 Index and the CRSPTMCT Index, which tracks the entirety of the US equity market. As seen below, the NDXT10 Index generated substantially stronger returns than the CRSPTMCT Index, 24.6% vs. 15.7% respectively, over the period July 5th 2023 to June 28th 2024. The NDXT10 Index boasts higher Sharpe and Sortino ratios than the CRSPTMCT Index, despite elevated volatility.

Metric	Traditional 60/40 Portfolio	5% Exposure to NDXT10	10% Exposure to NDXT10	NDXT10 Index	CRSPTMCT Index
Cumulative Return	163.9%	195.0%	226.2%	1018.3%	395.2%
Annualized Return	9.2%	10.3%	11.4%	24.6%	15.7%
Annualized Volatility	7.8%	8.2%	9.2%	24.7%	16.1%
Sharpe Ratio	0.92	1.02	1.01	0.92	0.85
Downside Deviation	7.8%	5.4%	6.0%	15.3%	10.1%
Sortino Ratio	0.92	1.55	1.56	1.47	1.36

Exposure to Secular Growth Stories in Technology

NDXT10 offers exposure to investment themes that are currently generating a lot of interest in the markets, including secular growth stories such as cybersecurity, cloud computing and artificial intelligence. It offers exposure to leading semiconductor companies such as Nvidia, Qualcomm, Arm Holdings, AMD, and Broadcom among others. These companies are reimagining AI chips for modern workloads and gaining market share. It also offers exposure to enterprise software and software-as-a-service companies including large established players such as Microsoft, Adobe, and Autodesk, as well as cybersecurity companies such as Palo Alto Networks, Zscaler and Fortinet. Companies with strong, diverse product portfolios and a track record of strong returns – such as Apple, Meta Platforms and Alphabet – also feature heavily in the index.

NDXT10 Exposure: Potentially Beneficial to a Traditional 60/40 Portfolio in a Few Ways

Over the last decade, interest rates have experienced several distinct cycles. Rates remained at historic lows throughout most of 2014-2015 until the Federal Reserve began a very gradual rate hiking cycle in December 2015. The last hike in the cycle was in December 2018, after which the Fed was forced to pause on account of a brief but intense bear market. Rates were kept at modest levels until the Covid-19 pandemic forced emergency cuts back down to historic lows in March 2020, remaining there until historically high inflation prompted one of the steepest rate hiking cycles in history to commence in March 2022. Following its last hike in June 2023, the Fed paused at levels similar to previous rate cycle peaks pre-2008, and is now once again contemplating rate cuts. Throughout most of these cycles, NDXT10 has generated outperformance and demonstrated its potential benefits to a traditional 60/40 portfolio. Additionally, it is likely to be do particularly well during periods when the traditional 60/40 portfolio comes under pressure, for example when economic growth is running above-trend and driving interest rates higher. It could also potentially be beneficial in periods of high inflation when equities, but especially bonds, typically come under pressure from central bank tightening and higher rates. This could result from the thesis that many of the largest companies in the Tech sector have achieved strong pricing power to better navigate inflationary times.

Conclusion

Investors looking to diversify their exposure away from local Canadian markets to international markets can benefit from increasing exposure to NDXT10 in a number of ways. As outlined above, the addition of NDXT10 to a traditional 60/40 portfolio enhances the overall return profile. Investors benefit from exposure to secular growth stories in technology such as cybersecurity, cloud computing and artificial intelligence, while mitigating home bias in their portfolios and gaining diversification benefits.

ETFs currently tracking the NDXT10 Index include the Evolve Nasdaq Technology Index Fund (Canada: QQQT) and Evolve Nasdaq Technology Enhanced Yield Index Fund (Canada: QQQY).

Source: Nasdaq Global Indexes, FactSet, Bloomberg