

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

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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 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.

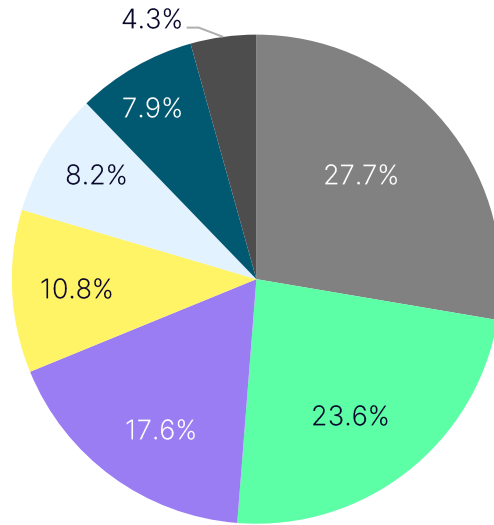
Investors are likely to be encouraged that the modified traditional 60/40 portfolios with exposure to NDXT10 generate higher returns than the traditional 60/40 portfolio, with the added benefits of exposure to secular growth stories in technology and mitigation of home bias.

Simulated NDXT10 Exposure Added to a Traditional 60/40 Portfolio

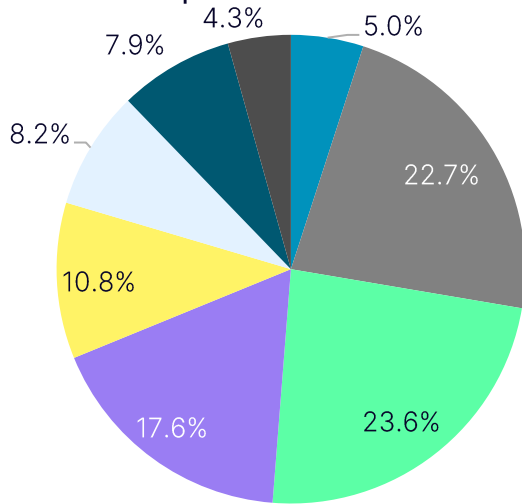
For the purposes of our analysis, we will analyze a modified 60/40 portfolio derived from recent allocations of VBAL. Currently, the ETF has the following equity and bond holdings: the Vanguard US Total Market Index ETF (tracking the CRSPTMCT Index), the Vanguard Canadian Aggregate Bond Index ETF (BCFATRDU Index), the Vanguard FTSE Canada All Cap Index ETF (ACCANXF Index), the Vanguard FTSE Developed All Cap Ex North America Index ETF (ACDXNAN Index), the Vanguard Global Ex-US Aggregate Bond Index ETF (BGRCTRDH Index), the Vanguard US Aggregate Bond Index ETF (LBUFTRDH Index), and the Vanguard FTSE Emerging Market Index ETF (FQEACRCA Index), with weights of 28%, 24%, 18%, 11%, 8%, 8% and 4% respectively (as of June 30, 2024).

The charts below detail the holdings and weights of a traditional 60/40 portfolio and modified 60/40 portfolios with 5%/10% exposure to NDXT10.

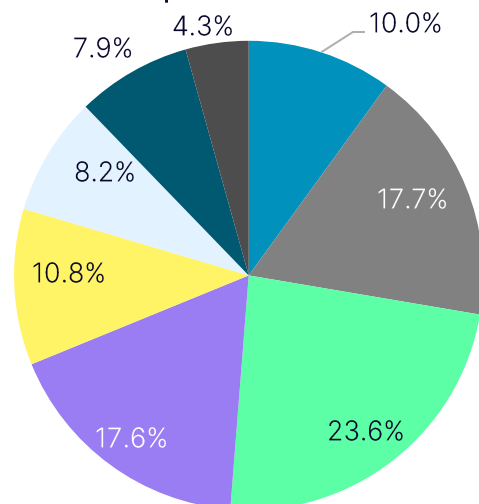
Traditional 60/40 Portfolio (VBAL ETF)



5% Exposure to NDXT10

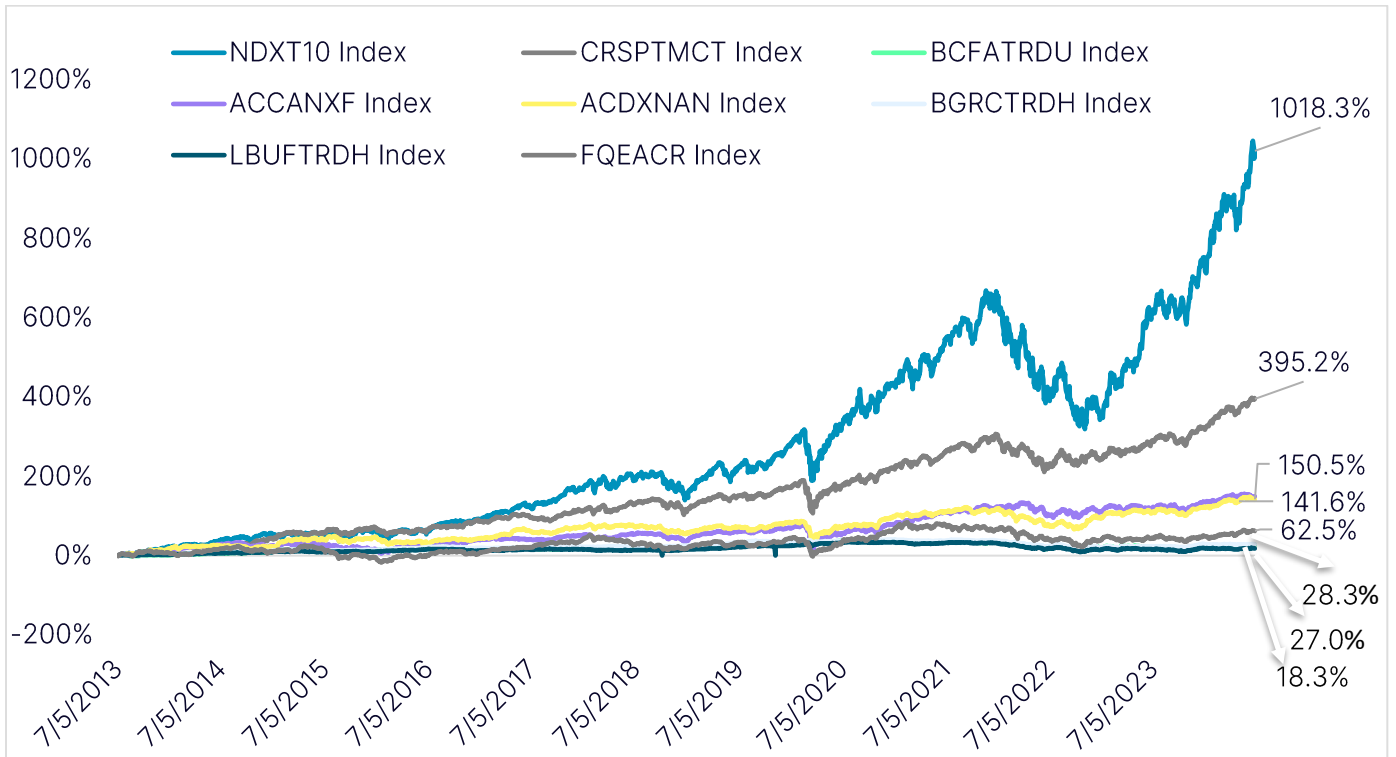


10% Exposure to NDXT10



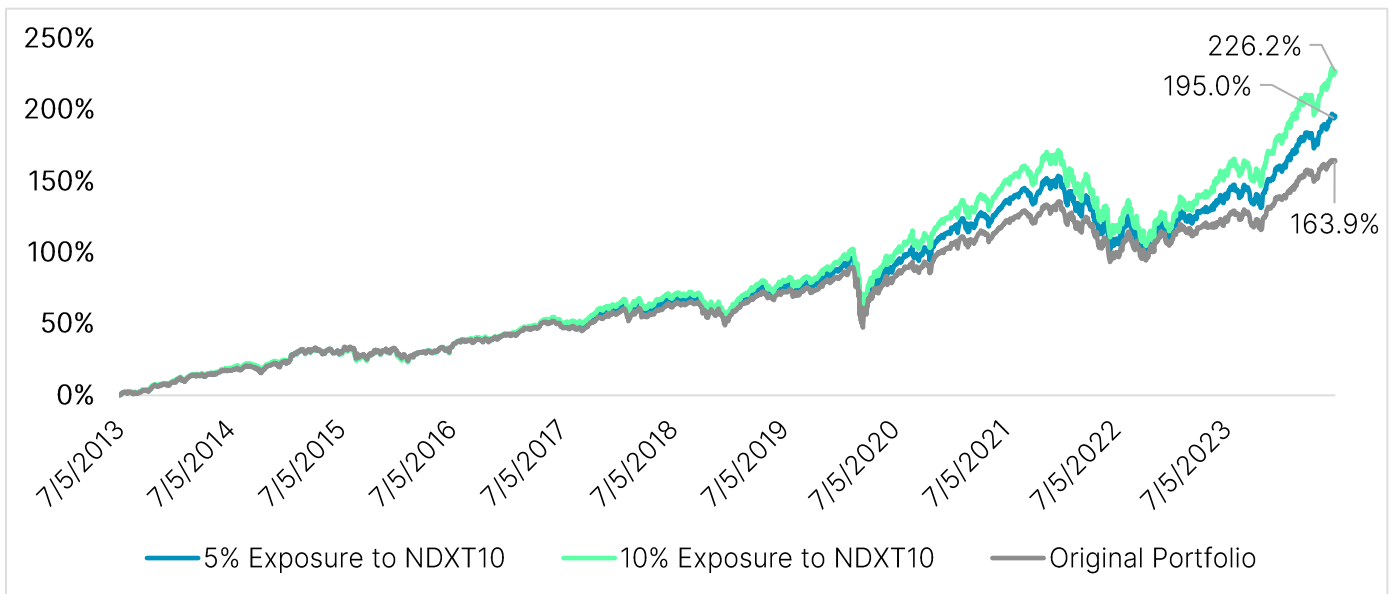
	Nasdaq-100 Technology Sector Market-Cap Weighted™ Index
	Vanguard US Total Market Index ETF
	Vanguard Canadian Aggregate Bond Index ETF
	Vanguard FTSE Canada All Cap Index ETF
	Vanguard FTSE Developed All Cap Ex North America Index ETF
	Vanguard Global Ex-US Aggregate Bond Index ETF
	Vanguard US Aggregate Bond Index ETF
	the Vanguard FTSE Emerging Market Index ETF

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 above 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

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 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.

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

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

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 2023 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.

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 above, 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.

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

Adding NDXT10 exposure to a traditional 60/40 portfolio can be beneficial 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. An addition of NDXT10 exposure to a traditional 60/40 portfolio could 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.

An Incremental Opportunity to Mitigate Home Bias

Canadian investors with a strong home bias in their portfolios can potentially benefit from gaining exposure to NDXT10 to offset some of the headwinds to markets from weakness in the local Canadian economy. Indexes such as NDXT10 offer exposure to themes that have strong fundamental underpinnings and are global in nature. Even in an environment where Canadian markets are rallying due to the prospect of rate cuts and/or stronger earnings, investors are likely to recognize a qualitative benefit to their diversification levels by increasing exposure to other markets.

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.

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).

Source: Nasdaq Global Indexes, FactSet, Bloomberg

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