Nasdaq

Four Benefits of a Multi-Asset, High-Yield Index in 2019

High Yield, Asset Class Diversification and Low Volatility in a Single Index

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Amidst political and economic uncertainty due to ongoing trade tensions, recent market volatility and fears of slowing global growth, high-yield strategies can help ameliorate market turbulence and bring investors some relief. The Nasdaq U.S. Multi-Asset Diversified Income Index—a high-yield strategy—delivered a dividend yield between 6% and 9% across more than ten years of index history (live since June 2012), along with other advantages. Specifically, the Index provides four key benefits to those in search of yield: a very high yield, asset class diversification, and a low volatility overlay. As a result, downside protection ensues. The following discussion will analyze these four benefits by comparing the Index to an Equity and a Bond Benchmark, and will show that the Index performed closely to its Equity Benchmark thus significantly outperforming its Fixed Income Benchmark. Finally, this analysis will illustrate the Index's performance during periods of rising rates, as well as during periods of high volatility to provide context of the current market environment.

At-a-Glance:

The Nasdaq U.S. Multi-Asset Diversified Income Index provides four main advantages:

- Very high yield: 6.9% yield as of March 2019, ranging from 6% to above 9% over the ten-year Index history
- Asset class diversification: The Index assigns an equal 20% weight to five asset class segments: Equities, REITs, Preferreds, MLPs and a High Yield Corporate Bond ETF
- Low volatility: The Index's underlying asset class segments (except for the Bond segment) apply a volatility cap, excluding securities that exhibited an annual volatility that is 15% or higher than their respective benchmarks
- Downside protection: A combination of the three points above have historically offered a cushion during market downturns compared to equities.

The Nasdaq U.S. Multi-Asset Diversified Income Index is designed to provide exposure to multiple asset segments, each selected to result in a consistent and high yield for the Index. The Index is comprised of securities classified as US equities, US Real-Estate Investment Trusts (REITs), US preferred securities, US master-limited partnerships (MLPs) and a high-yield corporate debt Exchange-Traded Fund (ETF).

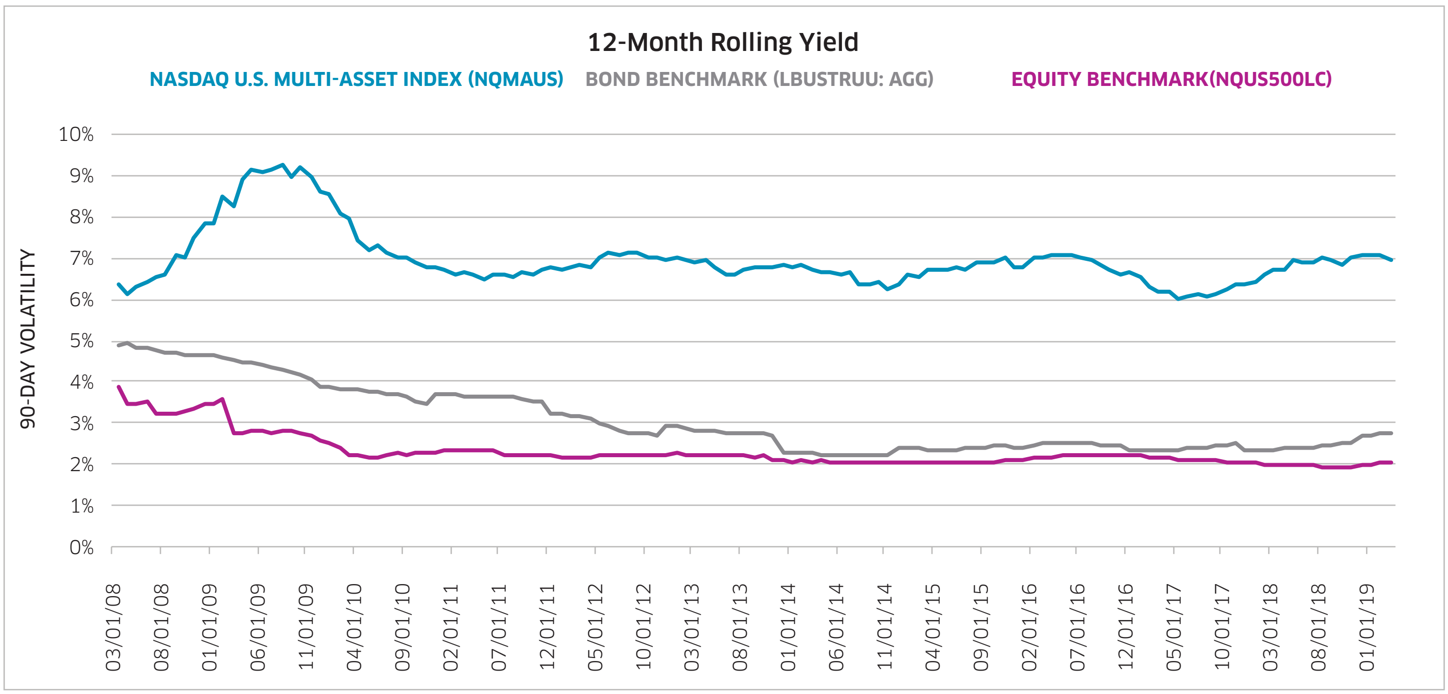
High Yield

Since the heart of the financial crisis in 2008, financial vehicles have struggled to deliver strong and stable dividend payments to investors. Take a plain-vanilla equity strategy: the Nasdaq U.S. 500 Large Cap index, which includes the largest 500 U.S. stocks. The twelve-month dividend yield for this equity index plunged from 3.9% in March of 2008 to 2.0% in March 2019, slightly up from its ten-year low of 1.9% in October 2018. Though the downtrend is clear, a low dividend yield among equities is not very surprising—one would expect a higher yield to come from fixed income strategies more than from equities.

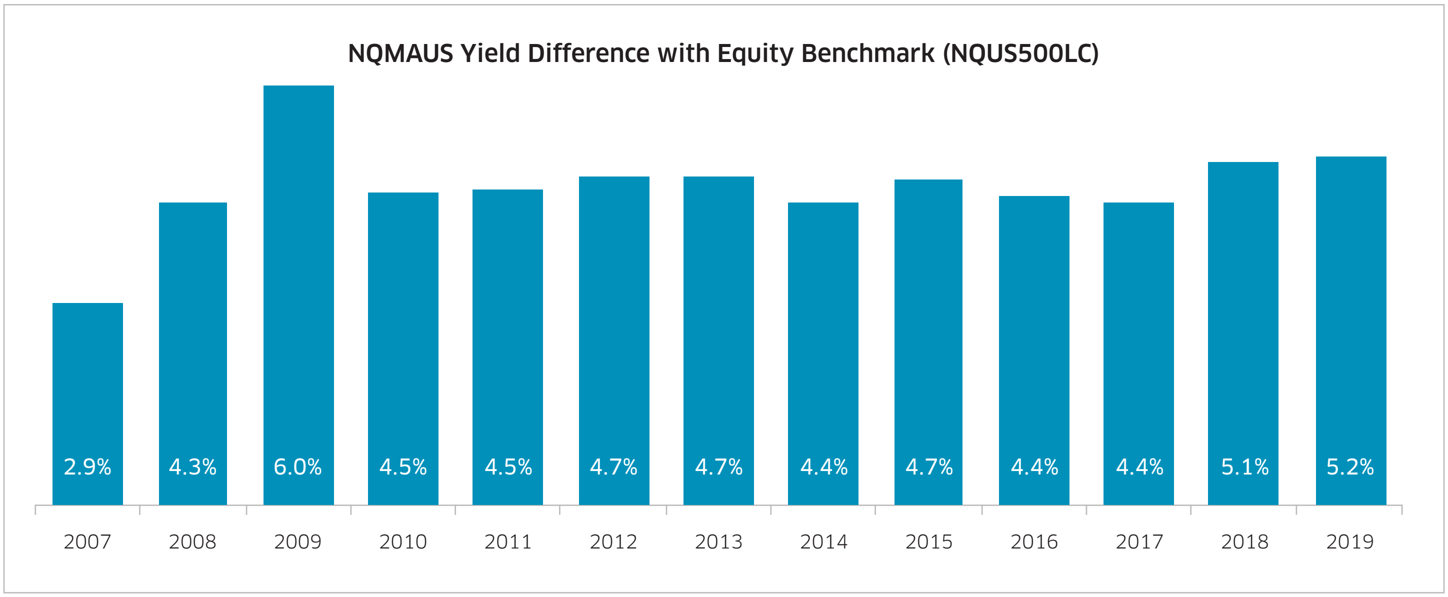
However, the yield for bond indexes is still at historical lows. Consider the Bloomberg Barclays U.S. Aggregate Bond Index (the underlying index for the AGG ETF). Its dividend yield has been almost cut in half since March of 2008, going from 4.9% to 2.8% in March 2019.

Historically low interest rates following the financial crisis certainly explain much of this downturn in yields—but even after four rate hikes by the Fed in 2018, dividend yields from traditional equity and bond benchmarks are still far off pre-crisis levels and have barely risen at all.

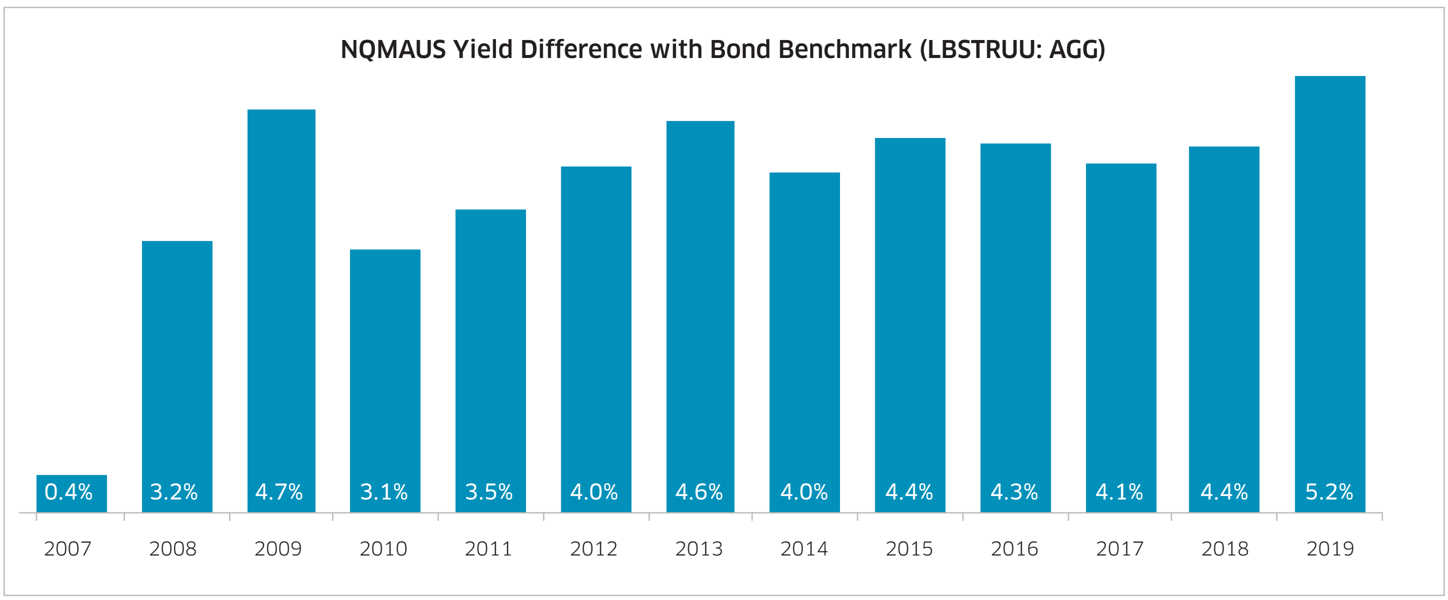
Comparatively, the Nasdaq U.S. Multi-Asset Diversified Income Index—comprised in equal parts of Equities, REITs, Preferreds, MLPs and High Yield Corporate Bond segments—delivered a yield between 6% and 7% in recent years, and over a 9% yield during the financial crisis, providing a momentous dividend cushion to plummeting asset prices.



The difference in yield between the Nasdaq U.S. Multi-Asset Diversified Income Index (NQMAUS) and the aforementioned Equity Benchmark (Nasdaq U.S. 500 Large Cap: NQUS500LC) has been substantial: NQMAUS shows a twelve-month annualized median yield that is 4.5% higher than that of NQUS500LC since March 2008.



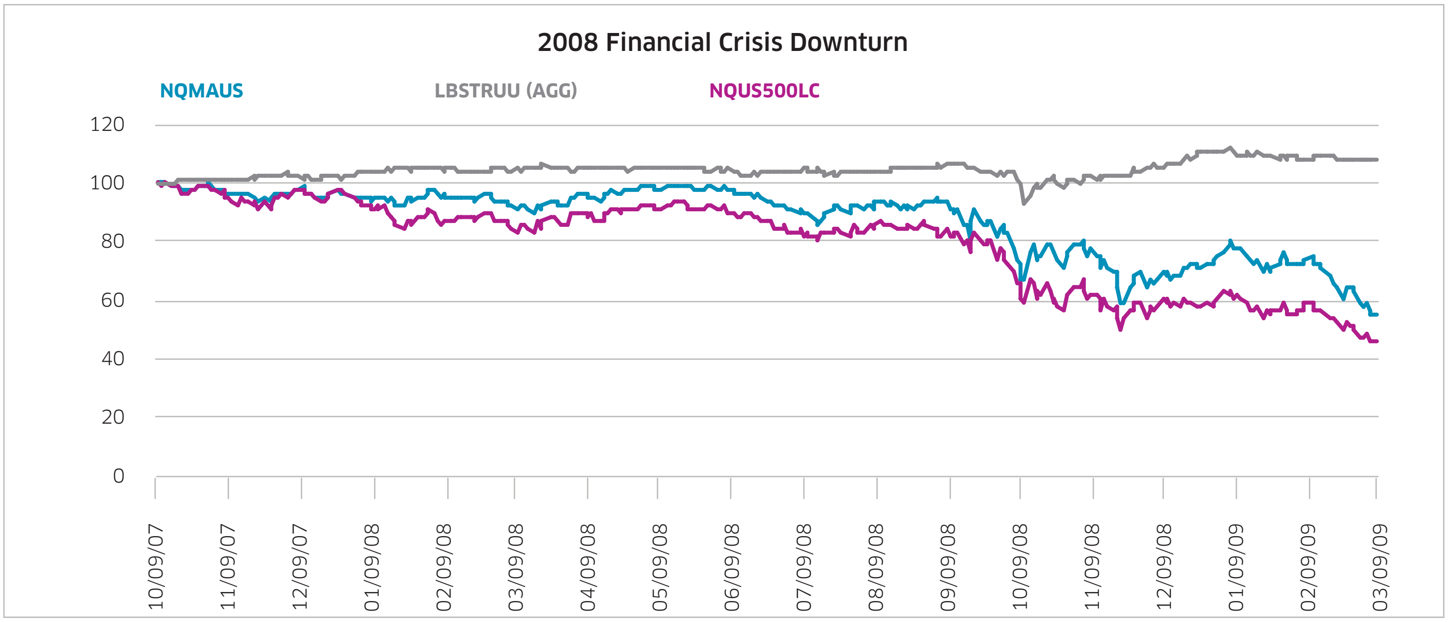
The story is only slightly different when comparing the yield for NQMAUS and the Bond Benchmark (Bloomberg Barclays U.S. Aggregate Bond Index, LBSTRUU: AGG). The respective yield figures were very close for the two indexes in 2007 prior to the full blow out of the financial crisis. Still, from 2008 to 2019 (annualized Q1 data), NQMAUS delivered a median yield that was 4.1% higher than that of the Bond Benchmark.



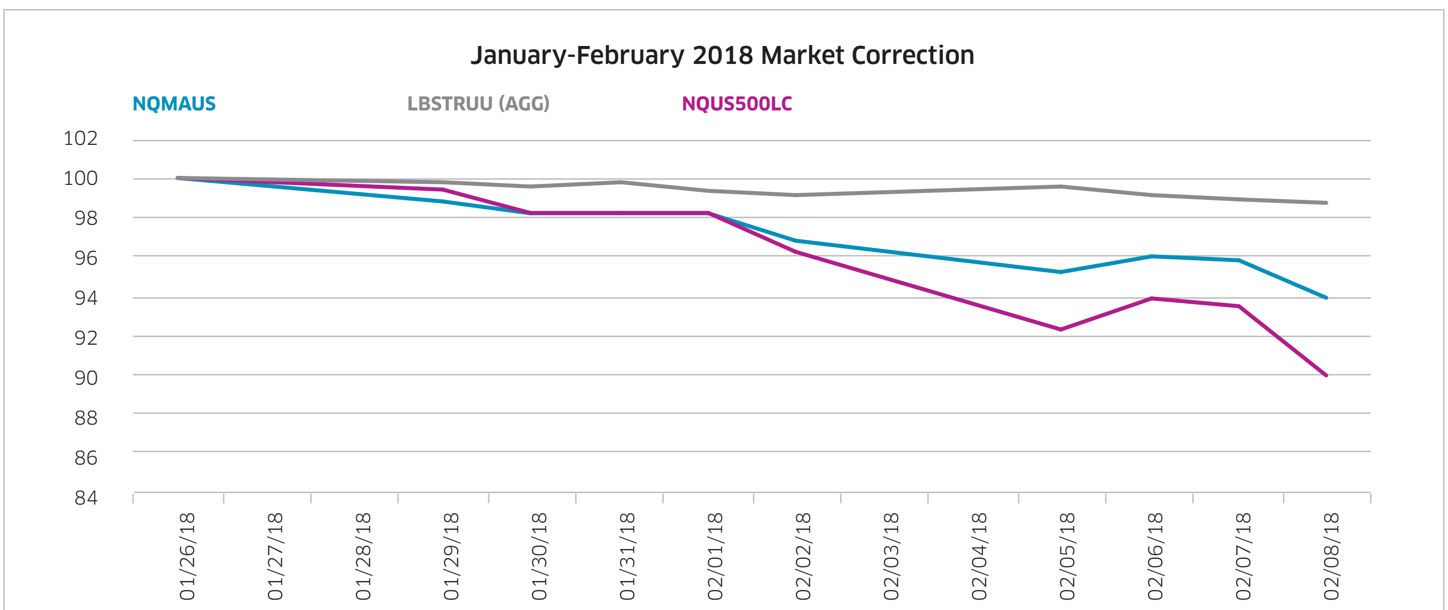
Downside Protection

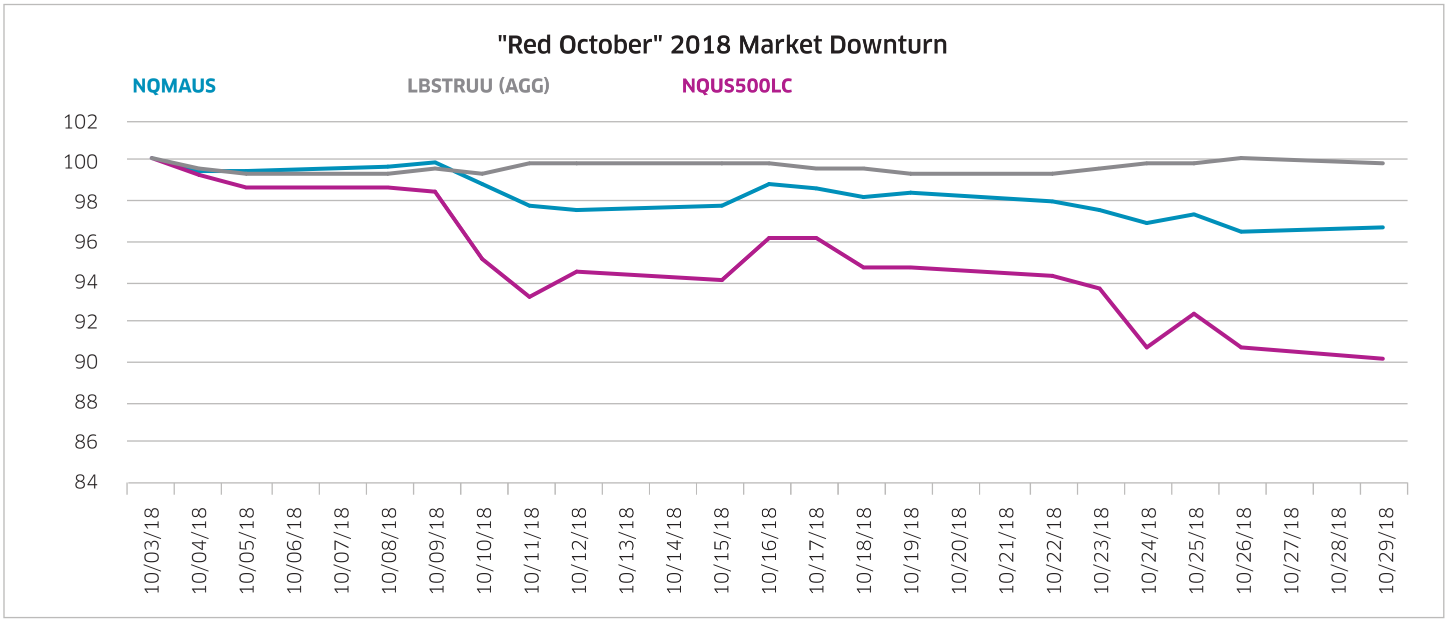
The Nasdaq U.S. Multi-Asset Index provides four key advantages: a strong and stable dividend yield—as mentioned above—asset class diversification and low volatility. The Index offers asset class diversification by assigning an equal weight of 20% to the five segments: Equities, REITs, Preferreds, MLPs, and a High Yield Corporate Bond ETF. Asset class diversification can be especially valuable during mature business cycles or periods of high volatility to help hedge against a potential market decline. In addition, the Index applies a volatility capping to each underlying segment (except for the High Yield Corporate Bond ETF) where securities that have an annual volatility of 15% or more in excess of the respective benchmark are excluded from inclusion. In turn, these three advantages combined offer partial downside protection when compared to equities during market downturns or corrections.

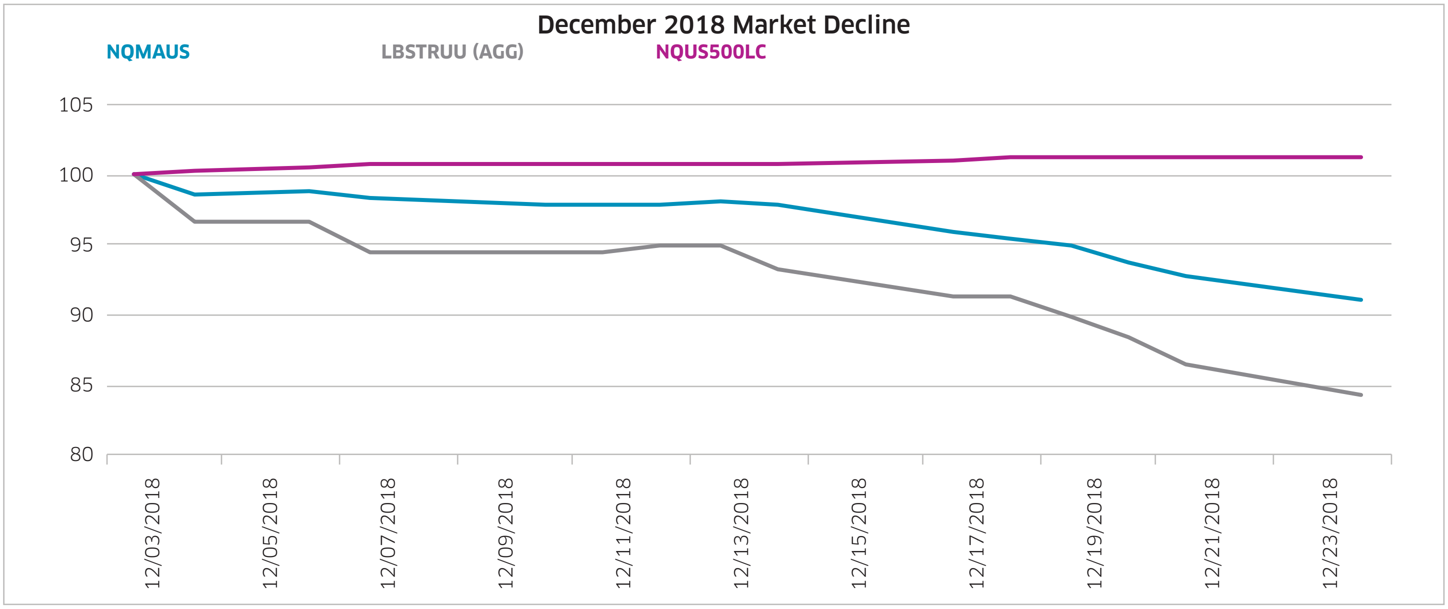
Comparing the Index's drawdown from the market peak prior to the financial crisis on October 9, 2007, to the bottom on March 9, 2009, the Index dropped 10% less when compared to the Equity Benchmark, as the chart below shows:



More recently, the Index has performed significantly better than the Equity Benchmark during the three market corrections in 2018: the first between January 26 and February 8, and the second during "Red October" from October 3 to October 29 and last, the third and most severe of the three during 2018, which pulled the market into bear territory from December 3 to Christmas Eve.



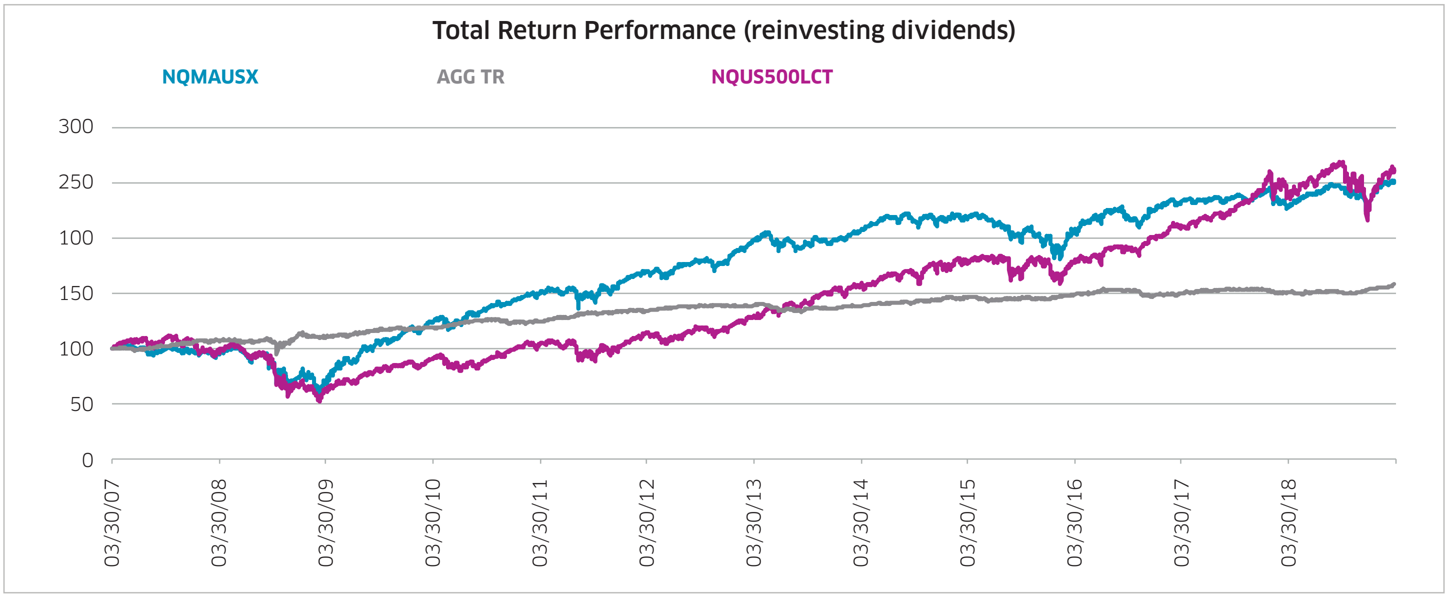




Volatility ruled during 2018: the stock market reached a record high during September, followed by a sharp correction in October and a near-bear market drop during December, before stabilizing in the first quarter of 2019.

DOWNTURN PERIOD	NQMAUS	NQUS500LC	LBSTRUU (AGG)
10/9/2007 to 3/9/2009	-44.2%	-53.3%	7.4%
1/26/2018 to 2/8/2018	-6.0%	-10.0%	-1.1%
10/3/2018 to 10/29/2018	-3.3%	-9.7%	-0.1%
12/3/2018 to 12/24/2018	-9.0%	-15.8%	-1.2%

Considering the Nasdaq U.S. Multi-Asset Diversified Income Index's high dividend yield, lower volatility and increased protection against market downturns compared to the Equity benchmark, the Index has performed exceptionally well, as depicted below.

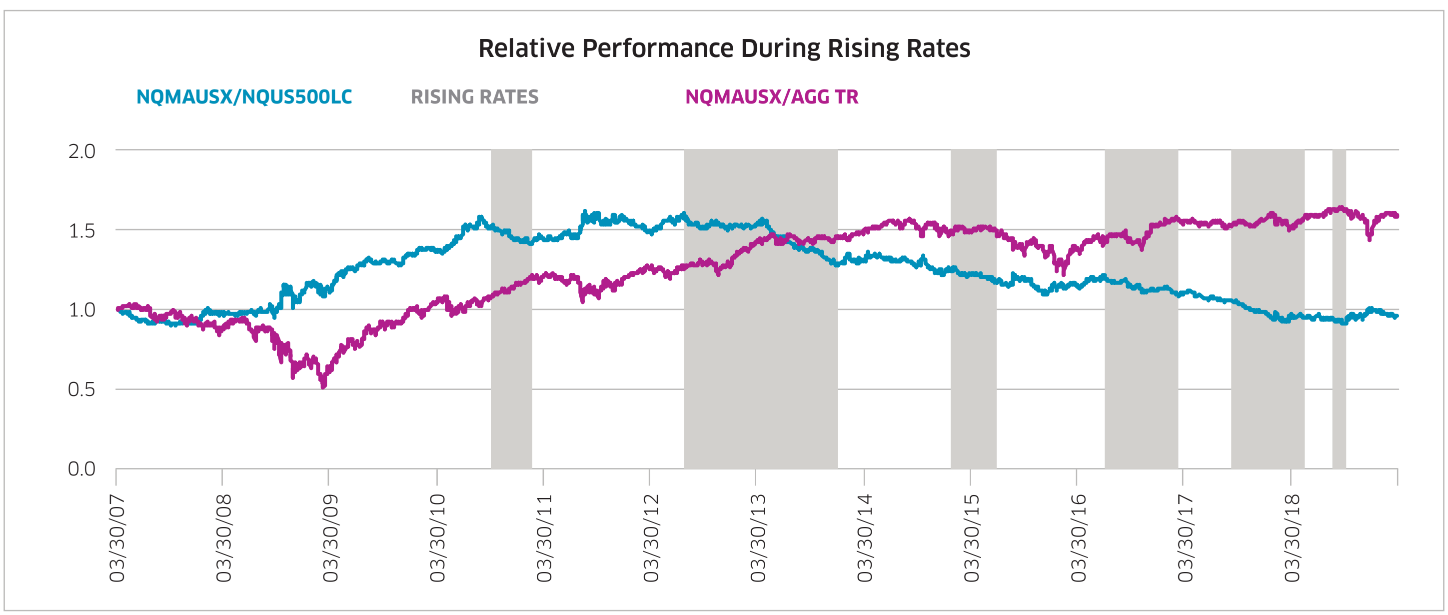


How does the Index perform during different market environments?

When compared against the Equity and Bond benchmarks, the Index is expected to perform somewhere in between, on average.

First, consider how the Index performs during periods of rising rates. The Federal Reserve raised the federal funds target rate four times in 2018 to 2.5 percent based on solid economic growth and a strong jobs market. During the Federal Open Market Committee meeting in March, Fed Chair Jerome Powell announced plans to shift from additional rate hikes in 2019 to a “wait-and-see approach”, citing expected slowing economic growth driven in part by global trade tensions and economic slowdowns in Europe and China. Nevertheless, Powell said that the U.S. economy was in a good place, and the Fed expects economic growth to continue this year albeit at a slower pace. Regarding interest rates, Powell implied that the Fed would patiently wait for a clear signal to change its current policy. We do not yet have enough data to estimate when the rising rates environment will resume.

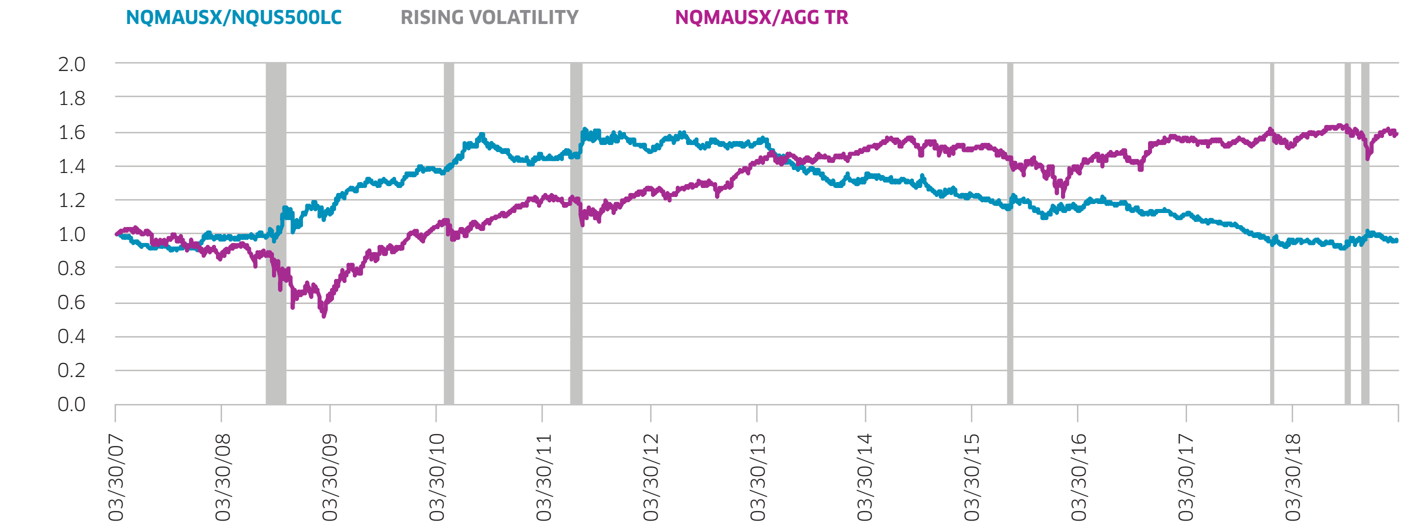
The chart below shows the relative performance of the Index against the Equity Benchmark (blue) and the Bond Benchmark (magenta). Therefore, an upward sloping curve indicates the Index outperformed the benchmark during that period, while a downward slope shows that the Index underperformed. During a period of rising interest rates—indicated by a shaded area in the graph below—the Index has typically outperformed the Bond Benchmark and underperformed the Equity Benchmark. This is precisely how the Index is expected to perform.



Now consider another market environment that we have seen come back in 2018: increased volatility. After a year of a smooth rise in market performance during 2017, the market corrections during January-February and October 2018 shook up the market, lifting volatility from its previously dormant state.

During periods of increasing volatility, shaded in the graph below, the Index outperforms the Equity benchmark and underperforms the Bond benchmark—again, as expected.

Relative Performance During Rising Volatility



Since there is an inverse relationship between the Index's outperformance to the Equity and Bond benchmarks during periods of rising rates when compared to periods of high volatility, the Index provides stability through asset class diversification.

Conclusion

The Nasdaq U.S. Multi-Asset Diversified Income Index provides exposure to a lofty dividend yield (6% to 9%) and asset class diversification, as well as lower volatility and downside protection when compared to the Equity Benchmark. Asset class diversification can be particularly valuable during a late-cycle phase or periods of high volatility to help protect against a potential market decline. Lastly, the inverse correlation between how the Index performs against the Equity and Bond benchmarks during periods of rising rates and rising volatility is a prime example of how asset class diversification can help mitigate sizable market swings under disparate market conditions. Investors can gain exposure to the Index through the First Trust Multi-Asset Diversified Income ETF (Nasdaq: MDIV).

Sources: FactSet, Bloomberg, Nasdaq Indexes
All data is as of 3/29/2019, unless otherwise noted.