



# Income Outlook: Short-Term Treasury Rates Signal a Potential Policy Shift

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The Global X Income Outlook for Q2 2023 can be [viewed here](#). This report seeks to provide macro-level data and insights across several income-oriented asset classes and strategies.

The first quarter of 2023 sent a sign of mixed signals amidst increasing volatility in the banking sector as depositors sought alternative options. All the while, major markets indices across both equity and fixed income markets saw a strong rebound. We spoke **last quarter** about expectations for interest rates to peak and the potential for a reversal in monetary policy. These trends appear to be materializing when examining the short-term yields of the U.S. treasury interest rate curve. As these trends potentially materialize further, income investors may find equity income strategies with a defensive stance an enticing option.

## Key Takeaways

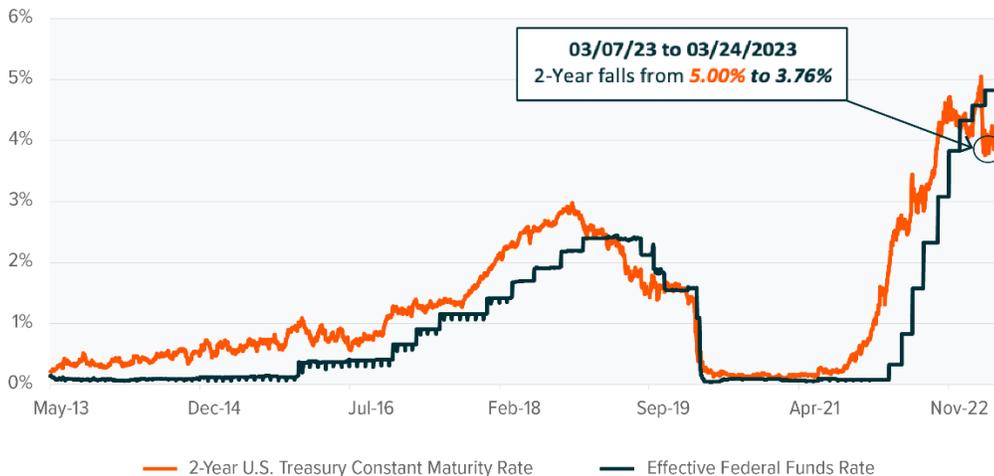
- Short term rates and futures markets are pointing to an eventual reversal in hawkish Federal Reserve monetary policy as investors gauge economic data like inflation and the state of the banking sector.
- Uncertainty in the global economy has increased investor interest in companies with strong fundamentals, steady balance sheets, and attractive valuations to supplement equity income portfolios, a trend we believe will continue in the near term.
- In periods of elevated uncertainty, market volatility often rises, making the options markets a potentially useful tool to monetize volatility for income focused investors with a risk management lens.

## 2-Year U.S. Treasury Rates Have Pivoted

The shape of the yield curve is leading to questions about what the economic outlook could entail, as well as Federal Reserve policy. With the curve firmly inverted, 2-year treasury rates moved past the 4% level while 30-year treasury rates sat at 3.7%.<sup>1</sup> 2-year U.S. treasury bonds have a demonstrated history of front-running the effective Federal Funds Rate, potentially being a predictor of future Federal Reserve monetary policy. Typically when sharp changes in interest rates occur, there is a larger catalyst behind current trends.

### 2-YEAR U.S. TREASURY YIELDS VS. EFFECTIVE FEDERAL FUNDS RATE

Source: Bloomberg. [Data Set]. Data from May 1st, 2013 to April 30th, 2023 and accessed on May 5th from Global X's Bloomberg Terminal.



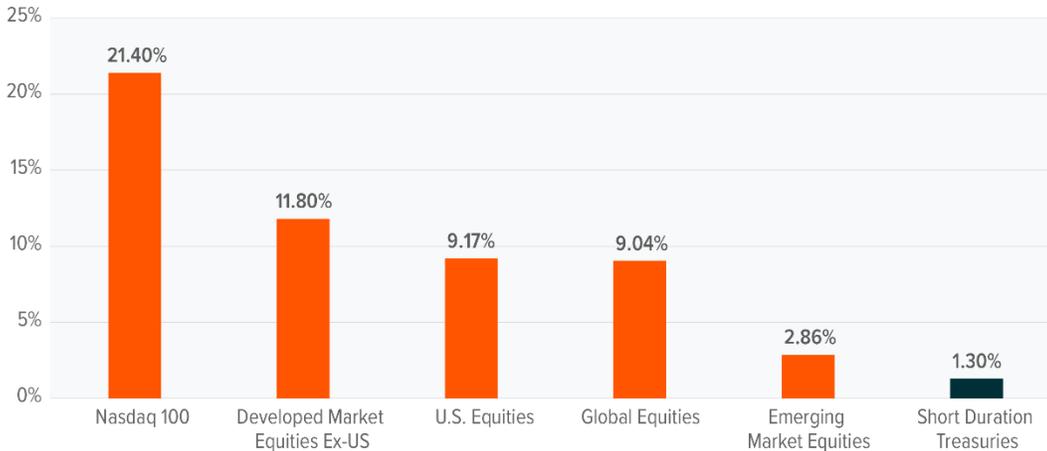


On March 10<sup>th</sup>, 2023, Silicon Valley Bank (SVB) experienced a significant bank run, leading to the bank being put under receivership of the Federal Deposit Insurance Corporation (FDIC). This means that the agency assumed total control over the failed bank. By March 24<sup>th</sup>, 2-year treasury yields had fallen over 100 basis points. This may indicate that the market believed the Federal Reserve may continue to soften its monetary policy towards a 2023 year-end 4.5% federal funds rate, implied by futures markets, as of 04.30.2023.<sup>2,3</sup> As the ICE BofA MOVE Index, a measurement of U.S. Treasury rate implied volatility, traded 61% above its 5-year average as of 04.30.2023, equity income investors, in particular, may want to seek strategies that invest in companies with robust balance sheets.<sup>4</sup> Strategies monetizing equity market implied volatility from selling options in exchange for a premium is another enticing option.

With a 5.1% 3-month U.S. treasury yield, as of 04.30.2023, coupled with no credit risk and minimal interest rate risk, the shorter-end of the yield curve is looking attractive.<sup>5</sup> However, there may be an opportunity cost to investors who decide to sit on the sidelines, moving forward. As discussed, rates have likely peaked and are expected to decline moving forward. We believe global equity markets are pricing this in given attractive year-to-date returns, relative to short duration treasuries. Interest rate sensitive sectors such as Technology and Communication Services, which have returned 21% and 25%, respectively, over the same timeframe, are potentially signifying declining rates moving forward as well.<sup>6</sup>

### YTD EQUITY MARKET RETURNS SIGNIFYING A POTENTIAL OPPORTUNITY COST

Source: Morningstar Direct. [Data Set]. Data from 01/01/2023 to 04/30/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License. Asset Class Representations are as follows: Developed Market Equities Ex-US, MSCI EAFE Index; U.S. Equities, S&P 500 Index; Global Equities, MSCI ACWI; Emerging Market Equities, MSCI Emerging Markets Index, Short Duration Treasuries; ICE Short US Treasury Securities Index.



**Past performance is not a guarantee of future results.**

### Quality Dividend Equities May Offer an Enticing Blend of Factors

Year-to-date, as of 04/30/2023, U.S.-listed equity strategic beta ETFs utilizing a quality factor screen have seen over \$12B in net flows, leading all other single factor strategic beta strategies and speaks to defensive positioning from equity investors.<sup>7</sup> Income investors seeking to take a similar stance within their equity dividend portfolios may find that a quality, high dividend equity portfolio offers the potential for both sustainable dividends and growth.



## QUALITY FACTOR EQUITY ETF FLOWS SIGNAL INVESTOR PREFERENCES

Source: Morningstar Direct. [Data Set]. Data from 01/01/2023 to 04/30/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License. Based on Morningstar's categorization of strategic beta funds.



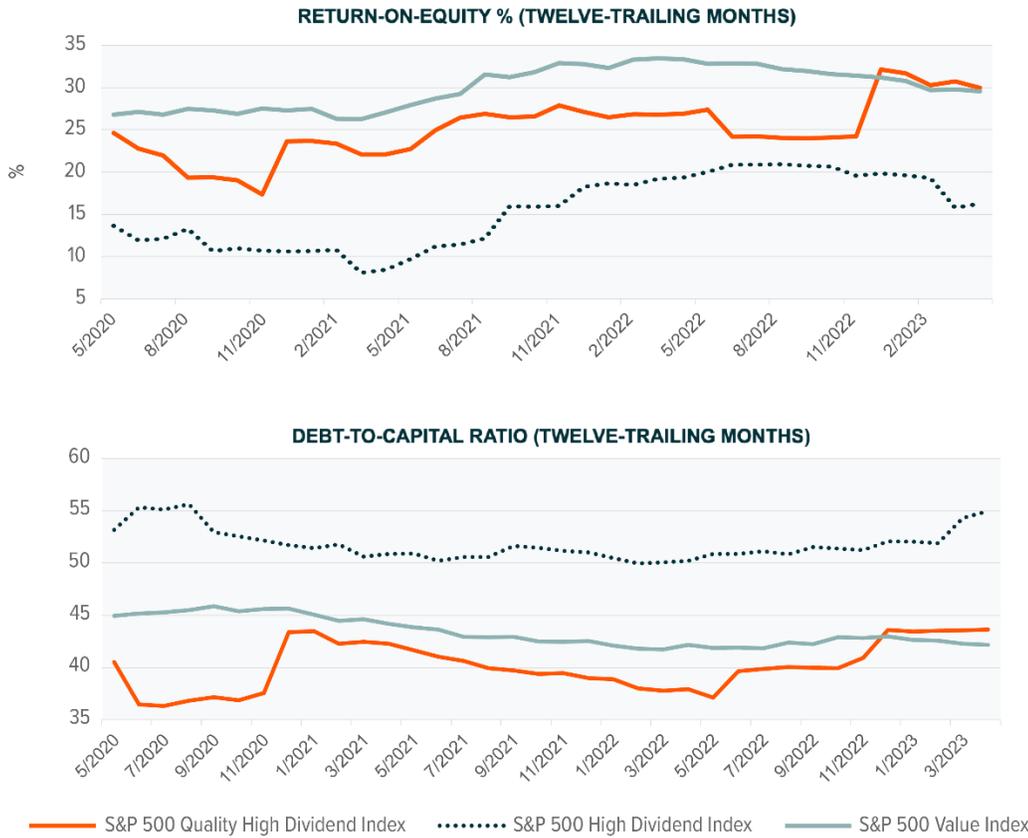
### Quality Dividend Equities Indirectly Exhibit Dividend Growth Attributes

The S&P 500 Quality High Dividend Index has benefitted from the its quality factor screen based on balance sheet ratios such as return on equity, financial leverage, and accruals ratio to define quality characteristics within its constituent selection process. We believe this is key since 463 U.S. equities, a 162% increase in number of companies from the prior year, as of 03.31.2023, saw their dividends decrease over the past twelve trailing months.<sup>8</sup> However, 72 out of the 77 constituents in the S&P 500 Quality High Dividend Index increased their dividends during their 2022 fiscal years.<sup>9</sup> This same index, which the Global X S&P 500 Quality Dividend ETF (QDIV) seeks to track, exhibited a higher level of return-on-equity with lower leverage relative to that of a high dividend portfolio, represented by the S&P 500 High Dividend Index.<sup>10</sup> Higher levels of return-on-equity may translate to higher levels of retained earnings on the balance sheet, therefore, translating to lower levels of needed leverage in an environment of elevated interest rates.



## FUNDAMENTALS – U.S. QUALITY HIGH DIVIDEND EQUITIES VS. U.S. HIGH DIVIDEND EQUITIES

Source: Morningstar Direct. [Data Set]. Data from 05/01/2020 to 04/30/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License.



### U.S. Quality Dividend Valuations Remain Attractive

Notably, as interest rates rose significantly in 2022, the value factor, relative to growth equities, outperformed.<sup>11</sup> This trend may continue as interest rates show signs of peaking, potentially resulting in a steeper yield curve. This may signal the early stages of economic expansion in the longer-term, allowing the value factor, a pro-cyclical factor, to potentially outperform. Since the recent collapse of Silicon Valley Bank, the yield difference between 10-year U.S. treasuries and 2-year U.S. treasuries (“2s10s”) has steepened, signifying this.<sup>12</sup>



## U.S. VALUE EQUITIES CONTINUED TO OUTPERFORM GROWTH IN THE NEAR-TERM

Source: Morningstar Direct. [Data Set]. Data measured from 04/30/2022 to 04/30/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License. Asset Class representations are as follows: Growth, S&P 500 Growth TR Index; Value, S&P 500 Value TR Index.



### Past performance is not a guarantee of future results.

Higher dividend yielding strategies tend to exhibit a level of exposure to the value factor. Historically, companies that pay high dividends relative to peers are more likely to be in the more mature phase of their business cycle in which less earnings are retained but distributed to shareholders in the form of a dividend. Quality dividend companies generally maintain similar levels of exposure to this factor too while simultaneously offering a higher chance of avoiding potential value traps associated with high dividend strategies that do not implement a quality screen.

## QUALITY DIVIDEND COMPANIES DEMONSTRATE ATTRACTIVE FORWARD PRICE-TO-EARNINGS RATIOS RELATIVE TO THE VALUE FACTOR

Source: Morningstar Direct. [Data Set]. Data measures monthly data from 05/2020 to 04/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License.



## Recent Market Uncertainty May Make Covered Call Strategies Attractive

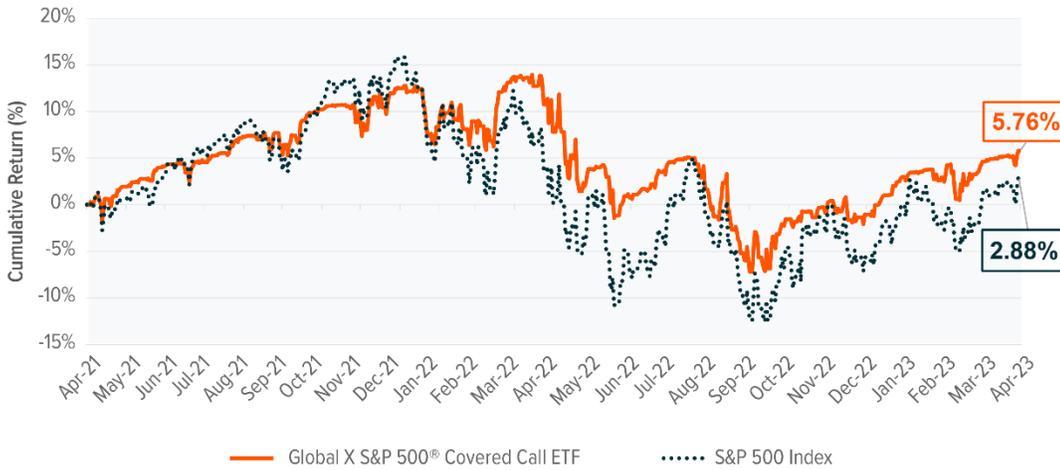
Amidst macroeconomic concerns in the banking system there have still been economic bright spots, such as a U.S. unemployment rate of 3.4%.<sup>13</sup> These mixed signals may have been a driver for the modest increase in the S&P 500's total return of 2.88% from 04.30.2021 to 04.30.2023.<sup>14</sup> During periods of equity market uncertainty, selling covered calls on an equity index offers the potential for outperformance when the reference index is expected to demonstrate a return less than the premium received. An "at-the-money"



covered call strategy may prove to be the most beneficial in such a scenario. Typically, all else equal, the closer the call option strike price is to the price level of the index at contract initiation, the higher the expected premium.

## XYLD HAS DEMONSTRATED RECENT OUTPERFORMANCE

Source: Morningstar Direct. [Data Set]. Data from 04/30/2021 to 04/30/2023 and accessed on May 05, 2023 from Global X Morningstar Direct License. XYLD returns signified by NAV returns.



**Performance data quoted represents past performance. Past performance is not a guarantee of 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. For performance current to the most recent month- and quarter-end, click to the fund web page [here](#).**

The premium proposition from a covered call strategy may be the main attraction. Covered call strategies offer a diversification opportunity in which upside participation in the underlying asset is sacrificed for premiums that are received for selling call options. This is different than a pure equity strategy, where income is reliant on company dividends. For fixed income securities, income is correlated to the level of interest rates. Global X's covered call ETFs' premiums have historically moved higher during periods of heightened market volatility. Below, we can see a twelve trailing month comparison of options premiums generated from Global X's at-the-money, covered call writing strategies on 100% of the notional coverage of the Nasdaq 100 (QYLD), S&P 500 (XYLD), Russell 2000 (RYLD), and Dow Jones Industrial Average (DJIA).



## GLOBAL X COVERED CALL ETFS' PREMIUMS ON THE NASDAQ 100, S&P 500, DOW JONES INDUSTRIAL AVERAGE, AND THE RUSSELL 2000

Source: Global X ETFS. [Data Set]. Monthly premiums measured from 05/21/2022 to 04/21/2023.

Covered Call Premiums - 100% Notional Coverage				
Start Date	Global X Nasdaq 100 Covered Call ETF	Global S&P 500 Covered Call ETF	Global X Russell 2000 Covered Call ETF	Global X Dow 30 Covered Call ETF
	QYLD	XYLD	RYLD	DJIA
May-22	3.12%	2.51%	2.78%	1.45%
Jun-22	4.27%	3.32%	3.86%	2.37%
Jul-22	3.62%	2.75%	3.75%	1.76%
Aug-22	2.78%	2.01%	2.58%	1.29%
Sep-22	4.02%	3.06%	3.36%	2.13%
Oct-22	4.36%	3.61%	4.31%	3.21%
Nov-22	3.09%	2.42%	2.77%	1.57%
Dec-22	3.02%	2.53%	2.95%	1.92%
Jan-23	2.88%	2.26%	2.53%	1.23%
Feb-23	2.69%	2.07%	2.54%	1.22%
Mar-23	3.26%	2.80%	3.42%	2.28%
Apr-23	2.40%	1.84%	2.52%	1.08%
Twelve Trailing Months (Total)	39.51%	31.18%	37.37%	21.51%
Twelve Trailing Months (Average)	3.29%	2.60%	3.11%	1.79%
# of Periods with 3%+ Premiums over the past 12 Months	8	3	5	1

### Conclusion: Defensive Dividends Can Potentially Mitigate Market Uncertainty

The first quarter of the new year saw a promising shift in equity market sentiment amidst recent volatility in the banking sector. This has led income investors to a crossroads of mixed signals such as low unemployment paired with elevated interest rate volatility. Taking a defensive stance in the form of quality dividends offers investors the potential to avoid value traps and maintain sustainable dividend growth. For investors who believe the aforementioned, mixed signals may persist, a covered call strategy, monetizing implied volatility of an equity index, may be prudent in providing option premium income with an elevated chance of lowering risk within the equity sleeve of a portfolio.

#### Related ETFS

[QDIV – Global X S&P 500 Quality Dividend ETF](#)

[QYLD: The Global X Nasdaq 100 Covered Call ETF](#)

[XYLD: The Global X S&P 500 Covered Call ETF](#)

[RYLD: The Global X Russell 2000 Covered Call ETF](#)

[DJIA: The Global X Dow 30 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. [Data Set]. data as of 04/30/2023 and accessed on May 5<sup>th</sup> from Global X's Bloomberg Terminal.
2. Bloomberg. [Data Set]. 2-year Treasury Yield data from 03/07/2023 to 03/24/2023 and accessed on April 24<sup>th</sup> from Global X's Bloomberg Terminal.
3. Bloomberg. [Data Set]. Federal Fund Rate futures curve data as of 04/30/2023 and accessed on May 5<sup>th</sup> from Global X's Bloomberg Terminal.



4. Global X ETFs with information derived from Bloomberg. [Data Set]. Data from 04/30/2018 through 04/30/2023 and accessed on May 5<sup>th</sup>, 2023 from Global X Bloomberg Terminal.
5. Morningstar Direct. [Data Set]. Data as of 04/30/2023 and accessed on May 5<sup>th</sup>, 2023 from Global X's Morningstar Direct License.
6. Morningstar Direct. [Data Set]. Data from 01/01/2023 to 04/30/2023 and accessed on May 5<sup>th</sup>, 2023 from Global X's Morningstar Direct License. Technology sector is represented by the S&P Technology Select Sector Index and Communication Services is represented by the S&P Communication Services Select Sector Index.
7. Ibid.
8. S&P Dow Jones Indices. (2023, April 4). S&P Dow Jones Indices Reports U.S. Common Indicated Dividend Payments Increased \$9.7 Billion During Q1 2023; 12-month Gain was \$59.7 Billion.
9. Morningstar Direct. [Data Set]. Data as of 03/31/2023 and accessed on April 24<sup>th</sup>, 2023 from Global X's Morningstar Direct License.
10. Morningstar Direct. [Data Set]. Data as of 04/30/2023 and accessed on May 5<sup>th</sup>, 2023 from Global X's Morningstar Direct License.
11. Morningstar Direct. [Data Set]. Data from 01/01/2022 to 12/31/2022 and accessed on April 24<sup>th</sup>, 2023 from Global X Morningstar Direct License. Asset Class representations are as follows: Growth, S&P 500 Growth TR Index; Value, S&P 500 Value TR Index. The S&P 500 Growth TR Index fell -29.41% during the measured timeframe. The S&P 500 Value Index fell -5.22% during this same timeframe.
12. Bloomberg. [Data Set]. 2-year Treasury Yield from 03/10/2023 to 04/30/2023 and accessed on May 5<sup>th</sup> from Global X's Bloomberg Terminal.
13. Bloomberg. [Data Set]. Unemployment rate data as of 04/30/2023 and accessed on May 5<sup>th</sup> from Global X's Bloomberg Terminal.
14. Morningstar Direct. [Data Set]. Data from 04/30/2021 to 04/30/2023 and accessed on May 5<sup>th</sup>, 2023 from Global X Morningstar Direct License.

## Glossary

**S&P 500:** S&P 500 Index tracks the performance of 500 leading U.S. stocks and captures approximately 80% coverage of available U.S. market capitalization. It is widely regarded as the best single gauge of large-cap U.S. equities.

**S&P 500 Growth Index:** The index measures the performance of growth stocks drawn from the S&P 500 index. The complete market capitalization of S&P 500 index is divided into growth and value segments by using three factors: sales growth, the ratio of earnings change to price, and momentum.

**S&P 500 Value Index:** The index measures the performance of value stocks drawn from the S&P 500 index. The complete market capitalization of S&P 500 index is divided into growth and value segments by using three factors: sales growth, the ratio of earnings change to price, and momentum. The index is market capitalization weighted.

**S&P 500 High Dividend Index:** Serves as a benchmark for income seeking equity investors. The index is designed to measure the performance of 80 high yield companies within the S&P 500 and is equally weighted to best represent the performance of this group, regardless of constituent size.

**ICE Short US Treasury Securities Index:** The Index is market value weighted, and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than one month and less than or equal to one year.

**MSCI EAFE Index:** The index measures the performance of the large and mid cap segments of developed markets, excluding the US & Canada equity securities. It is free float-adjusted market-capitalization weighted.

**MSCI Emerging Markets Index:** The index measures the performance of the large and mid-cap segments of emerging market equity securities. It is free float-adjusted market-capitalization weighted.

**ICE BofA MOVE Index:** a yield curve weighted index of the normalized implied volatility on 1-month Treasury options. It is the weighted average of volatilities on 2-year (20% weight), 5-year (20% weight), 10-year (40% weight), and 30-year (20% weight) treasuries.

**S&P 500 Quality High Dividend Index:** The S&P 500 Quality High Dividend Index measures the performance of S&P 500 stocks that exhibit both high quality and high dividend yield characteristics. Index constituents are equally-weighted, subject to a 25% Global Industry Classification Standard (GICS) Sector weight cap.

**Standard Deviation:** A statistical measurement of dispersion about an average, which, for a mutual fund, depicts how widely the returns varied over a certain period of time.

**Strike Price:** The fixed price at which an option holder can buy or sell the underlying asset. Also called 'exercise price'.

**"At-The-Money":** An options contract whose strike price is equal to that of the current market price of the underlying security.

**Return-On-Equity Ratio:** The percentage a company earns on its shareholders' equity in a given year (Year 1, 2, etc.). The calculation is net income divided by end-of-year net worth. The resulting figure is multiplied by 100.

**Debt-to-Capital Ratio:** This ratio measures a firm's financial leverage. This ratio is calculated by dividing long-term debt (excluding other liabilities) by total capitalization (the sum of common equity plus preferred equity plus long-term debt).

**Financial Leverage:** Financial Leverage ratio is a measure of a company's indebtedness, based on debt to total assets.

**Forward Price-to-Earnings:** Price/projected earnings for a stock is the ratio of the company's most recent month-end share price to the company's estimated earnings per share (EPS) for the current fiscal year. If a third-party estimate for the current year EPS is not available, Morningstar will calculate an internal estimate based on the most recently reported EPS and average historical earnings growth rates.

**Quality Factor Equity Strategy:** A group of equity ETFs that primarily aim to capture quality characteristics through their screening and/or weighting methodology. These characteristics will differ across index providers. Common quality characteristics include: high and stable levels of profitability, clean balance sheets, capital efficiency, return on assets, economic moats, and others.

**Fundamentals Factor Equity Strategy:** A group of equity ETFs which select and weight constituents on a variety of fundamental measures of their value. These inputs may include sales, adjusted sales, cash flow, dividends, share buybacks, book value, and others.

**Growth Factor Equity Strategy:** A group of equity ETFs that primarily aim to capture growth characteristics through their screening and/or weighting methodology. Common growth characteristics include: above-average long-term projected earnings growth, historical earnings growth, sales growth, cash flow growth, book value growth, momentum, and others.

**Dividend Factor Equity Strategy:** A group of equity ETFs which seek to deliver equity income by employing a number of dividend-related screening and/or weighting criteria. Dividend-oriented strategies include screening a universe of stocks for dividend-paying firms, weighting stocks on the basis of dividend payments, screening on the basis of dividend growth or yield, isolating firms based on metrics that would indicate dividend stability, and other dividend-related criteria.

**Momentum Factor Equity Strategy:** A group of equity ETFs that primarily aim to capture momentum characteristics through their screening and/or weighting methodology. ETFs belonging to the momentum strategic-beta group will select and/or weight their constituent securities on a number of momentum factors, which might include price momentum, adjustments to earnings estimates, and earnings surprises.

**Value Factor Equity Strategy:** A group of equity ETFs that primarily aim to capture value characteristics through their screening and/or weighting methodology. These characteristics will differ across index providers. Common value characteristics include: low price/prospective earnings, price/book, price/sales, and price/cash flow ratios, above-average dividend yields, and others.

**Risk-Oriented Factor Equity Strategy:** A group of equity ETFs which attempt to either reduce or increase the level of risk relative to a standard benchmark. Low-volatility and high-beta strategies are the most common examples of risk-oriented strategies.



**Accruals Ratio:** Accruals are a measure of the quality of a firm's earnings, the accruals ratio is the change in net operating assets over the last 12 months divided by the average net operating assets over the same period.

**Strategic Beta:** Widely referred to as "smart beta"—refers broadly to a growing group of indexes and the exchange-traded products and other funds and investment products that track them. The majority of these indexes seek to enhance returns or minimize risk relative to a traditional market capitalization weighted benchmark. These benchmarks and the investable products that track them exploit many of the same "factors" (size, value, quality, momentum, etc.) or to mitigate risk in a manner similar to active managers.

**Effective Federal Funds Rate:** calculated as a volume-weighted median of overnight federal funds transactions

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Index returns are for illustrative purposes only and do not represent actual fund performance. Index returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

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Investing involves risk, including the possible loss of principal. There is no guarantee dividends will be paid. Companies may reduce or eliminate dividends at any time.

QYLD, XYLD, RYLD and DJIA engage in options trading. An option is a contract sold by one party to another that gives the buyer the right, but not the obligation, to buy (call) or sell (put) a stock at an agreed upon price within a certain period or on a specific date. A covered call option involves holding a long position in a particular asset and writing a call option on that same asset with the goal of realizing additional income from the option premium. By selling covered call options, the funds limit their opportunity to profit from an increase in the price of the underlying index above the exercise price, but continues to bear the risk of a decline in the index. A liquid market may not exist for options held by the fund. While the fund receives premiums for writing the call options, the price it realizes from the exercise of an option could be substantially below the indices current market price.

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