Understanding the Income Landscape for Options Strategies

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Income-driven investors face a volatile market due to the ongoing efforts by the Federal Reserve (Fed) to constrict the money supply. Mixed inflation, labor, and economic growth data are further contributing to instability. In this environment, we believe that it is important for investors to have the wherewithal to diversify their assets into entities that focus on total return, rather than just yield or price appreciation. Options strategies can provide this avenue, as they offer varying levels of upside potential and downside risk mitigation. They can be a cornerstone piece of a broader investment strategy or a supplemental addition as a source of premiums. In this report, we highlight an array of investment vehicles that investors can implement to navigate recent market turbulence.

Key Takeaways

- Rising interest rates and mixed economic data have led to some elevated volatility across the broader equity markets. This is making it difficult for investors who rely on dividend income to allocate assets.
- Options strategies offer investors the ability to diversify across sectors by leveraging different underlying assets. They also provide flexibility that will allow them to pursue varying investment goals with an income focus in mind.
- Covered call options strategies come in many shapes and sizes. Global X offers a number of these strategies in the ETF structure, which we believe can bring compelling diversification potential to investor portfolios in the current market landscape.

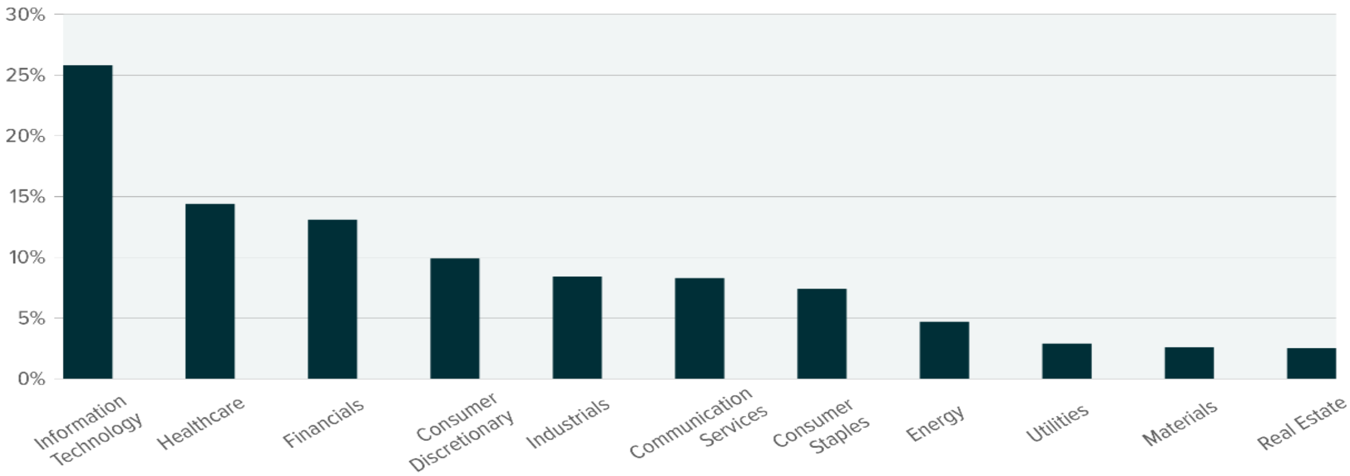
Income Investors Are Navigating a Tumultuous Economic Environment

Charting a path for the equity markets over the balance of 2023 is becoming increasingly challenging. High levels of inflation and elevated interest rates are likely to persist, at least in the near term, and this may well result in soft economic growth and lower real income rates. Complicating matters further for those looking to operate a dividend-driven income portfolio are the conflicting economic indicators that are being released around the globe.

For example, despite slipping 0.1% sequentially in April, to 4.9%, the Consumer Price Index (CPI) remains well above the Fed's 2% target inflation rate.[1] Still, U.S. consumer demand remains robust. Consumer spending historically accounts for about two-thirds of all U.S. economic activity, and it has continued to grow over the last two quarters, capped off by a 2.9% increase in retail sales in March.[2] All the while, major sectors that make up the S&P 500, like Information Technology and Consumer Discretionary, as referenced in the graph below, are seeing equity values push higher. This combination of data creates uncertainty for investors that typically target dividend yielding equities, as corporate costs have also been on the rise. Should elevated interest rates be maintained over the balance of the year, or a potential earnings recession come to fruition, this could erode the value of these equity positions.

S&P 500 SECTOR BREAKDOWN (AS OF 03/31/2023)

Sources: Global X ETFs with information derived from S&P.



Options Can Offer Investors Various Paths to Diversification

When seeking yield, income-oriented investors tend to focus on specific sectors like consumer staples, real estate, and utilities. Businesses in these sectors typically offer solid dividends, generate stable cash flows, and hold up well against broader market volatility. That said, constructing a portfolio around any given sector, or series of sectors, still exposes investors to risks and opportunity costs.

Implementing options strategies can help address these concerns while keeping income generation at the forefront of their investment objectives. Options can help lower a beta coefficient associated with a portfolio, reduce leverage, and support higher account cash balances in anticipation of future investments. Due to their low cost, options can also give investors room to take a wider variety of positions while maintaining a relatively defensive stance.

Another compelling feature of options is the cushion that they can provide against volatility. As asset classes, equity and fixed income are inversely correlated with volatility. Options, on the other hand, can work in conjunction with volatility, recognizing higher premiums as the proverbial fear indexes like the VIX rise. This trait is supportive of income-seeking strategies like covered call writing and cash covered put writing, where the premiums received from writing contracts can represent a source of return that varies from other asset classes. Broadly, adding these functions into portfolios during times of elevated volatility can help investors diversify their portfolios, potentially enhancing their total returns while reducing risk.

The Global X Covered Call Suite Offers Flexible Exposures

The base covered call strategy consists of buying a stock or basket of stocks and selling a call option on those same securities. The sale of the option contract provides the writer with a premium, which helps to lower the breakeven point on the underlying investment. As market volatility rises, the premium received upon writing a contract typically increases as well. This premium, in combination with some foregone upside potential, helps the strategy perform in choppy and sideways markets. Of course, depending on the moneyness of the option and the amount of coverage pursued, the investor can retain some ability to benefit from upward moves by the underlying instrument.

GLOBAL X COVERED CALL ETF STRATEGY SUMMARY

Sources: Global X ETFs.

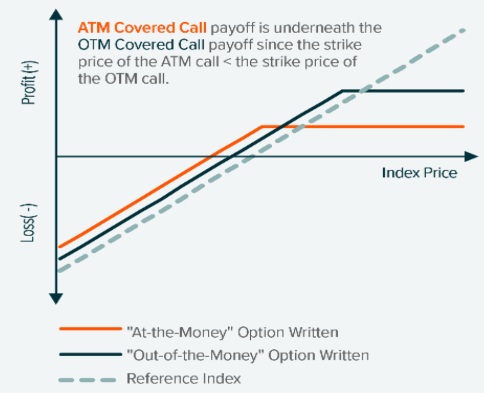
A covered call is a popular option strategy designed to produce premiums with the potential to increase risk-adjusted returns.

ETF Process

1. Purchase securities underlying the reference index.
2. Sell a call option on the reference index at a specified strike price.

NOTICE: The Covered Call payoffs in **orange** and **dark blue** are *above* the dotted, light blue reference index line. The gaps signify the premiums received for the sold call options.

Covered Call Strategy Payoff



Covered Call Features

- Seeks premiums from the sale of call options that can exceed the dividend expectations of a reference index.
- Upside potential is capped in the event that the reference index appreciates beyond the strike price.
- Option premiums tend to increase during volatile markets, offering a potential risk management component.
- No additional downside protection beyond the premiums received.

Max Profit
(Short Call Strike Price – Reference Index Price) + Short Call Premium

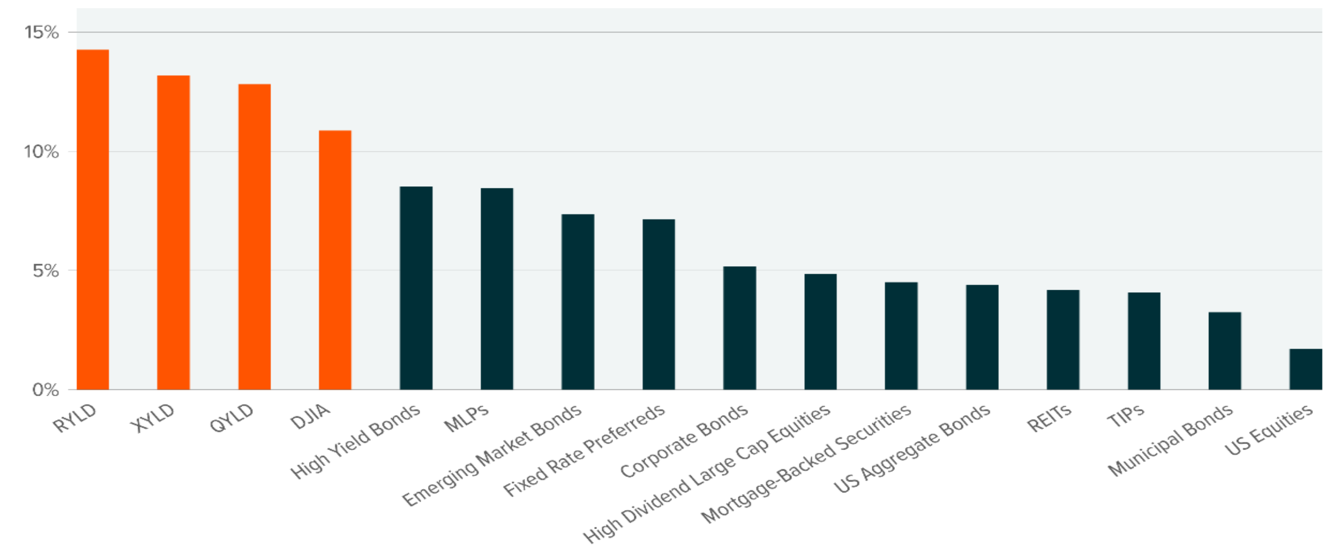
Max Loss
(–Reference Index Price) + (Short Call Premium)

For illustration purposes only.

Global X uses the covered call strategy to create products that cater to income-oriented investors and those investors looking for risk-adjusted returns. Our core Covered Call ETFs, including the Dow 30 Covered Call ETF (DJIA), the Nasdaq 100 Covered Call ETF (QYLD), the S&P 500 Covered Call ETF (XYLD), and the Russell 2000 Covered Call ETF (RYLD), seek to generate potential income by writing at-the-money calls against the entirety of the underlying portfolio. The graph below highlights the current distributions generated by these ETFs relative to other asset classes.

ASSET CLASS YIELD VS. GLOBAL X COVERED CALL ETF DISTRIBUTIONS[1]

Sources: Global X ETFs with information derived from Bloomberg L.P. (n.d.) as of March 31, 2023. Data retrieved December 2, 2024.



Past performance does not guarantee future results.

U.S. equity asset class yields are their 12-month yields. Fixed income yields are yield-to-worst. Covered Call ETFs' distributions are indicated by their trailing 12-month distributions relative to the respective fund's most recent Net Asset Value and capital gains over the 12-month period. [1]A portion of the Funds' distributions are estimated to include a return of capital. For information on the breakdown of the most recent distribution, please the 19a notices for RYLD, XYLD, QYLD and DJIA.

Asset class representations are as follows: High Yield Bonds, Bloomberg US Corporate High Yield Total Return Index; Fixed-Rate Preferreds, ICE BofA Fixed Rate Preferred Index; US Aggregate Bonds, Bloomberg US Aggregate Bond Index; Emerging Market Bonds, Bloomberg EM USD Aggregate Total Return Index; TIPS, Bloomberg US Treasury Inflation Notes TR Index; Corporate Bonds, Bloomberg US Corporate Bond Total

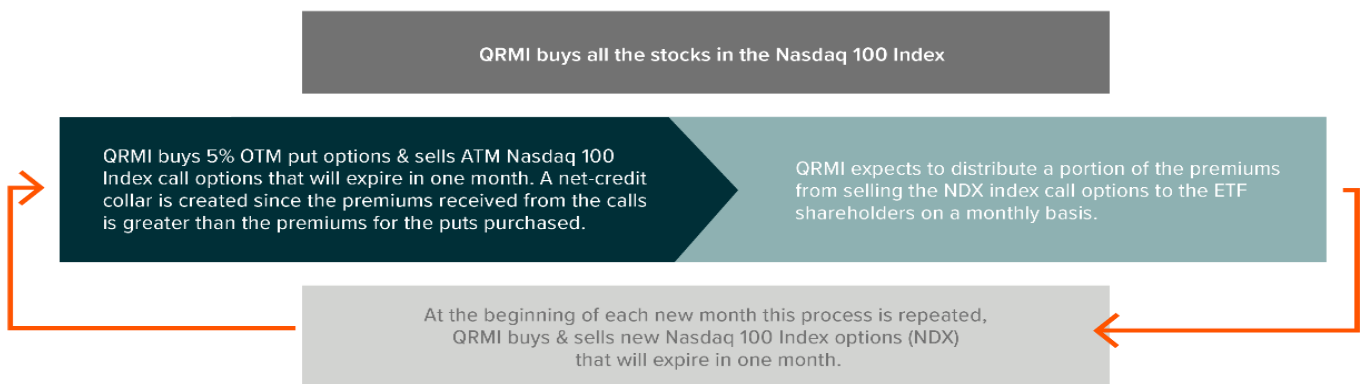
Return Index; REITs, FTSE Nareit All Equity REITs Index; U.S. Equities, S&P 500 Index; MLPs, S&P MLP Index; Mortgage-Backed Securities, Bloomberg US MBS Index; High Dividend Large Cap Equities, S&P 500 High Dividend Index; Municipal Bonds, Bloomberg Municipal Bond Index.

Global X's Covered Call & Growth ETFs seek to maintain long exposure to the underlying instrument. The methodology for these ETFs consists of writing at-the-money calls on half of the underlying assets in the fund. ETFs like the Nasdaq-based QYLG and the S&P 500-based XYLG may not generate a similar level of premium as the core covered call funds. However, investors can diversify their holdings across these indices and realize 50% of the indices' gains or losses. If options are appropriate for an investor, their decision between 100% covered and 50% covered would depend on their specific objectives and current market views.

Global X also offers funds that seek to provide downside risk mitigation in conjunction with premium returns. As the graphic below shows, our risk-managed income strategies like QRMI, our Nasdaq 100 Risk Managed Income ETF, use net credit collars that derive value from writing calls and purchasing puts. The strategy takes a portion of the premiums earned from writing call contracts and uses them to create asset protection by purchasing 5% out-of-the-money puts. This feature prevents the fund from losing any more than 5% of its value, exclusive of fees, over the life of the options.

RISK MANAGED INCOME PROCESS EXPLAINED

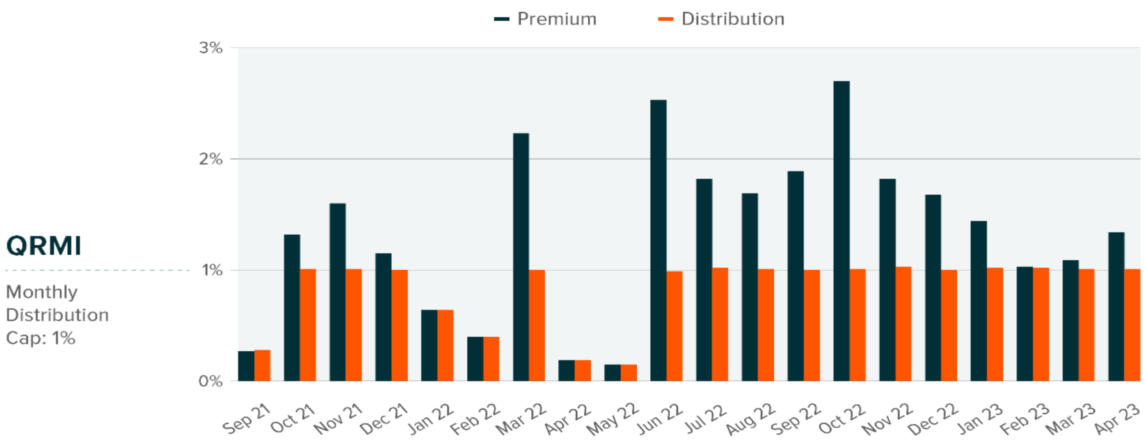
As an example of how an ETF implement a net-credit collar strategy, the Global X Nasdaq 100 Risk Managed Income ETF (QRMI) maintains exposure to the stocks in the Nasdaq 100, while buying put options & selling call options on the index each month.

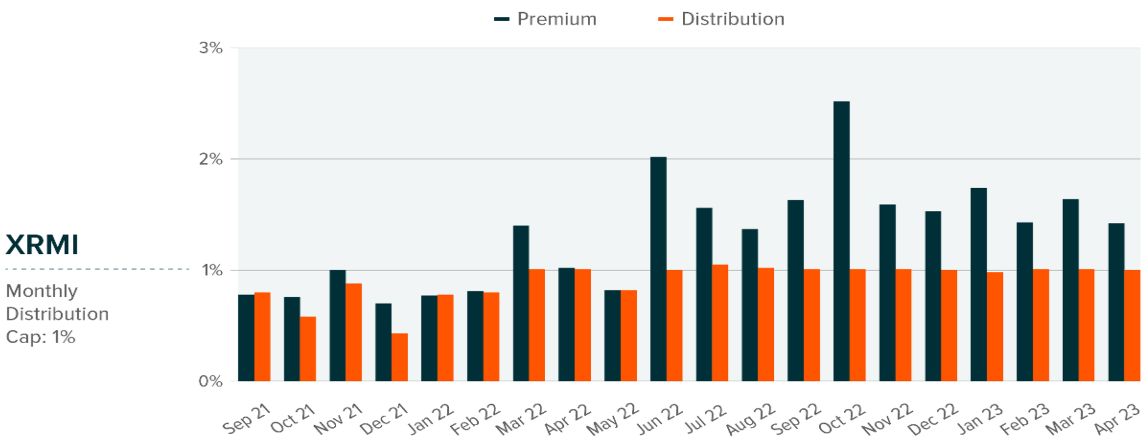


For illustration purposes only.

RISK MANAGED INCOME – HELPING INVESTORS RETRIEVE NET PREMIUMS BY COMBINING COVERED CALLS WITH PROTECTIVE PUTS

Sources: Global X ETFs with information derived from: Bloomberg, L.P (n.d.) [Global X Risk Managed Income premiums] [Data set]. As a general guideline, the monthly distribution of QRMI & XRMI are approximately capped at the lower of: a) 100% of net premiums, or b) 1% of net asset value. The excess amount of options premiums received, if applicable, is reinvested into the fund.





Distributions are subject to change.

A portion of the distribution are estimated to include a return of capital. These do not imply rates for any future distributions. For information on the breakdown of the most recent distribution, please the 19a notices for XRMI and QRMI.

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 on the fund names below.

Conclusion: Options Can Provide a Source of Premiums Amid Uncertainty

Inflation and residual strength across the U.S consumer market and other various sectors seem likely to keep market volatility elevated and uncertainty prevalent. Options strategies offer varying levels of sector exposure, potential yield, and downside risk mitigation, and they can help investors navigate a broad range of conditions, including the ones they face today. When selecting options strategies, like the options ETFs offered by Global X, investors can focus on their desired market factors and vehicles such as hedged protection or potential income generation. Markets will always be variable, some more than others. But we believe that options strategies can help investors bring some diversification to their portfolios.

Related ETFs

XRMI- Global X S&P 500 Risk Managed Income ETF

QRMI - Nasdaq 100 Risk Managed Income ETF

QYLD - Global X Russell 2000 Covered Call ETF

XYLD - Global X S&P 500 Covered Call ETF

DJIA – Global X Dow 30 Covered Call ETF

RYLD - Global X Russell 2000 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. Bls.gov. (2023, May 10). Consumer Price Index Summary.
2. Census.gov. (2023, April 14). Advance Monthly Sales for Retail and Food Services, March 2023.

Glossary

Consumer price inflation (CPI): CPI measures the average change in prices that consumers pay for a defined basket of goods and services.

Covered Call: A covered call involves purchasing securities, such as equities, and then selling a call option on those securities.

Cboe Volatility Index® (VIX® Index): The Chicago Board Options Exchange SPX Volatility Index, commonly referred to as VIX, reflects a market estimate of future volatility, based on the weighted average of the implied volatilities.

S&P 500 Index: 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.

Put: A put is an option where the entity holding the option has the right but not the obligation to sell a security at a predetermined price within a certain period or on a specific date. Typically, a fee is paid for this right.

Call: A call is an option where the entity holding the option has the right but not the obligation to buy a security at a predetermined price within a certain period or on a specific date. Typically, a fee is paid for this right.

Cash Covered Put: Option strategy involving selling an out-of-the-money put option while simultaneously setting aside the capital needed to purchase the underlying stock at the option's strike price.

At-the-Money: An option in which the underlying's price equals the strike price.

Beta: Measures how an asset moves versus an index.

Moneyness: The relative position of the current price of an underlying asset with respect to the strike price of an option.

Out-of-the-Money: Options that, if exercised, would require the payment of more money than the value received and therefore would not be currently exercised.

Collar Strategy: An options strategy in which the investor purchases a protective put while selling a call option on the same reference asset.

Net Credit Collar Strategy: An options collar strategy featuring the sale of a call option that earns a premium higher than the price of a purchased put option.

Protective Put: A protective put involves purchasing securities, such as equities, and then buying a put option on those securities.

Nasdaq 100 Index: The Nasdaq-100 Index includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies including investment companies.

12-Trailing Month Distributions: The distribution rate that 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 period.

Correlation: Correlation indicates the strength of the linear relationship between two different variables. A correlation that is greater than zero indicates a positive relationship. A value that is less than zero signifies a negative relationship. A value of zero indicates no relationship between the two variables.

Out-of-the-money: Options that cannot be exercised because the price of the underlying asset has not moved passed the strike price necessary for them to gain intrinsic value.

In-the-money: Options that, if exercised, would require the payment of less money than the value received and therefore would be currently exercised.

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This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information is not intended to be individual or personalized investment or tax advice and should not be used for trading purposes. Please consult a financial advisor or tax professional for more information regarding your investment and/or tax situation.

The Funds 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, in this case U.S. common equities, and writing a call option on that same asset with the goal of realizing additional income from the option premium. DJIA, QYLD, QYLG, XYLD, XYLG, and RYLD write covered call index options on the Down Jones Industrial Average, Nasdaq 100, S&P 500, and Russell 2000 Indexes, respectively. 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 they continue to bear the risk of a decline in the index. While the funds receive premiums from writing the call options, the price they realize from the exercise of an option could be substantially below the indices current market price. QRMI and XRMI engage in the purchase of puts, which, in return for the payment of premiums may provide them protection from a significant decline of the Nasdaq 100 index if the put options become in the money (Nasdaq 100 closes below the strike price as of the expiration date); but during periods where the Nasdaq 100 Index appreciates, the Fund will underperform due to the cost of the premiums paid. A liquid market may not exist for options held by the funds. The Funds are all non-diversified.

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