Introducing the Global X S&P 500 Quality Dividend Covered Call ETF (QDCC)

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On May 8, 2024, we listed the Global X S&P 500 Quality Dividend Covered Call ETF (QDCC) on the New York Stock Exchange. QDCC is designed to offer investors a potential source of current income and a differentiated exposure to the S&P 500 through allocations to the top 200 companies in the index based on various quality metrics including return-on-equity (ROE), accruals, and financial leverage. The fund is intended to offer portfolios positions that are expected to share a positive relationship with volatility, as well as broad exposure to quality dividend producing companies that exist in the S&P 500.

Covered call option strategies generally seek to provide two core functions to a portfolio. The first is to produce a source of current income, which is meant to be addressed through the sale of call options. The second is diversified exposure, be it to differing asset classes, market sectors, or underlying instruments. The Global X S&P 500 Quality Dividend Covered Call ETF (QDCC) is a fund designed to potentially check both these boxes, writing call options to generate premium returns while holding a reference asset that seeks to attain quality dividend distributions.

Key Takeaways

- The Global X S&P 500 Quality Dividend Covered Call ETF (QDCC) is a 100% covered call strategy that operates on a systematic basis, writing contracts each month in exchange for premium income.
- Supplementing quality dividends that may be distributed by the Global X S&P 500 Quality Dividend ETF (QDIV), option premiums represent an opportunity to boost the yield on this underlying position. Additionally, by maintaining QDIV as the reference asset for the options it writes, QDCC provides investors with exposure to a specific set of underlying equities and associated risk factors.
- A quality dividend strategy may be suited to perform well in a late-cycle environment. However, recent economic dynamics suggest that the market’s peak may be further out on the horizon.

QDCC Is a Covered Call Strategy for Income Investors Seeking Equity Exposure

The Global X S&P 500 Quality Dividend Covered Call ETF (QDCC) operates a systematic covered call option strategy wherein it purchases the Global X S&P 500 Quality Dividend ETF (QDIV) and writes at-the-money FLEX call options on the same vehicle equating to 100% of its notional holdings monthly. The use of FLEX options provides it the opportunity to customize key contract terms including strike price, exercise style, and expiration date. Consequently, the fund harnesses European-style options, which cannot be exercised prior to their expiration date, to write monthly at-the-money call options that expire on the third Friday of every month. The fund will proceed to distribute to shareholders the lower of half the premium received or 1% of the QDCC’s NAV.

COVERED CALL PROCESS EXPLAINED

Sources: Global X ETFs.

For Illustration Purposes Only

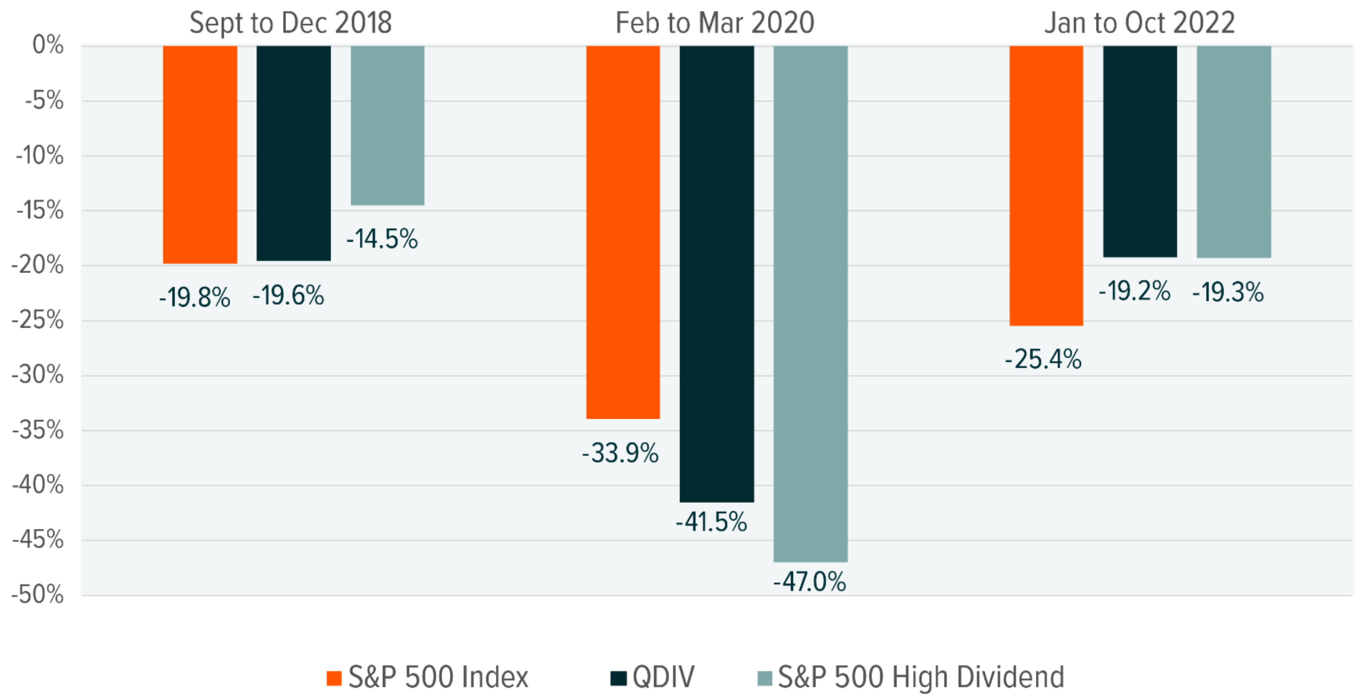
Option Premiums Can Enhance Yield Without Sacrificing Quality

One of the primary criticisms associated with investing in quality dividend strategies is that investors are unable to attract the yields that they might if their holdings entailed more dividend-growth oriented positions. Indeed, as of March 28, 2024, the S&P 500 Quality High Dividend Index (the “Quality Index”), which QDIV seeks to track, provided a current yield of 2.90%, while the S&P 500 High Dividend Index (the “High Yield Index”) had a yield of 4.64.[1] However, by introducing a covered call writing strategy to a portfolio like the former, featuring quality dividend equities, investors might be able to address this concern by harnessing option premia to drive up their yield and still maintain their underlying portfolio of blue-chip dividend payers. By implementing a covered call strategy, an investor is essentially capping the upside price appreciation potential that they might be able to realize by maintaining their underlying equity holdings at the strike price of the option. However, in exchange for doing so they may receive income in the form of an option premium. With a portion of this premium being redistributed to shareholders, the fund may provide a measure of supplemental yield on top of the quality dividends that it seeks to reap.

Based on the internal functions of the covered call strategy, which caps equity price appreciation potential, it might be easy to fixate on the yield potential it provides and fail to appreciate or misinterpret the other functions that exposure to the reference asset can offer. QDIV, for example, is a fund that maintains holdings in 200 quality companies of the S&P 500, as defined by metrics including return on equity, accruals, and financial leverage. The makeup has produced dividend income that investors may seek. Additionally, it has enabled the fund to witness less-material drawdowns relative to the S&P 500 and S&P 500 High Dividend Indexes during various market contractions.

RECENT DRAWDOWNS: S&P 500, HIGH DIVIDEND, AND QUALITY DIVIDEND

Sources: Global X ETFs with information derived from Morningstar Direct as of March 28, 2024. S&P 500 Index, Global X S&P 500 Quality Dividend ETF (QDIV), and S&P 500 High Dividend Index drawdowns of 10% or more, using data from July 13, 2018 (QDIV inception date) to March 28, 2024. Data retrieved April 24, 2024.
QDIV performance based on market price returns.

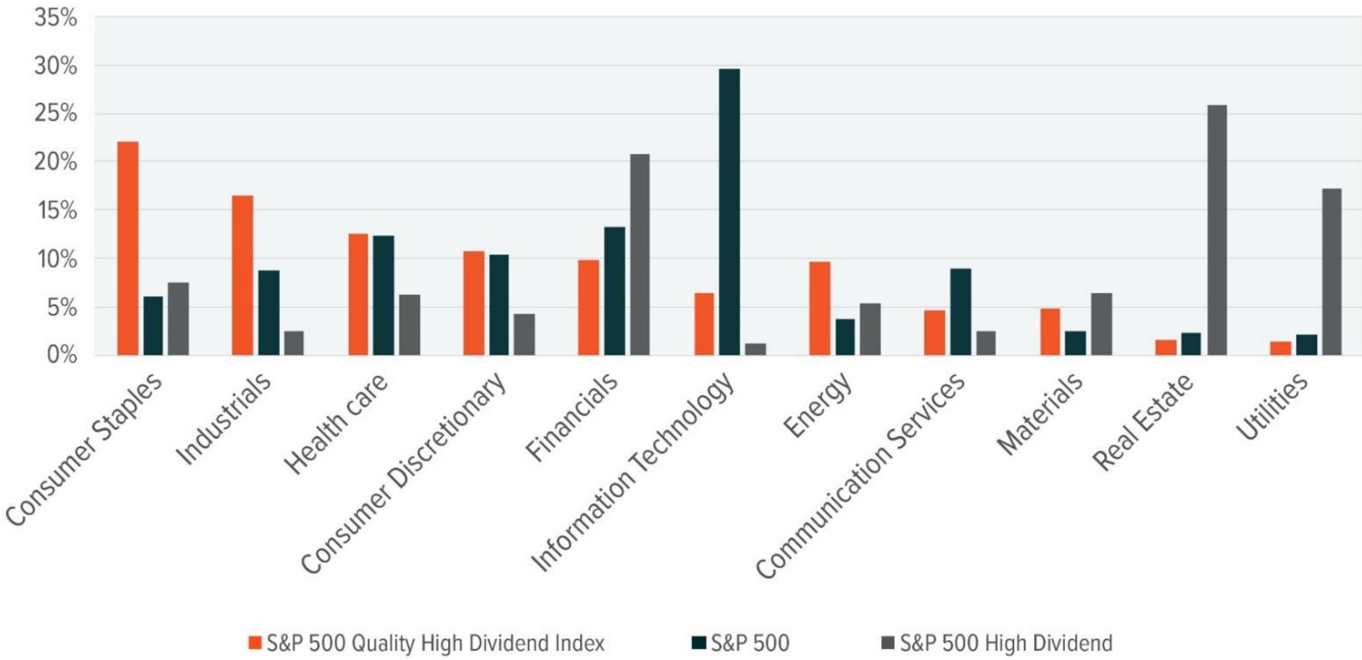


Performance shown is past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance current to the most recent month- or quarter-end, please visit QDIV.

The defensive posture taken using QDIV as an underlying investment, relative to the S&P 500, is supplemented further by the diverse sector exposures currently laid out through quality dividend investments. The Quality Index exhibits a sector breakout with tilts toward consumer staples and industrials, as opposed to real estate and utilities where income investors are more likely to gravitate, and where high yield indexes are likely to offer exposure, as well. Relative to the broader S&P 500, with equity tilts leaning toward the information technology and financial sectors, QDCC also has a differentiated exposure.

S&P 500 QUALITY HIGH DIVIDEND VS S&P 500 AND S&P 500 HIGH DIVIDEND SECTOR EXPOSURE

Sources: Global X ETFs with information derived from S&P Global. Data as of March 28, 2024. Data retrieved April 5, 2024.



Quality Dividend Companies May Experience Some Choppiness in the Near Term

The quality metrics that we've highlighted here (ROE, few accruals, soft financial leverage) are typically those attributable to large-cap companies that rarely make moves to slash or halt their dividend payouts. These are the same companies that generally maintain a long history of earnings growth, and their stocks typically do well when positive market momentum begins to subside and investors cycle out of growth-oriented positions.

In the recent market environment, investors might have been looking for this type of shift to have taken place, with momentum for the S&P 500 and Nasdaq 100 tapering, to an extent, as markets moved through the first quarter. As the period rounded out, however, momentum picked back up, signaling that the recent rally may still have legs. In conjunction with supportive economic data that's been released across the interim, highlighting a resilient jobs market and less-extraordinary rates of inflation, which illustrate the maintained health of the economy, this momentum may leave a late-cycle trading environment on the back burner, for now.[2,3]

As investors in quality dividend companies wait for this environment to transpire, uncertainty surrounding future rate decisions by the Federal Reserve and ambiguity pertaining to the timetable necessary for a "flight to quality" to take place may promote elevated volatility for the underlying constituents of QDIV. This factors in to a QDIV covered call strategy in that call option premiums generally share a positive correlation with volatility. When supplementing this potential premium income with the dividend distributions already provided by its underlying ETF, QDCC may be able to provide potential investors with a competitive current yield.

QUALITY DIVIDEND'S ABOVE-MARKET YIELD COULD BE BOOSTED BY COVERED CALL PREMIUMS

Sources: Global X ETFs with information derived from Bloomberg L.P. S&P 500, S&P 500 Quality High Dividend, and S&P 500 High Dividend Index trailing twelve-month dividend yields from April 1, 2021 to March 28, 2024. Data retrieved April 11, 2024.

Index data is for illustrative purposes only and does not represent actual Fund performance. Past performance does not guarantee future results.

Conclusion: QDCC is Designed to Supplement Quality Dividends with Premium Income

Covered call option strategies represent an interesting investment opportunity for income-driven accounts. However, when operated using an underlying reference asset such as QDIV, which already seeks to provide a competitive yield, an instrument may be created that can produce a level of income worthy of making it a primary contributor to a broader portfolio. Indeed, QDCC seeks to create this exposure, and when combining this income potential with a stock constituency of quality dividend producing companies, which may provide it a measure of loss mitigating characteristics during broad market declines, the end result is an instrument that might drive higher yield across a broader portfolio while staking an interest in quality dividend companies in the S&P 500.

Related ETFs

QDCC – Global X S&P 500 Quality Dividend Covered Call ETF

QDIV – Global X S&P 500 Quality Dividend 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 L.P. S&P 500 Quality High Dividend Index and S&P 500 High Dividend Index current yields gross dividends as of March 28, 2024. Data retrieved April 11, 2024
2. U.S. Bureau of Labor Statistics (2024, January 11). Consumer Price Index Summary
3. U.S. Bureau of Labor Statistics (2024, February 2). The Unemployment Situation – January 2024

Glossary

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

S&P 500 Quality High Dividend Index: An index designed to measure the performance of S&P 500 members that exhibit both quality and high dividend yield characteristics.

S&P 500 Growth Index: An index designed to measure the performance of S&P members defined as growth stocks using factors including sales growth, the ratio of earnings change to price, and momentum.

S&P 500 High Dividend Index: An index designed to serve as a benchmark for income seeking equity investors by tracking 80 high-yield companies within the S&P 500, equally weighted to best represent the performance of the group, regardless of constituent size.

Roll Date: In the operation of a systematic option strategy, is the date on which the fund will divest its existing option positions and purchase or write new options to maintain a near-perpetual level of option exposure.

At-the-Money: An option contract is considered to be "At the Money" when its strike price is equivalent to the current value of its underlying asset.

Current Yield: A measure of income return that is calculated by dividing the annual dividends received by the current market price of the security.

Strike Price: The price passed which an underlying reference asset must move in order for an option contract to become exercisable. For a call contract, it represents the price of the underlying asset that must be exceeded. For a put contract, it represents the price through which an underlying reference asset must fall.
