TD Global
Investment Solutions

Year in Review and Look Ahead
15 Minutes

2024, A Repeat Performance - Almost

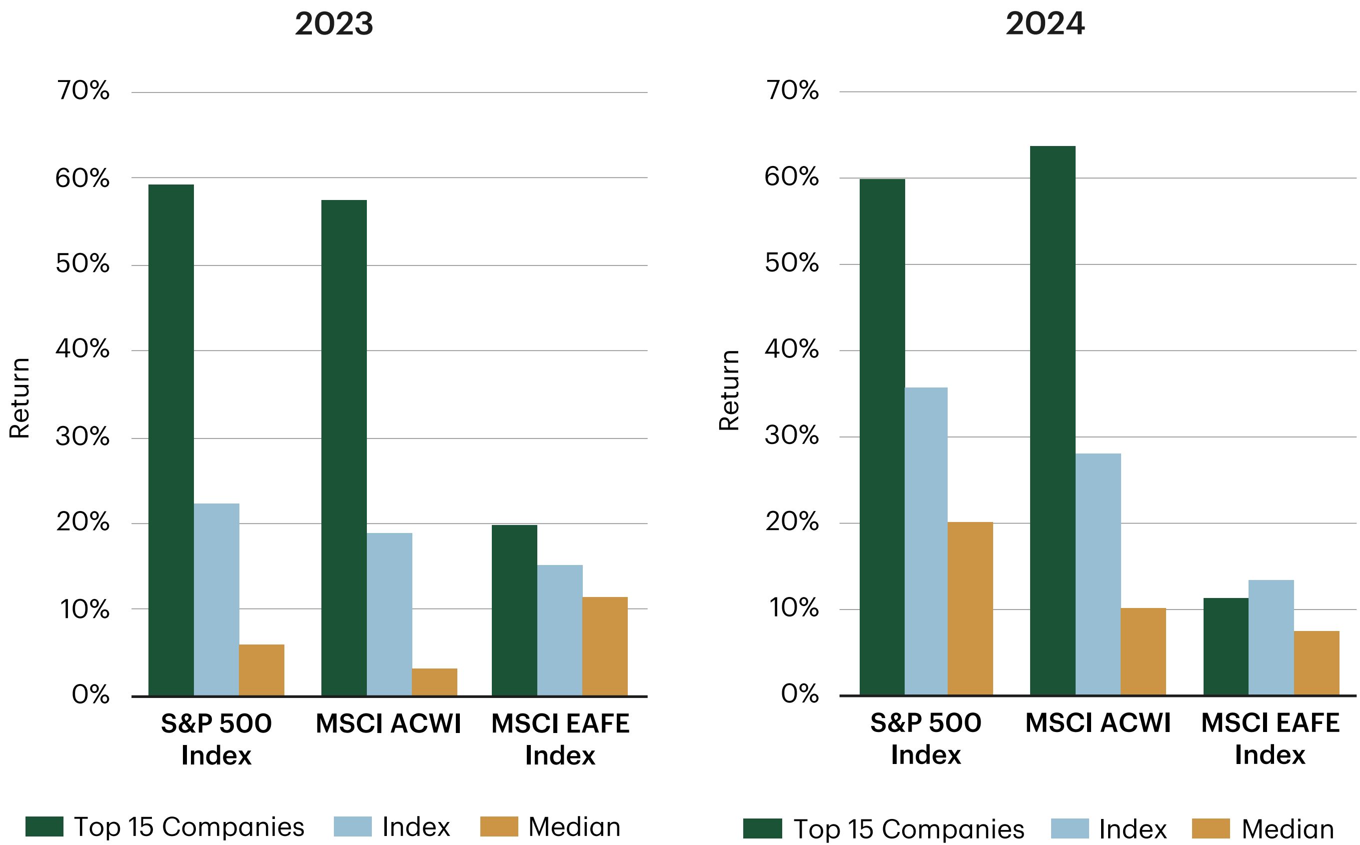
Tamara Owchar, CFA,
Vice-President & Director, TD Asset Management Inc.

Taking a broad view of global market performance in 2024, it's clear that markets continued to deliver strong results, closely resembling the dynamics of 2023. Equity markets saw robust gains, due in large part to the same narrative: the dominance of a select few mega-capitalization (cap) names. These market heavyweights once again provided double-digit returns, driving the cap-weighted indexes even higher and creating challenges for investors with strategies underexposed to these key players.

While the magnitude of the disparity between the top 15 largest companies globally and the broader market was not as stark as in 2023, the influence of these names on cap-weighted index performance remains. The broadening out of the market is a welcome development, but the outsized impact of the mega-caps on both benchmarks and active portfolios kept them firmly at center stage for 2024.

Despite the challenging market environment, Low Volatility strategies at TD Asset Management Inc. (TDAM) delivered solid returns on an absolute basis, and with less volatility than the cap-weighted indices. In addition to providing better risk adjusted returns in 2024, the Low Volatility strategies weathered the market correction in July, shielding investors from the market whipsaw and provided portfolio protection.

Figure 1: Cap-weighted index performance is still driven by a few large players



Source: FactSet Research Systems Inc. All data is in CAD as of Dec 31, 2024.

The Magnificent 7: Adversaries to low volatility

The Magnificent 7 – Meta, Alphabet, Nvidia, Tesla, Apple, Microsoft and Amazon – continued to dominate markets, presenting challenges for strategies like low volatility that use weighting schemes other than capitalization weighting. Similar to 2023, a substantial portion of the total return of MSCI ACWI Index in 2024 could be attributed to just 7 of the 2,650 constituents.

For low volatility investors, these seven stocks continue to be a source of frustration when comparing relative performance to cap-weighted benchmarks over recent history. The Magnificent 7, and in particular NVIDIA, Meta, Telsa and Amazon, fall amongst the more volatile securities within the investable universe. Because of this, low volatility strategies will tend to have little to no exposure to these names. When market performance is being driven by a broad spectrum of players, the impact on relative performance is not as extreme. However, the returns being generated from these dominant players, have created a persistent headwind for low-volatility strategies competing against cap-weighted benchmarks.

Figure 2: Consistent Dominance - Performance of the 10 largest companies in the MSCI ACWI Index

2023

Apple Inc.
Microsoft Corporation
Amazon.com, Inc.
NVIDIA Corporation
Alphabet Inc. Class A
Alphabet Inc. Class C
Tesla, Inc.
Meta Platforms Inc. Class A
UnitedHealth Group Incorporated
Exxon Mobil Corporation
MSCI ACWI Equal Weighted Index
MSCI ACWI

-40% 0% 40% 80% 120% 160% 200% 240%

Returns

2024

Apple Inc.
Microsoft Corporation
NVIDIA Corporation
Amazon.com, Inc.
Meta Platforms Inc Class A
Alphabet Inc. Class A
Alphabet Inc. Class C
Broadcom Inc.
Taiwan Semiconductor Manufacturing Co., Ltd.
Tesla, Inc.
MSCI ACWI Equal Weighted Index
MSCI ACWI

0% 40% 80% 120% 160% 200% 240%

Returns

Source: FactSet Research Systems Inc. All data is in CAD as of Dec 31, 2024.

NVIDIA: Protagonist or antagonist?

NVIDIA once again emerged as a pivotal player, contributing significantly to cap-weighted benchmark returns in both 2023 and 2024. Its outperformance relative to the S&P 500 Index, the Information Technology sector, and even its Magnificent 7 peers is striking.

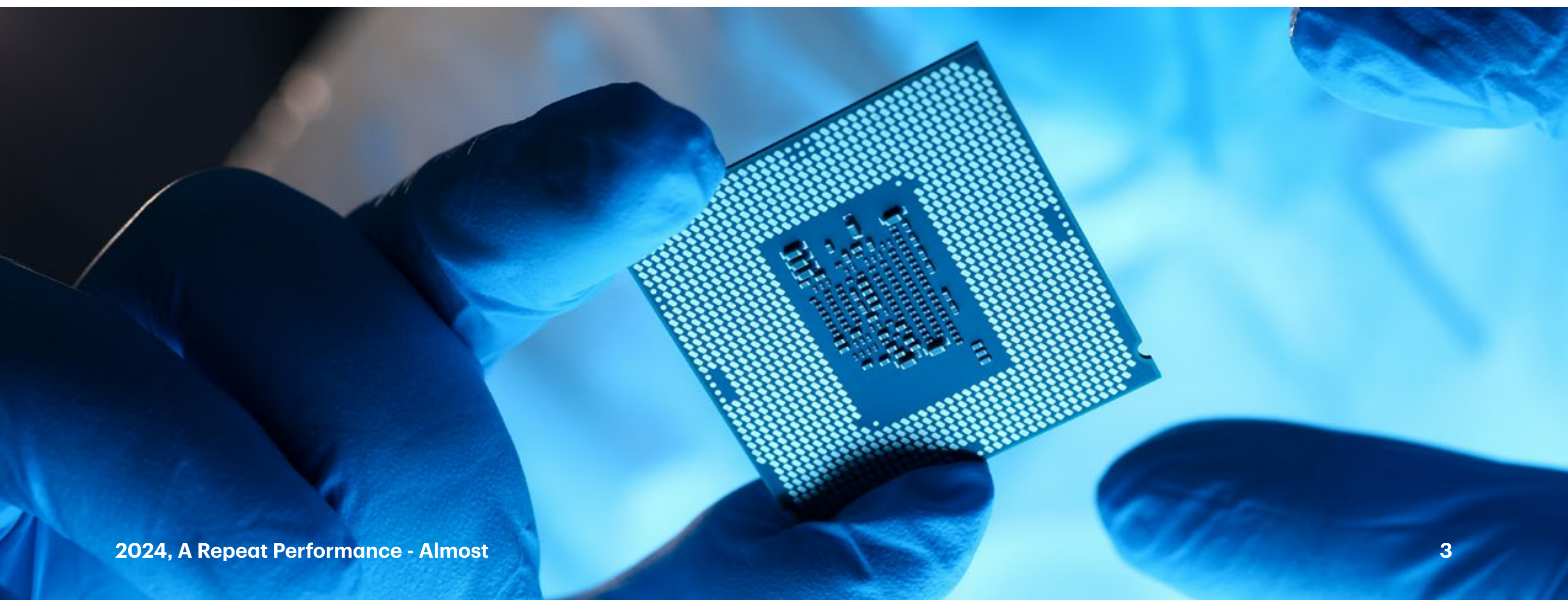
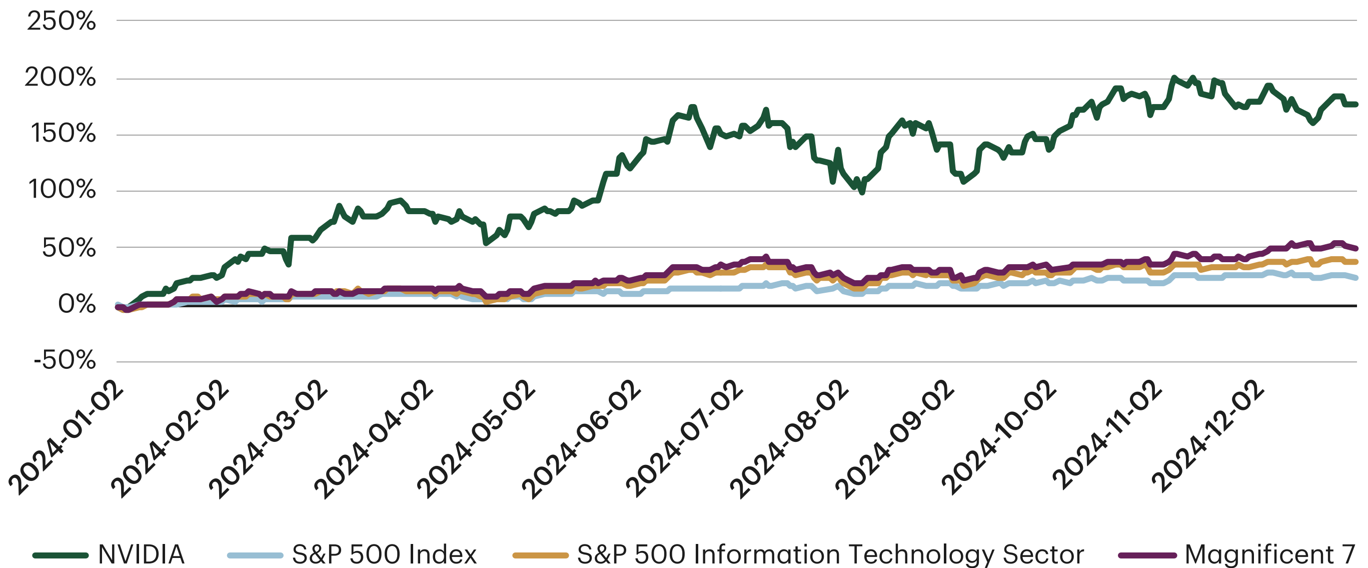


Figure 3: NVIDIA outpaces in 2024

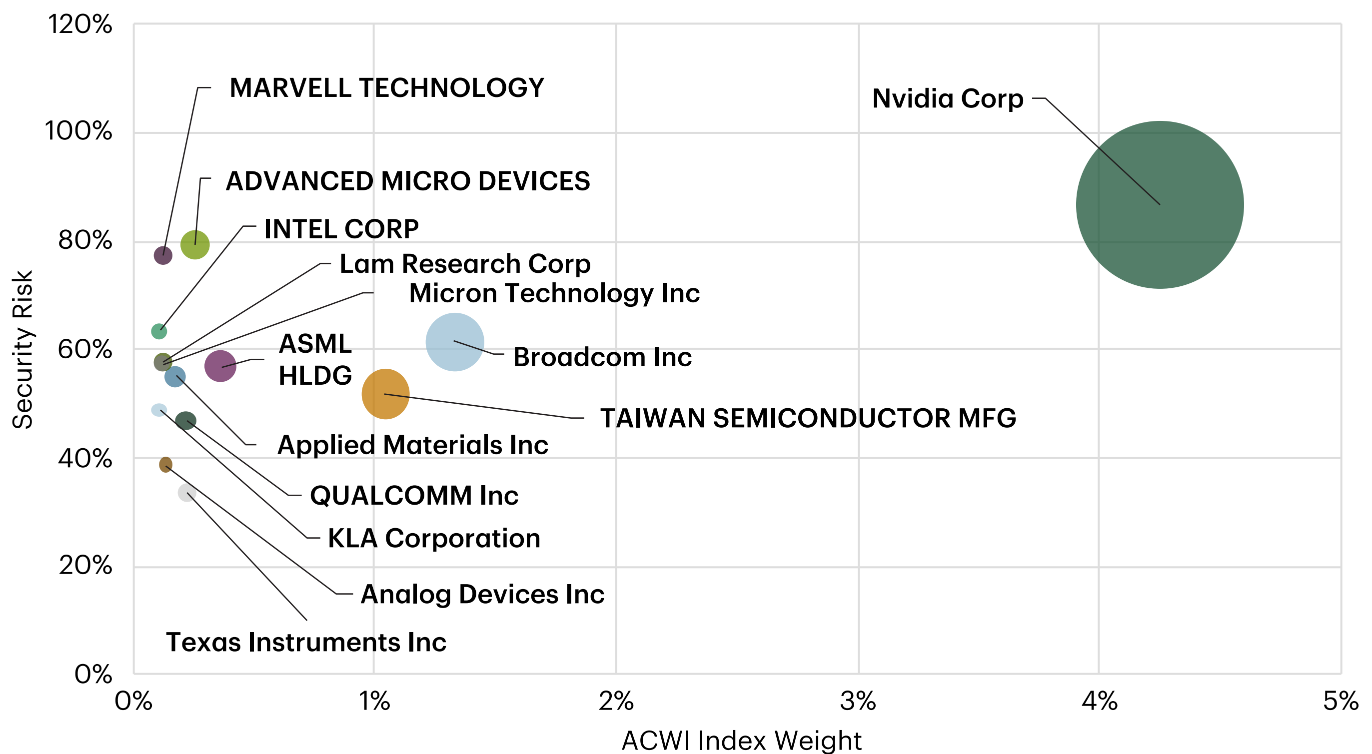


Source: Bloomberg Finance LP. All data is in CAD as of Dec 31, 2024.

For low volatility investors, NVIDIA represents more of an antagonist than a hero. When viewing the investible universe from a volatility perspective, NVIDIA is in the highest volatility group, and as a result, low volatility strategies will have little or no exposure to the stock.

Moving beyond the entire universe and focusing on the Semiconductors and Semiconductor Equipment Industries peer group, NVIDIA not only has the largest absolute risk, but its contribution to total risk of the MSCI ACWI Index dwarfs the rest of its peers standing at approximately 16% as of December 31, 2024. This concentration underscores its outsized influence: where NVIDIA goes, so goes the cap-weighted index.

Figure 4: The largest names in the semiconductor industry, their absolute risk, and their contribution to total risk of the MSCI ACWI Index



Source: TD Asset Management Inc., MSCI Inc. Data as of Dec 31, 2024.

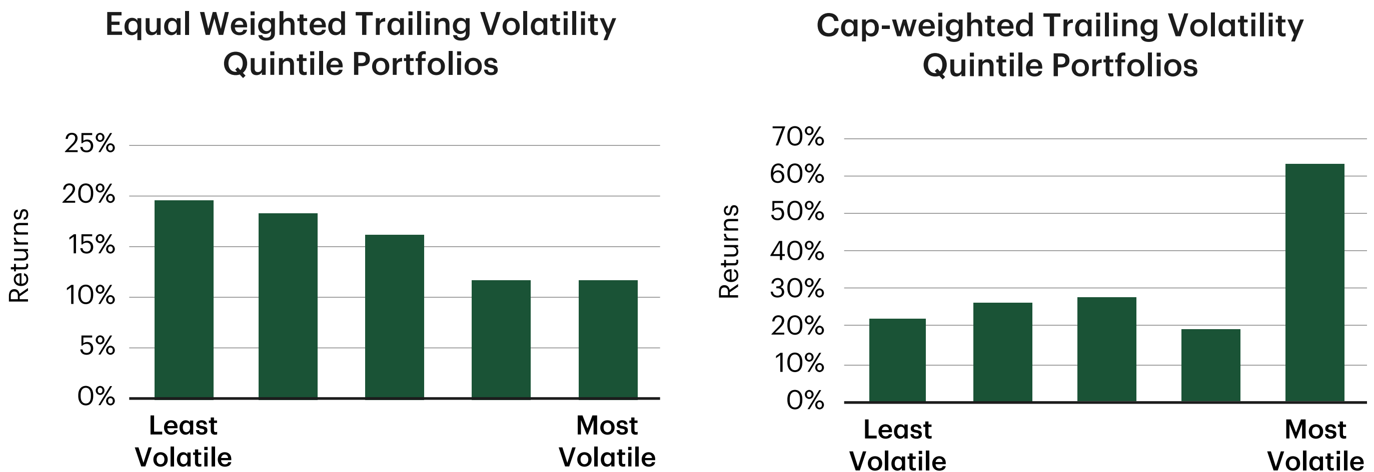
The question whether NVIDA can sustain its outperformance looms large. NVIDIA has many tailwinds that will continue to help buoy the stock including government interest for AI hardware, and data centre demand. But the journey is not without headwinds such as increased competition, regulatory and geopolitical factors as well as innovation uncertainty. The Technology sector is traditionally a more volatile sector. Fluctuations in stock prices can occur for any number of reasons, some of which may have nothing to do with the business fundamentals of NVIDIA. Regardless of what the future holds, NVIDIA's journey appears as though it will continue to be a volatile one.

Style performance: Low volatility style performance overshadowed by market concentration

In 2024, style factors fared better compared to 2023[1], with several delivering positive returns. The low volatility factor posted positive returns over the one-year period, and as expected, performed especially well during periods of market stress. The third quarter correction highlighted the importance of having low volatility funds within an investor's asset mix as these strategies provided critical downside protection.

When dividing the investable universe into low volatility quintiles and assessing the return of each quintile on an equal-weighted basis, over 2024, low-volatility stocks outperformed their high-volatility counterparts. However, if we weight the stocks in the groups by market-cap, the concentration effect reversed this dynamic, and high-volatility names dominated. The positive impact from exposure to the low volatility style may have been overshadowed by the impacts of market concentration on a relative basis. Nonetheless, the Low Volatility strategies posted strong absolute performance, capturing the expected market upside while providing capital preservation and minimizing participation on the downside.

Figure 5:
Low Volatility style performance in 2024 – ACWI Index returns by volatility quintile



Source: TD Asset Management Inc., MSCI Inc. All data is in CAD as of Dec 31, 2024.

Performance

[1] Source: Bloomberg LP. Data as of Dec.31, 2024.

Behind the scenes: Central banks begin to ease

With inflation reverting to more targeted levels as the year passed, central banks from around the globe began to ease. The Swiss National Bank led the way with rate cuts in March and June, followed by Sweden and Canada. The U.S Federal Reserve (Fed) eventually joined the fray, cutting rates by 50 basis points (bps) in September and another 25 bps in December, signaling further rate cuts on the horizon as the recent slowing of the labour market was believed to be a bigger risk to the economy than inflation.

With inflation appearing to be under control and central banks reducing rates, the soft-landing/no landing scenario has become more likely with global economies avoiding a recession. Our research has shown that the performance of the low volatility style is impacted more heavily by the general direction of the market with very little correlation between the performance of the style and the level or changes of inflation or interest rates[2]. Should central banks be successful in avoiding recession and the markets continue to post strong results led by the concentrated cast of more volatile characters, it is reasonable to expect low volatility strategies to continue participating on the upside but lag the cap-weighted benchmarks on an absolute basis. However, should the concentrated market begin to unwind, low volatility equities are expected to outperform.

[2] https://www.td.com/content/dam/tdgis/document/ca/en/pdf/newsroom/bpm-oct-2022-baghramyan.pdf

The third quarter casting change – Low Volatility strategies take the stage

The third quarter brought a dramatic turn in the market narrative reminding investors once again of the importance of an allocation to low volatility within their asset mix. Softer U.S employment numbers in July triggered a sharp correction with global cap-weighted indices falling more than 7% in less than three weeks. The stocks that had been driving the positive performance of the market became its “Achilles’ heel”. The concentration risk of seemingly well diversified passive market-cap weighted indices was on full display.

Low volatility strategies will generally lag in strong upward moving markets and lose less than cap-weighted indices in strong down markets providing better capital preservation in periods of market stress. During the market correction which occurred in the third quarter, the Low Volatility strategies at TDAM continued posting positive returns, avoiding the downturn completely. The main reason was not simply because of the strategies’ exposure to the low volatility style factor, but also because of the relative lack of exposure to the more volatile names that led the correction.

Act Q4: The rebound

The Fed began its path to lowering rates with a cut of 50 bps in September. That helped markets to quickly recover from the concentration correction in the third quarter. Global markets finished the quarter on a positive note which continued into the fourth quarter. Much like the first half of the year, the positive market performance was fueled by the Consumer Discretionary, Communications Services and Information Technology sectors, and prominently within those sectors the group of the Magnificent 7.

This risk-on highly concentrated market environment was once again a challenge for the Low Volatility funds as strategies utilizing this investment style were not able to keep pace. Adding to an already complex plot was Donald Trump’s success in the U.S presidential election. Early moves from the president-elect have included indications of the desire to increase tariffs and tighten immigration policies, which could introduce new inflationary pressures on the U.S economy challenging the Fed’s ability to continue monetary easing and risking a soft/no-landing scenario.

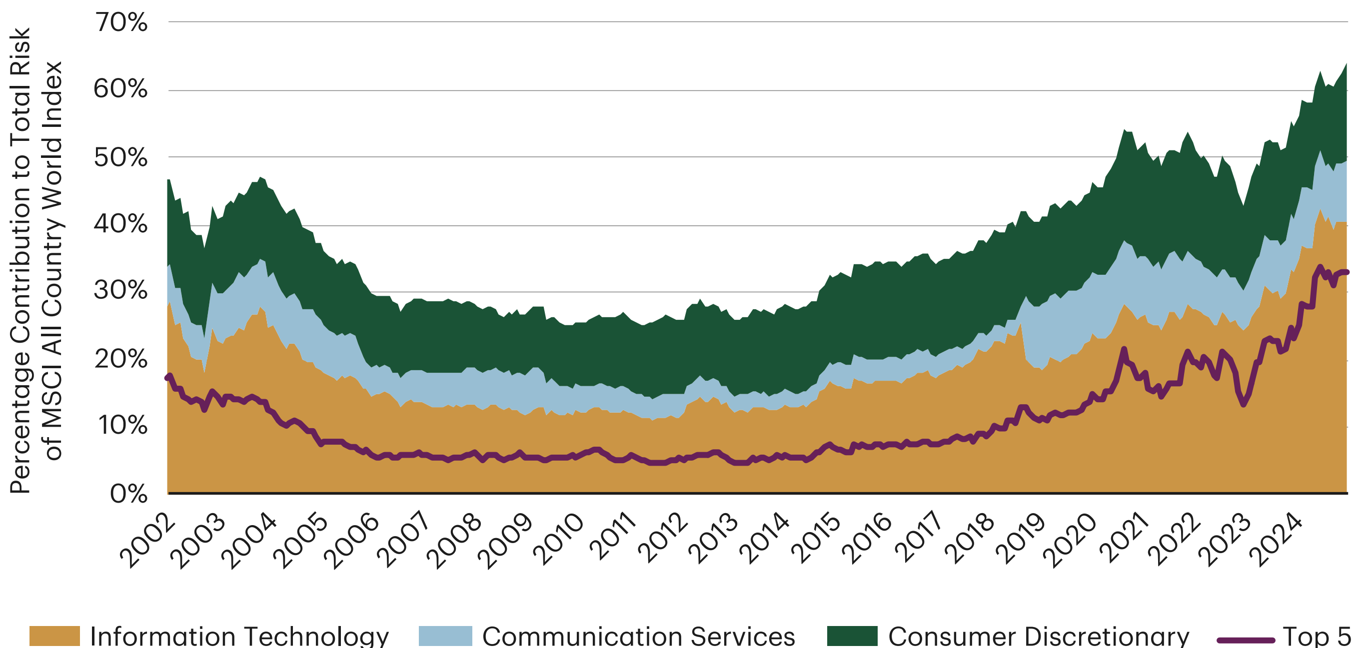
Low Volatility

Encore Performance? The Outlook for 2025

The exceptional performance of global equity markets is another one for the books. The MSCI ACWI Index surpassed the performance of 2023 boasting a return of over 28% to close out 2024. Despite the challenges of a highly concentrated market, Low Volatility strategies at TDAM had a solid year, delivering double digit returns with less volatility, resulting in strong risk adjusted returns over 2024. Should investors expect an encore performance for 2025?

As we enter the new year, risk remains elevated due to the unprecedented market concentration. Over 30% of the total risk of the MSCI ACWI Index can be attributed to 5 of the 2,650 constituents. This level of risk residing in a select few names is not something we have seen in recent history. Historically, periods of high market concentration tend to reverse as witnessed during the tech bubble of the late 1990s. Investors overly reliant on the current cast of highly volatile characters run the risk of a sharp correction.

Figure 6: Concentration Risk - MSCI All ACW Index Risk Contribution by Sector



Source: TD Asset Management Inc., MSCI Inc. Data as of Dec 31, 2024.

Given the heightened concentration and potential volatility, a long-term focus on risk adjusted returns through strategies like low volatility remains crucial. Over a full market cycle, low volatility strategies can deliver comparable long-term returns to cap-weighted indices with significantly reduced risk. This reduction in risk can provide investors downside protection in periods of market stress or serve as a means for risk redistribution allowing investors room in their risk budget to allocate to more aggressive, return seeking assets. ■

Long-term Returns

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