



The Enduring Paradox of Low Vol Investing



History doesn't repeat itself, but it often rhymes, as Mark Twain is reputed to have said. Over the last couple of years, the stock market has seen an AI surge, and although a different set of companies did well in each of those years, the sense of déjà vu for investors has been palpable. By their nature, low volatility strategies have not participated in the AI rally, steering clear of concentrated returns—and risks—in a handful of AI companies. However, these strategies have still been able to deliver compelling risk-adjusted results, and they remain well-positioned to protect portfolios from deconcentration and downside risks.

Market Concentration

Equity markets have continued to deliver strong results; the returns of the S&P 500 Index, the MSCI All Country World Index (MSCI ACWI) and the S&P/TSX Composite Index over the past three years have been significantly higher than their long-term averages. For example, the MSCI ACWI delivered 19.9% in 2023, 28.6% in 2024 and 17.2% in 2025, all of which are much higher than the index's 30-year average return

of about 8% per annum.¹ Like the past two years, it's been the dominance of a few large-capitalization companies, mostly those tied to the AI theme, which has driven cap-weighted indexes higher. In addition to the so-called Magnificent 7 stocks that continued to show strong returns in 2025, other companies tied to the AI trade, such as Broadcom, Palantir Technologies and Micron Technology, also had banner years.

¹ Source: Bloomberg Finance L.P. As of December 31, 2025.

Nine out of the ten companies that contributed most to the MSCI ACWI's returns last year are heavily connected to AI and tend to be more volatile than the overall index. Since low volatility strategies usually focus on traditionally stable sectors like Utilities, Consumer Staples and Healthcare, they missed out on much of the AI-fueled tech surge.

Although the broader market experienced above-average returns for another year, low volatility strategies at TD Asset Management Inc. (TDAM) also achieved double-digit absolute returns while maintaining lower volatility compared to their cap-weighted benchmarks.

Figure 1: Largest contributors to MSCI ACWI return

Company Name	Return	Contribution to MSCI ACWI Return	3-Year Beta	AI stock?
NVIDIA Corp	32.4%	1.54%	2.1	✓
Alphabet Inc., Class A	58.0%	0.75%	1.2	✓
Broadcom Inc.	43.2%	0.67%	2.0	✓
Alphabet Inc. Class C	57.5%	0.63%	1.2	✓
Microsoft Corp.	9.9%	0.58%	1.0	✓
Taiwan Semiconductor Manufacturing Corp.	45.2%	0.43%	1.4	✓
Palantir Technologies	124.0%	0.30%	2.3	✓
JPMorgan Chase & Co.	30.1%	0.29%	0.9	
Micron Technology, Inc.	224.0%	0.26%	2.0	✓
Samsung Electronics	122.9%	0.25%	1.2	✓

Source: FactSet Research Systems Inc. As of December 31, 2025. All data is in CAD.

The use of the MSCI ACWI Index is for information purposes only and is not necessarily correlated to any investment strategy.

2025 Performance: A Tale of Two Halves

At the start of 2025, low volatility strategies demonstrated notable resilience. Throughout the initial four months, global markets experienced significant disruption due to shifts in trade policies, culminating in U.S. President Donald Trump's Liberation Day tariff announcements, which marked the most substantial rise in trade barriers since the 1930s. During this challenging period, TDAM's low volatility strategies offered meaningful protection against market instability, delivering positive returns despite global benchmarks declining by mid-single digits.

However, as the year progressed, the narrative shifted. By the third and fourth quarters, the combination of Federal Reserve rate cuts, an easing of trade tensions and the AI trade led to a powerful market rally. As 2025 came to an end, the performance of low volatility strategies highlighted the enduring paradox of defensive investing: it is often most valuable when it is most overlooked.



Why Low Volatility?

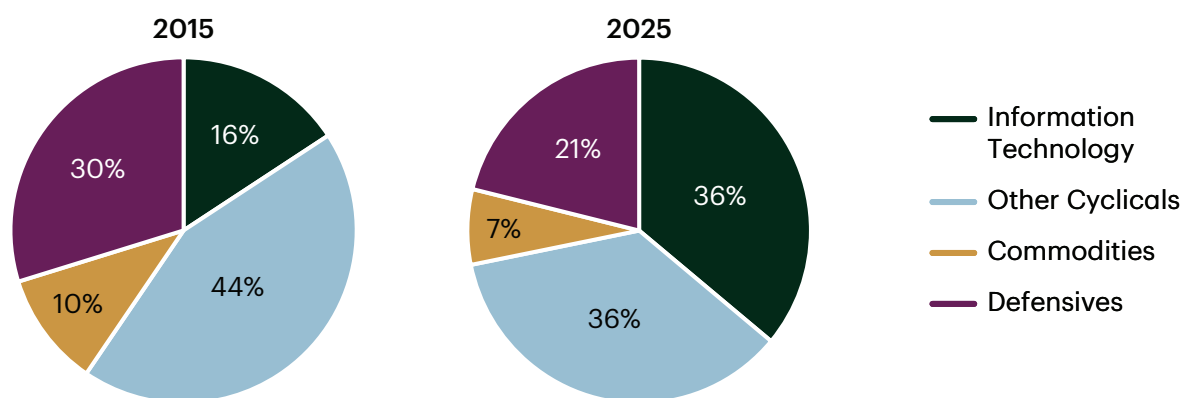
Although “risk-on” strategies dominated 2025, low volatility continues to offer compelling advantages for 2026. It has the potential to deliver improved risk-adjusted returns, shield portfolios from policy surprises and geopolitical events, and offer diversification away from Technology and AI sectors. Also, as their names suggest, these low volatility strategies have provided a smoother return experience in equity markets than traditional funds.

- **The TD Canadian Low Volatility Fund (F series)**, whose inception date is April 15, 2014, produced a one-year return of 23.81%, a three-year return of 13.41%, a five-year return of 11.37%, and a 10-year return of 9.00%.
- **The TD U.S. Low Volatility Fund (F series)**, whose inception date is September 10, 2013, produced a one-year return of 0.90%, a three-year return of 5.96%, a five-year return of 7.89%, and a 10-year return of 7.63%.
- **The TD Global Low Volatility Fund (F series)**, whose inception date is November 28, 2011, produced a one-year return of 8.62%, a three-year return of 10.70%, a five-year return of 8.99%, and a 10-year return of 6.40%.
- **The TD Q Canadian Low Volatility ETF**, whose inception date is May 26, 2020, produced a one-year return of 24.43%, a three-year return of 14.66%, a five-year return of 13.13%, and a since-inception return of 13.68%.
- **The TD Q U.S. Low Volatility ETF**, whose inception date is May 26, 2020, produced a one-year return of 3.35%, a three-year return of 7.23%, a five-year return of 9.23%, and a since-inception return of 9.20%.
- **The TD Q International Low Volatility ETF**, whose inception date is July 5, 2019, produced a one-year return of 19.05%, a three-year return of 14.18%, a five-year return of 10.04%, and a since-inception return of 7.06%.

All returns are as of December 31, 2025.

The Sharpe Ratios for three of these TDAM strategies (the TD Canadian Low Volatility Fund, the TD Q Canadian Low Volatility ETF and the TD Q International Low Volatility ETF) exceeded those of the cap-weighted indices. This is important because you can think of the Sharpe Ratio as a way to measure how much risk you take to get returns. While higher returns are good, if the investment swings violently up and down like a frightening bungee jump to get there, some investors might run for the exits.

Figure 2: MSCI ACWI exposures



Source: FactSet, TDAM. As of December 31, 2025.

“Information Technology” consists of companies in the Information Technology sector, plus Alphabet, Amazon, Ali Baba, Meta Platforms and Tencent. “Other Cyclical” consists of Consumer Discretionary, Financials and Industrials sectors. “Commodities” includes Energy and Materials sectors. “Defensives” is Communication Services, Consumer Staples, Healthcare, Real Estate and Utilities sectors.

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TD’s low volatility strategies look different than the equity markets investors typically track. While major markets are increasingly concentrated in volatile sectors like Information Technology and Consumer Discretionary, which increases their risk profile, TDAM’s low volatility strategies are diversified across sectors with the goal to have a lower overall risk

profile. In practice, this means that low volatility strategies will have higher weights in sectors with lower volatility and lower weights in more volatile sectors. Within TDAM’s low volatility funds and ETFs, this brought a volatility reduction of 13.3% to 56.1% in 2025, compared to their respective benchmarks (**Figure 3**).

Figure 3: Volatility Reduction in TD low volatility funds and ETFs

Fund / ETF	1-Year Volatility	Reduction in Volatility
TD Canadian Low Volatility Fund	5.88%	28.6%
S&P/TSX Composite Index	8.23%	
TD Q Canadian Low Volatility ETF	5.19%	35.4%
MSCI Canada Index	8.03%	
TD U.S. Low Volatility Fund	9.58%	27.6%
S&P1500 Index	13.24%	
TD Q U.S. Low Volatility ETF	11.77%	13.3%
MSCI US Index	13.27%	
TD Global Low Volatility Fund	4.79%	56.1%
MSCI World Index	10.90%	
TD Q International Low Volatility ETF	4.91%	27.7%
MSCI EAFE Index	6.79%	

Source: TD Asset Management. As of December 31, 2025.

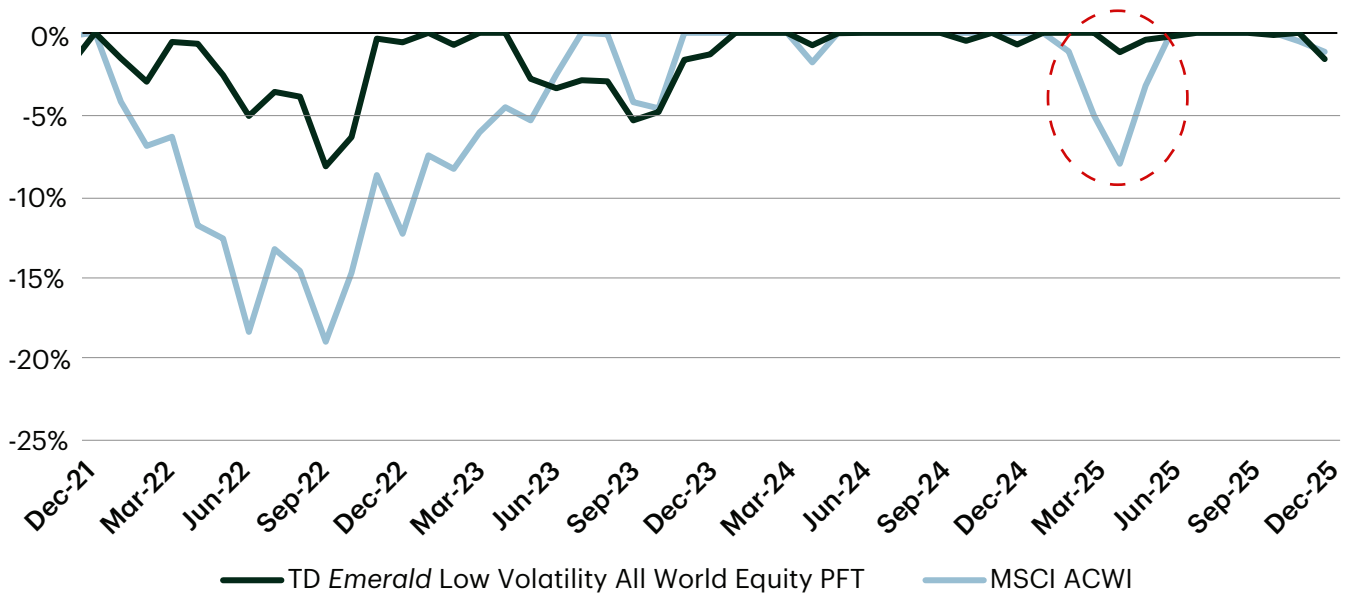
The growing concentration of riskiness into a few volatile sectors can lead to volatile returns since shocks which impact these sectors - whether economic, geopolitical or other - will have an outsized impact on returns.

AI and Low Volatility

AI companies initially included the pick-and-shovel businesses which are building the semiconductor chips, such as NVIDIA, Broadcom and Taiwan Semiconductor Manufacturing Corporation, as well as businesses which are expected to benefit from providing AI services, such as Microsoft, Alphabet, Amazon and Meta. However, over the course of the last couple of years, the AI trade has broadened to companies expected to benefit from the building of AI infrastructure, including those in the Materials, Utilities and Industrials sectors. While this has been positive for market returns, it does increase stock market risk. If the AI trade stops working, the impact on returns will reverberate beyond the traditional Information Technology firms.

Low volatility strategies can be thought of as an insurance policy against an overly aggressive market. Just as we pay a fee for auto insurance, the cost of a low volatility strategy is possible underperformance during rapid market rallies. However, the benefit of low volatility is a more stable absolute return stream and downside protection when stock market gains turn to losses. Over the long run, empirical evidence suggests that low volatility strategies give up less in hot markets than they earn back in downturns, resulting in highly competitive returns against the market, even more so when they are risk-adjusted. The question is, how long can hot markets persist?

Figure 4: TD Emerald Low Volatility All World Equity PFT downside protection



Source: TDAM. As of December 31, 2025.

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Past Performance: Any performance information referenced represents past performance and is not indicative of future returns. There is no guarantee that the investment objectives will be achieved.

Performance

Things to Watch

In 2026, the macro environment is transitioning from a focus on crisis management to an emphasis on structural adjustments to tariffs and an evolving international system. Key themes to watch for the rest of the year include fiscal stimulus versus tariffs, the new Federal Reserve leadership, elevated concentration risks, the state of the gold trade and geopolitical developments.

Fiscal Stimulus versus Tariffs

The One Big Beautiful Bill Act is projected to offer the U.S. a moderate economic boost in 2026. Yet, if the unemployment rate keeps rising, wage growth stays slow, the housing market remains sluggish, and manufacturing stays weak, the Federal Reserve might realize it may be behind the curve in plans to cut interest rates. These factors could pose risks to consumer spending and overall economic growth. These are conditions in which low volatility investments usually perform well.

New Fed Leadership

With a new Federal Reserve Chair expected in May 2026, market participants are preparing for a possible adjustment in policy orientation. Uncertainty associated with this leadership change could prompt a shift towards defensive investment strategies. Additionally, if the appointed chair aligns closely with the current administration's policies, there is potential for more accommodative monetary measures, even if inflation remains above target. If 2026 experiences both elevated inflation and slowing economic growth, sectors such as Consumer Staples and Healthcare, generally characterized by lower volatility, are expected to demonstrate resilient performance.

Elevated Concentration Risks

Concentration risk has been increasing in 2026. Currently, just five out of the more than 2,500 constituents of the MSCI ACWI account for over 35% of its total risk.² It has been unusual in recent times to see so much risk concentrated in so few stocks. Historically, high market concentration has reversed, as seen during the tech bubble of the late 1990s. Investors who focus too heavily on today's most volatile stocks face an increased likelihood of a significant decline in the value of their holdings in a market correction.

The Gold Trade

Gold had a banner year in 2025, with the yellow metal up nearly 65% in USD³, as central banks and, increasingly, retail investors acquired the asset. Central banks have been purchasing gold in an effort to diversify their holdings away from the U.S. dollar since the U.S. froze Russian assets in 2022 in response to Russia's invasion of Ukraine. This trend is expected to continue because emerging market central banks are still underweight gold reserves compared to developed market central banks. Retail flows into gold were also strong in 2025, with inflation fears, market concentration worries and geopolitical concerns driving interest in the metal despite steadily higher prices. Low vol strategies tend to be underweight gold companies as their stock prices are typically quite volatile. Continued rising gold prices are likely a headwind to low vol strategies, but if the luster comes out of the precious metal and gold stocks tumble, low vol strategies should provide more stable returns.

Geopolitical Concerns

Over the past five years, numerous geopolitical concerns have arisen, including Russia's invasion of Ukraine, ongoing conflicts in the Middle East, and growing tensions between the U.S. and China as well as between China and Taiwan. More recently, with President Trump's election, there appears to be a breakdown in the rules-based order established after 1945. Further geopolitical shocks could erode market confidence and have real-world economic impacts. In such cases, low volatility strategies have the potential to provide protection, as they typically invest in mature, stable companies whose products and services remain in demand even during economic slowdowns.

² Source : TDAM. Bloomberg Finance L.P. Data as of December 31, 2025.

³ Source: Bloomberg Finance L.P. As of December 31, 2025.

Conclusion

Given the high concentration and the corresponding increase in the percentage of market volatility coming from just a few sectors, maintaining a long-term focus on risk-adjusted returns with low volatility strategies is essential. Over a full market cycle, such strategies can offer equity-like returns with lower risk, providing downside protection during market stress and allowing investors to allocate more risk to higher-return assets. ■

Long-term Returns



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Sharpe Measure is a ratio of returns generated by the fund, over and above the risk-free rate of return and the total risk associated with it and can change monthly. A high and positive ratio shows superior performance and a low and negative ratio is an indication of unfavourable performance.

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