



# 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.<sup>1</sup> 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.

<sup>1</sup> 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	✓

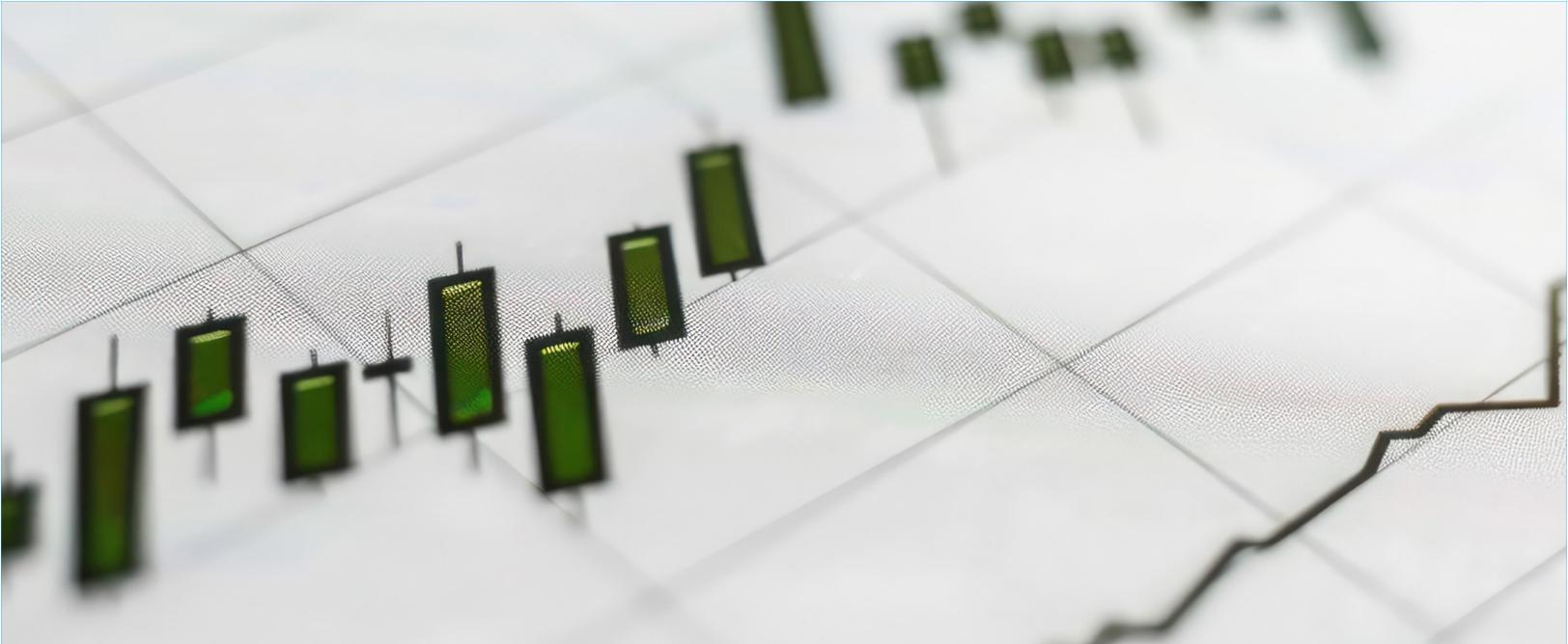
Source: FactSet Research Systems Inc. As of December 31, 2025. All data is in CAD.

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 offer diversification away from Technology and AI sectors.

At first glance, returns were below those of their respective cap-weighted benchmarks for the TD *Emerald* Low Volatility Canadian Equity Pooled Fund Trust, the TD *Emerald* Low Volatility All World Equity Pooled Fund Trust, the TD *Emerald* Low Volatility Global Equity Pooled Fund Trust, and the TD *Emerald* Low Volatility Global Equity Non-Taxable Investor Pooled Fund Trust. (The TD *Emerald* Low Volatility Canadian Equity Pooled Fund Trust, whose inception date is November 9, 2009, delivered a one-year return of 26.04%, a three-year return of 16.4%, a five-year return of 14.13%, and a 10-year return of 10.94%. The TD *Emerald* Low Volatility All World Equity Pooled Fund Trust, whose inception date is September 5, 2011, delivered a one-year return of 11.15%, a three-year return of 11.70%, a five-year return of 10.24%, and a 10-year return of 7.32%. The TD *Emerald* Low Volatility Global Equity Pooled Fund Trust, whose inception date is December 22, 2009, delivered a one-year return of 10.38%, a three-year return of 10.24%, a five-year return of 9.48%, and a 10-year return of 7.68%. The TD *Emerald* Low Volatility Global Equity Non-Taxable Investor Pooled Fund Trust, whose inception date is April 26, 2017, delivered a one-year return of 10.63%, a

three-year return of 10.80%, a five-year return of 10.00%, and a since-inception return of 7.48%. All performance data is as of December 31, 2025.)<sup>2</sup>

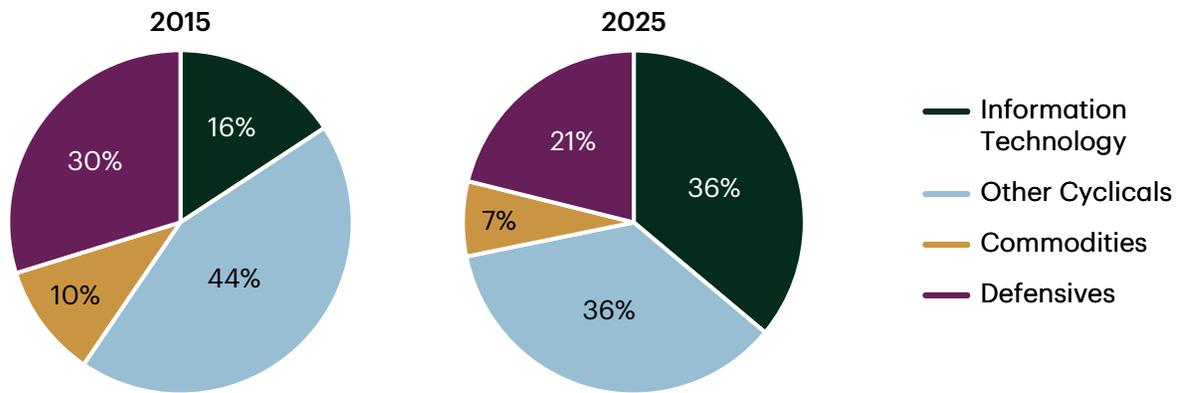
However, all of these strategies’ Sharpe Ratios exceeded those of the cap-weighted indices. For investors with defined risk parameters or concerns about market volatility and/or concentration, this enhanced risk-adjusted performance represented a favourable outcome.

The events of 2025 demonstrated that policy changes can occur with little warning. Low volatility could serve as an effective risk management tool, offering ongoing protection against the uncertainties associated with global trade dynamics and fiscal disputes. Although market participants became more accustomed to tariffs as the year advanced, the rest of 2026 may present new and unanticipated challenges in trade, economics or geopolitics. In this context, low volatility continues to deliver resilience against such potential disruptions.

Since global markets exhibit increasing correlation with technology stocks, low volatility strategies serve as effective diversifiers by offering exposure to industries such as Food and Food Products, which are less influenced by the AI trend. Notably, the composition of the MSCI ACWI has shifted significantly over the past decade, with the weighting of volatile Information Technology companies more than doubling.

<sup>2</sup> 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.

**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 Cyclicals” 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.

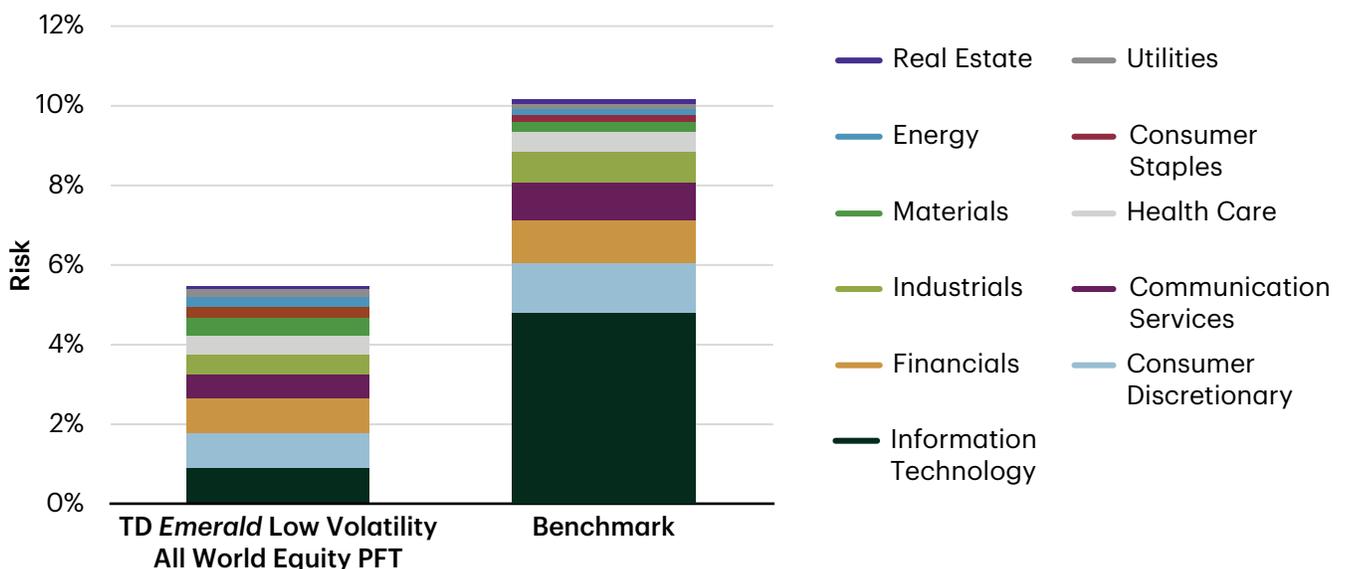
The use of MSCI ACWI is for information purposes only and is not necessarily correlated to any investment strategy.

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 have both a lower overall risk profile and a much more balanced exposure to risk, as shown in **Figure 3**.

Discretionary, Financials and Communication Services sectors also contributing a significant amount to the riskiness of the benchmark. Shocks which impact these sectors, whether economic, geopolitical or other, will have a large effect on portfolio returns. The risk profile for the TD *Emerald* Low Volatility All World Equity Pooled Fund Trust is more balanced. Not only is total risk much lower (about 54% lower), there is no outsized risk exposure to any one or a small group of sectors.

The left-hand bar shows that the Information Technology sector alone accounts for about 45% of the risk of the entire MSCI ACWI, with the Consumer

**Figure 3: Contribution to risk by sector**



Source: TDAM. As of December 31, 2025.

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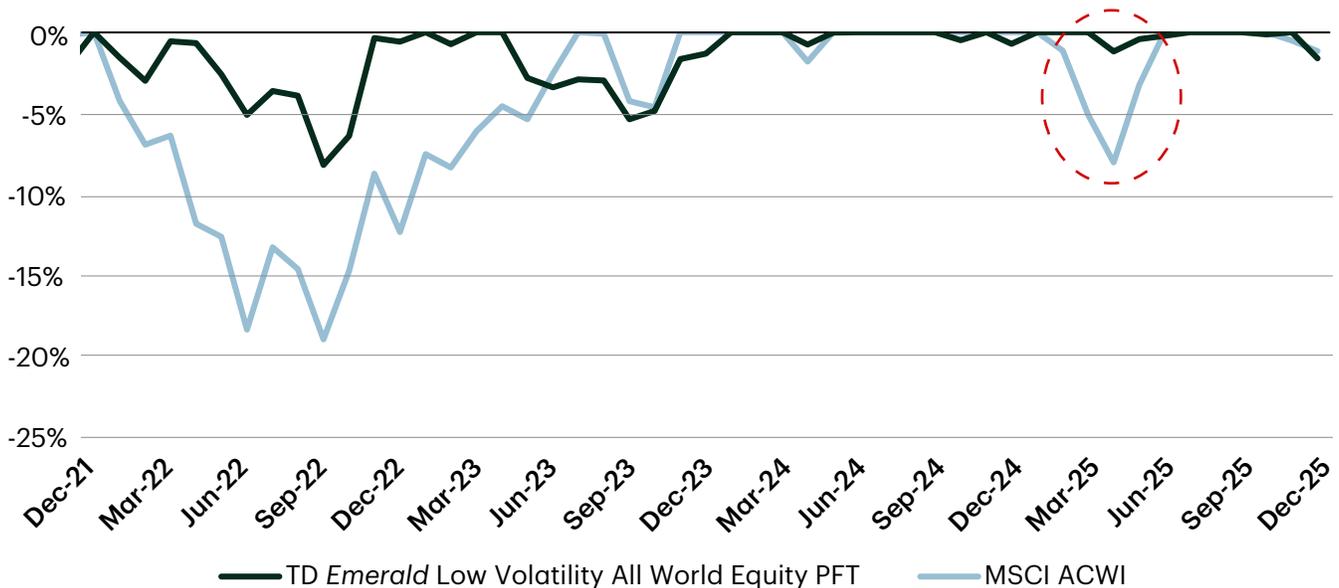
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# AI and Low Volatility

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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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.<sup>3</sup> 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 USD<sup>4</sup>, 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.

<sup>3</sup> Source : TDAM. Bloomberg Finance L.P. Data as of December 31, 2025.

<sup>4</sup> 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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