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Minimum Volatility:why it's outperformance in 2025

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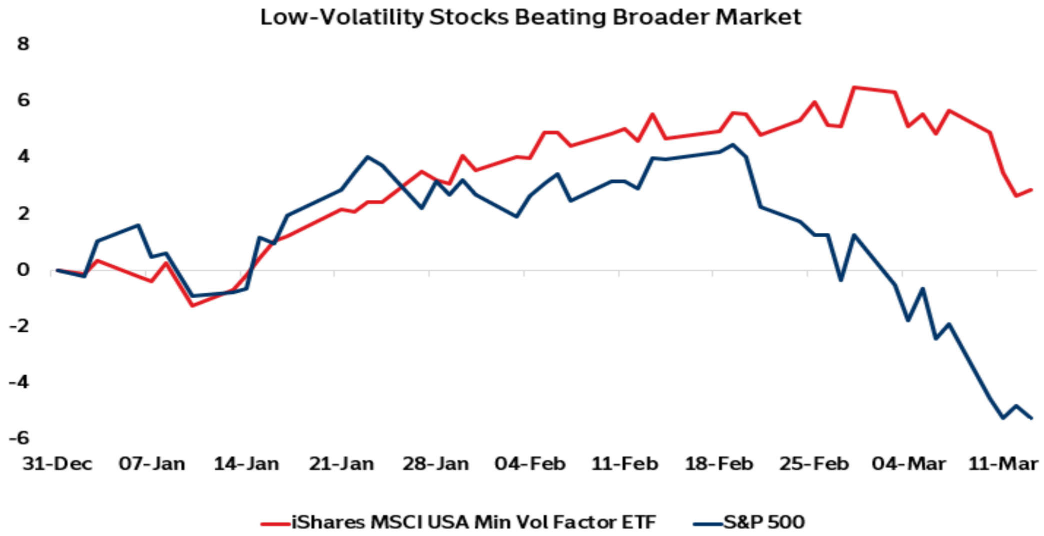
Chart of the Week



Source: Bloomberg Finance L.P., Momentum Global Investment Management, as at 13 March 2025.

What this chart shows

Minimum volatility (or "min vol") strategies aim to provide equity market exposure while reducing overall risk. They achieve this by emphasizing stocks that have historically exhibited lower price swings and lower correlations with each other. Unlike defensive sector funds, which concentrate on specific industries like utilities or healthcare, min vol strategies use quantitative portfolio optimization to construct a diversified mix of stocks with lower volatility characteristics.

So far in Q1 2025, minimum volatility strategies have outperformed the S&P 500. This has echoes of the unwinding of the Tech Boom in 2000. From Q1 2000, tech stocks retreated from lofty valuations investors sought solace in minimum volatility stocks. Over the next two years the market retreated 24% with minimum volatility stocks falling 5%, that's an annualised outperformance of over 10%. However, several macroeconomic and market-specific factors help explain this shift:

Rising Market Volatility: While equities have continued to grind higher, market volatility has increased due to concerns over persistent inflation, Federal Reserve policy uncertainty, and geopolitical risks. In such an environment, high-beta stocks tend to experience larger price swings, while min vol stocks—often characterised by more stable earnings and lower market sensitivity—hold up better.

Defensive Rotation & Sector Trends: Investors have started to rotate away from high-growth, high-valuation stocks (such as tech) toward more stable, defensive companies. With the market pricing in the increasing risk of recession in the US, sectors like consumer staples, utilities, and healthcare, which tend to be more heavily represented in min vol strategies, have benefited from this shift.

Interest Rate & Liquidity Concerns:The potential for higher-for-longer rates increase pressure on speculative, high-growth stocks while favouring companies with stronger balance sheets, predictable cash flows, and lower leverage—a profile that aligns with many min vol holdings.

Risk-Adjusted Return Focus: With markets still near all-time highs, investors are more conscious of downside risks and are shifting toward strategies that offer a smoother ride without sacrificing too much upside potential. Historically, min vol strategies tend to outperform in volatile or uncertain periods, as they provide equity exposure while reducing drawdowns.

Why this is important

The outperformance of minimum volatility in Q1 2025 reflects a market environment where investors are becoming more cautious, favouring stability over speculative momentum. While min vol strategies are not designed to lead in strong bull markets, their ability to weather market turbulence and provide smoother returns is proving attractive in an environment of rising volatility and shifting macroeconomic expectations. If uncertainty persists, this trend could continue throughout the year.

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Important notes