MACKENZIE Investments

Low volatility equity: the strategic case for a core allocation

Executive summary

We believe low-volatility equity is most effective when underwritten as a core strategic allocation rather than as a tactical response to market stress. The objective is to retain meaningful participation in the equity risk premium while reducing the depth and duration of losses that can destabilize funded status, spending programs, liquidity plans and risk budgets.

The long-run evidence is compelling but should not be oversimplified. The low-volatility anomaly describes the finding that higher stock-level risk has not been reliably rewarded by higher return. Lower-risk stocks have often produced market-like returns with lower volatility and smaller drawdowns. Yet the effect is episodic: defensive portfolios may lag materially when capitalization-weighted benchmarks are led by a concentrated group of higher-beta companies.

Implementation determines whether the intended outcome survives portfolio construction. Risk definitions, exposure constraints, expected-return inputs, turnover, transaction costs and capacity all influence the realized result. This paper reviews the anomaly, its institutional relevance, recent benchmark-relative headwinds and the construction principles required for a durable low-volatility allocation.

The low-volatility anomaly

The low-volatility anomaly is the long-run empirical finding that higher equity risk has not been reliably rewarded by higher return. In the simplest capital asset pricing model, expected return rises in proportion to market risk. The historical relationship has been less orderly: across many samples, the return line has been substantially flatter, and the most volatile stocks have frequently delivered the weakest return per unit of risk.

Lower-risk equities have therefore produced outcomes that are stronger than conventional risk–return intuition would predict, often combining market-like absolute returns with lower volatility, smaller drawdowns and higher risk-adjusted returns. The central proposition is not that low-volatility stocks always outperform. It is that investors have not consistently been compensated for assuming the highest stock-level risk.

Evidence across markets and sectors

The effect has been documented over long periods, across major developed and emerging equity regions, and within sectors. That breadth matters. It reduces the likelihood that the result is simply a persistent allocation to traditionally defensive industries such as utilities or consumer staples. It also supports a diversified implementation that seeks lower-risk securities within a broad opportunity set rather than relying on a narrow sector profile.

Why the effect may persist

Several structural and behavioural forces can sustain the anomaly. Leverage constraints may lead investors to seek higher-beta securities when they cannot scale lower-risk portfolios to meet return objectives. Benchmark-relative incentives can also discourage large allocations to low-beta stocks because relative risk may rise even when total portfolio risk falls.

Behavioural demand can reinforce these constraints. Investors may overpay for securities offering a small probability of an outsized gain, extrapolate the success of prominent growth companies, or express optimistic views more readily than pessimistic ones. Trading costs, shorting frictions and uncertain timing make these mispricings difficult to arbitrage completely.

Compounding and the path of capital

The compounding benefit is distinct from the anomaly itself. When average returns are similar, a smoother path generally produces a higher geometric return because losses reduce the capital base on which future gains compound. A portfolio that rises 10% and then falls 10% finishes 1% below its starting value. For institutions, the practical consequence is broader: deeper losses raise the recovery hurdle and can narrow contribution, spending and rebalancing flexibility precisely when liquidity is most valuable.

Downside asymmetry and recent market leadership

Low volatility equity is designed to participate less fully in market declines than in advances. This asymmetry can matter more than a modest difference in average return because drawdown depth determines the gain required to recover. Historical index evidence shows that lower-volatility equity experienced materially smaller losses and shorter recovery periods in two major global dislocations.

FIGURE 1 – Spectrum of quantitative investment strategies

Market episode	World equity drawdown	World low volatility drawdown	World equity days to recover	World low volatility days to recover
Dot-com bubble	-47%	-21%	731	248
Global financial crisis	-57%	-42%	1,026	466

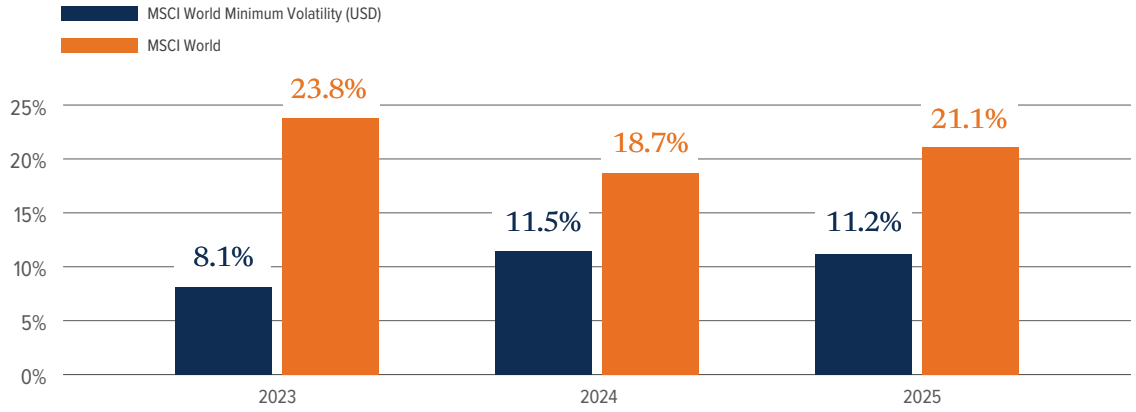
Source: Morningstar and Mackenzie Investments, Low volatility: Helping investors stay invested. World equity: MSCI ACWI GR USD; world low volatility: MSCI ACWI Minimum Volatility GR USD. Recovery is measured from trough to prior peak.

A difficult benchmark-relative regime

From 2023 through 2025, developed-market benchmarks benefited from strong performance among their largest growth-oriented constituents. A defensive portfolio that was not capitalization weighted faced two related headwinds: lower market sensitivity during a rising market and persistent underweights to the securities contributing most to index returns.

The MSCI World Minimum Volatility (USD) Index generated positive gross returns in each year, but the broad MSCI World Index advanced significantly more. The episode illustrates the anomaly's episodic nature and the importance of separating a difficult relative regime from a breakdown in the long-run risk–return relationship.

FIGURE 2 – Developed-market minimum volatility versus the broad market



Source: MSCI World Minimum Volatility (USD) Index and MSCI World Index factsheets; gross USD calendar-year returns through Dec. 31, 2025. Index returns do not reflect fees or expenses and cannot be invested in directly.

Implementation determines outcomes

Low volatility is a risk objective, not a standardized formula. A historical-volatility screen, a constrained minimum-variance portfolio and a return-aware active framework can carry the same label while producing different concentrations, macro sensitivities, turnover and realized outcomes.

A durable framework should combine multiple risk measures, explicit limits on sector, country, style, interest-rate, issuer and liquidity exposures, and expected-return information that preserves participation where the risk budget permits. Transaction-cost forecasts, turnover controls, participation limits and capacity assumptions should be embedded directly in construction rather than applied after the fact.

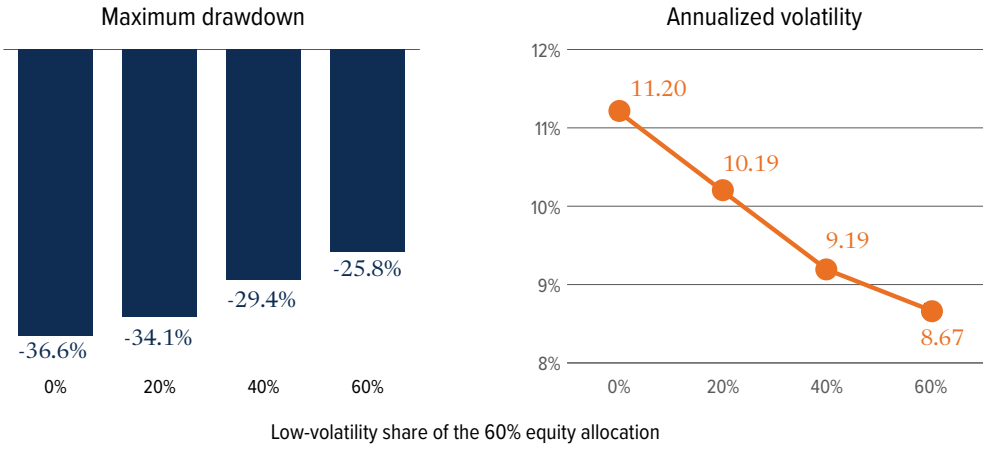
FIGURE 3 – An integrated low-volatility process

Investable universe	Alpha research	Portfolio construction	Implementation
Filter broad regional universes for liquidity and investability.	Rank securities within relevant regional and sector peer groups using proprietary return forecasts.	Integrate expected returns, proprietary risk models, benchmark-relative limits and position constraints.	Rebalance with transaction-cost forecasts, participation limits, capacity discipline and investment-team review.

Allocation and evaluation framework

The portfolio role should determine the evaluation framework. When low volatility serves as core defensive equity, the central measures are realized volatility, beta, downside capture, maximum drawdown, recovery and sufficient participation over a full market cycle. Illustrative index analysis shows that replacing part of a traditional equity allocation with low-volatility equity reduced maximum drawdown and realized volatility while preserving broadly comparable long-run returns. The exercise demonstrates how the risk profile can change as the low-volatility share rises; it is not a recommended allocation.

FIGURE 4 – Hypothetical example: increasing low-volatility exposure reduced drawdown and volatility



Source: Morningstar and Mackenzie Investments, Low volatility: Helping investors stay invested. May 29, 1993 to Dec. 31, 2024. Fixed income remains 40% in each illustration. Index-based and hypothetical CAD currency; no fees or transaction costs. Past performance is not indicative of future results. Fees and transaction costs would affect drawdown and volatility information shown.

A core defensive allocation should be assessed on whether it reduces the severity of equity losses without sacrificing the participation needed to support long-term return objectives. A policy-aware allocation should also be assessed on funded-status sensitivity, spending coverage, rebalancing capacity and policy adherence through stress. Sector, country, style, rate and issuer exposures; turnover; trading costs; and capacity discipline should be monitored alongside performance.

Mackenzie GQE low-volatility equity capability

Within Mackenzie GQE, we apply a common research and portfolio-construction architecture across World, US, Canadian and Emerging Markets low-volatility strategies. We combine bottom-up alpha research with explicit risk constraints and implementation economics to preserve the intended lower-risk equity profile while seeking to add value relative to the corresponding minimum-volatility benchmark.

We rank securities within relevant regional and sector peer groups using more than 20 proprietary signals grouped into value, growth, quality and informed investor. Our customized optimizer integrates expected returns, proprietary risk models, benchmark-relative limits and transaction-cost forecasts. Daily monitoring, disciplined capacity management and investment-team review support consistent implementation.

FIGURE 5 – Regional low-volatility strategies

Strategy	Benchmark	Excess-return objective	Expected tracking error	Target holdings
World	MSCI World Minimum Volatility	1.0%–1.5%	Approx. 2%	Approx. 200
US	MSCI US Minimum Volatility	0.5%–1.0%	Approx. 2%	Approx. 200
Canadian	MSCI Canada Minimum Volatility	Approx. 1.0%	Approx. 3%	Approx. 100
Emerging Markets	MSCI EM Minimum Volatility	Approx. 1.5%	Approx. 4%	Approx. 150

Source: Mackenzie Investments strategy materials. Objectives and expected characteristics are indicative and not guarantees, are presented for illustrative purposes only, and are subject to change and may differ for an actual client account.

Conclusion: resilience through a full market cycle

We believe low-volatility equity can improve the resilience of equity risk without requiring institutions to abandon long-term growth exposure. Its return path can diverge materially from a capitalization-weighted benchmark for extended periods, and that divergence must be underwritten in advance. The decisive test is whether the strategy delivers lower-risk equity participation that remains diversified, implementable and durable through a full market cycle.

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