YieldMax ETFs: What They Are And Are They Safe

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The rapid increase in interest in the stock market since the start of the pandemic has some important by-products. One of those is the rocketing appeal in using options as part of an overall investing strategy. Options are not new, nor are exchange-traded funds (ETFs), which have been around for more than 30 years. However, the combination of the ETF product structure, with options driving the performance from within, is entering a golden era of sorts.

What Are YieldMax ETFs?

Enter YieldMax ETFs, a recently-launched product line, launched through a collaboration between Tidal Investments (the advisor) and ZEGA Financial (the sub-advisor). The product line now includes more than 30 funds, just two years after the initial launch of a Tesla-based ETF (YieldMax TSLA Option Income Strategy (TSLY)) on November 22, 2022. At the core of these funds is the idea of taking the price volatility of an underlying stock or set of stocks, and using a strategy known as "credit call spreads" to convert that volatility into a high level of income, modest participation in price upside, and some degree of downside protection.

How YieldMax ETFs Work

YieldMax ETFs are typically a combination of three investments. First is a backing of the options strategy using U.S. Treasury Bills, which frequently make up more than 80% of the value of the ETF each month, when expiring options are replaced with newer options contracts. The other two investments are a pair of options. Instead of buying the stock outright, as some of its peers do, YieldMax buys call options to act as a surrogate for owning the stock. These are "out of the money" call options, which means that the fund can benefit from some of the future price appreciation, if any, in the target stock. The other option is the sale of a call option, which has a strike price between 0% and 15% of the current stock price. That means that the upside in the stock is limited, but in exchange for giving up that potential return, the shareholder receives a handsome income payout each month. Depending on the ETF and market conditions, Yield Max ETFs will also use other option strategies, such as selling put options. These obligate the holder of the option to buy the underlying stock at a future price that is typically below the price of the stock when the put option is sold. In other words, the investor is receiving cash now in exchange for the risk of being forced to buy the stock later.

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Key Components Of Yield

Max ETFs Underlying Assets

As noted above, the underlying assets are call options (bought and sold) and T-bills. The stock itself is not owned, and does not have to be for the strategy to work. The calls obligate the holder to produce the shares if "called" upon. And the sale of the other call position brings in the income.

Income Distribution

Income is generated from the sale of the call options, since the investor is sacrificing upside to be paid now. That income and any other cash flow resulting from the T-bills or other assets is delivered to shareholders in a monthly dividend.

Expense Ratio

Expense ratios for these ETFs are typically 0.99% of assets, which gets them just under the 1.00% rate that industry participants often screen for in considering candidates to be sufficiently cost-efficient. But frankly, YieldMax ETFs are a different breed altogether, given their tremendous income-producing potential. The product line also includes several applications of the strategy to more than a single stock, and those have expense ratios slightly above 1.00%.

Benefits Of YieldMax ETFs

This fairly new line of ETFs has attracted lots of attention during its first two years of existence. That is due to a combination of the popularity of the Magnificent 7 stocks like Nvidia, Microsoft, Tesla and Meta, and the increased demand for income from an ever-growing number of Baby Boomers, who are retiring or shifting from growth toward income in their investment objectives.

1. High Yield

These ETFs typically yield above their peers, since they aim to spin off option income from single stocks, which are more volatile than indexes (baskets of stocks).

2. Portfolio Diversification

There are some YieldMax funds that allocate among stocks, but the most popular so far have been the ones aimed at a single stock. While those stocks can present big risk from lack of diversification, the use of T-bills and options acts as a potential risk modifier.

3. Ease of Access

The ETF package is a nice match for the combination of call options known as a call spread. While the elements of these portfolios can be created and managed by investors on their own, there are variables each month based on how volatile the stocks involved and the market happen to be.

4. Monthly Or Quarterly Income

Monthly income from these ETFs is more in sync with the pace at which investors prefer to receive portfolio cash flow if they are using that money to live on.

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Potential Risks Involved with YieldMax ETFs

Market Volatility

Let's be crystal clear on this. This is still stock market investing. So of course there is risk and volatility in the price of these securities.

Credit Risk

T-bills are considered to be very safe investments, and options are heavily-regulated and in the case of the contracts used by YieldMax, quite liquid. That said, if the fund company's success reaches the point where they need to resort to private placement options contracts, as has been the case with other ETF producers, that could introduce credit risk.

Interest Rate Risk

Interest rates impact everything, as does market volatility. The key impact here is the extent to which rates hurt the prices of the underlying stocks, as well as the income available from that large T-bill allocation. Interest rates also may have an impact on the premiums available to bring in as income via the call option sales that drive these products.

YieldMax ETFs Vs. Traditional ETFs

YieldMax is not a new concept, but it does take the option-driven approach to another level. By applying call spread investing and trading to single stocks, investors who are income-oriented but would like to get a piece of the potential return from lower yield and no yield stocks, can look at YieldMax ETFs as a potential investment.

YieldMax ETFs Vs. Traditional Dividend Stocks

Dividend investing is changing rapidly. Stocks do not yield as much as they used to, thanks in part to rising stock prices and also because company management increasingly back stock instead of using their excess cash flow for dividends. And, short-term bond rates are much higher than a few years ago. That makes YieldMax ETFs an intriguing investment for those who want to complement their traditional approach to income investing.

Popular YieldMax ETFs In The Market

It should come as no surprise that the most popular YieldMax ETFs in terms of assets are those that target single stocks that are very popular. Those include NVDY (YieldMax NVDA Option Income Strategy), which applies the YieldMax call spread methodology to Nvidia; MSTY (YieldMax MSTR Option Income Strategy), which points to MicroStrategy, CONY (YieldMax COIN Option Income Strategy), which is based on Coinbase stock; and TSLY, in which Tesla is the underlying stock.

Fees And Other Considerations

The expense ratio and other fees, though modest for a product line as innovative as this one, is still a consideration for investors. When the yield is flowing and the stocks are holding up, that roughly 1% cost is lost in the profits and income. But in a sustained rough stock market, all costs of investing should get more scrutiny.

How Safe Are YieldMax ETFs?

Start with the idea that when investing, nothing is totally "safe." But working up from there, the T-bills, options (which commit less money to the stock's future price movement than buying shares outright) and the oversight of the firms involved here provide a competitive environment for these new ETFs to succeed.

Tips For Managing Risks Associated With YieldMax ETFs

The best thing investors can do in considering YieldMax ETFs is to understand the different parts of the fund's asset allocation, how they work separately and together. Only then can someone determine to what extent, if any, the combination of features, benefits and risks fits for them.

Who Should Consider Investing In YieldMax ETFs?

Investors seeking to access the underlying stocks and stock baskets these ETFs aim to track, but do with higher expected income, are the most likely candidates to give YieldMax funds a good look. Personally, I own several of them, as a complement to my own dividend stock and income ETF portfolio. That said, I also take the additional step of using hedging mechanisms to buffer my portfolio against severe stock price weakness or other risks cited above.

Bottom Line

YieldMax ETFs are popular for many good reasons. But with any investment, it is a personal choice, and research and true understanding of what one is buying is the best way to meet your own expectations without risking disappointment.

Frequently Asked Questions (FAQs)

What is a YieldMax ETF?   ⌄

Do YieldMax ETFs pay monthly dividends?   ⌄

Who is the parent company of YieldMax?   ⌄

Disclosure: I own several YieldMax funds.

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BREAKING

What We Know About Elon Musk's 'Department Of Government Efficiency' — As Musk Pushes Tax Changes

Derek Saul Forbes Staff

Derek Saul has covered markets for the Forbes news team since 2021.

◼ ¹ 🗨   Nov 19, 2024,10:15am EST

TOPLINE The world's richest man Elon Musk's role in the upcoming Trump administration is growing clearer as president-elect Donald Trump tapped him to lead the "Department Of Government Efficiency," and, though exactly what the commission will do is still not exactly known, social media posts and reports have hinted at what government functions will be the first targets of the streamlining efforts.

Elon Musk attends a House Republicans meeting Wednesday.   GETTY IMAGES

KEY FACTS

Musk, alongside fellow billionaire and former GOP presidential candidate Vivek Ramaswamy, will lead the "DOGE" bureau, Trump announced last Wednesday, with the name an apparent nod to the "doge" dog meme often referenced by Musk.

Despite its name, the billionaire-led commission is not proposed as an official government agency, but rather an advisory board which will "provide advice and guidance from outside of Government," wrote Trump, who set forth the department's primary objectives are to "dismantle Government Bureaucracy, slash excess regulations, cut wasteful expenditures and restructure Federal Agencies."

Trump said the commission will wrap by July 4, 2026, though Musk posted last Wednesday on his X social media platform he expects to be "done much faster."

Details are scant on how exactly DOGE will operate, and it's unclear how much funding the commission itself would receive, but recent social media posts and campaign trail fodder provide some insight.

Ramaswamy called last Wednesday for a "massive downsizing," while Musk backed a roughly 75% reduction in the amount of U.S. federal agencies," though any widesweeping funding changes would need to get approval from Congress.

The department's official X account went live last Wednesday with the aptly named @DOGE handle. "Working overtime to ensure your tax dollars will be spent wisely!," read the account's first ever post.

In an appearance last week on the "Joe Rogan Experience" podcast, Musk said he hopes to "curtail [government] agencies to be much smaller" and to only "stick to what Congress authorized," also calling for massive severance packages for government employees impacted by a potential purge ("a couple years of pay") and predicting "America's toast" if the government doesn't reduce spending.

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NEWS PEG

Musk and Ramaswamy have discussed making a smartphone app for Americans to file taxes for free online, the Washington Post reported Tuesday, citing anonymous sources. Musk has often lobbed at the Internal Revenue Service, calling Tuesday to "simplify the tax code."

CRUCIAL QUOTE

"A reasonable formula to fix the U.S. government: Milei-style cuts, on steroids," Ramaswamy posted Monday, referencing Argentinian President Javier Milei, the Musk ally who has cut his country's annual spending by a reported 32% since taking power last year.

DOGE CALLS FOR APPLICATIONS

In an X post last week, the commission requested individuals to apply to join the group. "We need super high-IQ small-government revolutionaries willing to work 80+ hours per week on unglamorous cost-cutting," the department said, calling for interested applicants to send their resumes directly to DOGE via direct message on X.

WHERE COULD DOGE CUTS BE MADE?

Musk intends to pare down the Federal Trade Commission, Internal Revenue Service, Justice Department and Securities and Exchange Commission, reported the Wall Street Journal, citing two unnamed sources who have discussed the plans with Musk. The centibillionaire also endorsed last week a New York Post analysis story identifying several areas to potentially curb spending, ranging from big-ticket items like billions of dollars annually spent on maintaining unused government government to more dubious, smaller expenses like a $20,600 disbursement in 2022 toward a diversity, equity, inclusion, and accessibility exhibit in Ecuador.

SURPRISING FACT

Musk said last month he could identify "at least $2 trillion" in cuts from the federal government's $6.75 trillion budget. But Scott Bessent, the odds-on favorite to land the top economic role of Treasury secretary in Trump's cabinet, expressed skepticism about that proclamation, telling Forbes last week he's "not sure how they've gotten to that number," but "look at the way [Musk] runs his companies. He runs them pretty well."

WHAT DOES DOGE MEAN FOR TESLA?

As an outside advisor to the federal government, Musk won't need to divest any investments or step down from any positions at private companies. That means Musk can proceed as normal as the chief executive officer and largest individual shareholder of the $1 trillion electric vehicle firm Tesla, the $210 billion aerospace and communications firm SpaceX and the $40 billion generative artificial intelligence startup xAI. "While Musk will now have another role to balance along with his myriad of other roles at Tesla/SpaceX/xAI, we believe the major benefits for Musk and Tesla far outweigh any negatives," wrote Wedbush analyst Dan Ives in a note to clients last week. Shares of Tesla rose are up more than 30% since the election. Musk's reported targeting of the FTC, IRS, DoJ and SEC with his cost-cutting commission brings into question potential conflicts of interest, as those are the primary agencies which would regulate and probe Musk's companies.

CHIEF CRITIC

"The Office of Government Efficiency is off to a great start with split leadership: two people to do the work of one person. Yeah, this seems REALLY efficient," Sen. Elizabeth Warren, D-Mass., wrote in a post to X last week, receiving more than 150,000 likes.

TANGENT

Dogecoin, the meme cryptocurrency token famously touted by Musk, is up about 10% since Trump announced the DOGE commission. Part of a broader crypto rally, Dogecoin is up more than 100% since election night, outstripping the 35% gain of bitcoin, by far the most valuable digital asset. Dogecoin is the sixth most valuable cryptocurrency in the world, with a market capitalization of $57 billion, more than those of public companies Delta Airlines, Ford or Kraft Heinz. "The funniest name is DOGE," Musk quipped to Rogan when talking about the new commission.

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