

WISDOMTREE U.S. MULTIFACTOR INDEX: A YEAR IN REVIEW

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At WisdomTree's core is the belief that it may be possible to generate greater [excess return](#) over time by taking on greater [active risk](#) and concentrating index holdings in stocks that have greater exposure to the factors that historically have been associated with excess return. We designed the [WisdomTree U.S. Multifactor Index \(WTUSMF\)](#) to target factors consistent with many "[smart beta](#)" approaches. But we believe our method of combining factors to maximize the potential for higher absolute and [risk-adjusted return](#) is unique. The Index now has more than a year of live performance, and we are pleased with the results.

Attractive Performance Results

Over the past year, WTUSMF was able to outperform other indexes with similar objectives on both an absolute return and risk-adjusted return basis. It is also interesting to note that the Index showed 238 [basis points \(bps\)](#) of outperformance against the [S&P 500 Index](#), the barometer for U.S. equity markets, while also exhibiting less risk-increasingly important given the rise in [volatility](#) this year.

One-Year Performance

Index	Total Return Performance	Standard Deviation	Sharpe Ratio
WisdomTree U.S. Multifactor	18.92%	10.87%	1.62
Goldman Sachs ActiveBeta U.S. Large Cap Equity	18.17%	12.09%	1.39
MSCI USA Diversified Multiple-Factor Index	17.04%	11.84%	1.33
John Hancock Dimensional Large Cap	16.11%	12.00%	1.23
S&P 500	16.54%	12.41%	1.23
Russell 1000 Diversified Factor	12.44%	10.66%	1.04

Sources: WisdomTree, Bloomberg, for the period 6/9/17–6/8/18. Start date coincides with WisdomTree Index inception of 6/9/17, and performance through 6/8/18 is a one-year time frame. Past performance is not indicative of future results. You cannot invest directly in an index.

WisdomTree U.S. Multifactor Index

WisdomTree blends both fundamental and technical factors to create a [composite factor score](#) for the purposes of stock selection. The composite score is an average of four factors, with [value](#) and [quality](#) being driven by fundamentals, while [momentum](#) and [correlation](#) are driven by [technical](#) factors or price. Because each factor has an equal weight, all of them are pushing or pulling the composite factor score with some force. During a market environment where you see increased volatility, correlations and return dispersions, you might expect the technical factors to generate more force through larger changes in relative rank.

At the most recent quarterly [rebalance](#), the largest change in scores for the drops were correlation, representing almost 50% of the total drops, and momentum, representing a little over 30%. The largest changes in scores for the additions were momentum (50%) and correlation (31%). Now, just because we didn't see a large change in individual fundamental scores doesn't mean the Index fundamentals remain the same. The shifts, driven by the technical factors, also influenced the composition and fundamentals of the Index.

The Index has a sector-neutral constraint, so there weren't large differences in the sectors, but there were some minor adjustments based on price changes since the last rebalance. The most notable changes to the basket are highlighted in the table below.

Comparison of Fundamentals

Index	Market Cap (Weighted Average \$B)	Large-Cap Weight	Mid-Cap Weight	Dividend Yield	Net Buyback Yield	Price-to-Earnings (P/E) Ratio	Estimated Price-to-Earnings (P/E) Ratio	Return on Equity	Return on Assets
WT U.S. Multifactor (Before Rebalance)	\$25.56	60.35%	39.65%	1.38%	2.20%	15.8x	15.9x	18.31%	4.95%
WT U.S. Multifactor (After Rebalance)	\$24.20	56.86%	43.14%	1.38%	1.88%	15.8x	16.4x	19.14%	5.42%
S&P 500 Equal Weight	\$48.34	86.08%	13.92%	1.82%	1.71%	21.3x	16.9x	13.25%	3.18%
S&P 500	\$202.99	97.71%	2.29%	1.82%	1.93%	22.0x	17.2x	14.95%	3.37%

Sources: WisdomTree, FactSet, as of 6/11/18. Subject to change.

- Reinforced Exposure toward [Mid-Cap](#) Segment:** During the last quarterly rebalance, it was noticeable that the Index rebalanced into more mid-cap exposure, adding approximately 15%. This recent rebalance saw continued confirmation with a small increase to mid-cap equities. This is important to note because since the last rebalance we have seen strong relative strength from the smaller capitalization segment. One common discussion about the equal-weighted [S&P 500](#) is its mid-cap drift, and that can be seen in its weighted average market cap being \$48 billion compared with the S&P 500's \$203 billion. The WisdomTree U.S. Multifactor Index has a weighted average market cap half that of the equal-weighted S&P 500, showcasing even more of a size tilt away from pure mega caps.
- Lower Interest Rate Sensitivity Continued:** We continue to witness increased volatility and poor performance from some of the "traditional" lower-volatility and high-[dividend-yield](#) securities. The risk-adjusted momentum score would work to potentially keep these types of securities from achieving a high composite rank. At the last rebalance, the aggregate Index dividend yield fell by 33 bps, and the preference to remain in lower-dividend-yielding equities continued with this rebalance. The weighted average market cap and [leverage](#) of the Index remain below the S&P 500 Index; both support potentially lower interest rate sensitivity.
- Stepping Up the Quality:** Because quality is one of the factors, it's no surprise to us that there was a slight increase in the [return-on-equity](#) and [return-on-assets](#) measurements. The quality score looks at companies that display strong quality metrics currently but also exhibit an improvement in the metrics. Typically, you would expect to "pay up" for this type of quality basket, so it is encouraging to see the Index trade at a lower [price-to-earnings \(P/E\)](#) multiple than the S&P 500 Index. On a trailing earnings basis, the Index is priced more than 25% lower than both the S&P 500 Index and S&P 500 Equal Weight Index, which should attract interest from those concerned about rising multiples in the U.S.

The WisdomTree U.S. Multifactor Index has been a relatively strong performing U.S.

equity index in 2018, and the rebalance process we just completed is a critical driver of its long-term addition to value. In follow-up posts, we will continue to showcase how the deep factor tilts of this process contrasts with many other multifactor indexes that involve much lower-grade tilts on the market. In our view, when designing a multifactor process that competes with a true [alpha-seeking](#) manager, one should lean into active share like this multi-factor index does.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

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DEFINITIONS

Smart Beta: A term for rules-based investment strategies that don't use conventional market-cap weightings.

Risk-adjusted returns: Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.

Basis point: 1/100th of 1 percent.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Volatility: A measure of the dispersion of actual returns around a particular average level.

Composite Factor Score (CFS): Taking individual measurements of factor exposures, and combining them into a single measure meant to represent multifactor exposure for a certain asset. For example, in the case of the WisdomTree U.S. Multifactor Index, the composite factor score aims to measure factor exposures to Value, Quality, Momentum and Low Correlation as they relate to a single asset.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Quality: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Momentum: Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Correlation: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Technical indicators: Type of analysis that tries to determine future price patterns using historical price patterns.

Rebalance: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

Mid-Cap: Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Dividend yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Leverage: Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

Return on Equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA): Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Alpha: Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.