THE WISDOMTREE Q2 2022 ASSET CLASS AND RISK FACTOR REVIEW AND OUTLOOK

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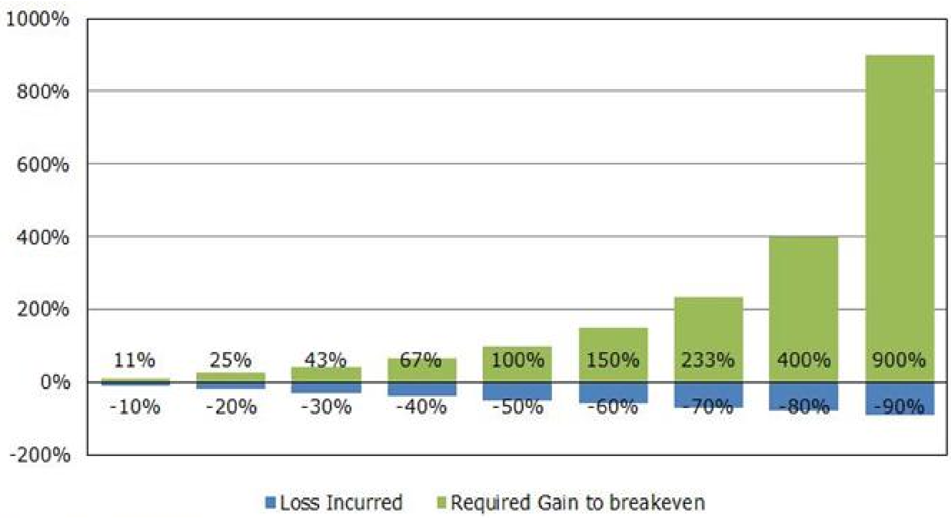
This article may be relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

We recently shared with you our Q2 Economic and Market outlook. In this blog post, we share our asset class and risk factor outlook.

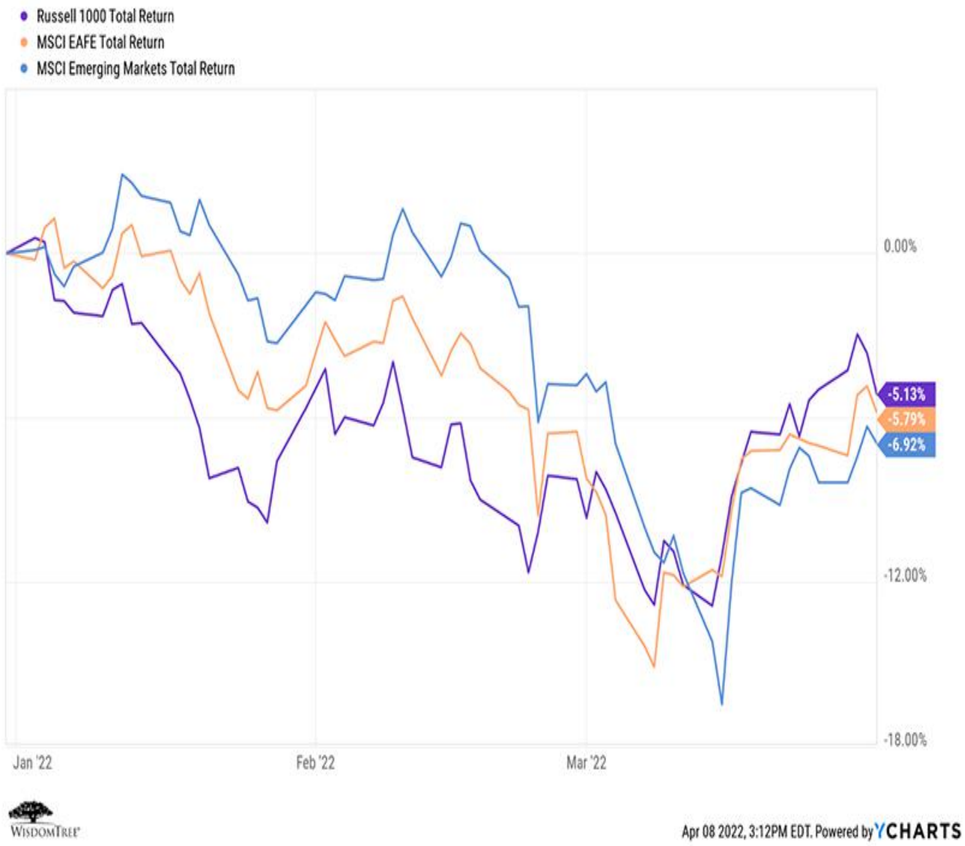
Regular readers of WisdomTree blogs know that we are firm believers in both asset class and risk factor diversification when building our Model Portfolios. We believe this increases the potential for more consistent performance over full market cycles. This goes together with our belief in the power of compounding—if you don't lose as much in down markets, you don't have to win as much in up markets to still come out ahead in the long run.



Source: BizNews, September 2014.

Equity Asset Class Review and Outlook

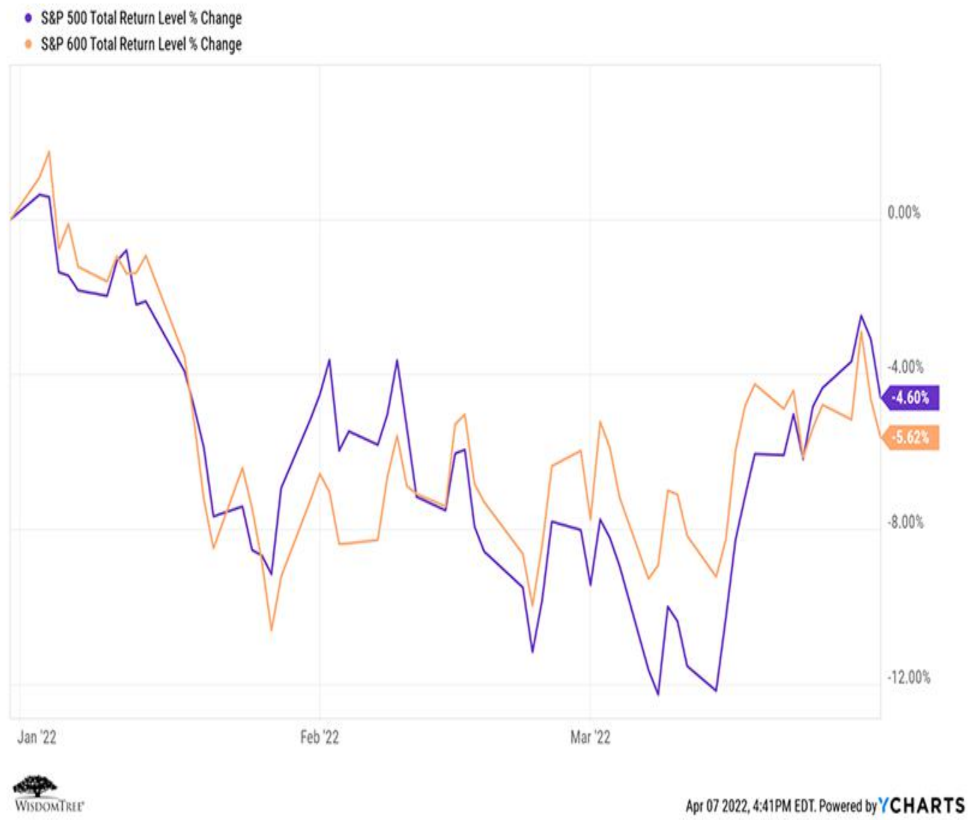
Let's begin with a quick Q1 review of asset class performances. Geographically, the U.S. outperformed the EAFE and emerging markets ("EM") regions, at least partially due to a consistent strengthening of the dollar, but with respect to the EM, mostly due to the ongoing economic and market slump in China.



Source: YCharts, Q1 2022 data. You cannot invest in an index, and past performance does not guarantee future results.

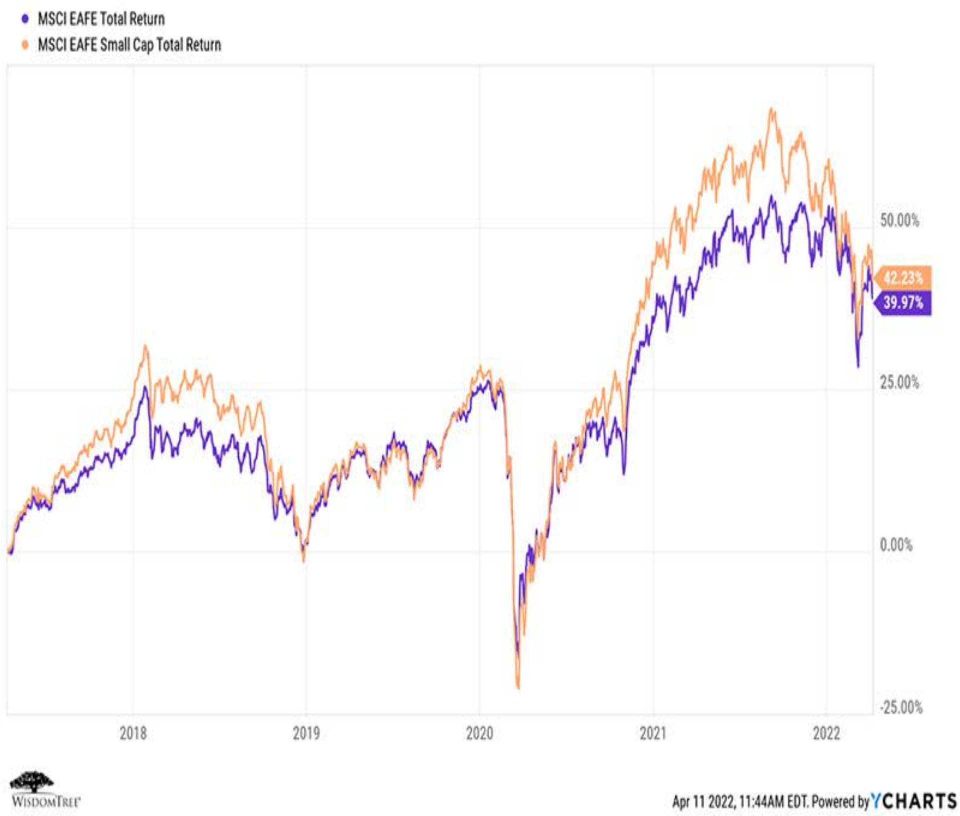
For definitions of the terms in the chart above, please visit the glossary.

Within the U.S., large caps continued to outperform small caps. We believe this may change as we move through the year.



Source: YCharts, Q1 2022 data. You cannot invest in an index, and past performance does not guarantee future results.

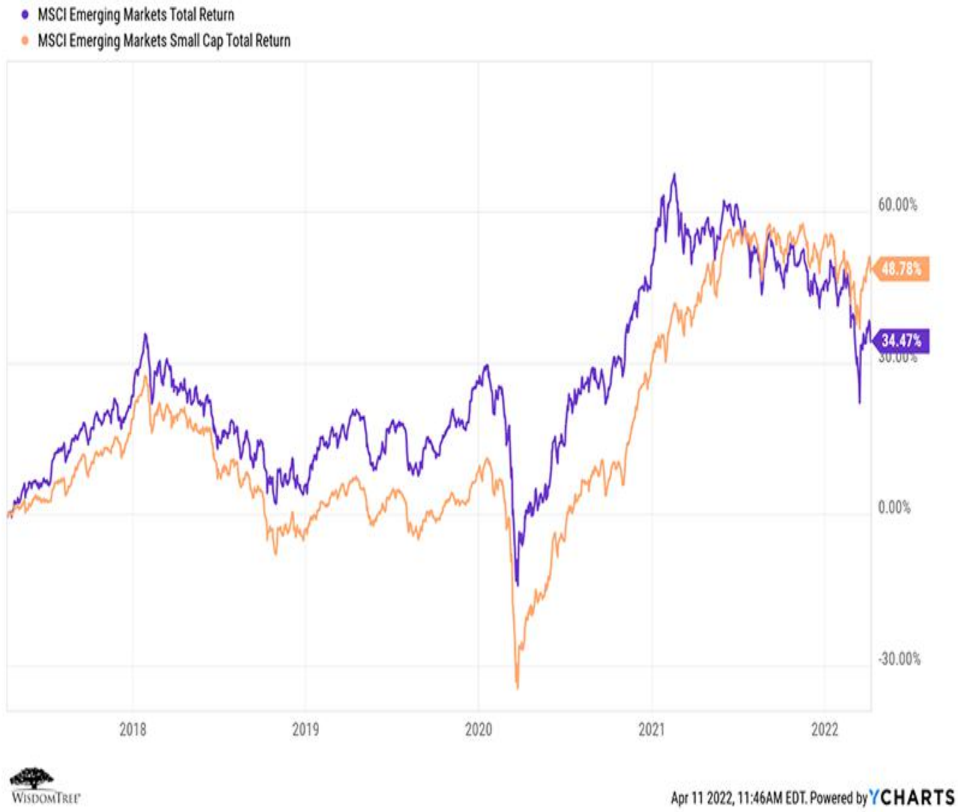
EAFE small caps underperformed EAFE large caps for the quarter, but a longer time horizon "lens" illustrates why we like that asset class as a strategic holding in our Model Portfolios.



Source: YCharts, five-year data through 4/8/22. You cannot invest in an index, and past performance does not guarantee future results.

For definitions of the terms in the chart above, please visit the glossary.

The comparative outperformance of EM small versus large caps is more dramatic—which is why we also maintain a strategic allocation to EM small caps within our Model Portfolios.



Source: YCharts, five-year data through 4/8/22. You cannot invest in an index, and past performance does not guarantee future results.

Outlook

Heading into this year, we were optimistic on EAFE and EM allocations relative to the U.S. The ongoing economic slump in China, the invasion of Ukraine and the fairly relentless strengthening of the dollar now give us pause; therefore, we remain in line with the MSCI ACWI Index with respect to our geographic allocations. We added to our U.S. small-cap allocation at the beginning of the year, funding it with a reduction to large-cap growth stocks.

On a relative basis, that trade has worked well for us (i.e., large-cap growth stocks fell more than small-cap stocks), but small caps continue to underperform on an absolute basis relative to large caps. We believe that may change over the course of the year because we believe we may see another “economic reopening” cycle at some point in 2022.

Equities	-	0	+	Rates & Credit	-	0	+	Real Assets & Alternatives	-	0	+
Equities w. Bonds				Duration				Commodities			
U.S. LargeCap Growth				U.S. Treasuries				Precious Metals			
U.S. LargeCap Value				Investment Grade				Infrastructure			
U.S. Small / MidCap				High Yield				MLPs			
Europe, Australia, Far East				Securitized				Managed Futures			
Europe, Australia, Far East SmallCaps				Non-US				Volatility Management			
Emerging Markets				Interest Rate-Hedged				Options-Based Overlays			
Emerging Markets SmallCaps				Alternative Credit				Target Range			

Outlooks are on a relative, not absolute, basis. Red = negative relative outlook, yellow = neutral relative outlook, green = positive relative outlook.

Equity Risk Factor Review and Outlook

The first quarter saw a dramatic “factor rotation” in the U.S. away from large-cap growth and toward value and dividends. The dispersion between the performance of value and growth stocks is now as wide as it has ever been. Interestingly, because the fixed income market also suffered during the quarter, value and dividend stocks provided the better “hedge” to the equity market downturn.

U.S. Factor Return YTD as of 3/31/2022

The performance dispersion between high-dividend stocks and non-dividend-paying stocks was dramatic.

Year-to-Date S&P 500 Dividend Yield Quintiles Performance

For the most recent standardized and month-end performance, click on the respective ticker: WTHYE, WTDGI

We also witnessed the outperformance of value and dividend stocks in small caps.

The performance dispersion between high-dividend stocks and zero-dividend-paying stocks in small caps was almost as dramatic in large caps.

Year-to-Date Russell 2000 Dividend Yield Quintiles Performance

Although large-cap stocks outperformed small-cap stocks at the asset class level, we saw outperformance of smaller-cap stocks within the large-cap Index due primarily to the dramatic decline of large-cap growth stocks over most of the quarter. (We use the S&P 500 Equal Weight Index as a proxy for smaller-cap stocks within the S&P 500 Index.)

Another interesting dispersion between large caps and small caps is the performance of the quality factor. Within small caps, quality shined. (We define quality as firms that have strong earnings, balance sheets and cash flows.) Here, we compare the S&P 600 Index to the Russell 2000 Index—the S&P 600 is considered the higher-quality Index because it eliminates more negative earning companies than the Russell 2000 Index.

But this quality trade has yet to show up in large-cap stocks. We believe it will as we move through what we believe will be an increasingly volatile 2022.

Outlook

Most of the WisdomTree products and Model Portfolios have inherent factor tilts toward value, dividends and quality. This served us very well in the first quarter, especially the tilts toward value and dividends. We believe this trend will continue as investors increasingly focus on fundamentals and the “sooner rather than later” benefits of sustainable dividends and share buybacks.

We believe both the size and quality factors will become increasingly important as we move through 2022—a year we believe will be marked by increased volatility, rising rates and increasing geopolitical tensions but also by an “economic reopening regime” at some point during the year. This phase of the economic cycle historically benefitted the size, value, dividend and quality risk factors.

Conclusions

2022 has been an interesting year so far. We continue to believe there will be a valuation “tug of war” between generally solid earnings and rising interest rates.

Something we find interesting is that, for the past six months or so, the market “narrative” was that because growth and tech stocks are “longer duration” assets (because their earnings and cash flows are expected further out in the future), they were more highly sensitive to the rise in rates, hence their downturn over much of the quarter.

But growth stocks “caught a bid” in the past few weeks, despite the continued rise in rates, somewhat breaking that narrative. Our hypothesis is that this happened because valuations had fallen sufficiently to reattract investors.

How this “correlation” plays out over the remainder of the year remains to be seen. This is why we are adamant about being both asset class and risk factor diversified in our Model Portfolios—the market is smarter than we are, so we need to "spread our bets."

Our Model Portfolios and most of our products have inherent factor tilts toward dividends, value, quality and size. Given our economic and market outlook for the remainder of this year, we think that is a rather good place to be.

Important Risks Related to this Article

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You cannot invest directly in an index.

DEFINITIONS

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

EAFE : Refers to the geographical area that is made up of Europe, Australasia and the Far East.

Emerging market : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than $10 billion. Large cap is an abbreviation of the term “large market capitalization”. Market capitalization is calculated by multiplying the number of a company’s shares outstanding by its stock price per share.

Small caps : new or relatively young companies that typically have a market capitalization between $200 million to $2 billion.

MSCI ACWI Index : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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 tim.

Dividend : A portion of corporate profits paid out to shareholders.

Dispersion : A measure of the statistical distribution of portfolio returns.

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.

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 tim.

S&P 600 Index : The S&P 600 is an index of small-cap stocks managed by Standard and Poor's. It tracks a broad range of small-sized companies that meet specific liquidity and stability requirements.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

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

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.