HOW TO REDUCE BETA WITH A MULTIFACTOR APPROACH

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June 28 marked the second anniversary of the WisdomTree U.S. Multifactor Fund (USMF).

USMF's performance has proven resilient amid volatile market conditions and factor performance. Its balanced factor exposure and stock selection using fundamental and technical factors has allowed it to keep pace with the market with lower volatility. The S&P 500 Index (S&P 500) has seen multiple moves greater than 13% on both the up and down sides over this period.

USMF can diversify a portfolio's core U.S. allocation given its higher risk-adjusted return, tracking error and beta of 0.83 against the S&P 500[1]. This can be attractive as the economy heads into the latter part of the cycle, where diversified asset allocation becomes increasingly important.

USMF Outperforms Largest Multifactor Products

Multifactor investing is growing in popularity. Assets under management for the 10 largest multifactor exchange-traded funds (ETFs) in the market have grown north of 23% over the last 12 months, totaling $12.9 billion. Performance across these ETFs has been mixed, as their objectives and methodologies are diverse.

Below, we highlight these statistics and compare USMF to both the S&P 500 and S&P 500 Equal Weight Index (S&P 500 EW).

We believe the S&P 500 EW is a better benchmark for USMF because it, too, deviates from market cap weighting. Market cap-weighted indexes tend to exhibit significant contribution to performance from a limited number of companies given their more concentrated weighting.

It's always interesting to see how deviating from market cap weighting reduces the S&P 500 EW's beta to the S&P 500, since it doesn't have concentrated bets in a handful of companies. The same logic can also be applied to USMF, whose weighting and stock selection allows it to maintain a lower beta to the S&P 500 while having better risk-adjusted return.

This is the type of differentiated return profile that we favor to complement a core U.S. equity exposure.

Average Annual Returns 6/29/17–6/28/19					
	Total Return	Standard Deviation	Sharpe Ratio	Beta	Tracking Error
WisdomTree U.S. Multifactor Fund (USMF)	11.75%	12.20%	0.96	0.83	4.55%
Top 10 AUM Multifactor ETF Median	9.08%	13.68%	0.66	0.96	3.56%
S&P 500 Equal Weight Index	10.25%	13.16%	0.78	0.92	3.15%
S&P 500 Index	12.52%	13.95%	0.90	1.00	-

Sources: WisdomTree, Bloomberg, as of 6/28/19. Sharpe ratio does not deduct the risk-free rate.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

For standardized performance of USMF, please click here.

Fundamental Differences

One of USMF's objectives is to provide investors with a balanced exposure to the following six factors: Low Correlation, Momentum, Quality and Value as part of the explicit methodology, along with Size and Low Volatility inherent in the methodology's weighting. A balanced exposure to all factors should pay off in the long term, as academic research shows all factors tend to outperform in both absolute and risk-adjusted terms.[1]

USMF's portfolio achieves its desired aggregate characteristics compared to both a cap-weighted and equally weighted benchmark. As shown below, USMF has a significant mid-cap tilt and higher return on assets (ROA) and return on equity (ROE) and a lower aggregate P/E ratio than both the S&P 500 EW and S&P 500. These measures show balanced exposure to Size, Quality and Value.

Aggregate Fundamentals as of 6/28/19								
	Constituents	Large-Cap Wgt (%)	Mid-Cap Wgt (%)	P/E Ratio	PEG Ratio	ROA	ROE	Shareholder Yield (%)
WisdomTree U.S. Multifactor Fund (USMF)	200	62.49	37.51	15.89	1.67	4.82	18.65	4.83
S&P 500 Equal Weight Index	505	84.92	15.08	18.59	1.90	3.40	14.00	4.56
S&P 500 Index	505	97.75	2.25	19.78	1.83	3.77	16.30	4.62

Sources: WisdomTree, FactSet, as of 6/28/19. Exposures are subject to change.'

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Another of USMF's goals is to generate excess returns through stock selection using factors as an alpha signal. Over the last 24 months, factors, as broadly defined, have experienced mixed performance. Despite outperforming over the long run, not all factors will always outperform. Defensive factors, like Quality and Low Volatility, outperformed the more aggressive ones, like Value and Size, as expected during the latter part of the economic cycle. The Momentum factor also benefited from the extended trends and beta-type rallies in the market over this period. Factor performance is not only driven by the equity markets, as some factors are more sensitive to interest rates than others. Therefore, we favor a balanced factor exposure.

Thanks to its stock selection, USMF, through a less concentrated and more diversified basket, has been able to keep pace with an equity market that has been driven by a handful of high market-capitalization companies over the last two years.

In short, after 24 months of live performance, USMF has met the goals that were set out when it was launched and has the potential to generate higher absolute returns over the long run.

Unless otherwise stated, all data sourced is Bloomberg, 6/29/2017 - 06/28/2019.

[1]Source: Kenneth R. French Data Library.

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Diversification does not eliminate the risk of experiencing investment losses.

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DEFINITIONS

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

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

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.

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.

Tracking Error : Can be discussed as both the standard deviation of excess return relative to a specific benchmark, or absolute excess return relative to a specific benchmark.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

S&P 500 Equal Weight Index : Designed to track the equally weighted performance of the 500 constituents in the S&P 500 Index.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Low Correlation : Characterized by assets that have a relatively lower correlation vs the market over time. This term is also associated with the Low Correlation 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.

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.

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.

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.

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