AN ALTERNATIVE APPROACH TO LOWER-VOLATILITY INDEXING STRATEGIES

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In December, we passed the two-year anniversary of the WisdomTree Dynamic Long/Short U.S. Equity Fund (DYLS)—an interesting alternative strategy WisdomTree launched at the end of 2015. The market environment over the last two years was a struggle for any funds that incorporated bearish bets, as the market has been robust over the last few years.

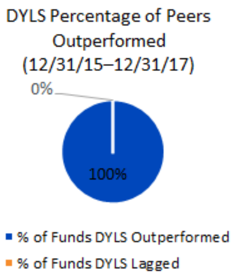
With anxieties over market valuations, the "quantitative tightening" program underway by the Federal Reserve (Fed) to remove their emergency accommodation, and the past several days of heightened volatility, it seems useful to evaluate strategies that have a goal of reducing volatility in the marketplace.

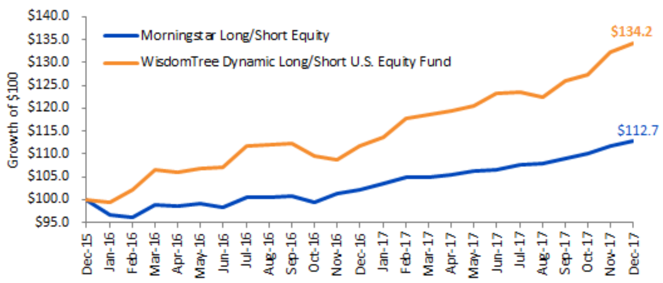
Even my mentor, Professor Jeremy Siegel, one of the more bullish market prognosticators, has been generally more cautious of late with subdued expectations, thinking the market will pause and we'll get a correction later this year.

WisdomTree established DYLS to incorporate a dynamic hedge of market beta that would react to changes in valuations and underlying earnings quality and earnings momentum. During robust earnings environments, like we've seen for much of the last two years, the hedge ratio remains at zero and the Fund remains fully invested.

DYLS will not always be fully invested and hasn't been in real time either: There was a period after the Fund launched in late 2015 and in early 2016 when it was fully hedged and protected from the market sell-off that occurred in the first two months of 2016, until the hedge came off March 2 and DYLS participated in the upturn for the rest of 2016.

When we evaluate the performance of DYLS versus its peer group, we can see a fairly robust track record. It has beaten 100% of its active manager peers and the Morningstar peer group return by more than 20% cumulatively since its inception.





	Fund Information			Average Annual Total Returns as of 12/31/17									
				NAV Returns (%)					Market Price Returns (%)				
Fund/Index/Category	Ticker	Exp. Ratio	Inception Date	1-Year	Common Period	3-Year	5-Year	10-Year	1-Year	Common Period	3-Year	5-Year	10-Year
WisdomTree Dynamic Long/Short U.S. Equity Fund	DYLS	0.48%	12/23/2015	20.1%	15.6%	N/A	N/A	N/A	20.3%	15.6%	N/A	N/A	N/A
S&P 500 Index				21.8%	16.1%	11.4%	15.8%	8.5%	21.8%	16.1%	11.4%	15.8%	8.5%
Morningstar Long/Short Equity				10.2%	6.2%	4.0%	6.7%	4.0%	10.2%	6.2%	4.0%	6.7%	4.0%

Sources: Morningstar, WisdomTree, 12/31/07–12/31/17. "Common period" refers to 12/31/15–12/31/17 due to availability of Morningstar category performance data. 12/23/15 represents the inception date of DYLS. The % of Peer Group Beaten is the fund's total-return percentile rank compared to all funds within the same Morningstar Category and is subject to change each month. 255 investments included in peer group for Morningstar Long/Short Equity Category.

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 www.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.

Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

One of the benefits of utilizing DYLS in an ETF format is that the portfolio exposures are readily observable and underlying risks are known. There are two drivers of this ETF:

- **The Long Portfolio:** The long portfolio strategy is designed to have a lower market multiple (whether on price-to-earnings or price-to-cash flow variables) than the market while also improving quality variables such as return on equity or return on assets.
- **The Short Portfolio:** The short portfolio strategy hedges market risk based on a proprietary risk indicator that incorporates valuation and earnings momentum signals.

We have also considered DYLS to be an alternative to other lower-volatility strategies, including the minimum variance indexes that lower portfolio volatility by taking stock selection and sector risks.

One risk to a traditional minimum variance indexing strategy is an embedded interest rate sensitivity that is inherent to many low-volatility stocks. With interest rates starting to be pressured higher with the quantitative tightening program of the Fed and expanding federal deficits, higher rate sensitivity could be a drag for traditional low-volatility stock strategies, especially since we see these stocks trading at a premium multiple to the market instead of a discount to the market, like the WisdomTree Dynamic Long/Short U.S. Equity Index.

	WT Dynamic Long/Short U.S. Equity Index	S&P 500 Index
Price/Earnings	16.53x	23.28x
Earnings Growth Expectations	9.59%	11.77%
Price/Cash Flow	9.93x	14.02x
Price/Book	3.48x	3.39x
Return on Equity	19.33%	13.75%
Return on Assets	4.23%	3.11%
ROE x Earnings Retention	13.52%	7.91%

Sources: WisdomTree, FactSet. Data as of 12/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.

We've seen the WisdomTree Dynamic Long/Short U.S. Equity Index have a similar up capture ratio as the minimum variance index, while having a lower net beta over the last two years.

Index	Return	Standard Deviation	Sharpe Ratio	Up Capture vs. S&P 500	Beta vs. S&P 500
WisdomTree Dynamic Long/Short U.S. Equity	15.12%	6.27%	2.33	77.74%	0.53
MSCI USA Minimum Volatility	14.49%	7.00%	1.99	79.22%	0.64
S&P 500	15.19%	7.81%	1.88	100.00%	1

Sources: WisdomTree, Zephyr StyleADVISOR. Data as of 12/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.

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

Add to this what we see as a better combination of current fundamentals—lower market multiples and sector neutrality, which lowers an inherent interest rate factor sensitivity—and we see the WisdomTree Dynamic Long/Short U.S. Equity Fund, the fund that tracks the WisdomTree Dynamic Long/Short U.S. Equity Index, potentially being a compelling alternative to other volatility-reducing strategies investors have considered recently.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. The Fund will invest in derivatives, including as a substitute to gain short exposure to equity securities. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Derivatives used by the Fund to offset its exposure to market volatility may not perform as intended. The Fund may engage in "short sale" transactions and will lose value if the security or instrument that is the subject of a short sale increases in value. A Fund that has exposure to one or more sectors may increase the Fund's vulnerability to any single economic or regulatory development. This may result in greater share price volatility. The composition of the Index is heavily dependent on quantitative models and data from one or more third parties, and the Index may not perform as intended. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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

View the online version of this article here.

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You cannot invest directly in an index.

DEFINITIONS

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Quantitative Tightening : Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Bullish : a position that benefits when asset prices rise.

Correction : A drop of 10% or greater in an Index or stock from a recent high.

Dynamic Hedge : Strategy in which a currency hedge can be varied (as opposed to targeting a constant level) and change over the course of time.

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.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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.