WHEN WILL I BE LOVED? IN DEFENSE OF THE ENDOWMENT MODEL (AGAIN)

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05/26/2020

I've been cheated, been mistreated
When will I be loved

I've been put down, I've been pushed 'round
When will I be loved…

I've been made blue, I've been lied to
When will I be loved

(From "When Will I Be Loved," written and performed by The Everly Brothers, 1960, covered by Linda Ronstadt, 1975)

Like asset classes and risk factors, the "endowment model" rotates in and out of favor. What do we mean by the "endowment model?" In the context of individual investors, we believe it means:

- Broad and global diversification;
- Intelligent use of active vs. passive investment strategies (i.e., a cost/benefit optimization of active management fees or, in WisdomTree's phrase, "Modern Alpha®");
- A prudent use of nontraditional or lower-correlation investments in an attempt to improve overall portfolio diversification;
- A long-term time horizon; and
- Investment discipline through full market cycles.

From the mid-1990s until the great financial crisis (GFC) of 2007–2009, the endowment model was all the rage, as university endowment funds like Yale and Harvard racked up impressive performance numbers due to their then cutting-edge approach to investing. The wealth management industry raced to democratize and incorporate some of these investment ideas into their own client portfolios.

Following the GFC, however, the endowment model fell out of favor, as many of those same universities faced liquidity squeezes that pushed performances down. If you were not as illiquid as an endowment, however, the approach still made sense for many investors.[1]

But then *the great central bank rally* began in earnest, and from roughly 2013–2019, a new phrase came to be associated with the endowment model: *deworsification*. Essentially, investors who had anything in their portfolios except U.S. stocks and bonds saw reduced performance.

"Ride the beta wave" became the new investment mantra, and the endowment model for anyone beside the endowments essentially disappeared.[2]

Well, that regime may be ending. The dramatic market volatility over the past several months has many investors seeking, once again, to incorporate less-traditional or lower-correlation strategies into their portfolios.

At WisdomTree, we never lost faith in the potential benefits of an endowment model approach (for the right investor), and we have an asset allocation model portfolio called, explicitly, the “Endowment Model.” As of March 31, 2020, this model was allocated as follows:

Ticker	WisdomTree Endowment Model Portfolio - Moderately Aggressive	Weights	Expense Ratio
EPS	WisdomTree U.S. LargeCap Fund	10.00%	0.08%
NTSX	WisdomTree 90/60 U.S. Balanced Fund	10.00%	0.20%
SPDW	SPDR Portfolio Developed World ex-US ETF	7.50%	0.04%
XSOE	WisdomTree Emerging Markets ex-State-Owned Enterprises Fund	7.50%	0.32%
DGRS	WisdomTree U.S. SmallCap Quality Dividend Growth Fund	5.00%	0.38%
DLS	WisdomTree International SmallCap Dividend Fund	5.00%	0.58%
USMF	WisdomTree U.S. Multifactor Fund	5.00%	0.28%
Total Equity		50.00%	
AGGY	WisdomTree Yield Enhanced U.S. Aggregate Bond Fund	19.50%	0.12%
MTGP	WisdomTree Mortgage Plus Bond Fund	3.90%	0.45%
WFHY	WisdomTree U.S. High Yield Corporate Bond Fund	3.60%	0.38%
STOT	SPDR DoubleLine Sht Duration Tot Rtn Tactical ETF	3.00%	0.45%
Total Fixed Income		30.00%	
GLDM	SPDR® Gold MiniSharesSM Trust	4.00%	0.18%
IGF	iShares Global Infrastructure ETF	4.00%	0.46%
SWAN	Amplify BlackSwan Growth & Treasury Core ETF	4.00%	0.49%
BTAL	AGFiQ US Market Neutral Anti-Beta Fund	3.00%	0.45%
PUTW	WisdomTree CBOE S&P 500 PutWrite Strategy Fund	3.00%	0.44%
EMLP	First Trust North American Energy Infrastructure	2.00%	0.96%
Total Alts		20.00%	
Total		100.00%	0.28%

Source: WisdomTree. Allocations are subject to change. Foreside Fund Services, LLC, is not affiliated with the entities mentioned.

We believe some aspects of this portfolio are worth highlighting:

- The portfolio is globally diversified and, as with all WisdomTree model portfolios, it is “open architecture” and incorporates both proprietary and third-party investment strategies;
- The portfolio consists of both cap-weighted and factor-tilted ETFs, as we seek to optimize the costs and benefits of both passive and active management strategies;
- The portfolio incorporates WisdomTree’s 90/60 U.S. Balanced Fund (NTSX). This ETF uses the inherent leverage of futures contracts to gain a more capital-efficient exposure to a traditional “60%/40%” stock/bond allocation[3]; and
- This increased capital efficiency leaves “room” in the portfolio to allocate to potential lower-correlation strategies. As of March 31, 2020, these “alternatives” included real assets such as gold, master limited partnerships and infrastructure, as well as nontraditional volatility management strategies designed to potentially lower the equity beta profile of the overall portfolio.

As we work our way through the coronavirus pandemic and then into eventual recovery (hopefully in the second half of the year), we believe that we will have entered a new market regime that will be marked by increased long-term volatility. Advisors who seek lower-correlated potential sources of returns, as well as broader diversification in their client portfolios, may want to give the WisdomTree Endowment Model a look.

This approach to disciplined, long-term investing may, once again, *be loved*.

[1] In fact, in 2010, I wrote an article entitled, “In Defense of the Endowment Model,” which appeared in the May/June edition of the IMCA Investments & Wealth Monitor (pp. 32–36).

[2] For those who are interested, there is an annual survey of endowment performances conducted by the National Association of College and University Business Officers (NACUBO). The performances for the most recent fiscal year (July 1, 2018–June 30, 2019) are summarized here: https://www.nacubo.org/Press-Releases/2020/US-Educational-Endowments-Report-5-3-Percent-Average-Return-in-FY19.

[3]Investors often rely on the diversification potential of a 60% stock/40% bond portfolio in their asset allocation. NTSX incorporates this same logic to enhance the risk-return profile of a large-capitalization U.S. equity portfolio. Similarly, it can also be used as a 1.5x levered 60/40 strategy. NTSX seeks total return by investing 90% of its assets in the 500 largest U.S. stocks by market capitalization and 10% in short-term fixed income, and it targets a 60% notional exposure to U.S. Treasury futures.

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DEFINITIONS

Diversification : A risk management strategy that mixes a wide variety of investments within a portfolio.

Active : Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

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.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

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.

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

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.

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