

RISK FACTORS KEEP ON ROLLING

Scott Welch – Chief Investment Officer, Model Portfolios
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This article is 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.

*Big wheel keep on turning
Proud Mary keep on burning
And we're rolling, rolling
Rolling on the river*

(John Fogerty and Credence Clearwater Revival, 1969, with an iconic cover by Ike & Tina Turner, 1971)

I last wrote about [risk factor diversification last July](#), and it is well past time to revisit this important topic.

As a reminder, most investors are familiar with the visual of an asset class “performance quilt,” which highlights the importance of asset class diversification.

														2008 - 2022		
2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Ann.	Vol.
Fixed Income	EM Equity	REITs	REITs	REITs	Small Cap	REITs	REITs	Small Cap	EM Equity	Cash	Large Cap	Small Cap	REITs	Com dty.	Large Cap	REITs
5.2%	79.0%	27.9%	8.3%	19.7%	38.8%	28.0%	2.8%	21.3%	37.8%	1.8%	31.5%	20.0%	41.3%	16.1%	8.8%	23.4%
Cash	High Yield	Small Cap	Fixed Income	High Yield	Large Cap	Large Cap	Large Cap	High Yield	DM Equity	Fixed Income	REITs	EM Equity	Large Cap	Cash	Small Cap	Small Cap
1.8%	99.4%	26.9%	7.8%	19.6%	32.4%	13.7%	1.4%	14.3%	25.6%	0.0%	28.7%	18.7%	28.7%	1.5%	7.2%	23.2%
Asset Alloc.	DM Equity	EM Equity	High Yield	EM Equity	DM Equity	Fixed Income	Fixed Income	Large Cap	Large Cap	REITs	Small Cap	Large Cap	Com dty.	High Yield	REITs	EM Equity
-25.4%	32.5%	19.2%	3.1%	18.6%	23.3%	6.0%	0.5%	12.0%	21.8%	-4.0%	25.5%	18.4%	27.1%	-12.7%	6.6%	23.0%
High Yield	REITs	Com dty.	Large Cap	DM Equity	Asset Alloc.	Asset Alloc.	Cash	Com dty.	Small Cap	High Yield	DM Equity	Asset Alloc.	Small Cap	Fixed Income	Asset Alloc.	Com dty.
-26.9%	28.0%	16.8%	2.1%	17.9%	14.9%	5.2%	0.0%	11.8%	14.6%	-4.1%	22.7%	10.6%	14.8%	-13.0%	6.1%	20.2%
Small Cap	Small Cap	Large Cap	Cash	Small Cap	High Yield	Small Cap	DM Equity	EM Equity	Asset Alloc.	Large Cap	Asset Alloc.	DM Equity	Asset Alloc.	Asset Alloc.	High Yield	DM Equity
-33.8%	27.2%	15.1%	0.1%	16.3%	7.3%	4.9%	-0.4%	11.6%	14.6%	-4.4%	19.5%	8.3%	13.6%	-13.9%	5.4%	20.0%
Com dty.	Large Cap	High Yield	Asset Alloc.	Large Cap	REITs	Cash	Asset Alloc.	REITs	High Yield	Asset Alloc.	EM Equity	Fixed Income	DM Equity	DM Equity	Fixed Income	Large Cap
-35.6%	16.5%	14.8%	0.7%	16.0%	2.9%	0.0%	-2.0%	8.6%	10.4%	-5.8%	18.9%	7.6%	11.8%	-14.0%	2.7%	17.7%
Large Cap	Asset Alloc.	Asset Alloc.	Small Cap	Asset Alloc.	Cash	High Yield	High Yield	Asset Alloc.	REITs	Small Cap	High Yield	High Yield	High Yield	Large Cap	DM Equity	High Yield
-37.0%	25.0%	13.3%	-4.2%	12.2%	0.0%	0.0%	-2.7%	8.3%	8.7%	-11.0%	12.6%	7.0%	1.0%	-18.1%	2.3%	13.0%
REITs	Com dty.	DM Equity	DM Equity	Fixed Income	Fixed Income	EM Equity	Small Cap	Fixed Income	Fixed Income	Com dty.	Fixed Income	Cash	Cash	EM Equity	EM Equity	Asset Alloc.
-37.7%	18.9%	8.2%	-11.7%	4.2%	-2.0%	-1.8%	-4.4%	2.6%	3.5%	-11.2%	8.7%	0.5%	0.0%	-19.7%	1.0%	12.4%
DM Equity	Fixed Income	Fixed Income	Com dty.	Cash	EM Equity	DM Equity	EM Equity	DM Equity	Com dty.	DM Equity	Com dty.	Com dty.	Fixed Income	Small Cap	Cash	Fixed Income
-43.1%	5.9%	6.5%	-13.3%	0.1%	-2.3%	-4.5%	-14.6%	1.5%	1.7%	-13.4%	7.7%	-3.1%	-1.5%	-20.4%	0.6%	4.2%
EM Equity	Cash	Cash	EM Equity	Com dty.	Com dty.	Com dty.	Com dty.	Cash	Cash	EM Equity	Cash	REITs	EM Equity	REITs	Com dty.	Cash
-53.2%	0.1%	0.1%	-18.2%	-1.1%	-9.5%	-17.0%	-24.7%	0.3%	0.8%	-14.2%	2.2%	-5.1%	-2.2%	-24.9%	-2.8%	0.4%

Sources: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large Cap: S&P 500, Small Cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Commodity: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg US Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2008 to 12/31/2021. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns. J.P. Morgan "Guide to the Markets," U.S. data as of 12/31/22.

But, as regular readers know, what we believe is as important as asset class diversification is [risk factor diversification](#). And risk factor performance can be as

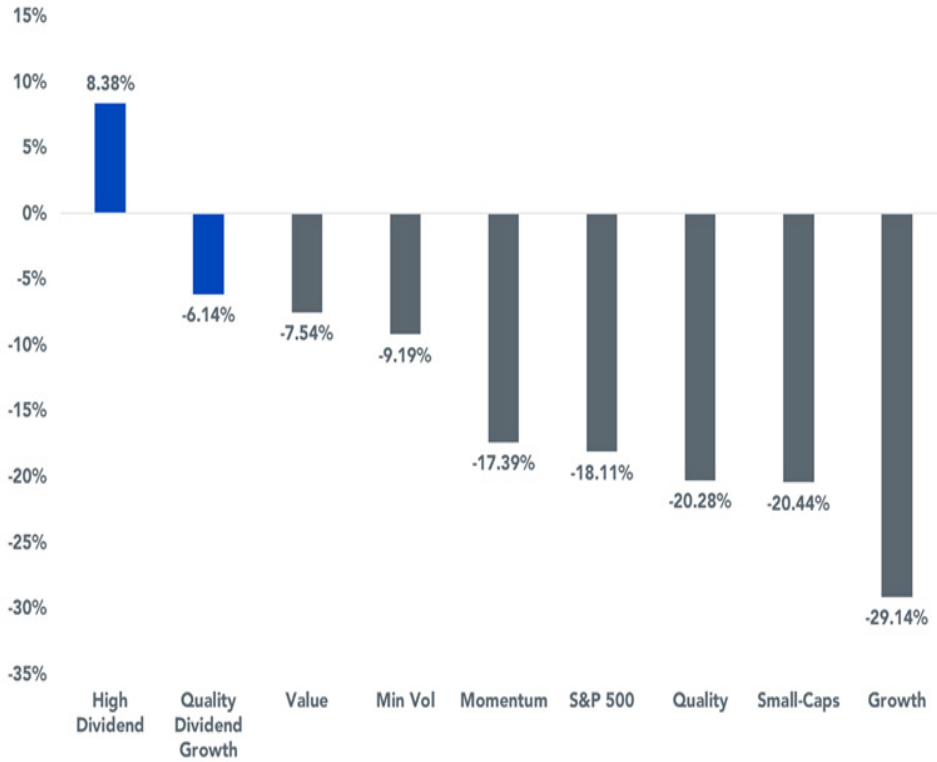
difficult to forecast as asset class performance.

															2008 - 2022	
2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Ann.	Vol.
Min. Vol.	Value	Small Cap	High Div.	Cyclical	Value	Value	Momen.	Small Cap	Momen.	Min. Vol.	Cyclical	Momen.	Value	Defens.	Min. Vol.	Small Cap
-25.7%	38.8%	26.9%	14.3%	20.1%	43.2%	17.7%	9.3%	21.3%	37.8%	1.9%	36.3%	29.8%	29.2%	5.3%	9.5%	23.2%
Defens.	Cyclical	Multi-Factor	Min. Vol.	Value	Small Cap	Min. Vol.	Min. Vol.	High Div.	Cyclical	Momen.	Quality	Cyclical	Cyclical	High Div.	Momen.	Value
-25.7%	38.9%	18.3%	12.9%	15.8%	38.8%	16.6%	5.9%	16.3%	27.3%	-1.6%	34.4%	27.8%	27.6%	-3.8%	9.2%	21.4%
High Div.	Multi-Factor	Momen.	Defens.	Small Cap	Multi-Factor	High Div.	Quality	Value	Quality	High Div.	Momen.	Small Cap	Quality	Min. Vol.	Quality	Cyclical
-27.6%	29.8%	18.2%	10.1%	16.3%	37.4%	14.9%	4.6%	15.9%	22.5%	-2.3%	28.1%	20.0%	27.2%	-9.2%	9.2%	20.9%
Quality	Small Cap	Cyclical	Quality	Multi-Factor	Cyclical	Multi-Factor	Cyclical	Cyclical	Value	Defens.	Min. Vol.	Quality	Multi-Factor	Value	High Div.	Momen.
-31.2%	27.2%	17.9%	7.9%	15.7%	35.0%	14.8%	2.8%	14.0%	22.2%	-2.9%	28.0%	17.1%	25.1%	-14.0%	8.1%	19.0%
Small Cap	Quality	High Div.	Multi-Factor	Momen.	Momen.	Momen.	High Div.	Multi-Factor	Multi-Factor	Cyclical	Value	Multi-Factor	Defens.	Multi-Factor	Cyclical	Multi-Factor
-33.6%	24.9%	15.9%	7.3%	15.1%	34.8%	14.7%	0.7%	13.7%	21.5%	-5.3%	27.7%	11.4%	25.0%	-15.9%	8.9%	18.5%
Value	High Div.	Min. Vol.	Momen.	Quality	Quality	Cyclical	Multi-Factor	Min. Vol.	High Div.	Quality	Multi-Factor	Min. Vol.	High Div.	Momen.	Multi-Factor	Quality
-36.9%	18.4%	14.7%	6.1%	12.8%	34.3%	13.6%	0.4%	10.7%	19.5%	-5.6%	26.6%	5.8%	21.9%	-17.4%	8.5%	17.0%
Multi-Factor	Min. Vol.	Quality	Value	Min. Vol.	High Div.	Defens.	Defens.	Quality	Min. Vol.	Multi-Factor	Small Cap	Defens.	Min. Vol.	Quality	Defens.	High Div.
-39.3%	18.4%	14.2%	-2.7%	11.2%	28.9%	13.0%	-0.9%	9.4%	19.2%	-9.7%	25.5%	5.2%	21.0%	-20.3%	8.3%	16.7%
Momen.	Momen.	Value	Cyclical	Defens.	Defens.	Quality	Small Cap	Defens.	Small Cap	Small Cap	High Div.	High Div.	Small Cap	Small Cap	Value	Defens.
-40.9%	17.8%	12.7%	-3.4%	10.7%	28.9%	10.7%	-4.4%	7.7%	14.6%	-11.0%	22.5%	1.7%	14.6%	-20.4%	8.0%	14.5%
Cyclical	Defens.	Defens.	Small Cap	High Div.	Min. Vol.	Small Cap	Value	Momen.	Defens.	Value	Defens.	Value	Momen.	Cyclical	Small Cap	Min. Vol.
-44.8%	16.6%	12.0%	-4.2%	10.6%	25.3%	4.9%	-6.4%	5.1%	12.3%	-11.1%	21.4%	-0.2%	12.9%	-27.2%	7.2%	13.9%

Sources: FactSet, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management. The MSCI High Dividend Yield Index aims to offer a higher-than-average dividend yield relative to the parent Index that passes dividend sustainability and persistence screens. The MSCI Minimum Volatility Index optimizes the MSCI US Index using an estimated security co-variance matrix to produce low absolute volatility for a given set of constraints. The MSCI Defensive Sectors Index includes Consumer Staples, Energy, Health Care and Utilities. The MSCI Cyclical Sectors Index contains Consumer Discretionary, Communication Services, Financials, Industrials, Information Technology and Materials. Securities in the MSCI Momentum Index are selected based on a momentum value of 12-month and 6-month price performance. Constituents of the MSCI Sector Neutral Quality Index are selected based on stronger quality characteristics than their peers within the same GICS sector using three main variables: high return on equity, low leverage and low earnings variability. Constituents of the MSCI Enhanced Value Index are based on three variables: price-to-book value, price-to-forward earnings and enterprise value-to-cash flow from operations. The Russell 2000 is used for Small Cap. The MSCI USA Diversified Multiple Factor Index aims to maximize exposure to four factors: Value, Momentum, Quality and Size. Annualized volatility is calculated as the standard deviation of quarterly returns multiplied by the square root of four. J.P. Morgan "Guide to the Markets," U.S. data as of 12/31/22.

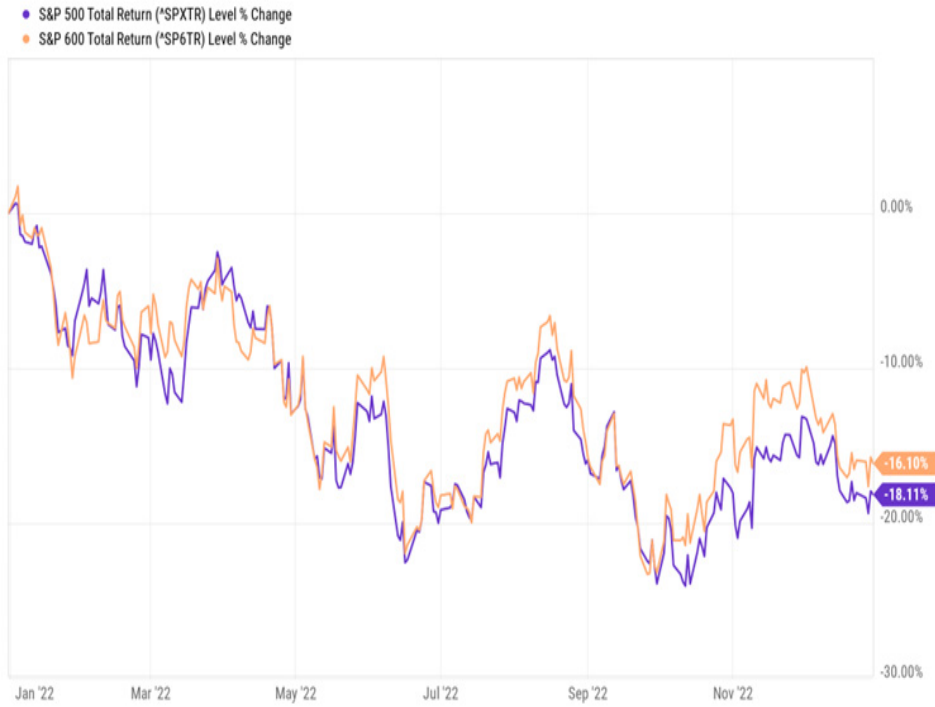
2022 Risk Factor Review

2022 witnessed one of the greatest factor rotations in history, as growth fell to earth and value roared back to life. The performance difference between the [growth](#) and [value](#) factors was one of the widest dispersions ever. We see that dividends also delivered significant outperformance.



Sources: WisdomTree, FactSet, Russell, MSCI, S&P, data as of 12/31/22. You cannot invest directly in an index. Past performance is not indicative of future returns. High Dividend: WisdomTree U.S. High Dividend Index. Quality Dividend Growth: WisdomTree U.S. Quality Dividend Growth Index. Value: Russell 1000 Value Index. Min Vol: MSCI USA Minimum Volatility Index. Momentum: MSCI USA Momentum Index. Quality: MSCI USA Sector-Neutral Quality Index. Small-Caps: Russell 2000 Index. Growth: Russell 1000 Growth Index.

While the chart above indicates that [small caps](#) underperformed, the chart uses the [Russell 2000](#) as the comparison Index. If we use the higher-quality [S&P 600 Index](#) instead, we see a different story.



Feb 12 2023, 12:44PM EST. Powered by YCHARTS

Source: YCharts, data from 1/01/22–12/31/22. You cannot invest in an index, and past performance does not guarantee future results.

On a different front, non-U.S. investing also rebounded in 2022, as both [EAFE](#) and [EM](#) markets outperformed the U.S., despite the headwind of a strong dollar rally for most of the year.

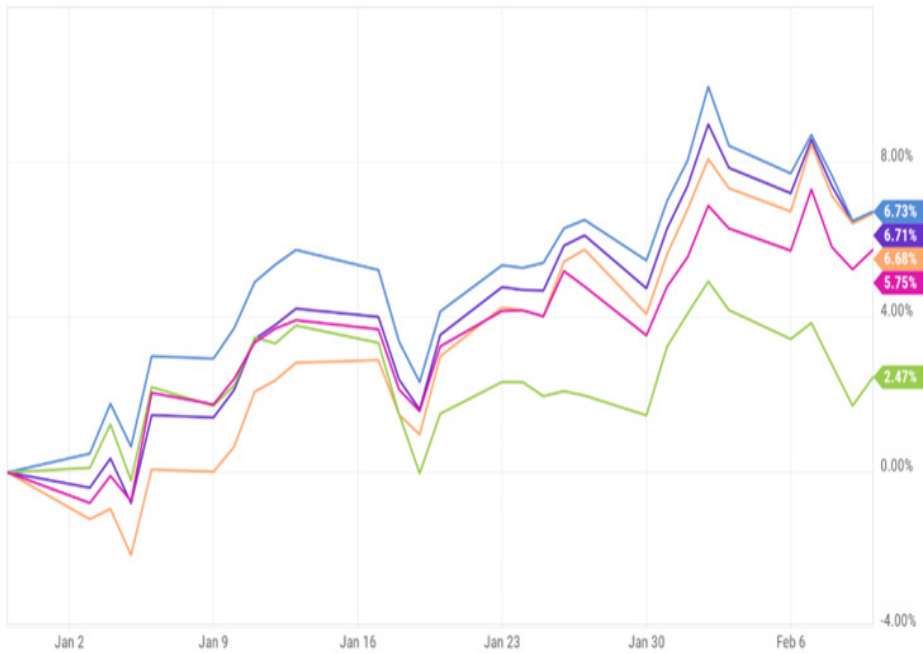


Source: YCharts, data from 1/01/22-12/31/22. You cannot invest in an index, and past performance does not guarantee future results.

What About 2023?

As we move through the first two months of 2023, we see much more volatile factor performances as the markets react to different economic reports and [Fed](#) actions/comments. Growth has mostly kept pace with value, while [dividends](#) are lagging.

- S&P 500 Total Return (*SPXTR) Level % Change
- S&P 500 Growth Total Return (*SPXGTR) Level % Change
- S&P 500 Value Total Return (*SPXVTR) Level % Change
- S&P 500 Dividend Aristocrats Total Return (*SPXDATR) Level % Change
- S&P 500 Quality Total Return (*SPXQTR) Level % Change



Feb 12 2023, 12:56PM EST. Powered by YCHARTS

Source: YCharts, YTD data through 2/10/23. You cannot invest in an index, and past performance does not guarantee future results.

At the same time, small caps have maintained and even widened their advantage over large caps.



Despite this increased “factor [volatility](#),” we continue to believe that [value](#) and [dividends](#) will outperform over the remainder of the year, and further out into the future as well. Factor rotations, such as we witnessed in 2022, tend not to be one-year phenomena but rather multi-year cycles.

We further believe that [quality](#) will become increasingly important as we head into an uncertain economic environment marked by generally rising interest rates, a slowing economy and increased market volatility. We believe that investors will once again focus on companies that exhibit stronger earnings, [cash flows](#) and [balance sheets](#) and therefore have a greater ability to protect their margins.

For valuation-driven (and therefore longer-term) investors, [U.S. small-cap stocks continue to present an interesting opportunity](#). Despite the narrowing of the gap between large- and small-cap valuations, small caps remain attractively valued on a comparative basis.

Russell 2000 Fwd. P/E (ex. Negative Earners) vs. Russell 1000





Conclusions

Given the factor tilts inherent in many, if not most, wisdomTree strategies (dividends, value, [size](#) and quality), we remain comfortable with the positioning and allocations within our Model Portfolios. Most of our models are benefiting from these factor tilts and have beaten their respective benchmarks over the past 12-15 months.

Given the difficulty in forecasting asset class and risk factor performances, however, we intentionally diversify our portfolio at both of those levels.

As a reminder, all publicly available WisdomTree Model Portfolios have certain common characteristics:

1. They are global in nature;
2. They are diversified at both the asset class and risk factor levels;
3. They are ETF-focused to optimize fees and taxes; and
4. We charge no strategist fee.

We are an **open-architecture** shop (that is, all our models include both WisdomTree and third-party products) for many reasons: (a) it's the right thing to do, (b) it's what end clients assume and advisors expect and (c) it allows us to build more risk factor-diversified portfolios.

We like the factor tilts currently embedded in our Model Portfolios, as we believe dividends, value and quality will shine as we move through 2023. We also believe size is showing distinct signs of rotating back into favor.

Financial advisors can learn more about the WisdomTree lineup of Model Portfolios by visiting our [Model Adoption Center](#).

Important Risks Related to this Article

Neither diversification nor an asset allocation strategy assures a profit or eliminates the risk of experiencing investment losses.

For retail investors: WisdomTree's Model Portfolios are not intended to constitute investment advice or investment recommendations from WisdomTree. Your investment advisor may or may not implement WisdomTree's Model Portfolios in your account. The performance of your account may differ from the performance shown for a variety of reasons, including but not limited to: your investment advisor, and not WisdomTree, is responsible for implementing trades in the accounts; differences in market conditions; client-imposed investment restrictions; the timing of client investments and withdrawals; fees payable; and/or other factors. WisdomTree is not responsible for determining the suitability or appropriateness of a strategy based on WisdomTree's Model Portfolios. WisdomTree does not have investment discretion and does not place trade orders for your account. This material has been created by WisdomTree, and the information included herein has not been verified by your investment advisor and may differ from information provided by your investment advisor. WisdomTree does not undertake to provide impartial investment advice or give advice in a fiduciary capacity. Further, WisdomTree receives revenue in the form of advisory fees for our exchange-traded Funds and management fees for our collective investment trusts.

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WisdomTree primarily uses WisdomTree Funds in the Model Portfolios unless there is no WisdomTree Fund that is consistent with the desired asset allocation or Model Portfolio strategy. As a result, WisdomTree Model Portfolios are expected to include a substantial portion of WisdomTree Funds, notwithstanding that there may be a similar fund with a higher rating, lower fees and expenses or substantially better performance. Additionally, WisdomTree and its affiliates will indirectly benefit from investments made based on the Model Portfolios through fees paid by the WisdomTree Funds to WisdomTree and its affiliates for advisory, administrative and other services.

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.

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+ [Risk Factors Are Rotating Back into Focus](#)

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DEFINITIONS

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

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 time.

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

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.

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.

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.

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

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

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

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.

Cash flows: a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

Balance sheet: refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

Size: Characterized by smaller companies rather than larger companies by market capitalization. This term is also related to the Size Factor, which associates smaller market-cap stocks with excess returns vs the market over time.