WISDOMTREE MANAGED FUTURES STRATEGY FUND—A NEW PERSPECTIVE

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The inclusion of a managed futures fund in a portfolio has historically been a contentious topic.

Once regarded by many investors to be the "best thing you were not invested in," AUM (assets under management) in the managed futures space has stagnated in recent years. Years of unrivalled absolute returns in equities have made it difficult to justify the inclusion of alternative funds.

But as we mentioned in our previous blog post, low interest rates combined with fears of inflation, present a unique opportunity for managed futures to boost returns and diversification.

WisdomTree's Approach to Managed Futures

Managed futures funds typically invest in a variety of uncorrelated asset classes through futures contracts. Most employ a long/short model, with the goal of profiting from both rising and falling markets.

Although not specifically intended for it, we believe a well-designed managed futures strategy should be able to detect inflationary or deflationary environments. These products also allow the investor access to the potentially attractive tax implications of futures investing.

The WisdomTree Managed Futures Strategy Fund (WTMF) aims to capture those benefits.

Effective June 4, 2021, we will be incorporating enhancements to the existing strategy that more closely align with investor objectives. After implementation, WTMF will hold a diversified set of equity, commodity, currency and Treasury futures contracts, outlined below.

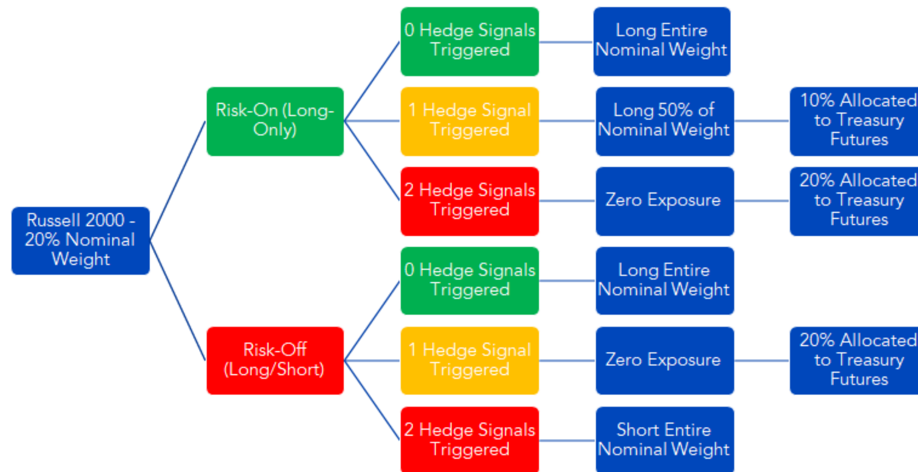
Tactical Equity Model

The exclusion of equity futures in WTMF going back to its inception has left performance on the table. Our goal is to incorporate a tactical equity model into the Fund to enhance absolute returns, while prioritizing WTMF's functionality as a diversifying alternative.

Our tactical equity model is a data-driven, systematic strategy that invests in a diversified basket of five broad equity index futures contracts (S&P 500, Nikkei 225, S&P/TSX 60, Euro Stoxx 50 and Russell 2000). The combined weight of this equity component of the model is limited to 40% of the exposure in the strategy.

A general macro indicator based on the VIX and high-yield credit spread is used to rotate between a long-only (risk-on) and long/short (risk-off) strategy. The model also uses contract-specific signals based on momentum and correlation (a sign of stress in the market) to reduce exposure or go short.

Any excess collateral available after reducing equity exposure in the model from the 40% target weight is allocated to either t-bills, or Treasury futures contracts as additional diversification. An example of the Russell 2000 contract is illustrated in the figure below.



Source: WisdomTree, 05/31/21. You cannot invest directly in an index.

Shorting is used sparingly, with only one of the possible six scenarios allowing for shorting. For each index, the strategy partially hedges or fully hedges exposure in three of the six scenarios. The result is a strategy that seeks consistent equity exposures and significantly reduced correlation to broad equity markets.

Commodity Model Enhancements

We believe commodities are a crucial contributor to the return and diversification characteristics of the Fund and will continue to remain a substantial Fund component.

In June, we will incorporate a two-factor momentum signal that seeks to provide higher conviction when taking a certain position in a commodity contract. The two momentum factors use significantly different methodologies, yet both seek to determine the direction a commodity is trending.

When both signals agree, we take either a long or a short position in the contract. If the two signals differ, there is less certainty about whether there is a reliable trend to trade on, and the nominal weight of the contract will instead be allocated to t-bills.

A critical factor of commodity futures investing is the carry cost associated with commodities. The enhanced commodity model takes the carry cost of each commodity into consideration when determining positions. If fully exposed to all commodities, the strategy would target a commodity exposure of 40%.

Currency Model Enhancements

Currencies also may offer excellent diversification to broad equity markets. In the new model, currency exposure will be reduced from 30% to 10%. We maintain exposure to currencies for their diversification benefits, while allowing for a greater allocation to asset classes that historically tend to generate higher returns.

Prior to the model changes, the currency component of WTMF consisted purely of developed market currencies. However, research has shown that adding emerging markets currency futures would have boosted returns.

For the enhanced currency model, we will utilize a rotation strategy that is either bullish or bearish the U.S. dollar (USD). Long USD exposure is obtained through the ICE U.S. Dollar Index futures contracts. Short USD exposure is obtained through a diversified set of emerging markets currency futures. An optimized momentum indicator based on the ICE U.S. Dollar Index determines whether the Fund is long or short USD.

Conclusion

While in recent years the managed futures space has seen limited growth, we believe the current market environment presents an excellent opportunity for these strategies to potentially add uncorrelated returns and reduce risk in a portfolio.

We believe the low cost of the Fund, combined with timely enhancements to the strategy,

make WTMF an ideal candidate for an investor looking to add diversification to their portfolio.

Important Risks Related to this Article

There are risks associated with investing including the possible loss of principal. An investment in this Fund is speculative, involves a substantial degree of risk, and should not constitute an investor's entire portfolio. One of the risks associated with the Fund is the complexity of the different factors that contribute to the Fund's performance, as well as its correlation (or non-correlation) to other asset classes. These factors include use of long and short positions in commodity futures contracts, currency forward contracts, swaps and other derivatives. Derivatives can be volatile and may be less liquid than other securities and more sensitive to the effects of varied economic conditions. The Fund should not be used as a proxy for taking long only (or short only) positions in commodities or currencies. The Fund could lose significant value during periods when long only indexes rise (or short only) indexes decline. The Fund's investment objective is based on historic price trends. There can be no assurance that such trends will be reflected in future market movements. The Fund generally does not make intra-month adjustments and therefore is subject to substantial losses if the market moves against the Fund's established positions on an intra-month basis. In markets without sustained price trends or markets that quickly reverse or "whipsaw," the Fund may suffer significant losses. The Fund is actively managed, thus the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Commodities and futures are generally volatile and are not suitable for all investors. Investments in commodities may be affected by overall market movements, changes in interest rates and other factors such as weather, disease, embargoes and international economic and political developments.

Diversification does not eliminate the risk of experiencing investment losses.

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DEFINITIONS

Managed futures : An alternative investment strategy in which futures contracts are used as part of the investment strategy.

Assets-under-management : The total market value of the investments that a person or entity manages on behalf of clients.

Absolute Return : A measurement of an asset's return without considering risk.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Inflation : Characterized by rising price levels.

Long (or Long Position) : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Deflation : The opposite of inflation, characterized by falling price levels.

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.

Nikkei 225 Stock Average Index : A price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange.

Euro Stoxx : Refers to the Euro Stoxx 50 Index, a market capitalization-weighted stock index of 50 large, blue-chip European companies operating in Eurozone nations.

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.

Risk-on/risk-off : refers to changes in investment activity in response to perceived risk. During periods when risk is perceived as low, investors tend to engage in higher-risk investments. When risk is perceived as high, investors tend to gravitate toward lower-risk investments.

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.

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.

Collateral : something pledged as security for repayment in the event of a loss.

Treasury Bill : A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).

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

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Commodity : A raw material or primary agricultural product that can be bought and sold.

Carry : The amount of return that accrues from investing in fixed income or currency forward contracts.

Bullish : a position that benefits when asset prices rise.

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

ICE U.S. Dollar Index (DXY) : a geometrically- averaged calculation of six currencies weighted against the U.S. dollar. Current exposures include the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and, & Swiss franc.