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# WISDOMTREE INTERNATIONAL MULTIFACTOR: NOT THE LOW VOLATILITY YOU'RE USED TO...

Alejandro Saltiel – Head of Indexes, U.S.  
04/16/2020

“Everybody has a plan until they get punched in the mouth.”

–“Iron” Mike Tyson

To say that recent performance in global markets has been humbling would be an understatement. While the world grapples with the challenges of the global pandemic, we've continued to focus on the things we can control. One theme that we think will increasingly come into focus later this year is the idea of risk management and re-examining where and how investors generate returns. While [beta](#) had been a great trade on the way up, it's been equally unpleasant on the way down. This is why we believe a [multi factor](#) approach to markets could make sense, particularly in the developed international space.

While we apply it globally, our methodology seeks to provide investors with balanced exposure to factors such as [value](#), [quality](#), [momentum](#) and [low correlation](#) to drive returns in excess of the market.

On top of the stock selection, we are also firm believers in the ability of our dynamic currency model to determine the appropriate levels of currency risk to manage [volatility](#) and boost returns.

While our research shows that developed market currencies tend to [mean revert](#), they unquestionably add volatility to international portfolios. Therefore, our currency model aims to balance the [alpha](#) potential of timing currencies correctly with the volatility reduction benefits of being [hedged](#) when risk is not in favor. Below, we try to explain the key drivers of our strategy's return in some of the most volatile periods since 2008.

## Implicit Tilt to [Low Volatility](#)

Since its inception in August 2018, [WisdomTree International Multifactor Fund \(DWMF\)](#), while down approximately 12%, has outperformed the [MSCI EAFE Index](#) by more than 3% annualized at NAV and has had a beta of 0.79<sup>1</sup> versus the index. In risk-adjusted terms, DWMF's [Sharpe ratio](#) also exceeds that of the broad market index<sup>2</sup>. For standardized performance of DWMF, please click [here](#).

Despite not using low volatility as an explicit stock-selection factor, we do believe it can improve a strategy's [risk-adjusted](#) characteristics and therefore use it as part of the weighting mechanism. Furthermore, some of our factor definitions, like risk-adjusted momentum, reward lower volatility companies and implicitly tilt DWMF toward the low volatility factor. (For more on our multifactor methodology, please refer to this [piece](#).)

In the performance attribution analysis below, we can show that as of March 31, 2020, the stocks underlying DWMF, segmented by quintile, have contributed 129 [basis points \(bps\)](#) to the total outperformance. It's also worth highlighting that, as a result of its methodology, DWMF has been consistently over-weight in the lowest volatility quintile,

which has been the best-performing category in the developed international universe. At the same time, the methodology has resulted in it being under-weight in the higher volatility quintiles, which in turn have lagged the market.

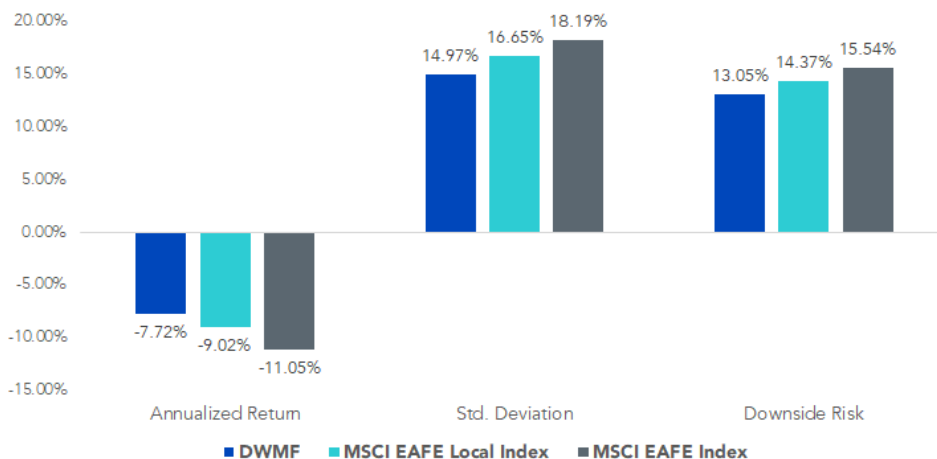
WisdomTree International Multifactor Stocks vs MSCI EAFE Index Volatility Quintile Attribution (08/31/2018 - 03/31/2020)									
Category	Attribution Components				Average Category Weights			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Stocks Weight	Benchmark Weight	+/- Wgt	Stocks Return	Benchmark Return
1st Quintile (Lowest Volatility)	0.65%	1.00%	0.58%	2.23%	52.76%	38.04%	14.72%	-6.84%	-8.78%
2nd Quintile	0.09%	-1.35%	-0.04%	-1.30%	25.12%	22.89%	2.22%	-13.92%	-10.26%
3rd Quintile	0.27%	0.37%	-0.44%	0.20%	14.59%	19.10%	-4.50%	-11.89%	-13.16%
4th Quintile	0.48%	-0.61%	0.21%	0.08%	5.28%	12.89%	-7.61%	-17.56%	-14.82%
5th Quintile (Highest Volatility)	0.04%	0.21%	-0.16%	0.08%	2.24%	7.08%	-4.83%	-13.20%	-14.09%
<b>Total</b>	<b>1.51%</b>	<b>-0.38%</b>	<b>0.15%</b>	<b>1.29%</b>				<b>-9.77%</b>	<b>-11.05%</b>

Sources: WisdomTree, FactSet. Data as of 3/31/20. Returns shown are average annual returns.

For purposes of displaying attribution, data shown is for the stocks underlying DWMF, segmented by quintile. Past performance does not guarantee future results, and actual fund performance will vary. Average weights refer to the average weight over the analysis period. Allocation refers to the portion of return which is attributable to a category being over-weight versus the benchmark. Stock selection refers to the portion of return which is attributable to the equities held versus the benchmark. Interaction refers to the portion of return attributable to the effects of how the selection and allocation effects interact with each other within the portfolio versus the same effects in the benchmark. Weights subject to change. You cannot invest directly in an index. Index performance does not represent actual fund performance.

In terms of risk management, DWMF shows a 3% improvement in [standard deviation](#) compared to the broad benchmark, along with lower downside risk<sup>3</sup>. This can be attributed to the implicit low volatility tilt in the stock selection and the dynamic currency hedge overlying the stock position.

**Return & Risk Characteristics**

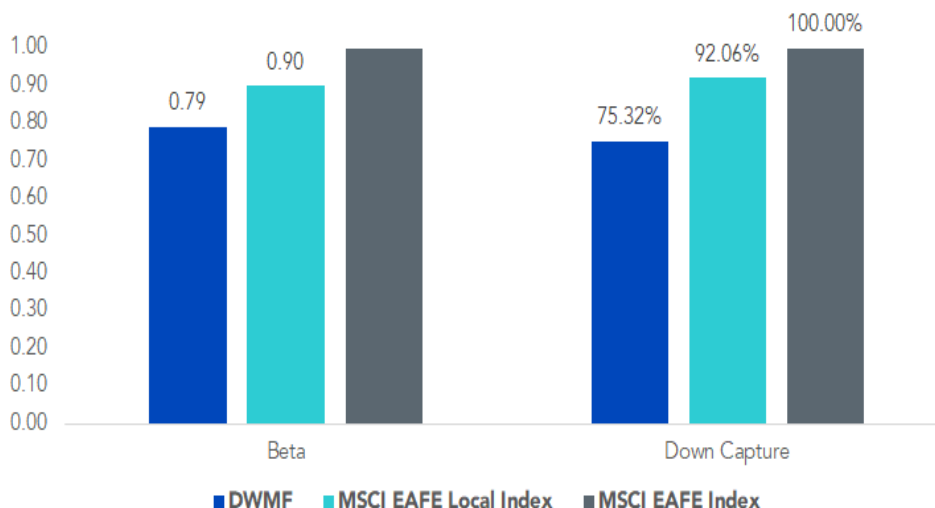


Sources: WisdomTree, Zephyr StyleADVISOR. Data from 8/31/18 to 3/31/20. You cannot invest directly in an index.

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](http://wisdomtree.com).

Over the past 19 months, the U.S. dollar (USD) has slightly strengthened versus a basket of global currencies.<sup>4</sup> Therefore, the [MSCI EAFE Local Index](#) has outperformed its USD version. DWMF's dynamic currency hedge has also contributed positively to relative performance versus both the MSCI EAFE and MSCI EAFE Local Indexes. DWMF also shows attractive [downside protection](#) versus both versions of the MSCI EAFE Index.

**Beta & Down-Capture**



Sources: WisdomTree, Zephyr StyleADVISOR. Data from 8/31/18 to 3/31/20.

### Balanced Exposure vs. Low Volatility Strategies

Finally, DWMF provides investors with a low volatility tilt while maintaining more consistent country and sector exposures compared to the broad MSCI EAFE universe, thanks to its balanced factor exposure and its embedded +/- 5% sector and country bands.

While it has provided comparable results during the most recent period, traditional low volatility methodologies tend to have more significant sector and country deviations. Both the [MSCI EAFE Minimum Volatility Indexes](#) and [S&P BMI International Developed Low Volatility Indexes](#) are significantly over-weight in defensive sectors and under-weight in [cyclical sectors](#), while also being under-weight in France, Germany and the UK in favor of Japan and Switzerland.

<sup>1</sup>Sources: WisdomTree, StyleADVISOR as of 3/31/20.

<sup>2</sup>Sources: WisdomTree, StyleADVISOR. DWMF Sharpe Ratio: -0.66; MSCI EAFE Index Sharpe Ratio: -0.73, as of 3/31/20.

<sup>3</sup>Downside risk measures volatility in periods where return is below the mean. It addresses shortcomings of standard deviation, which makes no distinction between upside deviations and downside deviations.

<sup>4</sup>Source: Bloomberg, as of 3/31/20.

#### Important Risks Related to this Article

Investing involves risk, including possible loss of principal. Investments in non-U.S. securities involve political, regulatory and economic risks that may not be present in U.S. securities. For example, foreign securities may be subject to risk of loss due to foreign currency fluctuations, political or economic instability or geographic events that adversely impact issuers of foreign securities. Derivatives used by the Fund to offset exposure to foreign currencies may not perform as intended. There can be no assurance that the Fund's hedging transactions will be effective. The value of an investment in the Fund could be significantly and negatively impacted if foreign currencies appreciate at the same time that the value of the Fund's equity holdings falls. While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models, and the models may not perform as intended. 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](#)

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## DEFINITIONS

**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.

**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.

**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.

**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.

**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.

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

**Mean reversion**: The concept that a series of returns has a tendency to return to its average level over longer periods, even if shorter periods can exhibit wide swings.

**Alpha**: Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.

**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.

**Low Volatility**: Characterized by lower standard deviation of price over time. This term is also associated with the Low Volatility Factor, which associates lower volatility stocks with better risk-adjusted returns vs the market over time.

**MSCI EAFE Index**: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

**Sharpe ratio**: Measure of risk-adjusted return. Higher values indicate greater return per unit of risk, specifically standard deviation, which is viewed as being desirable.

**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.

**Basis point**: 1/100th of 1 percent.

**Standard deviation**: measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

**MSCI EAFE Local Currency Index**: A market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan, with performance measured in local currency term.

**Downside protection**: A broad investment conception referring to the potential mitigation of risk or negative return experience.

**MSCI EAFE Minimum Volatility Index**: The Index optimizes the MSCI EAFE universe for the lowest absolute risk using a given set of constraints.&nbsp;

**Cyclical sectors**: Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.