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# “WORD MAN, WE NEED EACH OTHER – WORDS AND MUSIC”

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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.*

*“Word man, we need each other. Words and music.”*

*(From the movie Eddie and the Cruisers, 1983)*

If you don't know the movie Eddie and the Cruisers (and it's likely that you don't, though I recommend it), the actor Michael Paré plays Eddie Wilson, a talented but troubled musician in the early 1960s—the birth days of rock 'n' roll. Tom Berenger plays Frank Ridgeway, a shy poet, whom Eddie calls “word Man.” Eddie was expressing his belief that you need both words and music to succeed—which was why the two of them got along despite being completely different people.

In late 2020, the WisdomTree Research team built a list of five distinctive investment themes that we believe have a high likelihood of playing out over the course of 2021. That's the “music.” The “words” are the WisdomTree Model Portfolios that fit each investment theme.

Here is a summary of those themes (presented alphabetically), why we believe in them and the corresponding WisdomTree Model Portfolio that aligns with that theme.

## 1. [Cyclical Rotation](#)

COVID-19 cases are spiking, which may put a damper on economic growth in Q1. At the same time, we believe we are making progress on the vaccination front, and the worst may soon (hopefully) be behind us. Additionally, Congress just passed a substantial [fiscal stimulus](#) package, and with the Biden Administration stepping in and the Democrats in control of both houses of Congress, we believe yet another (perhaps even larger) fiscal stimulus package will be approved before the end of Q1.

This translates into a potentially substantial catalyst to the economy. As we've noted in other blog posts, [small cap](#), [value](#) and [emerging market](#) stocks tend to perform very well as [economic growth recovers](#):

### Typical behavior of global business cycle



- Value** Value stocks are pro-cyclical and have historically performed more strongly coming off the bottom of an economic cycle
- Quality** Quality stocks are more defensive in nature and have tended to perform best at the peak of an economic cycle or at the beginning of an economic slowdown

Source: NASDAQ, November 2018. This chart is for illustration purposes only and may not reflect actual market behavior. Past performance does not guarantee future results.

We can also see this in “real time” by comparing the recent performance of these three asset classes versus the broader [S&P 500 Index](#):



Source: YCharts, data as of 1/12/21. You cannot invest in an index, and past performance is no guarantee of future results.

**Model Portfolio Implications:** The WisdomTree [Strategic Core Equity](#), [Siegel-Wisdom Tree Longevity and Global Equity models](#) all have strategic “tilts” toward small cap and value stocks and are over-weight in emerging markets (EM) compared to the [MSCI ACWI Index](#). They are well positioned to benefit from what we believe will be a continuance of the current cyclical rotation as the economy recovers.

### 2. Disruptive Growth

While we believe in the current cyclical rotation back toward size, value and EM, we also believe that the COVID-19 pandemic fundamentally and perhaps permanently altered the way we work, socialize and entertain ourselves. We believe this has led to certain

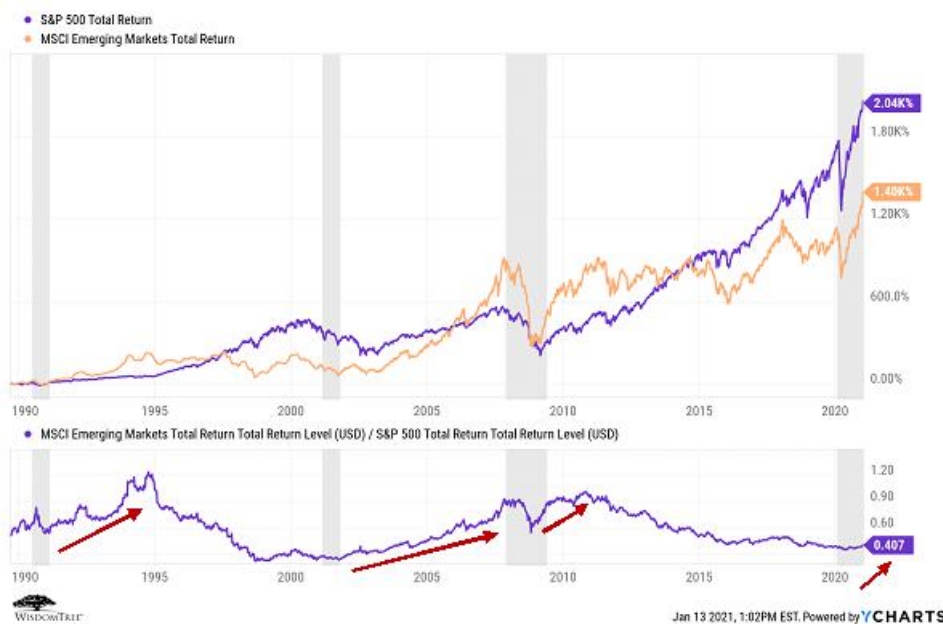
“thematic” sectors and industries that are showing huge growth trends. We refer to this as “disruptive growth,” and we think it will be with us for years to come. These industries include (but are not limited to) financial technology, cloud-based computing, platform-oriented businesses, human genomics, cybersecurity and online gaming and e-sports.

**Model Portfolio Implications:** With this growth theme in mind, in mid-2020 we launched the WisdomTree [Disruptive Growth model](#). We identified six specific industry sectors and ETFs that focused on those sectors, and the performance of this model since inception has been exactly what we hoped for, outperforming both broad market indexes (e.g., the S&P 500) and even tech-oriented indexes (e.g., the [NASDAQ](#)). This portfolio carries high valuations corresponding to its high growth rates, and it will be [volatile](#), but for advisors looking to capitalize on a thematic growth trend, we think it may be very interesting.

### 3. Emerging Markets

Based on our evaluation of fundamentals, economic and earnings growth prospects and our view on the dollar, we made the strategic decision back in late 2018 to go over-weight in emerging markets compared to the MSCI ACWI Index. (We are also over-weight in the U.S. and correspondingly under-weight in developed international, or [EAFE](#) stocks.)

Our conviction to EM remains in place and is perhaps stronger than ever. As we mentioned above, EM historically has outperformed during periods of economic recovery. (The shaded gray areas below show periods of U.S. recession.)

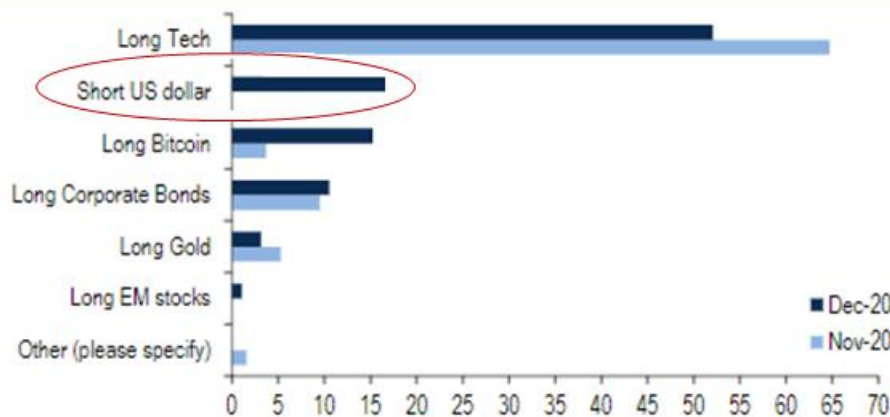


Source: YCharts, data as of 1/12/21. You cannot invest in an index, and past performance does not guarantee future results.

**Model Portfolio Implications:** All of our [Strategic Core Equity](#) models are strategically over-weight in EM, and we believe they are well positioned to capitalize on the resurgence in EM performance.

While our general market outlook is for a continuation of a weaker dollar, we do recognize that this has become a very “crowded” trade and is perhaps due for somewhat of a reversal:

**Exhibit 11: What do you think is currently the most crowded trade?**



Source: Bank of America Global Fund Manager Survey, December 2020.

Despite this, we continue to like the fundamental story of emerging markets and remain very comfortable with our current over-weight positioning.

**4. Quality and Income**

“Quality” companies refer to those with strong [balance sheets](#), [earnings](#) and [cash flows](#). This was a particularly “out of favor” factor throughout most of 2020, as “[junk](#)” companies dominated:

**No Profits, No Cash, No Problem**

Unprofitable Russell 3000 stocks are outperforming profitable ones and the index



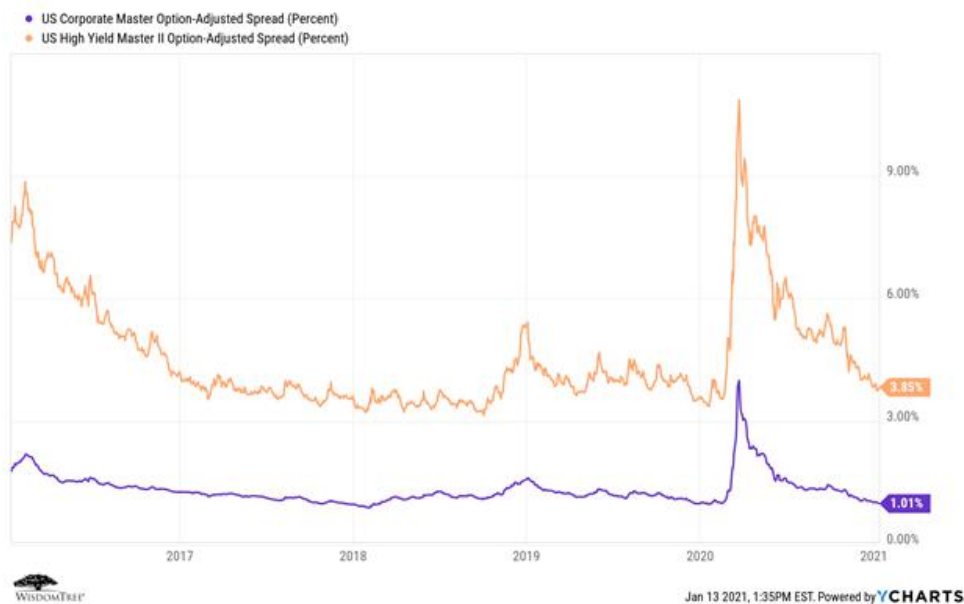
Source: Bloomberg

Note: Russell 3000 Index value is based on total return. Other figures are averages.

**Bloomberg**

Sources: Bloomberg, The Daily Shot, 12/10/20. You cannot invest in an index, and past performance does not guarantee future results.

On the income front, we maintain our belief that interest rates will remain lower for longer. We have seen an increase in rates over the past several weeks as economic and COVID-19 vaccine news have hit the headlines, but that is relative—they are still very low, and credit spreads are back to historical averages:



Source: YCharts, data as of 1/12/21. You cannot invest in an index, and past performance does not guarantee future results.

**Model Portfolio Implications:** We continue to believe that advisors and end clients looking to generate current income out of their portfolios are better served by focusing on high-quality, yield-focused equities versus taking excessive risk in their bond portfolios.

Our [Global Dividend](#), [Global Multi-Asset Income](#) and [Siegel-WisdomTree Longevity models](#) are built explicitly with these themes in mind. They all “tilt” toward higher-quality companies and are currently income-focused but allocate to [yield](#)-oriented equities instead of potentially riskier bond strategies. In a marketplace generally “starved for yield,” we have seen a great deal of advisor interest in these models, and we like how they are positioned in the current environment.

5. [Reflation](#)

The last, but not the least, of our investment themes for 2021 is “reflation”—the reappearance of inflationary pressures as the global economy recovers. It is true that, to date, these inflationary pressures have not really materialized, at least in the “headline” indicators:

Figure 7\_FRED

That said, the recovering global economy, combined with a weak dollar, has put upward pressure on the global commodity complex (i.e., “input prices”)—a trend we expect to continue:

Figure 8\_Commodities Indexes

We also believe there is a tremendous level of “pent-up demand” because of the COVID-19 lockdowns. As the vaccinations roll out and additional fiscal stimulus is implemented, we believe we may see a surge in consumption in the second half of 2021.

**Model Portfolio Implications:** We believe our [Strategic Core Equity](#) and [Endowment models](#) are well positioned in the event that we do see “reflation” enter the markets over the course of 2021. Both portfolios have allocations to inflation-sensitive equities, and the Endowment model has an explicit allocation to commodities and other real assets.

**Conclusion**

All WisdomTree models are built with specific investment objectives in mind and are designed to be “all-weather” portfolios—performing consistently regardless of market conditions.

That said, many of our models do have either strategic or tactical tilts embedded into them. Based on what we believe will be the five primary “investment themes” of 2021—cyclical rotation, disruptive growth, emerging markets, quality and income, and deflation—we are very comfortable with our current positioning and believe our models have the opportunity to perform very well as we move through the year.

*For definitions of terms in the blog, please visit our [glossary](#).*

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The Siegel-WisdomTree Longevity Model Portfolio seeks to address increasing longevity by shifting the focus to potential long-term growth through a higher stock allocation versus more traditional “60/40” portfolios.

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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## DEFINITIONS

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

**Fiscal Stimulus**: Using fiscal policy as a tool to provide economic growth.

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

**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.

**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.

**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.

**MSCI ACWI Index**: A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

**Nasdaq 100 Index**: Includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies, including investment companies.

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

**EAFE**: Refers to the geographical area that is made up of Europe, Australasia and the Far East.

**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.

**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.

**Core Earnings**: Income generated by the company's daily operations rather than one-time events or market fluctuations.

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

**Junk Bond**: A high-yield or non-investment grade bond. Junk bonds are fixed-income instruments that carry a rating of 'BB' or lower by Standard & Poor's, or 'Ba' or below by Moody's. Junk bonds are so called because of their higher default risk in relation to investment-grade bonds.

**Yield**: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

**Reflation**: The term is used to describe the first phase of economic recovery after a period of contraction. This period is typically characterized by the act of stimulating the economy through accommodative central bank policies and reducing taxes, to bring growth and inflation back up to the long-term trend.