LET THE GOOD TIMES ROLL

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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.

Let the good times roll
Let them knock you around
Let the good times roll
Let them make you a clown

Let them leave you up in the air

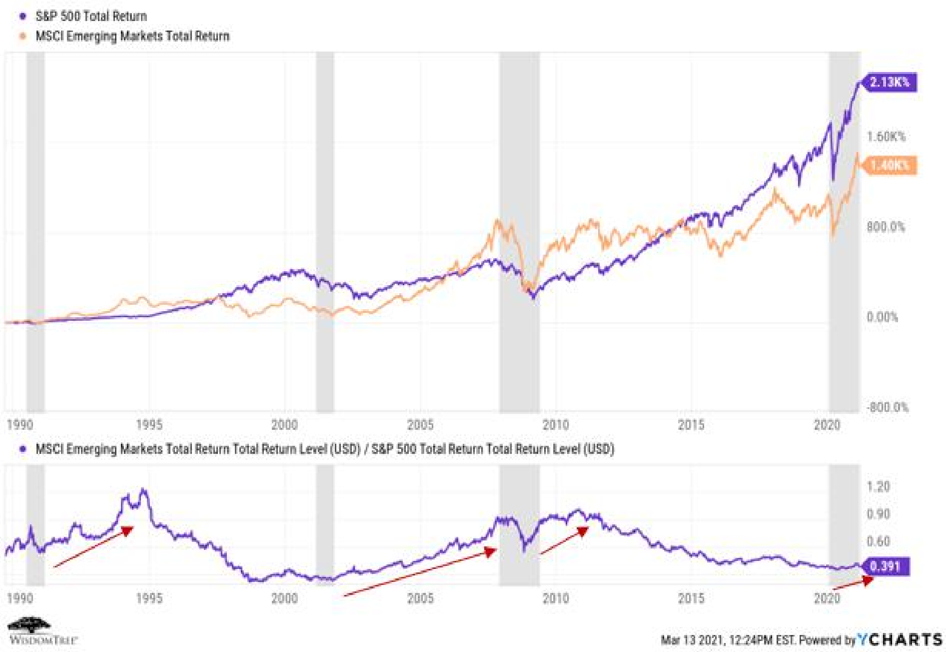
Let them brush your rock and roll hair
Let the good times roll
Let the good times roll, oh
Let the good times roll

(From "[Let the] Good Times Roll" by The Cars, 1978)

Investment Themes for 2021

As described in a previous blog post, WisdomTree has identified five primary investment themes that we believe have a high probability of playing out over the course of 2021 and beyond—emerging markets, reflation, quality and income, disruptive growth and cyclical rotation.

In this blog piece, we will take a deeper look into this last theme—cyclical rotation. We've blogged before that coming out of a recession, value, small-cap and emerging market stocks historically have outperformed. Let's a quick look at how that "cyclical rotation" trade has played out over time. We'll begin with emerging markets:



Source: YCharts, data as of 3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

While the [S&P 500 Index] has outperformed EM on a cumulative basis since 1990, we see specific periods of time when EM outperformed—typically aligned with the U.S. coming out of recession (the gray bars in the chart).

The current outperformance is more clearly visible if we look at relative performances since the beginning of Q3 2020.

Source: YCharts, data range from 7/1/20–3/2/21. You cannot invest in an index, and past performance does not guarantee future results.

How about [small-cap] stocks? Let's start with historical performance. We again see that small-cap stocks tend to lead as the U.S. comes out of recession:

Source: YCharts, data as of 3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

The bounce back for small-cap stocks in the U.S. has been especially pronounced since the announcement of the Pfizer COVID-19 vaccine back in early November:

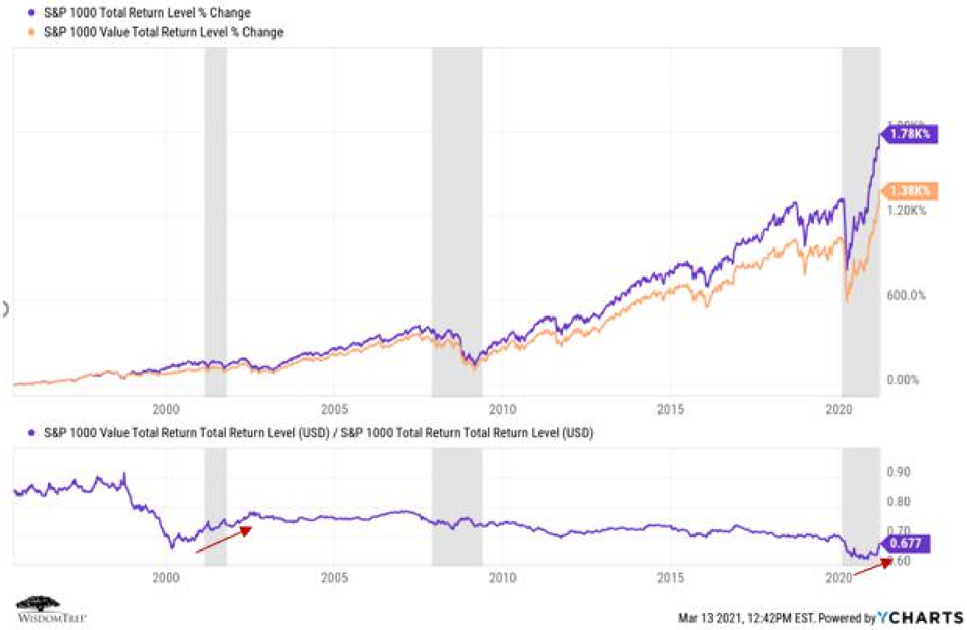
Source: YCharts, data range from 11/1/20–3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

Nor is this strictly a U.S. phenomenon. Here is a comparison of developed international ("EAFE") small-cap versus [large-cap](#) stocks since the beginning of Q3 2020:

Source: YCharts, data range from 7/1/20–3/12/21. You cannot invest in an index, and past performance does nc guarantee future results.

When investing in small-cap stocks, we believe that quality should be an essential screen, given the growing number of "zombie" companies that occupy the small-cap space—companies that are barely generating enough cash flow to cover interest expenses and rely instead on borrowing and other sources of financing to stay afloat.

Finally, let's look at the performance of value stocks versus the broader market, first historically and then since the beginning of Q3 2020. The picture is somewhat distorted by the incredible outperformance of growth stocks since roughly 2010.



Source: YCharts, data as of 2/7/21. You cannot invest in an index, and past performance does not guarantee future results.

But we see that value stocks have outperformed since the beginning of Q3 2020:

Figure 7_SP 1000 Total and Value Return

Model Portfolio Implications

At a strategic level, all of the WisdomTree Model Portfolios have certain common characteristics:

1. Relative to the MSCI ACWI Equity Index (our global equity benchmark), our core equity model is **over-weight** in the U.S. and EM, and **under-weight** in developed international ("EAFE"). This model can be (and is) used as a stand-alone model, and it is also a fundamental "building block" to our various strategic multi-asset models;

2. Also relative to the MSCI ACWI Index, we are **over-weight** in small cap and value stocks. The WisdomTree product set tends to "tilt" this way, based on the various screens we apply to our underlying Indexes. So, even though all our models are "open architecture" in that they include both WisdomTree and third-party strategies, we will normally have inherent small-cap and value tilts to our portfolios.

   Furthermore, all the WisdomTree small-cap strategies, across all geographies, have a quality screen—they seek to identify companies with strong balance sheets, profitability and cash flow. This is tangible in our core equity model, where we deploy DGRS, our small-cap quality dividend growth strategy, as our U.S. small-cap allocation, DLS, our International ("EAFE") SmallCap Dividend Fund, as our international small-cap allocation, and DGS, our Emerging Markets SmallCap Dividend Fund, as our EM small-cap allocation. All three carry explicit quality ("anti-zombie") screens.

3. Within our core fixed income model, which is both a stand-alone model and a fundamental building block of our various multi-asset models, we recently added an allocation to ELD, our emerging markets local currency debt strategy. This position aligns well with our both our "cyclical rotation" and our "emerging markets" investment themes[1].

Conclusion

We believe the cyclical rotation back toward small cap, value and emerging markets has "legs" –that is, we believe it will remain in place throughout 2021, and perhaps beyond. We believe this for several reasons:

1. We think the continued rollout of COVID-19 vaccinations, combined with massive fiscal stimulus, will drive a significant economic recovery in the U.S. in the second half of the year. Historically, this "phase" of the economic cycle is when the small-cap, value and emerging markets "risk factors" have performed well.

2. We are not "anti-growth," by any means. Growth continues to perform quite well, and one of our primary investment themes for 2021 is the continuation of a "disruptive growth" trend. But the performance and valuation differential between growth and value stocks and between small-cap and large-cap stocks had grown to historically wide levels. Since the markets historically have exhibited "reversion to the mean" tendencies, we believe this current cyclical rotation back toward small cap, value and emerging markets still has significant room to run.

If we are correct in our outlook, we believe our Model Portfolios are well-positioned to take advantage of and capitalize on what we believe will be significant "tailwinds." It's a nice feeling to have the wind at your back and to "let the good times roll."

[1]Model portfolio allocations are subject to change and should not be considered investment advice.

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You cannot invest directly in an index.

DEFINITIONS

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

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.

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

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than $10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

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 tim.

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.

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 tim.

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

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.