A POTENTIAL SOLUTION FOR NAVIGATING VOLATILITY

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On a recent podcast, WisdomTree Senior Investment Strategy Advisor Jeremy Siegel outlined his thesis for greater market volatility over the near term, resulting from inflation pressures in the macroeconomic system and an aggressive Federal Reserve policy stance necessary to counter them.

Yet because of inflation, the return to bonds can be challenged and Siegel still likes equities for their long-term inflation-hedging characteristics. Companies do a reasonably good job of passing along their rising input costs to consumers, which helps preserve profits and dividends.

The current macro backdrop poses a challenge for investors who desire equity market participation but have concerns about volatility. That became a key motivation for the recent launch of the WisdomTree Target Range Fund (GTR).

We discussed this macro setup and the strategy behind target range strategies in detail on *Behind the Markets*, a podcast brought to you by Jeremy Schwartz, WisdomTree's Global Chief Investment Officer.

In this episode, Jeremy talks to Michael McClary, CIO of Valmark Financial Group.

Listeners will hear about:

- McClary's background with Valmark as an ETF strategist. McClary has one of longest track records managing ETF portfolios. Further, there are thousands of financial plans that come through the Valmark team, so McClary and his team bring a unique vantage point to solutions that address the most common client pain points.

- The challenges McClary sees in building actively managed portfolios, and why ETFs are a preferred vehicle for Valmark clients.

- The principles of global diversification, and why Valmark constructs its ETF models with close to a 70/30 mix of U.S. stocks and international stocks.

- Why McClary designed the TOPS Target Range Index family that motivated the launch of GTR.

- The desirability of the WisdomTree Target Range Fund (GTR) from McClary's perspective.
  - Equity valuations are historically high, particularly for large-cap U.S. stocks.
  - U.S. fixed income is in a very precarious situation:
    - Interest rates are low.
    - Inflation is rising (negative real rates in many fixed income securities).
    - Credit spreads are tight.
  - Many investors may want more equity exposure but are not comfortable with the additional volatility that traditionally accompanies it. Strategies like GTR, which utilize options, can potentially help give more defined target ranges for returns and may help mitigate the volatility that comes from traditional equity investing.

- WisdomTree has often said with the current macro backdrop, the 75/25 equity/bond portfolio is our new 60/40. Others might look at the 70/30 equity/bond mix as the new 60/40.
    - GTR is one option for how one can consider adding that additional 10%–15% equity exposure into a global multi-asset portfolio.

- A summary of GTR positioning:
    - The Fund invests in one-year call spreads that are reset the third week of each January.
    - The underlying allocation of option call spreads across global ETFs:
        - 50% SPDR® S&P 500® ETF Trust (SPY)
        - 20% iShares Russell 2000 ETF (IWM)
        - 20% iShares MSCI EFAE ETF (EFA)
        - 10% iShares MSCI Emerging Markets ETF (EEM)
    - Restrikes of options positions occur if the value of an underlying ETF exceeds the strike price of the short call (cap) at any month-end (excluding December and January).
    - The strike prices of the option call spreads in GTR are:
        - Set 15% in-the-money (below the current price), and this is what potentially helps hedge market risk on the downside.
        - The short calls are sold 15% out-of-the-money (higher prices), which is what defines the top end of the target range strategy before any restrike events may occur.
        - McClary discussed the monthly restrike as something to help preserve further upside participation and not be capped for a full year on your upside of the market.

- How is the downside of the target range strategy managed? When you invest $100 in GTR, you are essentially going to see a portfolio that feels like $80–$85 of cash and collateral and $15–$20 of option premium.
    - To be specific, as of October month-end, there was approximately $81 of collateral in the Fund and $19 of long option premiums. That long call option premium could certainly fall to zero value if the markets were to fall below the strike price of those long call options. But the cash and collateral in the Fund is what preserves the value of the Fund and provides the target downside range of the Fund.

This is a very innovative new strategy, and WisdomTree was excited to work with McClary and the Valmark team to bring it to market.

You can listen to the full episode below:

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Developers:

- ES5 builds are disabled **during development** to take advantage of 2x faster build times.

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Fund will successfully implement its investment strategy. Moreover, while the Fund seeks to target returns within a prescribed range, thereby minimizing downside investment loss, there can be no guarantee that an investor in the Fund will experience limited downside protection, particularly short-term investors, investors that seek to time the market and/or investors that invest over a period other than the annual period.

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You cannot invest directly in an index.

DEFINITIONS

Inflation : Characterized by rising price levels.

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.

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

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

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.

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.

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

Real interest rate : Interest rate accounting for the impact of inflation. From the nominal interest rate, which does not account for the impact of inflation, the rate of inflation is subtracted to get to the real interest rate.

Credit spread : The portion of a bond’s yield that compensates investors for taking credit risk.

Options : Financial derivatives that give buyers the right, but not the obligation, to buy or sell an underlying asset at an agreed-upon price and date.

Call Spreads : An option spread strategy that is created when equal number of call options are bought and sold simultaneously.

Strike Price : The set price at which a derivative contract can be bought or sold when it is exercised.

Short Call : An options trading strategy in which the trader is betting that the price of the asset on which they are placing the option is going to drop.

In-the-money (ITM) : An in-the-money call option is an option with a strike price below the current market price.

Out-the-money (OTM) : An out-of-the-money call option is an option with a strike price above the current market price.

Option premium : The current price of any specific option contract that has yet to expire.

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).