A TIMELY OPPORTUNITY FOR MANAGING VOLATILITY

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2022 has opened with some shockwaves in the bond market and cascading volatility in the equity markets, particularly among the market's mega-growth names.

The macro environment is one we have discussed frequently in the blog—elevated inflation pressures are causing the Fed to start tightening policy.

Last November, we published an interview and podcast with Michael McClary, CIO of Valmark Financial Group, discussing potential solution for navigating volatility.

That solution was the WisdomTree Target Range Fund (GTR).

The investment strategy of GTR involves the rolling of option contracts that reset every January. GTR's options will be rolling next week, three days before expiration, consistent with the index methodology.

Investors entering GTR in mid-January would be entering the Fund close to when the strategy resets to a new 1-year target of a +15% and –15% call spread portfolio. While they can enter at any time of the year, we believe this may be a particularly comfortable time for investors to enter the strategy.

This makes the discussion of the opportunity set very timely, particularly with the macro environment shaping up exactly as we anticipated back in that November post above.

We reached out to McClary for an updated discussion of the macro environment that makes the target range investment strategy useful.

Schwartz: Why do you believe now is a particularly good time to consider GTR?

McClary:

> Signs lead us to believe 2022 will be quite different from 2021 and the last 5 years. While the opportunity exists for portfolios to provide marked additional gains in 2022, we feel the path to success may look different than the story we just experienced.
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> In 2021, many 60/40 and 70/30 portfolios returned double digits. They were able to get there through significant outperformance by equities, specifically, a concentrated selection of large-cap growth U.S. stocks. Likewise, returns across U.S. stocks broadly were above average, which helped make up for a –1.54% return in the Bloomberg U.S. Aggregate Bond Index. Over the past 5 years, we experienced similar leadership from large-cap growth stocks, with a larger gap over other global equities. However, bonds produced a respectable 3.54%.[1]
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> Looking forward, large cap U.S. growth stocks are trading at a lofty 28 times forward earnings.[2] We sometimes describe valuation like spreads in sports betting. While large-cap U.S. growth stocks may lead in 2022 and over the next 5 years, in order to do so they must overcome a multiple touchdown spread created by the pressure of maintaining a high multiple and low likelihood of returns coming from further multiple expansion. To make the situation more precarious, if rates rise, it could put direct pressure on growth stock multiples.
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> On the fixed income side, in my opinion, it takes some very optimistic and

creative math to get to a 3.57% annualized rate of return in bonds over the next 5 years. To the contrary, bonds may come under pressure and maintaining a positive return at all could be under question.

Therefore, we believe investors interested in growth over the next 5 years, without significantly changing their risk profiles, should consider ways to take some pressure off their 60/40 or 70/30 allocation and utilize sophisticated risk management ETFs.

The WisdomTree Target Range Fund (GTR) follows the methodology of the TOPS® Global Equity Target Range™ Index we developed. Our research on the index leads us to believe the volatility of the TOPS® Global Equity Target Range™ Index will be close to that of a traditional 70/30 portfolio.

We explicitly target 15% downside in selecting call spread strike levels, which provides risk management features that we expect to help mitigate pullbacks over 25% for traditional 70/30 portfolios such as occurred in 2008 when equities and fixed income both struggled.

Schwartz: How does Valmark suggest incorporating GTR into asset allocation portfolios for Valmark Advisors and others?

McClary:

We suggest advisors consider reducing exposure they have in traditional 70/30 portfolios and allocating to the WisdomTree Target Range Fund.

For example, perhaps an advisor puts 75% into their 70/30 model and 25% into GTR. By doing this, it could be argued that they would be able to maintain a similar overall risk level of their 70/30. However, the allocation to GTR should provide opportunity for equity upside and reduced overall exposure to the fixed income bucket of the portfolio. Further, we would expect GTR to act a bit different than the 70/30 allocation on a day-to-day basis, providing diversification benefits.

We are also seeing some advisors utilize GTR as a way to equitize bond or cash positions, without taking on full equity risk.

Similarly, we are seeing investors utilize GTR as a way to take a few chips off the table, using GTR to replace equity exposure and maintain exposure to stocks with risk management.

Schwartz: How does GTR compare to other choices advisors are looking at?

McClary:

In uncertain macro environments like today, you will always have fund managers who will promise investment alchemy, turning something of little value into gold through promised tactical success, without a clear way to execute on promises.

Instead of placing our faith in investments very different from the strategic long-term disciplined allocations we believe in, we feel some advisors would rather consider a transparent, liquid, rules-driven, institutional quality solution like GTR. The index methodology GTR is based on relies upon very specific rules which govern portfolio methodology, reducing the risk of surprises that can lead to investor disappointment when what they were running to fails to perform as expected and falls short of what they were running from.

[1] Total Return & Bloomberg U.S. Aggregate Bond Index as of 12/31/21.

[2] S&P 500 Growth Index, forward P/E, as of 12/31/21.

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You cannot invest directly in an index.

DEFINITIONS

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

Inflation : Characterized by rising price levels.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

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.

60/40 Portfolio : A portfolio of 60% equities and 40% fixed income.

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.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Bloomberg U.S. Aggregate Bond Index : Represents the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, as well as mortgage and asset backed securities.

TOPS® Global Equity Target Range™ Index : The Index tracks the performance of a cash-secured (i.e., collateralized) call spread strategy which consists of (1) buying long call options and selling short call options on a portfolio of four ETFs that track the performance of large- and mid-capitalization companies in the United States, developed market countries and emerging market countries, respectively, consisting of the SPDR® S&P 500® ETF Trust (“SPY”), iShares Russell 2000 ETF (“IWM”), iShares MSCI EAFE ETF (“EFA”), and iShares MSCI Emerging Markets ETF (“EEM”) (collectively, the “Underlying ETFs”); and (2) cash collateral.

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