

# I'VE GOT FRIENDS IN LOW PLACES

Scott Welch – Chief Investment Officer, Model Portfolios  
08/24/2020

*Well, I guess I was wrong  
I just don't belong  
But then, I've been there before  
Everything's all right  
I'll just say goodnight  
And I'll show myself to the door  
Hey, I didn't mean  
To cause a big scene  
Just give me an hour and then  
Well, I'll be as high as that ivory tower  
That you're livin' in  
'Cause I've got friends in low places  
Where the whiskey drowns  
And the beer chases my blues away  
And I'll be okay  
I'm not big on social graces  
Think I'll slip on down to the oasis  
Oh, I've got friends in low places...*

(From "Friends in Low Places," performed by Garth Brooks, 1990)

We recently wrote about the investor demand for "[low volatility](#)" [positions within their portfolio](#). Let's update our chart from that blog for year-to-date (it ain't pretty):

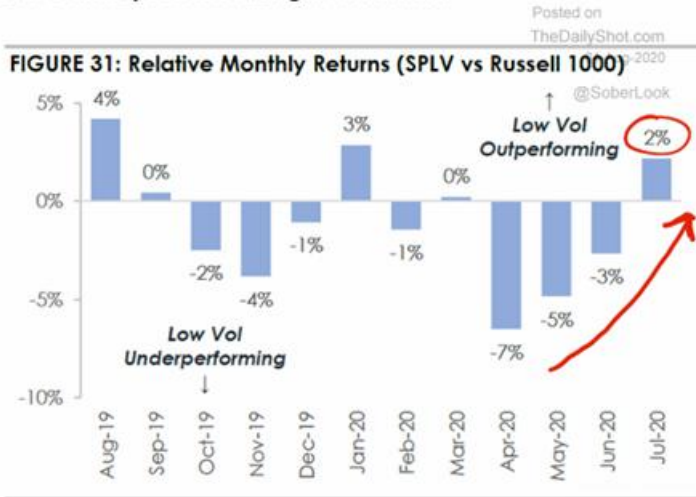


Source: YCharts, data as of 8/11/20. You cannot invest in an index. Past performance does not guarantee future results.

For definitions of indexes in the chart, please visit our [glossary](#).

If we broaden our horizons (i.e., compare "low vol" to the [Russell 1000 Index](#) instead of the [S&P 500](#), which is dominated by the [mega-cap](#) tech stocks), however, "[low vol](#)" seems to be making a bit of a comeback.

Low Volatility Factor Making a Comeback?



MarketDesk Research | Factor Views

Sources: MarketDesk Research and The Daily Shot, 8/6/20. You cannot invest in an index. Past performance does not guarantee future results. SPLV is the Invesco S&P 500 Low Volatility ETF. SPLV tracks the S&P 500 Low Volatility Index, which is a volatility-weighted index of the 100 least-volatile stocks in the S&P 500.

Furthermore, despite relatively anemic relative performance, investor demand for “low volatility” positions within their portfolios seems to be increasing, given the rise in overall market [volatility](#) due to the ongoing coronavirus pandemic and corresponding economic uncertainty. First, let’s illustrate the potential “regime change” in volatility:



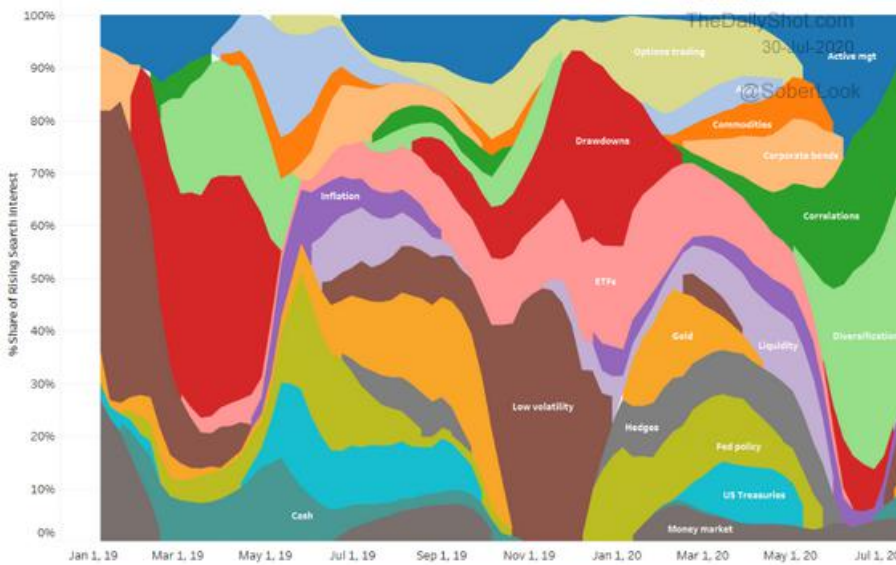
Aug 11 2020, 3:56PM EDT. Powered by YCHARTS

Source: YCharts, data as of 8/11/20. You cannot invest in an index. Past performance does not guarantee future results. CBOE Volatility Index® (VIX®): a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. It is the premier benchmark for U.S. stock market volatility.

Now, let’s examine how investors are reacting to this potential volatility “regime change.” This next chart somewhat resembles a surrealist painting, but it illustrates an interesting point—investors increasingly are seeking “diversification” within their

portfolios:

Investors Increasingly Concerned About Correlations and Diversification  
 % share of rising U.S. search interest by category



Data Sources: Google © 2020 Arbor Research & Trading, LLC. All Rights Reserved. Posted on TheDailyShot.com 30-Jul-2020 @Saberlook

Sources: Arbor Data Science and The Daily Shot, 7/30/20.

Finally, let's remind ourselves of the importance of [factor diversification](#) as well as asset class [diversification](#) when attempting to build a truly diversified portfolio. Just like asset classes, risk factors rotate in and out of favor. In this busy "risk factor performance quilt," focus your eyes on the dark green "multifactor" index box—notice how it tends to "cluster" around the middle, suggesting more consistent and stable historical performance relative to the other, more individual, risk factors:

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
Momentum (-1.8%)	Value (60.32%)	Correlation (28.0%)	Quality (15.8%)	LowVol (19.30%)	Quality (50.9%)	LowVol (-21.00%)	Value (28.1%)	Quality (25.67%)	LowVol (12.31%)	Quality (18.67%)	Value (46.52%)	LowVol (17.7%)	Momentum (7.46%)	Value (19.44%)	Quality (25.47%)	LowVol (-1.2%)	Size (28.2%)	Correlation (8.5%)
LowVol (-2.50%)	WTUSMFU (38.38%)	Multifactor (25.4%)	Value (15.26%)	Momentum (17.42%)	Correlation (7.3%)	Momentum (-25.75%)	WTUSMFU (40.1%)	WTUSMFU (23.22%)	Momentum (12.08%)	Value (17.73%)	Size (25.77%)	Multifactor (16.9%)	LowVol (5.32%)	WTUSMFU (13.9%)	Size (22.21%)	Momentum (-2.34%)	Quality (27.97%)	Size (-0.88%)
Multifactor (-2.87%)	Correlation (34.08%)	Value (36.6%)	Correlation (15.0%)	Value (17.30%)	Size (7.18%)	Multifactor (-32.55%)	Quality (38.0%)	Value (20.57%)	Multifactor (10.65%)	WTUSMFU (17.7%)	WTUSMFU (36.3%)	Correlation (15.2%)	Quality (1.5%)	Quality (12.27%)	WTUSMFU (19.63%)	Correlation (-3.07%)	Value (27.75%)	Momentum (-1.88%)
Correlation (-7.1%)	Quality (32.81%)	LowVol (18.5%)	Multifactor (16.4%)	Multifactor (15.42%)	Multifactor (5.8%)	Quality (-31.00%)	Correlation (28.8%)	Correlation (20.12%)	Correlation (6.42%)	Size (25.77%)	Correlation (36.8%)	Momentum (15.3%)	Size (10.60%)	LowVol (13.00%)	Value (19.1%)	Multifactor (-4.82%)	LowVol (27.85%)	Quality (-2.4%)
Quality (-4.27%)	Multifactor (30.97%)	Quality (27.48%)	WTUSMFU (21.4%)	WTUSMFU (14.0%)	WTUSMFU (5.7%)	Size (-32.67%)	Size (2.78%)	Momentum (27.56%)	Quality (3.4%)	Multifactor (15.67%)	Quality (31.78%)	Size (30.2%)	Multifactor (0.55%)	Size (11.52%)	Momentum (16.77%)	Size (-4.38%)	WTUSMFU (27.1%)	WTUSMFU (-4.70%)
Value (-15.4%)	Size (30.10%)	WTUSMFU (27.4%)	Size (7.50%)	Size (13.39%)	Momentum (5.3%)	Value (-38.47%)	Multifactor (38.5%)	Multifactor (27.38%)	Size (0.05%)	Correlation (15.52%)	Multifactor (2.2%)	Value (13.5%)	WTUSMFU (-1.31%)	Momentum (6.8%)	Multifactor (17.3%)	Quality (-4.82%)	Momentum (20.01%)	Multifactor (-5.55%)
WTUSMFU (-2.97%)	LowVol (27.01%)	Momentum (17.6%)	Momentum (5.59%)	Quality (12.57%)	LowVol (0.3%)	WTUSMFU (-38.85%)	LowVol (20.2%)	LowVol (55.9%)	WTUSMFU (11.1%)	Momentum (13.15%)	Momentum (27.9%)	Quality (13.2%)	Value (-5.9%)	Multifactor (19.6%)	LowVol (17.2%)	WTUSMFU (-7.82%)	Correlation (23.12%)	LowVol (-7.10%)
Size (-22.12%)	Momentum (25.57%)	Size (11.10%)	LowVol (5.07%)	Correlation (11.24%)	Value (6.2%)	Correlation (-8.0%)	Momentum (25.1%)	Size (14.5%)	Value (-1.24%)	LowVol (12.9%)	LowVol (28.7%)	WTUSMFU (22.5%)	Correlation (-7.79%)	Correlation (7.9%)	Correlation (13.51%)	Value (-43.2%)	Multifactor (20.11%)	Value (-48.97%)

Source: WisdomTree Asset Management, data through 7/31/20. You cannot invest in a factor. Past performance does not guarantee future results.

All of this focus on "low volatility" diversification brings us to what we think might be an interesting WisdomTree solution set—our U.S., EAFE (Europe, Australasia and the Far East) and Emerging Markets (EM) [multifactor strategies](#). All of these strategies screen for multiple risk factors, including [quality](#), [value](#), [momentum](#) and [low correlation](#) relative to the broader market.

The result is a "low vol" strategy (or, more specifically, a strategy that seeks to lower overall portfolio volatility by increasing the risk factor diversification), but at much more attractive [valuations](#) than the much-sought-after "low volatility" strategies.

As a point of comparison, as of mid-August a very popular ETF that tracks the performance of the S&P 500 Index currently trades at a [price-to-earnings \(P/E\) ratio](#) of



~24.9%. Another popular ETF that tracks the performance of the S&P 500 Low Volatility Index currently trades at a P/E ratio of ~23.3%—barely a discount for an Index that includes the hyper-valued mega-cap tech stocks.

But the [WisdomTree U.S. Multifactor Fund \(USMF\)](#) currently trades at a P/E ratio of ~18.2%—and it also carries lower valuations on a [price/sales](#), [price/cash flow](#) and [price/book basis](#). Additionally, the securities within USMF show significantly higher quality characteristics (e.g., [return on equity](#), [return on assets](#) and [leverage](#)) than those other two ETFs.

The bottom line? If you are seeking smarter diversification within your overall portfolio, the WisdomTree multifactor strategies may be able to help you get there without overpaying for the benefit of “low volatility.”

#### Important Risks Related to this Article

Diversification does not eliminate the risk of experiencing investment losses.

There are risks associated with investing, including possible loss of principal. Investing in a Fund exposed to particular sectors increases the vulnerability to any single economic, political or regulatory development. This may result in greater share price volatility. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. 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](#)

View the online version of this article [here](#).

**IMPORTANT INFORMATION**

**U.S. investors only:** Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.  
You cannot invest directly in an index.

## DEFINITIONS

**Russell 1000 Index** : A measure of the performance of the 1,000 largest companies by market capitalization in the Russell 3000 Index.

**Mega Cap** : Market Capitalization over \$100 Billion.

**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.

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

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

**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.

**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.

**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.

**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.

**Price-to-earnings (P/E) ratio** : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Price-to-sales (P/S) ratio** : share price divided by per share revenue.

**Price-to-cash flow (P/CF) ratio** : Share price divided by cash flow per share. Lower numbers indicate an ability to access greater amounts of cash flows per dollar invested.

**Price-to-book ratio** : Share price divided by book value per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Return on Equity (ROE)** : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Leverage**: Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.