GIMME SHELTER

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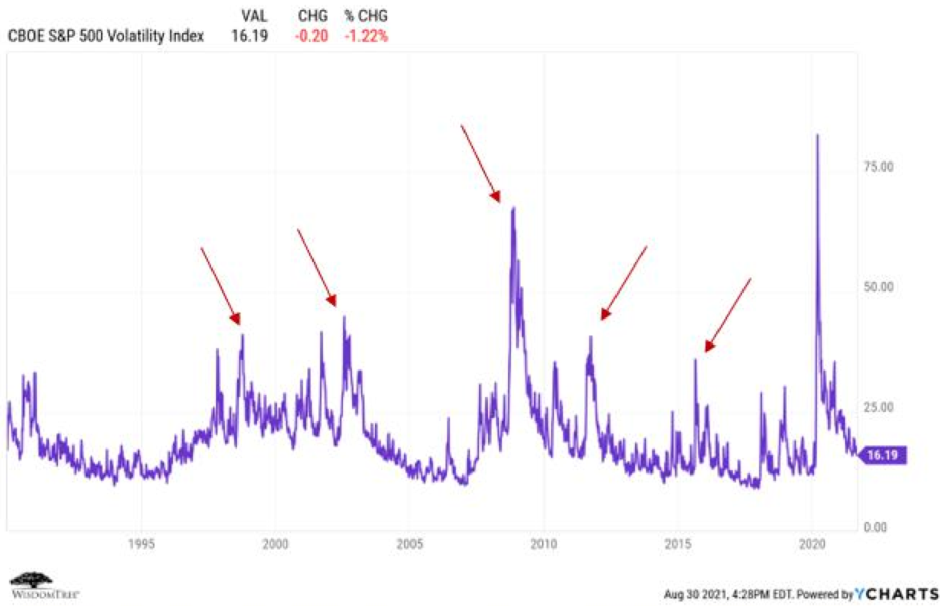
This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model Portfolios.

Ooh, a storm is threatening
My very life today
If I don't get some shelter
Ooh yeah I'm gonna fade away

(From "Gimme Shelter" by The Rolling Stones, 1969. RIP, Charlie Watts)

We frequently caution investors and advisors to not get overly concerned about market movements during the summer months. Trading volume tends to be lighter and so market movements can be magnified.

But September and October frequently are months of dramatically increased volatility. The CBOE S&P 500 Volatility Index (aka, the "VIX") is a widely used metric of broad market volatility. The red arrows in the VIX chart below correspond (from left to right) to September 1998, September 2002, October 2008, September 2011 and September 2015. (The large spike at the far right was, of course, in March 2020 when the COVID-19 lockdowns began.)



Source: YCharts, data through 8/30/21. You cannot invest in an index and past performance does not guarantee future results.

The current VIX level of around 16% is a little lower than the historical average of roughly 18%–20%. That is, investors are displaying a certain level of complacency about the market. Some of that, no doubt, is the summer doldrums, some of it is the fact that the Q2 earnings season was so strong, some of it is a general belief in a global economic recovery, and some of it is optimism about the [Federal Reserve (Fed)] maintaining its current accommodative stance (strengthened by Fed Chair Jerome Powell's recent Jackson Hole comments) as well as the potential for additional fiscal stimulus.

But there are uncertainties out there: the evolution of the delta and other variants of the COVID-19 virus and its potential impact on schools and lockdowns, inflation potential, fragile geopolitical relationships between the U.S. and China, Russia and Iran and, of course, the events in Afghanistan (which, while fairly insignificant in terms of the global economy and markets, may potentially have an impact on consumer sentiment in the U.S.).

Bottom line—historical precedent and the current facts on the ground suggest that we may see a dramatic spike in market volatility over the next three to four months. Fortunately, we can help.

As part of our **Outcome Focused** Model Portfolio solution set, we offer three **Multifactor** Model Portfolios (U.S., Developed International and Emerging Markets). These risk-factor-diversified all-equity models are managed explicitly as complements to more broadly diversified portfolios, as a means of potentially dampening the overall portfolio volatility.

We wrote recently on the potential benefits of risk factor diversification, and this is exactly what our multifactor models are designed to do. Here is our risk factor "performance quilt" through June 30:

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Momentum (−11.18%)	Value (40.93%)	Correlation (17.01%)	Correlation (11.07%)	Value (20.76%)	Quality (13.04%)	LowVol (−24.49%)	Value (46.46%)	Quality (20.13%)	Multifactor (13.97%)
LowVol (−13.14%)	WTUSMFU (29.54%)	Multifactor (16.92%)	Quality (10.43%)	Multifactor (18.44%)	Multifactor (9.44%)	Momentum (−26.59%)	WTUSMFU (27.26%)	WTUSMFU (15.96%)	LowVol (13.73%)
Multifactor (−13.72%)	Size (27.07%)	LowVol (14.67%)	Multifactor (8.59%)	LowVol (17.52%)	Correlation (9.43%)	Multifactor (−29.07%)	Quality (25.37%)	Value (13.89%)	Momentum (11.68%)
Quality (−14.37%)	Correlation (26.45%)	Momentum (13.18%)	Value (7.24%)	Momentum (15.75%)	Size (6.49%)	Value (−30.86%)	Size (23.27%)	Size (12.49%)	Correlation (9.94%)
Correlation (−16.35%)	Momentum (20.23%)	Quality (12.04%)	WTUSMFU (6.46%)	Correlation (15.57%)	WTUSMFU (6.15%)	Quality (−31.94%)	Correlation (21.76%)	Correlation (12.06%)	Quality (5.49%)
WTUSMFU (−22.15%)	Quality (19.49%)	WTUSMFU (11.67%)	Size (4.45%)	WTUSMFU (15.35%)	Momentum (5.4%)	Size (−34.84%)	LowVol (17.38%)	Momentum (11.93%)	Size (2.78%)
Value (−23.09%)	LowVol (18.93%)	Size (9.14%)	Momentum (2.99%)	Size (14.95%)	LowVol (1.4%)	WTUSMFU (−36.71%)	Multifactor (16.26%)	Multifactor (10.56%)	WTUSMFU (1.84%)
Size (−23.78%)	Multifactor (16.9%)	Value (8.86%)	LowVol (2.26%)	Quality (14.08%)	Value (0.66%)	Correlation (−36.9%)	Momentum (14.77%)	LowVol (9.54%)	Value (0.29%)

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 YTD
Value (16.8%)	Value (34.73%)	Correlation (20.35%)	Momentum (7.49%)	Value (16.07%)	Quality (27.01%)	LowVol (1.85%)	Quality (36.45%)	Momentum (24.89%)	Value (16.49%)
WTUSMFU (16.17%)	WTUSMFU (32.78%)	Value (14.19%)	Correlation (2.92%)	LowVol (11.8%)	Size (22.75%)	Momentum (0.65%)	Size (29.48%)	Quality (24.83%)	Size (11.91%)
Size (15.85%)	Size (32.11%)	Multifactor (13.67%)	Size (2.72%)	WTUSMFU (11.73%)	WTUSMFU (21.95%)	Size (−3.07%)	WTUSMFU (29.04%)	Size (21.84%)	Quality (10.24%)
Momentum (15.81%)	Correlation (29.25%)	WTUSMFU (13.14%)	LowVol (2.06%)	Size (10.99%)	Momentum (20.54%)	Multifactor (−3.91%)	Value (28.85%)	WTUSMFU (20.81%)	Multifactor (9.26%)
Correlation (15.76%)	Momentum (27.29%)	Quality (13.14%)	WTUSMFU (1.35%)	Momentum (10.07%)	LowVol (19.33%)	Correlation (−4.61%)	Correlation (28.04%)	Multifactor (19.51%)	LowVol (9.04%)
Quality (15.4%)	Quality (26.05%)	Size (13.06%)	Multifactor (0.67%)	Correlation (6.61%)	Multifactor (19.32%)	WTUSMFU (−4.64%)	Momentum (27.01%)	Correlation (19.16%)	WTUSMFU (7.95%)
LowVol (13.95%)	LowVol (24.56%)	LowVol (11.39%)	Quality (−0.58%)	Multifactor (6.09%)	Value (17.61%)	Quality (−7.39%)	LowVol (25.42%)	LowVol (11.64%)	Momentum (7.76%)
Multifactor (12.82%)	Multifactor (24.18%)	Momentum (10.29%)	Value (−2.3%)	Quality (4.69%)	Correlation (16.53%)	Value (−9.29%)	Multifactor (23.75%)	Value (2.88%)	Correlation (1.5%)

Source: WisdomTree, Factset, 2021 YTD through 6/30/21. The starting universe for the referenced "factor portfolios" is the 800 largest companies listed in the U.S. Securities in the Low Correlation portfolio are selected based on their trailing 6- and 12-month correlation versus the broad market. Securities in the Low Volatility portfolio are selected based on their trailing 12-month standard deviation. Securities in the Momentum portfolio are selected based on their trailing 6- and 12-month risk-adjusted performance. Securities in the Quality portfolio are selected based on stronger current and historical (3 year) measures of profitability compared to their peers in the same GICS industry using four main variables: Return on Equity, Return on Assets, Gross Profits over Assets, Cash Flow over Assets. Securities in the Value portfolio are selected based on more attractive valuation metrics compared to their peers in the same GICS industry using six main variables: Sales-to-Price, Book-to-Price, Earnings-to-Price, Estimated Earnings-to-Price, EBITDA-to-Enterprise Value, Operating Cash Flow-to-Price. Securities in the Size portfolio are selected based on their market capitalization compared to their peers in the starting universe. Securities in the Multifactor portfolio are selected based on a composite score calculated by equally weighting their Low Correlation, Momentum, Quality and Value scores.

The point is not which factors currently are in the lead, but rather the swirling, constantly changing tapestry of leaders. Market conditions can and do change rapidly and are very difficult to predict.

That is why all WisdomTree Model Portfolios are diversified at both the asset class and risk factor levels—we believe it helps to improve the consistency of performance through various economic and market regimes.

While the three WisdomTree multifactor models can be (and are) used as stand-alone portfolios—one of our largest relationships uses the U.S. model as its core equity holding—they were designed as complementary "sleeve portfolios" to allow advisors to increase risk factor diversification without necessarily disrupting the allocations of their existing portfolios.

Additional Potential Benefits

The multifactor models offer other potential benefits beside improved factor diversification. Specifically, improved asset style diversification, better quality, lower valuations and a higher dividend yield.

Let's look at a comparison of various metrics between the U.S. multifactor model, the S&P 500 Index, and the Russell 3000 Index:

Metric	U.S. Factor Model	S&P 500	Russell 3000
Large Cap Weight (%)	82.5	99.2	88.8
Mid Cap Weight (%)	14.9	0.8	9.2
Small Cap Weight (%)	2.57	0	2.0
Weighted Average Market Cap	342B	541B	434B
Dividend Yield (%)	1.58	1.3	1.23
Return on Assets (%)	4.81	3.63	2.9
Return on Equity (%)	19.58	16.94	13.69
Price to Earnings	20.5x	27.1x	32.4x
Forward Price to Earnings	18.2x	21.9x	23.2x

Sources: WisdomTree and FactSet, data as of 7/31/21. You cannot invest in an index and past performance does not guarantee future results. Factor model results are presented at net asset value.

You can see that the U.S. multifactor model currently is less concentrated in large-cap stocks, is trading at lower valuations (P/E and forward P/E), provides a better dividend yield, and offers an improved quality profile (ROA and ROE) in comparison to both the S&P 500 and Russell 3000 indexes.

Conclusion

As we reach the end of summer, the markets are relaxed and making Panglossian assumptions about the future ("All is for the best in this the best of all possible worlds"). But the fall historically has often slapped the market in the face with big doses of reality and volatility. Perhaps advisors and investors should consider a different approach—"plan for the worst but hope for the best."

You can learn more about our multifactor models on our Model Adoption Center on the WisdomTree website.

Important Risks Related to this Article

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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. .

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

Inflation : Characterized by rising price levels.

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

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 tim.

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.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

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.

Russell 3000 Index : Measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

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.

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.

Forward P/E ratio : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

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.

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