FIGHT TRADE WARS WITH FUNDAMENTALS

Brendan Loftus – Director, Portfolio Solutions
05/20/2019

On Friday, May 10, the U.S. followed through on its threat to raise tariffs from 10% to 25% on $200 billion worth of China's imports to the United States.

In a fully anticipated response, China announced it will hike tariffs on $60 billion worth of U.S. imports starting on June 1.

Markets pulled back from all-time highs on this news, as global growth expectations are adjusted back.

While investors attempted to digest this new development, the markets experienced a correction, which, after the strong gains so far this year, some may feel is overdue.

Increased volatility is nearly assured during periods of uncertainty such as these. But for those paying attention in the last 14-plus months, volatility should come as no surprise.

With strong corporate and domestic economic data, there have been multiple periods of sharp upward gains within the last year and a half. But these rises can cause inflated valuations, which in turn can lead to intense pressure during periods of uncertainty. We have seen clearly during recent market pullbacks that markets will react quickly to any new set of circumstances that call into question the current state of economic stability and the rate of global and domestic growth. And, as usual, stocks and sectors that rose the most on the way up declined the most in the correction.

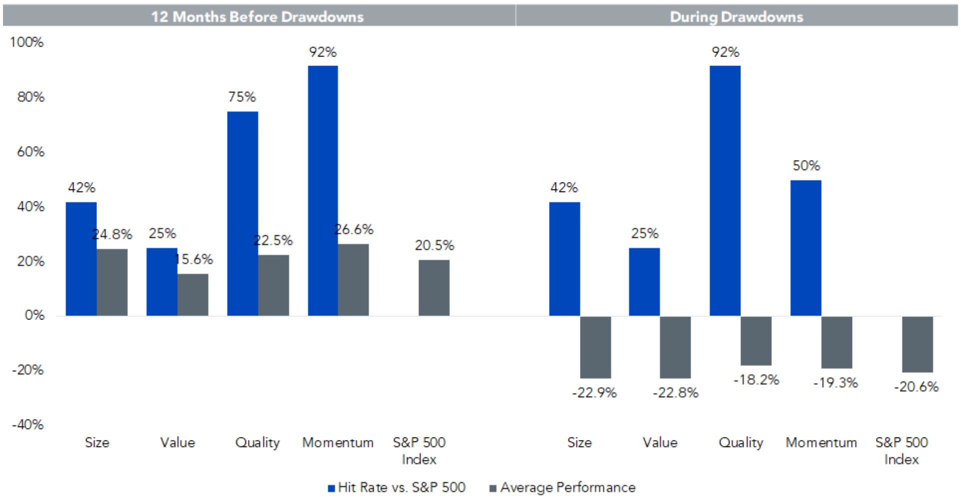
Thinking about where we are in the overall market cycle, most would agree that we're in the latter innings of a decade-long bullish market cycle. We must remember that these cycles don't simply end because markets return to what some might consider fair valuations. They end when the markets become overvalued. This is how virtually every market bubble has been created—and subsequently popped—as valuations simply couldn't back the underlying corporate fundamentals.

I am not signaling the end of this bull market as we know it, and neither is the vast majority of the Street. In fact, the underlying fundamentals on both the economy and the companies have been pretty stellar up to this point.

What we do need to realize, though, is that companies are going to be under increasingly more pressure to keep up and maintain long-run profitability. When markets face intense downward pressures, it is generally those higher-quality, more fundamentally sound companies that withstand the storm and emerge on the other side.

Our research has studied how quality as a factor has performed leading up to and during market drawdowns.

Figure 1: Factor Performance in Market Cycles



Sources: WisdomTree, Yardeni Research, Kenneth French Data Library, Bloomberg, 9/30/1997–11/30/2018, which represents latest date of available data. Size refers to the Lo 30 portfolio of all listed stocks in the bottom 30% of the total U.S. market capitalization. Value refers to the BIG HiBM portfolio of large-cap companies with high book/market ratios. Quality refers to the BIG HiOP portfolio of large-cap companies with high operating profitability. Momentum refers to the BIG HiPRIOR portfolio of large-cap companies with positive trailing price momentum. Past performance is not indicative of future results. You cannot invest directly in an index. Please refer to the glossary for defined terms.

This analysis shows that during a market drawdown—which we quantify as a 10% drop in the S&P 500 Index—quality as a factor has outperformed the S&P 500 every monthly period dating back to 1997. This is, by far, the best-performing factor in a drawdown period. Likewise, in the 12 months leading up to a drawdown, quality outperformed the S&P 500 in 75% of the months dating back to 1997.

Since the beginning, WisdomTree has recognized the important role these quality fundamentals can play in your overall market exposure. Our belief that a fundamentally weighted approach can produce attractive returns with less risk and expense than active management made us a pioneer in factor-based investing. We have implemented this philosophy across multiple asset and global Fund families, whether it be through our more defensive dividend-weighted strategies, our lower P/E, higher-quality approaches, our fundamental corporate bond strategies or even our new multifactor equity approaches.

In short, remember that reactionary markets are not a time for panic but a time for opportunity. Consider how improving the underlying fundamentals can help you navigate what would otherwise be rather uncertain markets.

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)

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

Correction : A drop of 10% or greater in an Index or stock from a recent high.

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

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.

Bullish : a position that benefits when asset prices rise.

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.