WisdomTree®

A MULTI-YEAR VALUE CYCLE BECKONS

Jeff Weniger, CFA, Head of Equity Strategy

THIS MAY BE THE FIRST INNING

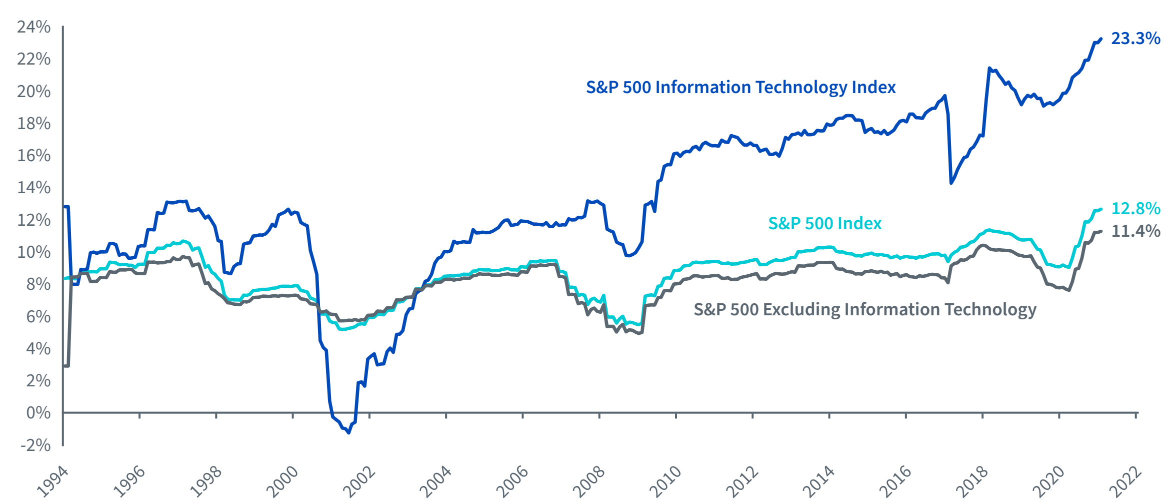
It's possible a new value cycle commenced in November 2021, reversing 14 years of woeful underperformance relative to growth. Figure 1 shows the performance of growth stocks relative to value. When the latter is rising, as was the case from 2007–2021, the former is outperforming. As you can see, the cycle that may have ended in November 2021 exceeds even that of the legendary growth stock run of the 1990s.

Figure 1: S&P 500 Growth Index Relative to S&P 500 Value Index (Total Return)

Source: Refinitiv, as of 2/9/22. Index returns based on total returns from 2/20/1975–2/24/2022. You cannot invest directly in an index. Past performance is not indicative of future returns.

While there are many theories as to why growth outperformed for most of the last generation, one of the key drivers has been a generalized expansion in tech stock profit margins (Figure 2). A common explanation has been the rise of the “platform economy,” wherein companies facilitate between groups through technology. The primary example of this business model is social media, which can scale better than traditional hardware and software businesses.

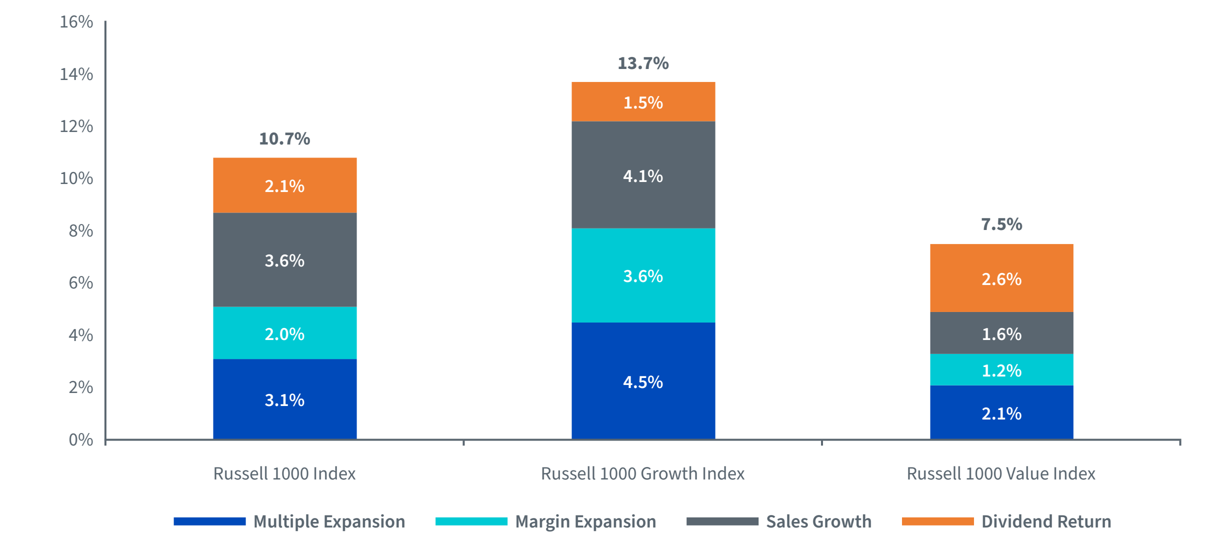
Figure 2: Net Profit Margin, S&P 500 Index and Information Technology



Sources: WisdomTree, FactSet, Russell, as of 1/31/22. Index returns based on total returns from 12/30/1994–1/31/2022. You cannot invest directly in an index. Past performance is not indicative of future returns.

Price-to-earnings (P/E) multiple expansion was also a major factor (Figure 3). One of my concerns for Big Tech is if the regulators start to get an itch for trust-busting—breaking up companies that are or are perceived to be monopolies—potentially crimping both margins and P/E multiples. That would be problematic for growth indexes, which own many of the Silicon Valley giants.

Figure 3: Returns Decomposition, 12/31/06–12/31/21

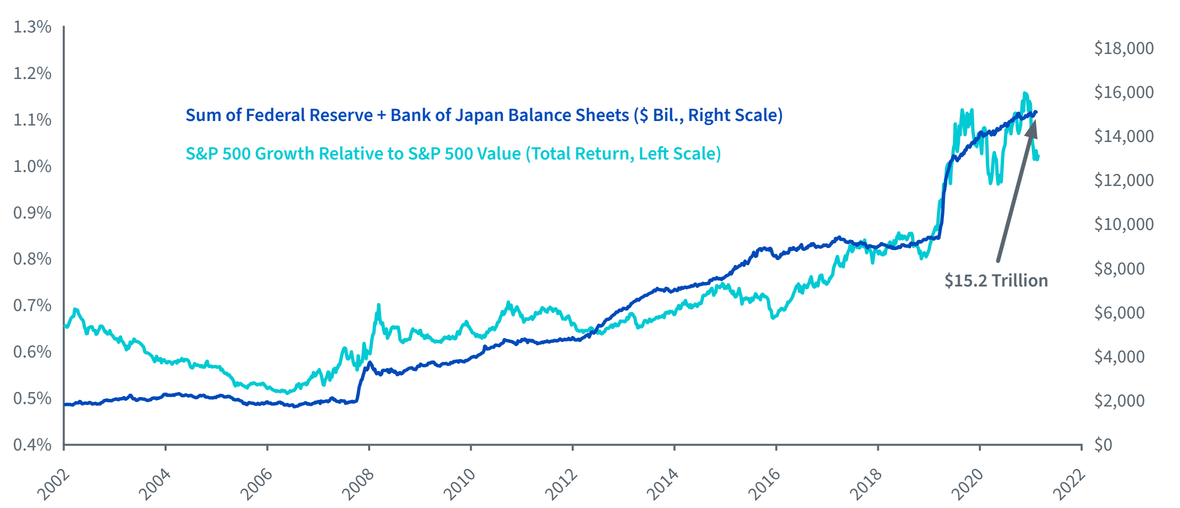


Sources: WisdomTree, FactSet, Russell. You cannot invest directly in an index. Past performance is not indicative of future returns.

Many say another reason growth stocks ran so high was because the world's central banks capped interest rates for several years. It makes sense; the present value of growth stocks' "out year" cash flows are greater when the rate with which they are discounted is tiny.

In Figure 4, the combined balance sheets of the Federal Reserve and the Bank of Japan tally to about USD$15 trillion. As the bond market purchases piled up, growth punished value as investors became comfortable with persistently low interest rates across the globe.

Figure 4: Central Bank Balance Sheet Expansion



Sources: Refinitiv, Federal Reserve, Bank of Japan, as of 1/27/22, with S&P performance through 2/10/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

Figure 5 shows the unintended—or maybe intended—consequence of the Federal Reserve's pinning of interest rates at zero, along with COVID-19 stimulus money burning a hole in people's pockets: a surge in brokerage account debit balances.

Figure 5: Debit Balances in Customers' Securities Margin Accounts ($ Millions)

Source: FINRA, as of 12/31/21.

Much of that money found its way into growth stocks, which benefited from a multi-year feeling that inflation was contained and economic growth would be hard to come by, adding a flavor of scarcity value to firms believed to have promising future business prospects.

GROWTH AND VALUE EARNINGS

Growth is dominated by Information Technology (Tech) and Communication Services sectors, while cyclical sectors such as Financials, Energy, Materials and Industrials often show up in value baskets. The sector differentials can be notable, as illustrated in Figure 6.

Figure 6: Sector Weights, U.S. Equity Indexes

Style Box		Sector Weights		
Category	Index	Tech + Communication Services	Financials + Energy + Materials + Industrials	Differential
Large-Cap Growth	Russell 1000 Growth	57.8%	9.4%	48.4%
Mid-Cap Growth	Russell Mid Cap Growth	39.8%	23.3%	16.5%
Large-Cap Blend	Russell 1000	39.2%	24.5%	14.7%
Small-Cap Growth	Russell 2000 Growth	25.9%	25.9%	0.0%
Mid-Cap Blend	Russell Mid Cap	23.3%	37.2%	-13.9%
Small-Cap Blend	Russell 2000	17.9%	39.1%	-21.2%
Large-Cap Value	Russell 1000 Value	17.5%	42.0%	-24.5%
Mid-Cap Value	Russell Mid Cap Value	13.7%	45.3%	-31.6%
Small-Cap Value	Russell 2000 Value	9.6%	52.7%	-43.1%

Source: Refinitiv, as of 1/31/22. You cannot invest directly in an index. Weightings are subject to change.

Growth stocks have a problem: *they don't appear to be growing.*

In Figure 7, the S&P 500 witnessed 50.6% earnings per share growth (EPS) in this fiscal year (FY1), capturing last year's bounce back from COVID-19. In FY2 and FY3, the Tech sector's earnings growth pace barely exceeded the Street's expectation for the broad market. Consider the example of the Industrials sector, which often populates value mandates. That group has a lower FY1, FY2 and FY3 P/E ratio than Tech, even though projected earnings growth is faster.

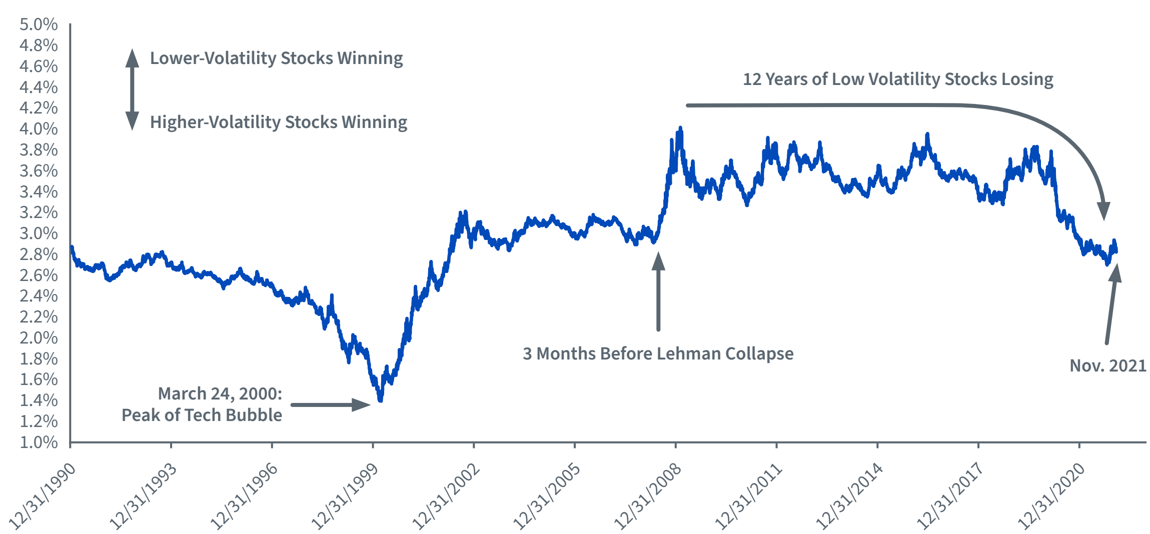
Figure 7: U.S. Sector-Level P/E's and Earnings Per Share Growth

	FY0 P/E	FY1 P/E	FY2 P/E	FY3 P/E	EPS Growth, FY1	EPS Growth, FY2	EPS Growth, FY3
S&P 500 Index	**32.4**	**21.5**	**19.8**	**17.9**	**50.6%**	**8.8%**	**10.2%**
Basic Materials	29.9	16.2	15.4	16.0	83.9%	5.3%	-3.5%
Utilities	20.8	19.8	19.4	18.0	5.4%	2.1%	7.3%
Information Technology	**38.2**	**27.9**	**25.2**	**22.5**	**37.0%**	**10.5%**	**12.2%**
Consumer Staples	24.9	22.6	21.3	19.7	10.4%	6.1%	8.2%
Consumer Discretionary	63.2	35.4	27.3	22.5	78.7%	29.6%	21.2%
Communication Services	26.8	19.5	18.6	16.1	37.8%	5.0%	15.0%
Healthcare	21.3	16.6	15.4	15.2	27.8%	8.2%	1.5%
Financials	21.9	13.2	14.6	13.0	65.3%	-9.3%	12.3%
Industrials	50.5	27.5	20.1	16.9	83.3%	36.8%	19.2%
Energy	NA	16.0	12.2	12.8	NA	31.4%	-4.3%

Source: Refinitiv, as of 1/31/22. FY0 represents the last fiscal year, FY1 is this fiscal year and so on.

Because many of our dividend-focused Funds often score well on volatility measures, Figure 8 is an eye-opener. The last dozen years have been tough for the market's dividend-paying stocks. That appears to have changed in November when lower-volatility stocks started clawing back.

Figure 8: S&P 500 Low-Volatility Index Divided by S&P 500 Index (Total Return)

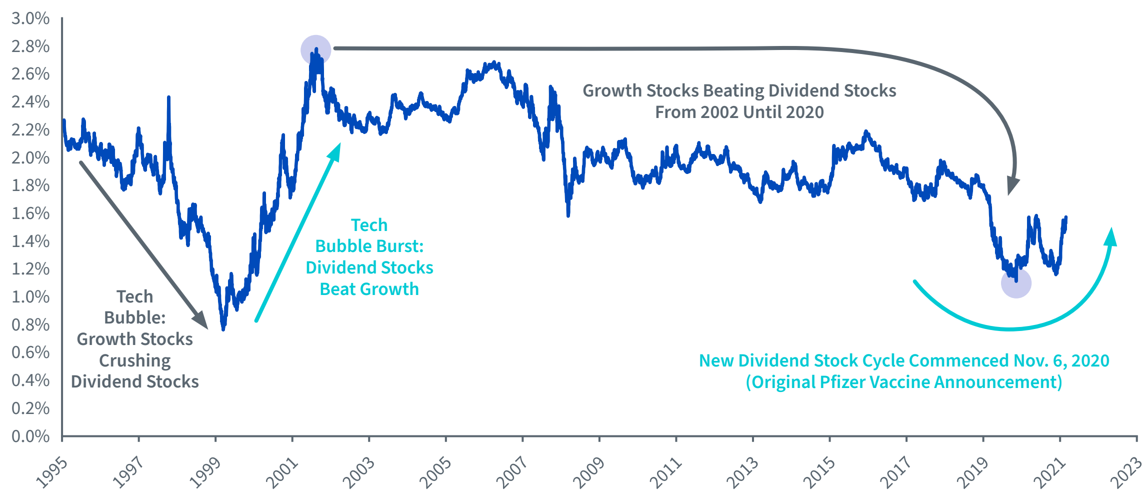


Source: Refinitiv, as of 2/15/22. Index returns based on total returns from 12/30/1994–1/31/2022. You cannot invest directly in an index. Past performance is not indicative of future returns.

Like the low volatility smart beta factor, dividend payers had a tough go for 18 years through 2020, mostly because that period was generally characterized by rising stock prices, especially coming out of COVID-19. So long as the name of the game was capital appreciation, investors chose not to clamor for the relative safety of dividend payments (Figure 9).

But the market has a different vibe to it recently. Dividends are “cool” again.

Figure 9: S&P 500 High Dividend Index Relative to S&P 500 Pure Growth Index (Total Return)

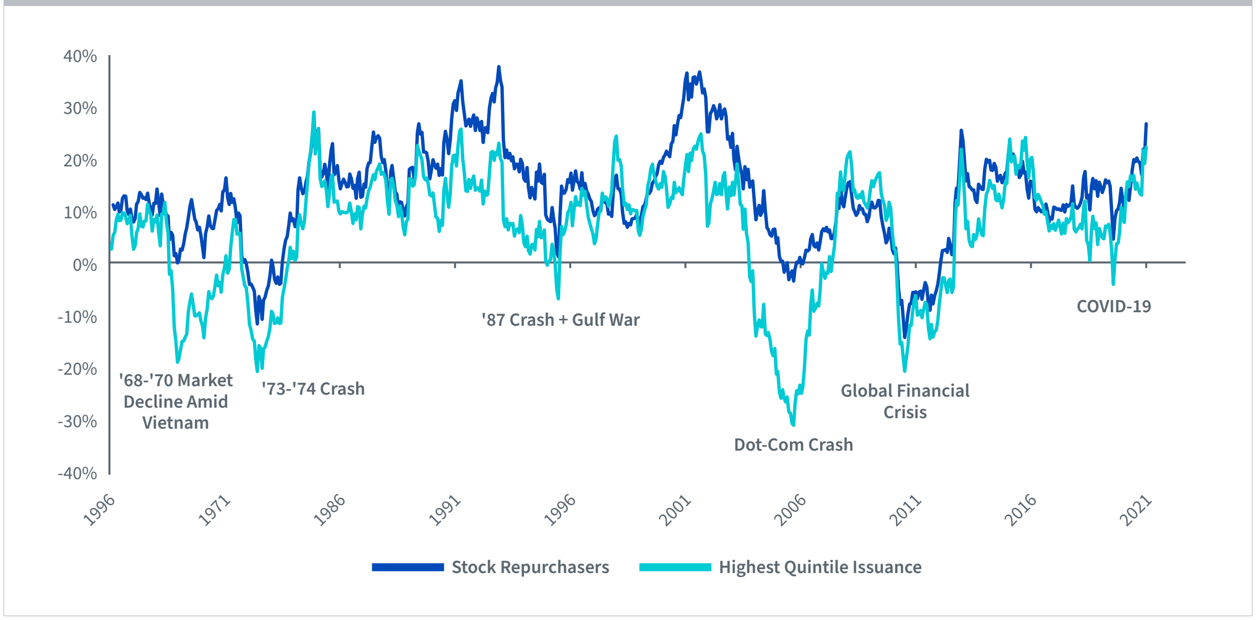


Source: Refinitiv, as of 2/15/22. Index returns based on total returns from 2/24/1992–2/24/2022. You cannot invest directly in an index. Past performance is not indicative of future returns.

With low volatility and dividend-paying concepts struggling for so long before finding footing lately, a corollary concept is the track record of "share buybackers."

In Figure 10, we see that bear markets have been cruel to companies that issue a lot of stock, in contrast to those that bought back stock. It makes sense: companies searching for capital before recessions often saw the rug pulled out from under them when the economy rolled over. In contrast, companies that buy back stock tend to have cash lying around, enabling them to weather the tough times.

Figure 10: Three-Year Annualized Returns by Share Issuance



Source: Ken French (Dartmouth), using CRSP Database, 7/31/1963–10/31/2021. You cannot invest directly in an index. Past performance is not indicative of future returns.

WISDOMTREE STRATEGIES FOR PLAYING INTO THE VALUE ROTATION

If you believe inflation is going to cause a problem for interest rates, sending investors into value at the expense of growth, two potential approaches are dividend-focused mandates and buyback screens.

For a dividend screen strategy, the **WisdomTree U.S. LargeCap Dividend Fund (DLN)** has been in the value camp since we launched it in 2006.

For a buyback focus, an idea would be the **WisdomTree U.S. Value Fund (WTV)**.

CONCLUSION

Judging by the lengths of prior cycles, it is possible that value's run relative to growth is just getting started. Because growth outperformed for nearly a generation, even core indexes such as the S&P 500 Index are lopsided toward non-dividend paying Silicon Valley giants. If the market continues to favor companies that are willing to pay robust dividends, it is possible that what we have seen of late could persist for many years.

Glossary:

Balance sheet: refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position. Bear market: A sustained downturn in market prices, increasing the chances of negative portfolio returns. Cash flows: a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures. Central bank: Refers to the monetary authority of any country. Cyclical sectors: Consumer Discretionary, Energy, Financials, Industrials, Information Technology and Materials sectors. Dividend-focused: A focus particularly on dividends when screening potential constituents for inclusion. Dot-com crash: The dot-com crash was triggered by the rise and fall of technology stocks. Earnings per share (EPS): A company's net profit divided by the number of common shares it has outstanding. Factor: Attributes that based on its fundamentals or share price behavior, are associated with higher return. Federal Reserve: The Federal Reserve System is the central banking system of the United States. Global financial crisis: The financial crisis of 2008, or global financial crisis, was a severe worldwide economic crisis that occurred in the late 2000s. It was the most serious financial crisis since the Great Depression. Growth stocks: Stocks whose share prices are higher relative to their earnings per share or dividends per share. Investors are willing to pay more because of their earnings or dividend growth expectations going forward. Gulf War: The Gulf War was a war waged by coalition forces from 35 nations led by the United States against Iraq in response to Iraq's invasion and annexation of Kuwait arising from oil pricing and production disputes. Inflation: Characterized by rising price levels. 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 versus the market over time. Margin lending: Allows individuals to borrow funds meant for investing by using their current assets held as collateral. Multiple expansion: Term for a rising P/E ratio, meaning that share prices are rising faster than earnings are growing. 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. Profit margins: Net income divided by total sales. Higher values indicate a greater fraction of each dollar of sales being left to the firm and its owners after expenses are accounted for. "Share Buybacker": A "share buybacker", also known as a share repurchaser, is when a company buys its own outstanding shares to reduce the number of shares available on the open market. Smart beta: A term for rules-based investment strategies that don't use conventional market-cap weightings. Value stocks: Stocks whose share prices are lower relative to their earnings per share or dividends per share. Investors pay less for these stocks because their earnings or dividend growth expectations going forward are lower. Volatility: A measure of the dispersion of actual returns around a particular average level.

Index Definitions:

S&P 500 Index: A 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. S&P 500 Growth Index: A market capitalization-weighted benchmark designed to measure the growth segment of the S&P 500 Index. S&P 500 Value Index: A market capitalization-weighted benchmark designed to measure the value segment of the S&P 500 Index. S&P 500 Information Technology Index: A market-capitalization weighted index that is designed to measure the performance of the Information Technology sector, as defined by the Global Industry Classification Standard. S&P 500 Low Volatility Index: An index that measures performance of the 100 least volatile stocks in the S&P 500. S&P 500 High Dividend Index: Serves as a benchmark for income-seeking equity investors. The index is designed to measure the performance of 80 high-yield companies within the S&P 500 and is equally weighted to best represent the performance of this group, regardless of constituent size. S&P 500 Pure Growth Index: A style-concentrated index designed to track the performance of stocks that exhibit the strongest growth characteristics by using a style-attractiveness-weighting scheme. Russell 1000 Growth Index: A measure of the large-cap growth segment of the U.S. equity universe, selecting from the Russell 1000 Index. Russell 1000 Index: A measure of the performance of the 1,000 largest companies by market capitalization in the Russell 3000 Index. Russell 1000 Value Index: A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index. Russell 2000 Growth Index: Measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. Russell 2000 Index: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index, representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Russell 2000 Value Index: Measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. Russell Midcap Growth Index: Measures the performance of the mid-cap growth segment of the U.S. equity universe. It includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values. Russell Midcap Index: Measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Russell MidCap Value Index: Measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Important Information

Investors should consider the investment objectives, risks, charges and expenses of the Funds carefully before investing. A prospectus containing this and other information is available by calling 866.909.9473 or visiting www.wisdomtree.com. Investors should read the prospectus carefully before investing.

DLN: There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

WTV: There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models, and the models may not perform as intended.

Please read each Fund's prospectus for specific details regarding each Fund's risk profile.

This material contains the opinions of the authors, which are subject to change, and should not 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. Unless expressly stated otherwise, the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

Jeff Weniger is a Registered Representative of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.