RETURN STACKING PORTFOLIOS

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The current market environment provides unique challenges that the WisdomTree Efficient Core Funds can help navigate. We discussed this topic in detail on a recent episode of Behind the Markets, a podcast brought to you by Jeremy Schwartz, WisdomTree's Global Head of Research.

In this episode, Jeremy talks to Corey Hoffstein, CIO and co-founder of Newfound Research, and Rodrigo Gordillo, president and portfolio manager at ReSolve Asset Management.

Listeners will hear about:

- A paper Corey and Rodrigo authored on "Return Stacking™"—they defined the concept and discussed practical implementation views on how to use it in portfolios.

- Diversifying strategies like managed futures have been out of favor, but Rodrigo saw a notable pickup of discussions following the release of this return stacking paper.

- Tactical asset allocation strategies using ETFs or futures, and why diversified systematic strategies can add value in that Return Stacked™ framework.

- How Rodrigo's firm created the Return Stacked™ 60/40: Absolute Return Index, an Index designed to preserve exposure to core stock and bond allocations while bolstering expected risk-adjusted returns with non-correlated return streams like trend following, global macro and tail-hedging strategies. WisdomTree's Efficient Core ETFs play a role in this Index, and I think it provides a useful example of how to surround efficient core strategies with alternative strategies.

- The types of strategies that work well to hedge different inflation regimes, and the dynamics of flows to gold that may have changed its relationship to inflation and unexpected inflation.
    - Corey talks about what he thinks investors should not do with a return stacked approach: add more long-only equities that just leverage up total equity exposure. What he finds most valuable is an absolute return alpha source or other diversifying strategies. Some examples:
        - High-quality corporate bonds
        - Managed futures and global macro strategies
        - Commodities or gold if you are willing to take on more tracking error relative to a traditional 60/40. The more you add to this, the more return stacking starts to feel like a risk parity strategy.

- The risks of risk parity strategies and misconceptions about what drove the bull market in bonds over the last 40 years. People believe the drop in interest rates drove the big bull market in bonds, but previously high coupons were a key driver, in Corey's view, and the move in interest rates just pushes back or pulls forward returns that come from coupons.
    - Rodrigo discusses what he thinks are misperceptions for risk parity strategies and how a leveraged bond strategy can still perform well in a period of rising interest rates.
    - How risk parity strategies performed during one of the last big inflation-driven markets of the 1970s–1980s when rates were increasing.

- The role for long/short strategies and other "convexity" strategies as hedges in the market. Convexity is a word you hear a lot with options strategies, and Corey described convexity strategies in simple terms as being able to add higher returns for a given change in the market—in either a positive or negative direction. This becomes most interesting on the downside for hedging strategies.

- How leverage really hurts portfolios in large down markets when all correlations go to 1 and everything declines together. Strategies that can hedge drawdowns—when applied with levered approaches—are something Corey finds valuable.

- How to think about managed futures strategies in a return stacked approach. Rodrigo talks about how the low returns of managed futures strategies were a real challenge when funded from a traditional 60/40 environment. But a return stacked portfolio added on top is a very different story and something investors should look for now with greater adoption of strategies like WisdomTree's Efficient Core Funds.

You can listen to the full episode below:

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DEFINITIONS

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

Return Stacked 60/40: Absolute Return Index : Aims to provide exposure to a U.S. 60% equity, 40% bond allocation while "stacking" diversifying alternative exposures including tail protection on top.

Risk-adjusted returns : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.

Trend-following : Also known as trend trading. It is a trading style that attempts to capture gains through the analysis of an asset's momentum in a particular direction.

Macro : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Tail risk : Also known as tail hedge. It is a form of portfolio risk that arises when the possibility that an investment will move more than three standard deviations from the mean is greater than what is shown by a normal distribution.

Inflation : Characterized by rising price levels.

Long-only bond strategy : a traditional approach to fixed income portfolio management.

Alpha : Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.

Tracking Error : Can be discussed as both the standard deviation of excess return relative to a specific benchmark, or absolute excess return relative to a specific benchmark.

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

Risk Parity : A risk management strategy that seeks to diversify assets based on their contribution to portfolio volatility.

Bullish : a position that benefits when asset prices rise.

Coupon : The annual interest rate stated on a bond when it's issued. The coupon is typically paid semiannually. This is also referred to as the "coupon rate" or "coupon percent rate.&rdquo.

Long (or Long Position) : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Convexity : A measure of the curvature, or the degree of the curve, in the relationship between bond prices and bond yields.

Correlation : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Drawdowns : Periods of sustained negative trends of return.