THE WISDOMTREE Q4 2023 ASSET ALLOCATION AND PORTFOLIO POSITIONING SUMMARY

WisdomTrees Model Portfolio Investment Committee
10/25/2023

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.

We recently posted a blog summarizing our general economic and market outlook as we move through to the end of 2023. You can also find a more comprehensive review in our Q4 2023 Economic & Markets Chart Deck.

In this blog post, we take those outlooks and translate them to our current Model Portfolio allocations and positions. Before we get to that, a quick reminder of our general framework with respect to our asset allocation and portfolio construction:

Source: WisdomTree. For illustration purposes only.

Now let's summarize our current economic and market outlook:

Q4 2023 Quarterly Strategic Outlook

Economy

- As the U.S. economy shows signs of reaccelerating, recession fears have abated
- Despite the economic momentum, labor market data and inflation continue to normalize
- While borrowers around the globe will increasingly feel the effects of higher interest rates, the U.S. may be better prepared than the rest of the world

Equities

- The recent tech-driven rally has intensified concentration risk in cap-weighted indexes
- While the S&P 500 Index trades at a steep premium to international equities, relative valuations outside of the top-heavy market gauges are near long-term averages
- Given the diverging macroeconomic picture for domestic and international markets, we have repositioned our portfolios with an overweight to U.S. equities
- Importantly, our U.S. equity allocations are tilted towards mid and small caps, dividend payers, and companies with lower valuation multiples

Fixed Income

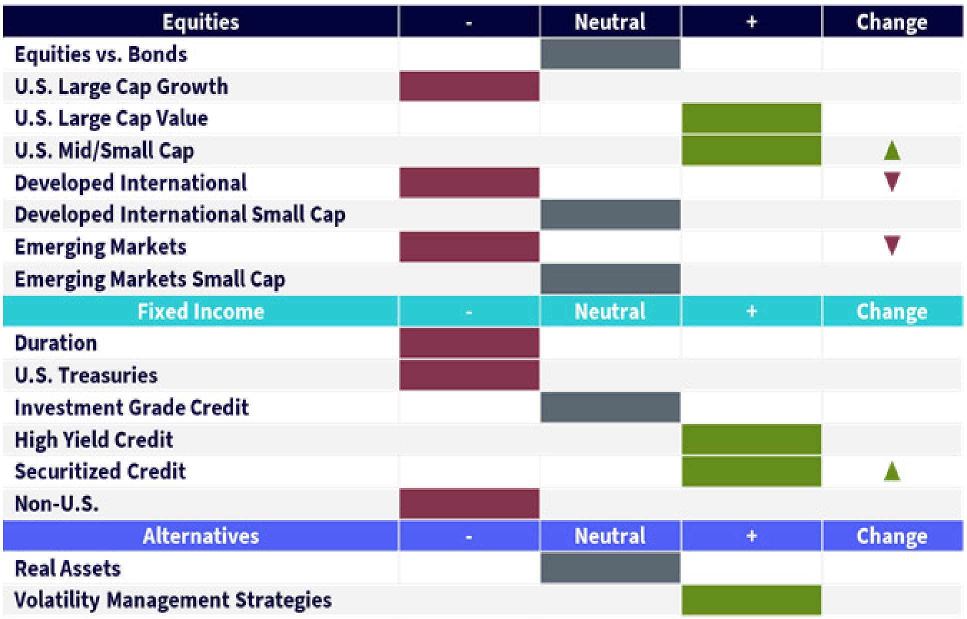
- With the inverted nature of the yield curve and our expectation for ongoing interest rate volatility, we remain allocated to short-term and floating-rate bonds
- We selectively rotated from credit into mortgage-backed securities due to attractive relative valuations, yet we remain overweight quality-screened high yield credit

Alternatives

- As stock-bond correlations have recently turned positive, we believe trend-following and other alternative strategies can play an important role in portfolios

Source: WisdomTree, September 2023. Actual results may vary.

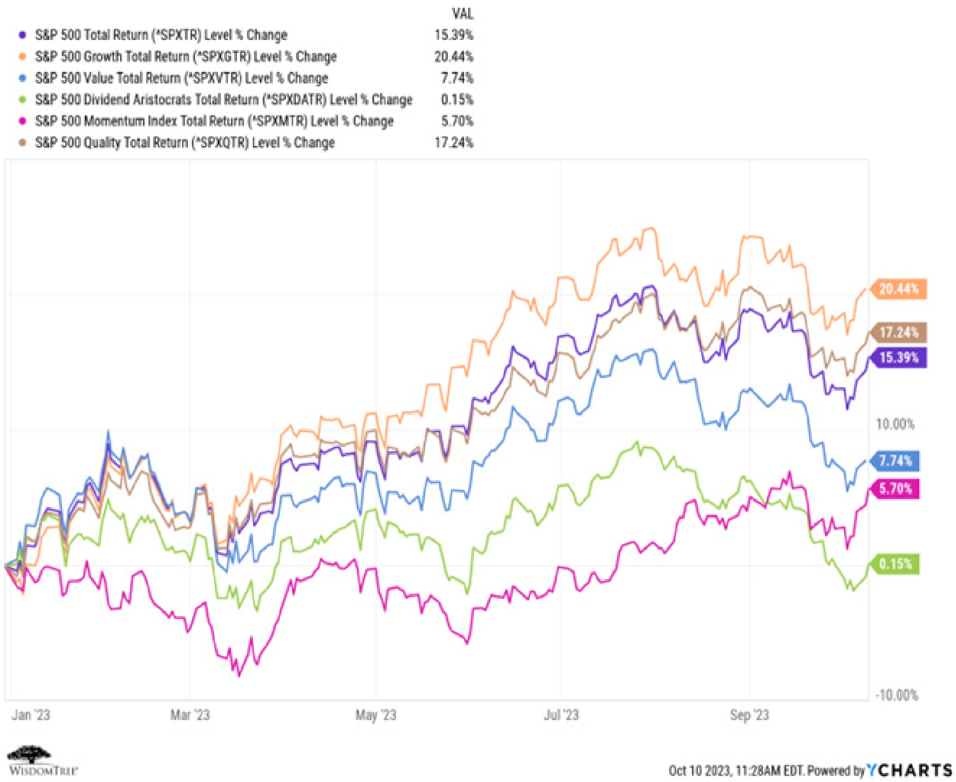
Finally, let's summarize our general asset class outlook:



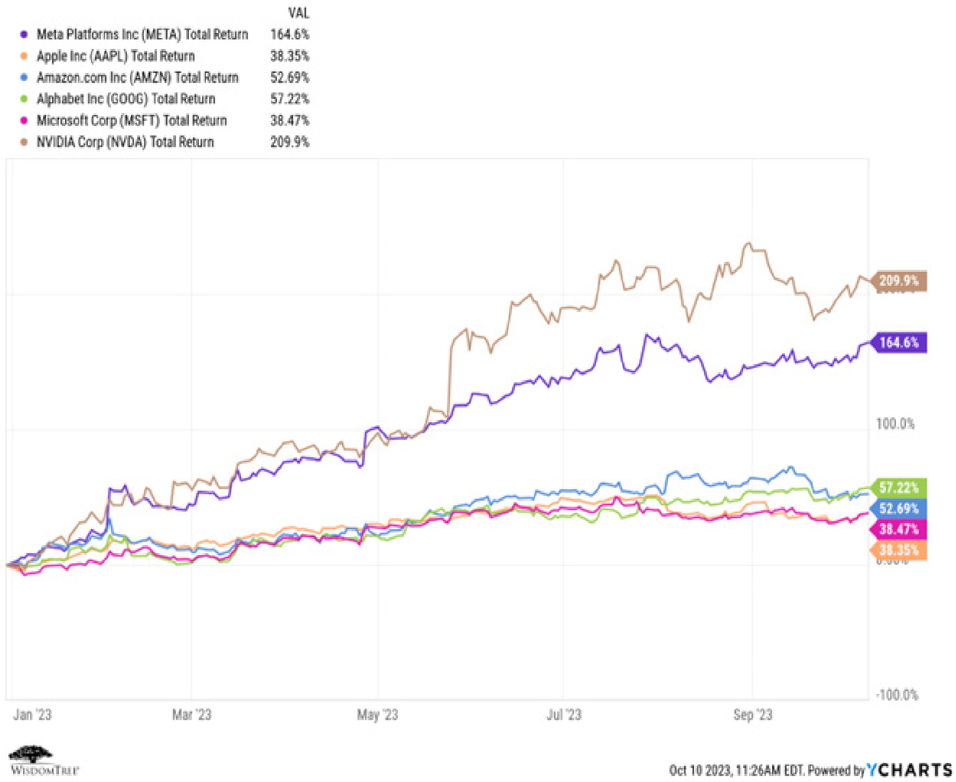
Source: WisdomTree, as of September 2023. Evaluations are subject to change as market conditions change. This is for illustration purposes and does not represent investment advice. All evaluations are on a relative and not absolute basis. Red = a negative relative evaluation; gray = a neutral relative evaluation; green = a positive relative evaluation. You cannot invest in an index and past performance does not guarantee future results.

Equities

Many of WisdomTree's ETF strategies (and, therefore, our Model Portfolios) have explicit factor tilts toward dividends, value, size and quality. These factors underperformed through the first three-quarters of 2023 as large-cap, growth and mega-cap tech stocks rallied strongly on the back of investor fascination with artificial intelligence (AI). Most companies believed to be positively influenced by the evolution of AI have benefitted so far this year, with Nvidia Corporation being the poster child (two charts).



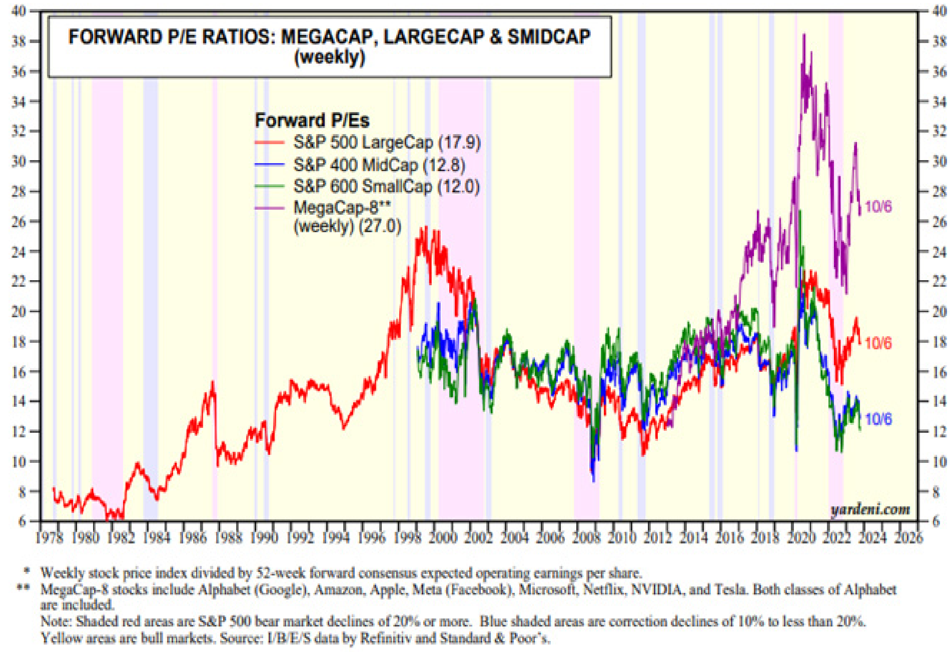
For definitions of terms in the graphs above, please visit the glossary.



Source for both charts: YCharts, Year-to-date performance through 10/9/23. You cannot invest in an index and past performance does not guarantee future results.

Despite this challenge for our overweighted factors, the rising rate environment in the third quarter resulted in a slight rollover of the growth factor and a possible re-rotation back into value stocks. Small caps and dividend stocks continue to trail, while quality, as usual, has proven to be the most consistent risk factor. This is why it remains the anchor factor in most of our Model Portfolios.

The valuation dispersion between large cap and small-cap stocks has become historically wide, and we believe mean rev ersion will set in at some point. We maintain our overweight allocations in small-cap stocks relative to our benchmarks.



Source: Yardeni Research, as of 10/9/23. You cannot invest in an index and past performance does not guarantee future results.

Finally, let's examine current valuations between U.S. and non-U.S. stocks. Combined with the higher dividend yield typically available outside the U.S., there appears to be an interesting relative value trade outside the U.S.

That said, we are uncomfortable with the economic growth environment outside the U.S., especially in Europe and China. This, combined with the strong dollar rally since midyear, led us recently to reduce our allocations to both EAFE (Europe, Australasia and Far East) and EM and to go overweight the U.S., relative to the MSCI ACWI index.

Bottom Line: Our Model Portfolios maintain factor tilts toward value, dividends, size and quality, but have moved to an overweight allocation in the U.S. Despite our Portfolio underweights to the mega-cap tech stocks through the first three quarters, our equity Models have largely matched or beaten their respective benchmarks. We attribute this to both our asset allocation and security selection decisions.

If we are correct in our view that the value trade is rebounding and that small caps present a relative value opportunity, our Portfolios are positioned to take advantage of that.

Fixed Income

Our primary narratives for 2023 are, "Higher for longer" and "There is income back in fixed income."

While we increased the duration of our fixed income allocations several months ago, we remain short duration relative to the Bloomberg Aggregate index. The market simply is not paying investors to take on duration risk.

While we remain constructive on high yield, we did recently move to lower our overweight allocations there in favor of adding to mortgage-backed securities.

At current rate and spread levels, high yield continues to offer elevated yield levels to investors, while maintaining a comfortable "buffer" against both a further rise in rates and/or a rise in spreads (right-hand chart below).

Meanwhile, on a relative value basis, agency-backed mortgages are exhibiting attractive spreads to Treasuries in comparison to their historical average (left-hand chart below).

Real Asset and Alternatives

Finally, for those advisors and investors for whom it made sense, we have advocated considering allocations to real assets and alternatives for most of the past two years.

Certainly, the inclusion of these types of strategies, depending on the strategies and exposures, benefited many investors as they provided excellent diversification to the abysmal stock and bond performances of 2022.

Most commodities have been range-bound for the past 12 months (and we maintain a neutral stance in our asset allocation positioning), but we still believe in the potential benefits of diversification within our Portfolios that have that investment objective.

Meanwhile, the correlation between stocks and bonds has risen to levels not seen in more than 10 years (left-hand chart). In this type of environment, the potential diversification benefits of both real assets and alternatives (focusing on managed futures or trend-following strategies) becomes even more important (right-hand chart).

Conclusion

Trying to predict future market performance is a fool's errand and a loser's game. But, given historical performances and trends, we like how our Portfolios are positioned. But it is also why we continue to favor longer-term time horizons and appropriate diversification at both the asset class and risk factor levels.

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.

View the online version of this article here.

IMPORTANT INFORMATION

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You cannot invest directly in an index.

DEFINITIONS

Dividend : A portion of corporate profits paid out to shareholders.

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 tim.

Size : Characterized by smaller companies rather than larger companies by market capitalization. This term is also related to the Size Factor, which associates smaller market-cap stocks with excess returns vs the market over time.

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.

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.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Mega Cap : Market Capitalization over $100 Billion.

Artificial intelligence : machine analysis and decision-making.

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.

Mean reversion : The concept that a series of returns has a tendency to return to its average level over longer periods, even if shorter periods can exhibit wide swings.

EAFE : Refers to the geographical area that is made up of Europe, Australasia and the Far East.

Emerging market : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

MSCI ACWI Index : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

Bloomberg Aggregate Bond Index : The Bloomberg Aggregate Bond Index or "the Agg" is a broad-based fixed-income index used by bond traders and the managers of mutual funds and exchange-traded funds (ETFs) as a benchmark to measure their relative performance.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Mortgage-backed securities : Fixed income securities that are composed of multiple underlying mortgages.