

# IS WISDOMTREE'S FIVE-TOOL MULTIFACTOR STRATEGY LIVING UP TO ITS PROMISE?

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Many investors familiar with the exchange-traded fund (ETF) landscape will agree that multifactor strategies have become a central part of the investment conversation. WisdomTree pioneered this effort over a decade ago with a fundamental approach to indexing, but only recently did we launch the WisdomTree U.S. Multifactor Index, which directly seeks exposure to [value](#), [quality](#), [momentum](#) and [low correlation](#), and indirectly provides [size](#) and [low volatility](#) exposure in a sector-neutral fashion. While investors still try to wrap their heads around these different multifactor strategies, we wanted to take advantage of the recent break from the [bull](#) market to compare and contrast real-time performance—in both up and down markets.

Since we launched our Index in June 2017, we have had sneak peaks into an up market, characterized by impressive stock returns and new market highs. We have recently also experienced vicious downdrafts in the market, accompanied by higher [volatility](#). Below we display returns for a few of the multifactor indexes that serve as the underlying index for some of the largest multifactor ETFs. We also show returns for the [WisdomTree U.S. Multifactor Index](#), which serves as the underlying Index for the [WisdomTree U.S. Multifactor Fund \(USMF\)](#). For context, we also include returns for the [MSCI US A Minimum Volatility](#), [S&P 500 Equal Weight](#), and [S&P 500 indexes](#), during this roller-coaster period in U.S. equity markets.

Index	Cumulative Total Return since WT Multifactor Inception (6/12/17)		
	Up Market	Down Market	Full Period since WT Inception
	(6/12/17–1/26/18)	(1/27/18–3/31/18)	(6/12/2017–3/31/18)
WisdomTree U.S. Multifactor	18.91%	-5.13%	12.80%
Goldman Sachs ActiveBeta U.S. Large Cap Equity	20.07%	-6.69%	12.04%
MSCI USA Diversified Multiple-Factor	19.08%	-6.68%	11.12%
Guggenheim Multi-Factor Large Cap	19.97%	-8.21%	10.12%
John Hancock Dimensional Large Cap	18.97%	-7.10%	10.52%
Russell 1000 Diversified Factor	15.72%	-6.49%	8.21%
MSCI USA Minimum Volatility	13.61%	-5.64%	7.20%
S&P 500 Equal Weight	17.28%	-7.01%	9.05%
S&P 500	19.54%	-7.72%	10.31%

Sources: WisdomTree, Bloomberg, as of 3/31/18. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. The WisdomTree U.S. Multifactor Index was launched on 6/12/17.

Please see our [glossary](#) for definitions of indexes contained in the chart.

## A Closer Look at Multifactor Index Performance

During the up-market trend, we were quite pleased with the ability of WisdomTree's Index to keep pace with the S&P

500 Index. We say this because the latest up trend was characterized by some of the S&P 500's largest names posting stellar returns. Our strategy, which contains a concentrated basket of 200 stocks, with about 45% of the Index's weight distributed to [mid-cap](#) stocks,<sup>1</sup> was nevertheless able to keep pace with the S&P 500 despite natural under-weights in these larger names. However, as the down market came over the last two months or so, and the [large-cap beta](#) trade broke down, stock selection again became advantageous. The [10-Year U.S Treasury yield](#) over this period rose from 2.66% to 2.73%,<sup>2</sup> providing meaningful headwinds for strategies like the MSCI USA Minimum Volatility Index, which tend to seek lower volatility by undertaking relative over-weights in defensive sectors such as Utilities and Consumer Staples. This is where the WisdomTree U.S. Multifactor Index truly shined, ***providing more downside protection than every other strategy shown here.*** Relative to the MSCI USA Minimum Volatility Index and the S&P 500 Index, respectively, this downside protection amounted to 51 and 259 [basis points](#) of outperformance over the two-month period.

Because of this balance—capturing most of the upside and providing more [downside protection](#)—not only did the ***WisdomTree U.S. Multifactor Index outperform the S&P 500 by approximately 250 basis points since its inception in June 2017, it beat all the other [smart beta](#) strategies above over this time period.***

We believe multifactor exposure, as well as innovative single factors such as low [correlation](#), can provide lower volatility through diversification, while also being less sensitive to [interest rate risk](#) than a strictly low- or minimum-volatility approach. Additionally, weighting by half low volatility while focusing the other half of the weighting based on a stock's [composite factor score](#) provides a risk and return framework that at its core, we believe, is more structurally sound for a variety of market environments.

### Conclusion: WisdomTree U.S. Multifactor Index Offers Balanced and Efficient Multifactor Exposure

Compared to the indexes shown above, the WisdomTree Multifactor Index has been the best and most balanced smart beta strategy investors could have adopted over the past nine months. We believe that as market volatility continues, whether it be via up or down days, stock selection will again play a vital role in investors' considerations. We believe the WisdomTree U.S. Multifactor Index provides pointed stock selection via value, quality, momentum and low correlation, giving investors a way to seek [alpha](#) when buying the biggest stocks by market-cap stops working. While we believe the right way to view multifactor exposure is through the lens of a long-term time horizon, once the large-cap beta trade starts to break down is when we believe thoughtful and rules-based stock selection can truly shine. And as a reminder, outside of bubbles, it is not the norm to have the biggest names by [market cap](#) consistently driving the market forward. In other words, with a large-cap beta run potentially behind us, now may be as good as time as any to introduce efficient multifactor exposure into the core of your portfolio for the long-term.

<sup>1</sup>Source: WisdomTree, as of 3/31/18.

<sup>2</sup>Source: Bloomberg. Period from the close of 1/26/18 through 3/29/2018

#### Important Risks Related to this Article

Diversification does not eliminate the risk of experiencing investment losses.

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For the top 10 holdings of USMF please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/usmf>

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You cannot invest directly in an index.

## DEFINITIONS

**Value Factor** : 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 time.

**Quality Factor** : Excess returns achieved by companies exhibiting higher quality or profitability vs the market. Typically measured using operating profitability, return on equity and/or return on assets.

**Momentum Factor** : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**Low Correlation** : Characterized by assets that have a relatively lower correlation vs the market over time. This term is also associated with the Low Correlation Factor which associates these stock characteristics with excess returns vs the market over time.

**Size Factor** : the average returns of small portfolios minus the average returns of the large portfolios after adjusting for growth or value tendencies.

**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 vs the market over time.

**Bullish** : a position that benefits when asset prices rise.

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

**MSCI USA Minimum Volatility Index** : Aims to reflect the performance characteristics of a minimum variance strategy applied to the large and mid cap USA equity universe.

**S&P 500 Equal Weight Index** : Designed to track the equally weighted performance of the 500 constituents in the S&P 500 Index.

**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.

**Mid-Cap** : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

**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.

**Beta benchmark** : Characterized by measuring the performance of a particular universe of equities without attempting to utilize selection and weighting to generate differences in performance relative to this universe.

**10- Year Treasury** : a debt obligation of the U.S. government with an original maturity of ten years.

**Basis point** : 1/100th of 1 percent.

**Downside protection** : A broad investment conception referring to the potential mitigation of risk or negative return experience.

**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.

**Interest rate risk** : The risk that an investment's value will decline due to an increase in interest rates.

**Composite Factor Score (CFS)** : Taking individual measurements of factor exposures, and combining them into a single measure meant to represent multifactor exposure for a certain asset. For example, in the case of the WisdomTree U.S. Multifactor Index, the composite factor score aims to measure factor exposures to Value, Quality, Momentum and Low Correlation as they relate to a single asset..

**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.

**Market capitalization-weighting** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.