# PORTFOLIO DIVERSIFIERS TO CONSIDER

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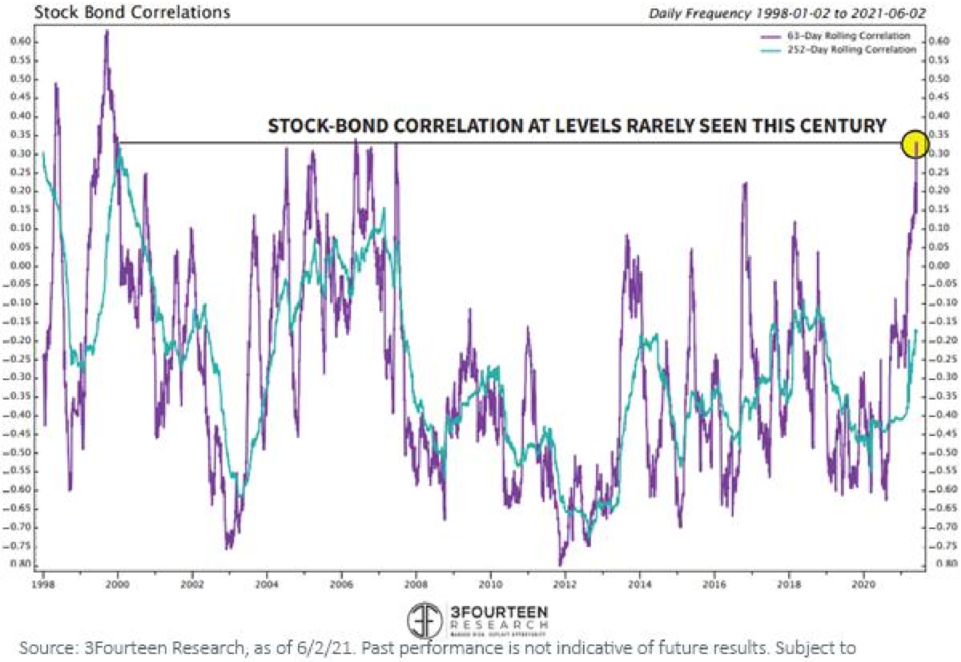
This post is going to cover what I believe is the most important question for portfolio diversification today: are bonds losing their role as the preferred hedge asset and portfolio diversifier that they've held for the last two decades?

Based on 63-day rolling correlation window analysis conducted by Warren Pies, founder of 3Fourteen Research, equity-bond correlation levels have spiked to levels rarely seen in the last two decades. These rising correlations—if they persist or rise even higher—would imply that bonds are starting to lose their diversification benefits, and there could be a time in the near future when stocks and bonds decline together.




Source: 3Fourteen Research, as of 6/2/21. Past performance is not indicative of future results. Subject to change.

In the past, we've assumed that on negative days for equity markets there would be bids in the U.S. Treasury bond market that would cause bond yields to fall and their prices to rise.

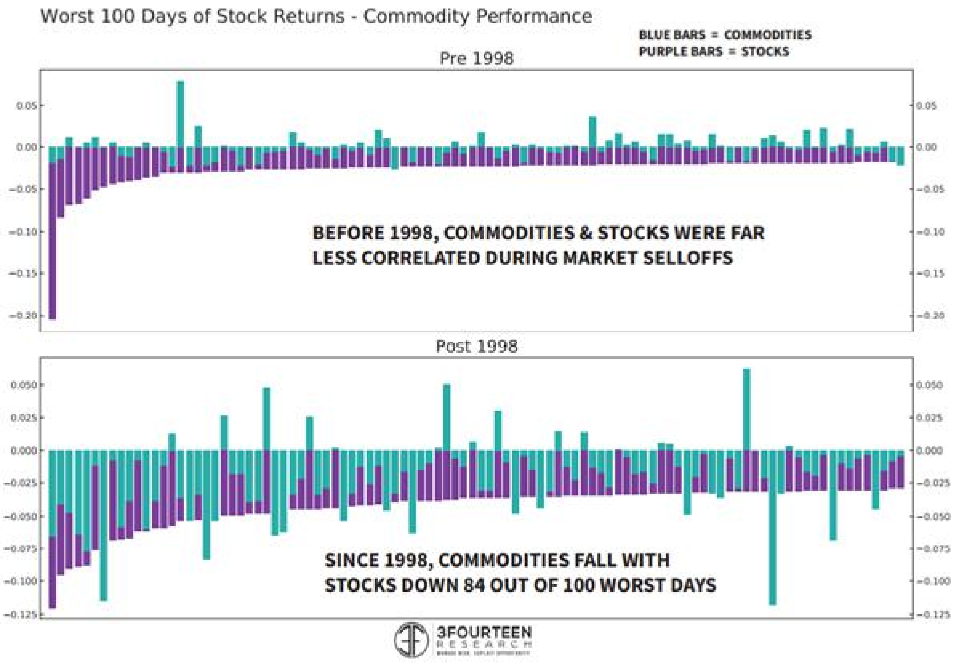
With the market starting to fear the consequences of rising inflation pressures—a narrative voiced by our Senior Investment Strategy Advisor, Wharton Professor Jeremy Siegel—it could be elevated for a number of years to come.

Rising rates could put some pressure on the stock market, and you'd lose this diversification property that bonds have historically provided.

3Fourteen Research highlights the importance of real assets like commodities, gold and oil for their inflation hedging properties—and 3Fourteen currently runs a dynamic, real asset model that is heavily allocating to all those assets in proportions that would be uncommon in traditional 60% equity/40% fixed income portfolio frameworks.

**Worst Day Analytics**

Evaluating performance on some of the worst trading days for equities can shed light on the value of diversifiers.

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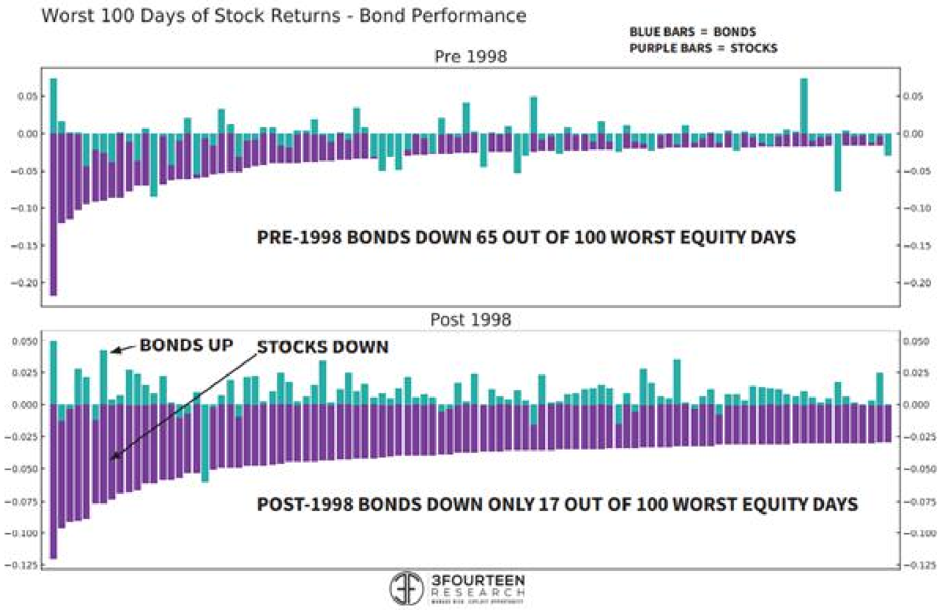
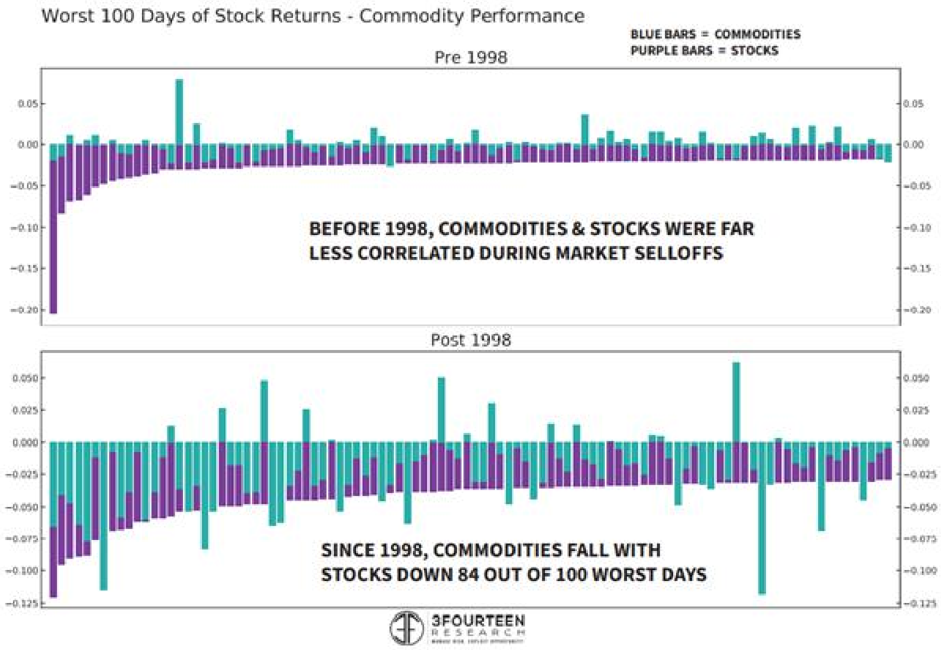
Looking at the 100 worst trading days for equities since 1998, bonds had a negative return on only 17 of them, showing that bonds served as a productive hedge asset over 80% of the time.

But if you look back before 1998, that relationship was more precarious. It was more likely that bonds also had a negative return on down days for stocks, as bonds were down on 65 of those 100 worst days for equities.

Interestingly, commodities had the opposite experience.

Since 1998, commodities returns were in sync with equities, declining on 84 of the 100 worst trading days for stocks. But before 1998, commodities were only down on 53 of those worst trading days for equities, in some ways being even better diversifiers than bonds.

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Commodities were in a brutal bear market for much of the last decade. There was not much inflation, and the structure of the commodities futures market was in contango such that the cost to roll futures eroded any gains to be made in spot prices.

During the last six to seven months, and particularly in 2021 to date, commodity prices have rebounded significantly, with both supply constraints and reopening demand creating this perfect mix of upward pressure on commodity prices.

The market dynamics look to be shifting such that bonds could be losing some of their historical dominance as the preferred portfolio diversifier. Commodities and managed futures strategies that rely heavily on commodity exposures are two places investors might look for new diversifiers within this changing macro regime. For two possible solutions, consider the WisdomTree Enhanced Commodity Strategy Fund (GCC) and the WisdomTree Managed Futures Strategy Fund (WTMF).

Important Risks Related to this Article

*No level of diversification or non-correlation can ensure profits or guarantee against losses.* GCC: There are risks associated with investing, including the possible loss of principal. An investment in this Fund is speculative, involves a substantial degree of risk, and should not constitute an investor's entire portfolio. One of the risks associated with the Fund is the complexity of the different factors which contribute to the Fund's performance. These factors include the use of commodity futures contracts. Derivatives can be volatile and may be less liquid than other securities and more sensitive to the effects of varied economic conditions. The value of the shares of the Fund relate directly to the value of the futures contracts and other assets held by the Fund and any fluctuation in the value of these assets could adversely affect an investment in the Fund's shares. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

**Commodities and futures are generally volatile and are not suitable for all investors.** Investments in commodities may be affected by overall market movements, changes in interest rates and other factors such as weather, disease, embargoes and international economic and political developments.

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## DEFINITIONS

**Hedge** : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

**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.

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

**Treasury** : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

**Yield** : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

**Inflation** : Characterized by rising price levels.

**Interest rates** : The rate at which interest is paid by a borrower for the use of money.

**Commodity** : A raw material or primary agricultural product that can be bought and sold.

**Bear market** : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

**Contango** : A scenario when the futures price is above the spot price. 

**Rolling** : trading out of a security that is close to maturing and into the same or similar security with a later maturity date.