

# AN ASSET ALLOCATION STUDY FOR A MODERATE PORTFOLIO

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Typically, moderate allocations are tracked against a 60/40 equity/fixed income benchmark. Ideally, while constructing such allocations, a [manager](#) would attempt to outperform by tactically over-weighting or under-weighting portions of the market or through the choice of which investment strategy to implement in various sleeves.

Below, I will show how WisdomTree's [dividend](#) methodology compares to a [market cap-weighted](#) 60/40 [value](#) benchmark without making any tactical bets. In addition, for those willing to alter asset allocations, we believe a continuous improvement in returns per unit of risk could be realized.

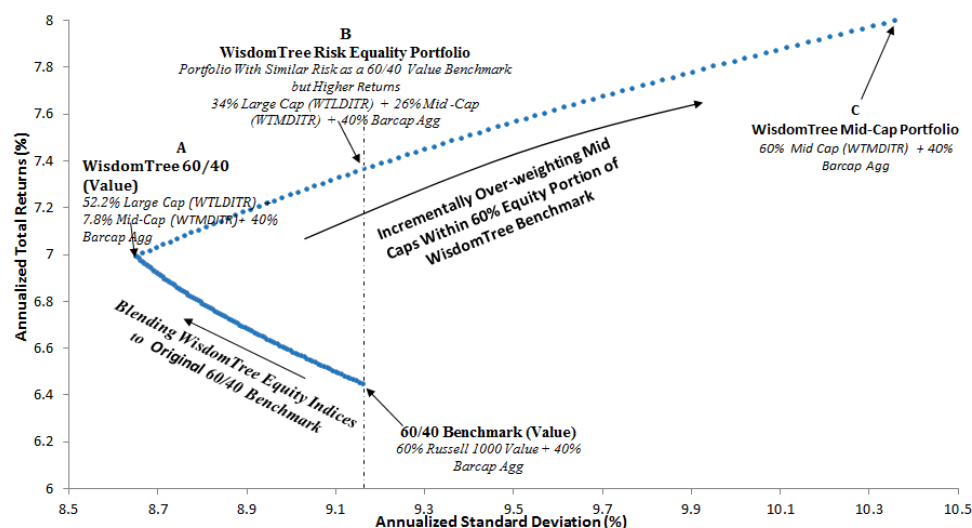
## Moving from Market Cap 60/40 to WisdomTree 60/40

In the chart below, we begin our journey at the central bottom where our benchmark allocation lives and go in a clockwise direction, making stops at **allocations A, B and C**.

The benchmark we show here is a traditional cap-weighted 60/40 combination consisting of the [Russell 1000 Value](#) and [Barclays U.S. Aggregate Total Return Indexes](#). Traveling along the lower edge, we gradually blend an 87% and 13% split of the [WisdomTree LargeCap \(WTLDI\)](#) and [MidCap Dividend \(WTMDI\)](#) Indexes to the equity portion of our starting benchmark while keeping the fixed income portion intact. A static split of 87/13 between large- and mid-cap distribution attempts to keep consistent with the Russell 1000 Value Index market cap breakdowns.<sup>1</sup>

## Asset Allocation Using WisdomTree Dividend Index Family

6/30/06–1/31/17



Source: Bloomberg, as of 1/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes and terms in the chart, visit our [glossary](#).

## Reducing Risk, Increasing Return

It is clear that as we blend WisdomTree dividend Indexes there is a continuous reduction of annualized [volatility](#) and improvement of annualized total return. Put another way, a manager tracking a 60/40 cap-weighted value benchmark could have potentially outperformed by blending the WisdomTree LargeCap and MidCap Dividend Indexes into their equity allocations.

In fact, an allocation consisting solely of WisdomTree Indexes (i.e., WisdomTree 60/40 or **allocation A** in the chart above) would have outperformed by 55 [basis points \(bps\)](#) with 51 bps of lower volatility on annualized basis.<sup>2</sup>

The results show an improved performance on a risk-adjusted basis without taking an asset allocation bet!

### Performance of Benchmark & WisdomTree 60/40 Allocation

	Annualized Risk (%)	Annualized Return (%)	Sharpe Ratio
60/40 Benchmark	9.16	6.44	0.65
WisdomTree 60/40 Allocation 'A'	8.65	6.99	0.75

Source: Bloomberg, as of 1/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.

## How About If We Change the Asset Allocation?

### 1. Moving Away From Large Caps to Mid Caps For a Static 60/40 Allocation

Now that we have established the outperformance generated by WisdomTree's dividend Indexes without altering asset allocation, let's take it a step further. What if we over-weight mid-cap equities? How would that change investors' positioning on the efficient frontier?

For the next step, we start with our **allocation A** consisting of all WisdomTree equities (87/13 split of large/mid-cap, consistent with Russell 1000 Value) and gradually over-weight mid-caps. As we move away from large-cap equities to mid-cap equities, we again notice a monotonous increase in annualized returns, though this time with increasing volatility.

On our way along the upper edge of this efficient frontier, our first stop is **allocation B**. In this allocation, we have an approximate 57/43 split of large- and mid-cap equities (34% large cap and 26% mid-cap, for a total 60% equity allocation) implemented again through WisdomTree dividend Indexes.

***This allocation is interesting because it over-weights mid-cap equities and has therefore outperformed by 72 bps on an annualized basis, while maintaining the same volatility as our original benchmark.***<sup>3</sup>

### Performance of WisdomTree Risk-Equality & Mid-Cap Allocation

	Annualized Risk (%)	Annualized Return (%)	Sharpe Ratio
WisdomTree Risk Equality Allocation 'B'	9.16	7.16	0.73
WisdomTree Mid-Cap Allocation 'C'	10.44	8.03	0.72

Source: Bloomberg, as of 1/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.

Finally, if we go all the way to the last stop on the upper edge of our chart above, we get our allocation C, with 60% in the WisdomTree MidCap Dividend and 40% in the Barclays bond Index. Although this allocation had higher volatility, it generated more than 100 bps of annualized outperformance over the benchmark.<sup>4</sup> Thus, on a risk-adjusted basis, it kept pace with increasing volatility by generating excess returns.

## 2. Moving Away from a 60/40 Model Itself, i.e., Over-weighting Equities

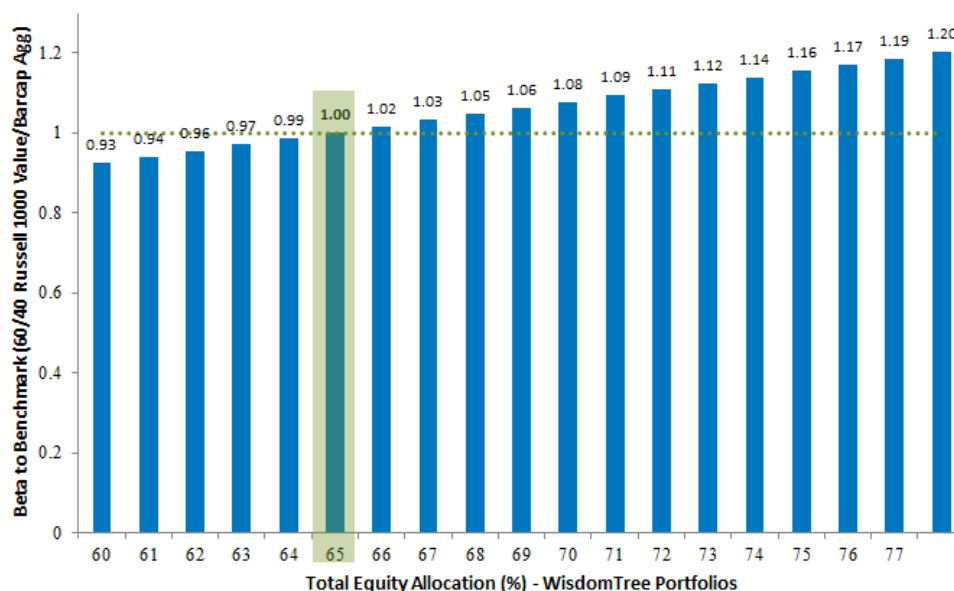
So far we have kept a constant 60% equity allocation. Another equally interesting question is, can I over-weight equities without increasing risk relative to our benchmark?

The chart below shows beta, i.e., a measure of risk for various WisdomTree allocations to our standard 60/40 benchmark, above. Each WisdomTree equity allocation is split 87:13 into large and mid-caps (as above) to ensure consistency with our Russell 1000 Value benchmark. The chart shows that by using WisdomTree component in equity piece, investors could have historically over-weight equities by up to 5% without increasing sensitivity (beta) or risk compared to a benchmark.

### Beta to a 60/40 Russell 1000/Barcap Agg Benchmark

#### WisdomTree Portfolio with Varying Equity Percentages and Rest in Barcap Agg

6/30/2016–12/31/2016



Source: Bloomberg, as of 01/31/2017

## Conclusion

It is clear that, historically, a manager who incorporated an element of WisdomTree's fundamentally weighted dividend

strategies would have benefitted from the outperformance over a cap-weighted benchmark during that period.

To an extent, WisdomTree's methodology also permitted investors to over-weight market segments such as mid-cap or even total equity allocation, which potentially generates higher returns over longer periods.

Our smart beta strategies have added value to investors' portfolios, and WisdomTree's core dividend family now has more than 10 years of proven track record. We believe blending WisdomTree's methodology to an all-cap-weighted portfolio can potentially yield better results for investors.

<sup>1</sup>Source: Bloomberg, as of 1/31/17.

<sup>2</sup>Source: Bloomberg, as of 1/31/17.

<sup>3</sup>Source: Bloomberg, as of 1/31/17.

<sup>4</sup>Source: Bloomberg, as of 1/31/17.

#### Important Risks Related to this Article

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

#### Annualized Performance of Indexes as of 1/31/17

	1 Yr	5 Yr	10 Yr
RU10VATR	24.39%	14.09%	5.66%
WTLDIR	20.20%	13.19%	6.55%
WTMDIR	26.69%	15.84%	8.40%
LBSTRUU	1.44%	2.09%	4.37%

Source: Bloomberg, as of 01/31/2017

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.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

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There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

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You cannot invest directly in an index.

## DEFINITIONS

**Active manager** : Portfolio managers who run funds that attempt to outperform the market by selecting those securities they believe to be the best.

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

**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.

**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 time.

**Russell 1000 Value Index** : A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

**Barclays US Agg Total Return Value Unhedged USD** : The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

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

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