

IMPLEMENTING "EFFICIENT CORE" PORTFOLIOS

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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.

WisdomTree introduced the [idea of "efficient core" portfolios](#) last fall. Given today's rapidly changing market regime, it is time for an update.

First, a quick reminder of the structure behind our capital efficient suite of individual products (using [NTSX](#) as the example). Put simply, if you have \$100 to invest, you can invest \$67 of it into [NTSX](#) and have the equivalent exposure to \$100 worth of an [S&P 500/Treasury](#) portfolio, leaving you with \$33 left to explore more [alpha](#)-seeking, yield-seeking or diversifying exposures within your overall portfolio.

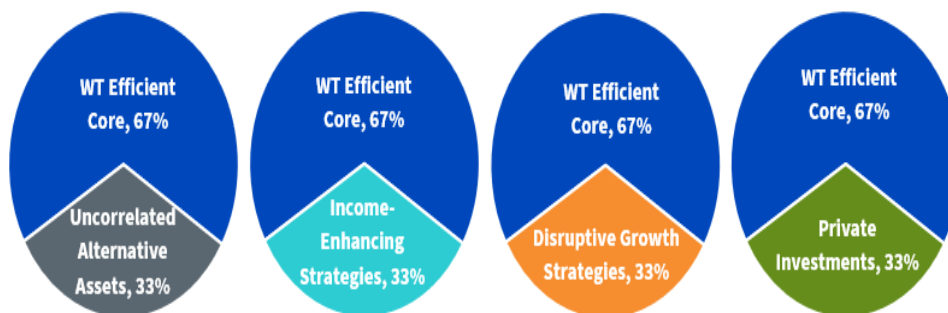
How the Capital Efficient Strategies Are Constructed

- **Equity component:** For every \$100 invested in the ETF, \$90 is invested in equity exposure via the [WisdomTree U.S. Efficient Core Fund \(NTSX\)](#). The equity component is a portfolio of 500 [large-cap](#) U.S. stocks, weighted by [market capitalization](#) to provide broad exposure to U.S. equities.
- **Cash component:** For every \$100 invested in the ETF, \$10 is held in short-term [collateral](#) that earns returns comparable to U.S. [Treasury bills](#).
- **Bond futures ladder:** To help magnify the potential benefits of the asset allocation, \$60 of bond futures are overlaid on top of the \$90 of equity exposure and \$10 of cash collateral.
 - Treasury futures are laddered (equal-weighted) across the 2-, 5-, 10- and 30-year segments of the yield curve to diversify interest rate risk.
 - The average effective duration for the fixed income portion of [NTSX](#) is typically 7–7.5 years and is meant to offer the duration profile of traditional aggregate bond indexes.

In addition to [NTSX](#), the other strategies currently available in our Efficient Core suite include [NTSI](#) (the EAFE version of [NTSX](#)), [NTSE](#) (the EM version), [GDE](#) (a gold plus equity version) and [GDMN](#) (a gold plus gold miners version).

In that introductory blog post from last fall, we provided some hypothetical examples of how advisors might allocate the freed-up capital.

1. Uncorrelated alternative assets to reduce volatility and/or add in additional potential sources of return.
2. Income-enhancing strategies to boost incremental yield on top of a 100% portfolio.
3. Maximum growth satellites to allocate to longer-term thematic and high-growth industries, sectors and firms.
4. Private investments for longer-term growth allocations.



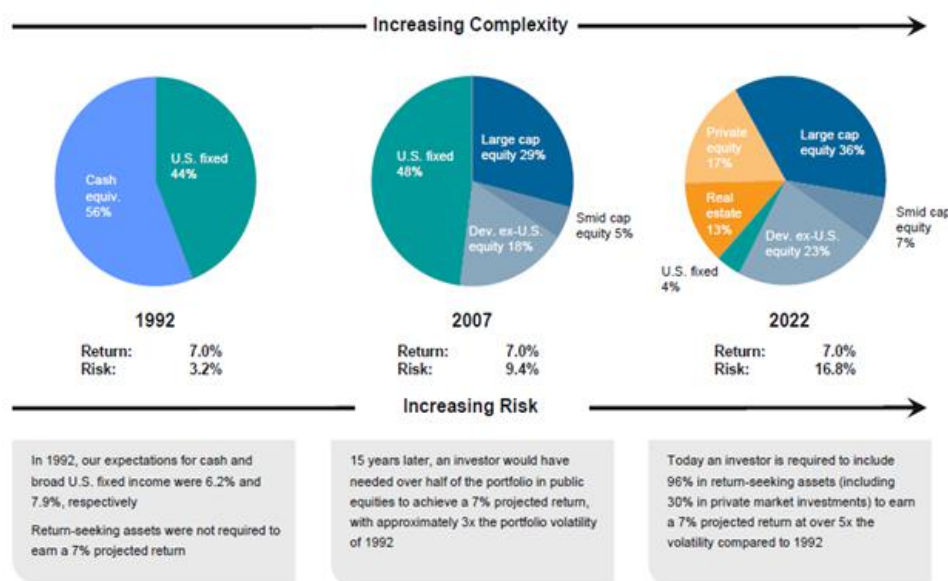
Why Now for Efficient Core Portfolios?

We seem to be at the beginning of a market regime that is different than most advisors have experienced in a long time—where it is not enough to simply allocate to long stocks and bonds to deliver the appropriate investment experience. U.S. and global stocks, as well as bonds, are down sharply year-to-date, so using just bonds to hedge equity risk is not working.

Given our view on rates (they will continue to rise), [inflation](#) (higher for longer than the consensus view) and what we believe will be consistently higher volatility in equity markets, we think this regime may be with us for quite some time.

From a longer-term perspective, meeting defined investor objectives with specific asset allocations has changed dramatically. Consider this chart, which is updated annually by investment consultant Callan Associates, based on their own capital market assumptions.

7% Expected Returns Over Past 30 Years



Source: Callan

Callan

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Assume the investment objective was an annualized 7% return. According to Callan's analysis, that objective could have been met in 1992 with a simple allocation to cash and [bonds](#), resulting in an annualized [standard deviation](#) of 3.2%.

In 2007, 15 years later, the same return target would have required an allocation to global equities and bonds, resulting in a standard deviation of 9.4% (three times that in 1992).

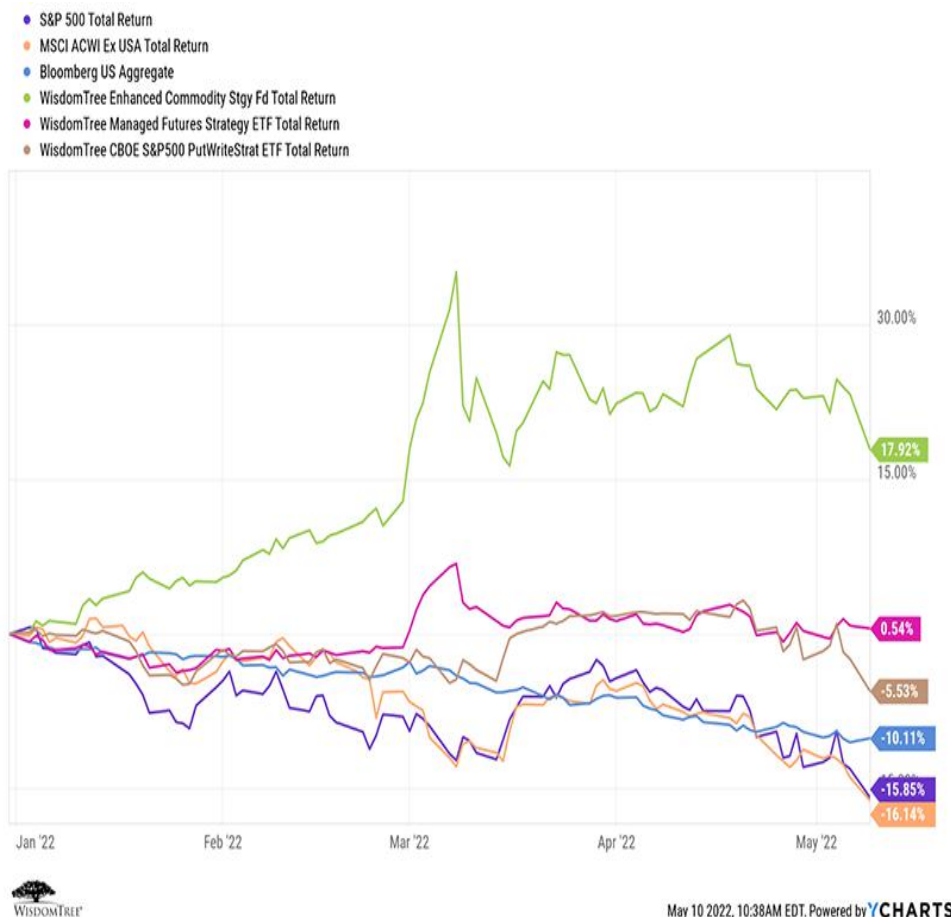
Roll forward to 2022 and that same 7% return target requires an allocation to global equities, private investments and real estate, resulting in a standard deviation of 16.8% (roughly five times that in 1992).

In other words, it might benefit advisors to consider additional portfolio allocations to meet long-term client objectives. We certainly are receiving more inbound enquiries asking some variation of the question, "What else might I put into

client portfolios, beside [stocks](#) and bonds?"

But how to fund them? Let's consider one simple hypothetical example, where the investment objectives are to hedge inflation and increase diversification within the portfolio.

Take a look at the YTD performances of (a) U.S. large-cap equities (as measured by the S&P 500), (b) large-cap non-U.S. equities (as measured by the [MSCI ACWI ex-U.S.](#)), (c) U.S. bonds (as measured by the [Bloomberg Aggregate](#)), (d) a global commodities strategy (using our own [GCC](#) at NAV), (d) a managed futures strategy (using our own [WTMF](#) at NAV) and (e) a variation of a hedged equity strategy that capitalizes on higher volatility (our own [PUTW](#) at NAV).¹



Source: YCharts, YTD data through 5/9/22. You cannot invest in an index and past index performance does not guarantee future results. In this chart, the "WisdomTree Enhanced Commodity Strategy" trades under the ticker GCC, the "WisdomTree Managed Futures Strategy" under the ticker WTMF and the "WisdomTree CBOE S&P 500 PutWrite Strategy" under the ticker PUTW. **Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.** WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total Returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

For the most recent standardized performance, click the respective ticker: [GCC](#), [WTMF](#), [PUTW](#).

The YTD performance differential between the core equity and bond exposures and the diversifying strategies is stark. Using the capital efficient strategies ([NTSX](#) and/or [NTSI](#) and [NTSE](#)) and using the freed-up capital to allocate to these diversifying strategies may have dramatically improved both overall performance and the inflation-hedging profile of the portfolio.²

This is just a simple hypothetical example. The opportunities to "explore" appropriate allocations for the freed-up capital are almost limitless and completely dependent on the investment objectives for the overall portfolio.

A final thought is this—many advisors have been hesitant to make reallocations within their clients' portfolios because of unrealized capital gains, the result of a remarkable multi-year bull rally in both stocks and bonds.

As bad as this year has been for most allocations, the result is the ability to make portfolio reallocations while minimizing realized gains, or perhaps even capturing tax losses that can offset gains elsewhere in the portfolio (i.e., "tax alpha,"

which is real money back into the end clients' pockets).

Conclusions

We think the time has come to [explore the possibilities of building efficient core portfolios](#). The market regime has changed and both advisors and clients are investigating innovative ideas.

One of the age-old questions we have always received as advisors is, "I like the idea of including non-core stocks and bonds into my portfolio, but how do I fund them?" We believe the efficient core portfolios can—well—efficiently address that question. You can still implement the core portfolio without having to pick and choose how to fund the portfolio satellite positions.

The primary point is the use of the WisdomTree Efficient Core suite of portfolios opens possibilities for advisors and investors to build truly customized portfolios in a highly capital-efficient manner, without sacrificing an underlying allocation to a traditional stock/bond portfolio.

¹ We use all WisdomTree strategies in this example for simplicity purposes. In actuality, all actual WisdomTree Model Portfolios are "open architecture" and contain both WisdomTree and third-party strategies.

² This is a hypothetical example for illustration purposes only and does not represent actual investment advice. Past performance does not guarantee future results.

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You cannot invest directly in an index.

DEFINITIONS

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.

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.

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.

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.

Market Capitalization : 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.

Collateral : something pledged as security for repayment in the event of a loss.

Treasury Bill : A treasury bill (T-Bill) is a short-term debt obligation backed by the U.S. government with a maturity of one month (four weeks), three months (13 weeks) or six months (26 weeks).

Inflation : Characterized by rising price levels.

Bond : A fixed-income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental).

Standard deviation : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

Stock : A stock (also known as equity) is a security that represents the ownership of a fraction of a corporation. This entitles the owner of the stock to a proportion of the corporation's assets and profits equal to how much stock they own. Units of stock are called "shares."

MSCI ACWI ex-U.S. Index : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States.

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.