WHERE TO TURN IF THE MARKET HAS COME TOO FAR, TOO FAST

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Since the presidential election on November 8, the S&P 500 Index has rallied an impressive 5%. Investors appear to be discounting the impact that lower tax rates, less regulation and new fiscal policies may have—well ahead of their potential implementation. Over that same time frame, the CBOE Volatility Index (VIX) dropped from almost 19 to just over 12, and the 10-Year yield went from 1.85% to 2.34% after being as low as 1.36% on July 8. In fact, the two weeks ending November 18 marked the third largest increase in the 10-Year yield over the last 30 years.

The sudden advancement of these three risk-on indicators may leave some people asking, "Have we come too far too fast?" With additional interest rate hikes on the horizon and aggressive discounting of President-elect Donald Trump's policies already taking place, some investors may be looking for good ideas about how to dial down some of their equity risk. One contrast we find noteworthy has been the underperformance of gold during this four-week stock market and U.S. dollar rally. An alternative strategy that has outperformed the traditional market hedge, gold, by 10.5%[1] since November 8 is the WisdomTree CBOE S&P 500 PutWrite Strategy Fund (PUTW).

The WisdomTree CBOE S&P 500 PutWrite Strategy Fund (PUTW)

PUTW, which seeks to track the CBOE S&P 500 PutWrite Index (PUT), writes at-the-money S&P 500 Index put options every month while simultaneously holding one- and three-month U.S. Treasury bills to cover maximum possible losses. With interest rates now rising, the Fund has the potential to generate positive returns from its short-term Treasury exposure, but the predominant source of total return comes from the option premiums PUTW receives from writing puts. As the S&P 500 Index falls below the strike price of the puts, so too will the value of the Index's contracts, but its descent would be cushioned by premiums. Essentially, a loss in the S&P 500 becomes the S&P 500 loss plus premiums. This generally provides a measure of downside protection for the strategy compared to a long-only S&P 500 position. The magnitude of this downside protection depends on the amount of volatility in the market, meaning higher volatility coincides with higher premiums and lower volatility the opposite. In other words, if the VIX starts to head higher, the efficacy of put writing increases.

On the flip side, if the S&P 500 rallies, premiums will still be the predominate source of return, creating potential underperformance to the equity market, given that the Fund never holds any stocks. For standardized returns of the WisdomTree CBOE S&P 500 PutWrite Strategy Fund, please click here.

Writing Puts as a Long-Term Strategy

While no one can predict how or when the Trump rally will end, writing puts is more than just a tactical strategy. WisdomTree believes it can help lower the overall volatility of an investor's equity exposure while generating long-term returns that have historically approached equity returns. Since the real-time inception of the CBOE S&P 500 PutWrite Index in June 2007, it has achieved similar returns to both gold and the S&P 500 with a lower standard deviation and a higher Sharpe ratio. It is important to note that it achieved this with a correlation of 0.86 to the S&P 500, whereas as gold showed essentially no correlation at all to the broader equity market. We believe it is this story—downside protection while maintaining the look and feel of the equity market—that makes put writing such a credible part of a portfolio and a potential shock absorber over time. While gold may still play a role as a noncorrelated part of a larger portfolio, we are mindful that gold can lag broader asset classes as nominal and real interest rates rise in the U.S. and as the dollar increases in value relative to foreign currencies.

		Cumulative Return		Average Annual Return as of 11/30/2016				Summary Statistics Since Inception*		
	PUT Index Inception	Since Presidential Election as of 12/7/2016	YTD as of 12/7/2016	1-Year	3-Year	5-Year	Since PUT Index Inception	Standard Deviation	Sharpe Ratio	Correlation to S&P 500 Total Return Index
CBOE S&P 500 PutWrite Index	6/20/2007	2.49%	7.92%	6.83%	7.15%	8.76%	5.96%	11.88	0.46	0.86
Gold (Spot)		-7.97%	10.64%	10.18%	-2.17%	-7.64%	6.37%	19.84	0.30	0.04
S&P 500 Total Return Index		4.98%	11.95%	8.06%	9.05%	14.43%	6.31%	15.62	0.38	1.00

Sources: WisdomTree, Bloomberg, Zephyr StyleADVISOR, as of 12/7/16. Summary statistics use the latest month-end since inception (6/29/07) as a starting date. 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.

Conclusion

At WisdomTree, we believe the alternative asset class serves an important role in driving improved risk-adjusted returns. We are aware that some investors find alternatives somewhat inaccessible, which is why we brought to market a put writing strategy that is systematic and passive in nature, wrapped in the exchange-traded fund vehicle at 38 basis points. To learn more about PUTW, the WisdomTree CBOE S&P 500 PutWrite Strategy Fund, please click here.

Unless otherwise noted, data source is Bloomberg, as of December 7, 2016 .

[1]Sources: WisdomTree, Bloomberg, 11/8/16–12/7/16. Returns calculated using net asset value (NAV). PUTW returned 2.49% and gold returned -7.97% over this period.

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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.

10-year government bond yield : Yields on the 10 year government debt security.

Risk-on/risk-off : refers to changes in investment activity in response to perceived risk. During periods when risk is perceived as low, investors tend to engage in higher-risk investments. When risk is perceived as high, investors tend to gravitate toward lower-risk investments.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Alternative Investment : An investment that is not one of the three traditional asset types (stocks, bonds and cash). Alternative investments typically include hedge funds, managed futures, real estate, commodities and derivatives contracts.

CBOE S&P 500 PutWrite Index (PUT) : Measures the performance of a hypothetical portfolio that sells S&P 500 Index (SPX) put options against collateralized cash reserves held in a money market account. The PUT strategy is designed to sell a sequence of one-month, at-the-money, S&P 500 Index puts and invest cash at one- and three-month Treasury Bill Rates. The number of puts sold varies from month to month but is limited so that the amount held in Treasury Bills can finance the maximum possible loss from final settlement of the SPX puts.

Put options : an option to sell assets at an agreed price on or before a particular date.

1-3 month U.S. Treasury Bill : A short-term debt obligation backed by the U.S. government with a maturity of less than 3 months.

Option premium : The current price of any specific option contract that has yet to expire.

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

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

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.

Sharpe ratio : Measure of risk-adjusted return. Higher values indicate greater return per unit of risk, specifically standard deviation, which is viewed as being desirable.

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.

Risk-adjusted returns : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.

Basis point : 1/100th of 1 percent.