LOSS PREVENTION IDEAS IF AUTUMN BRINGS COLD WINDS

Jeff Weniger – Head of Equity Strategy
08/18/2021

What a stark separation between the view of the world from Wall Street and from Main Street.

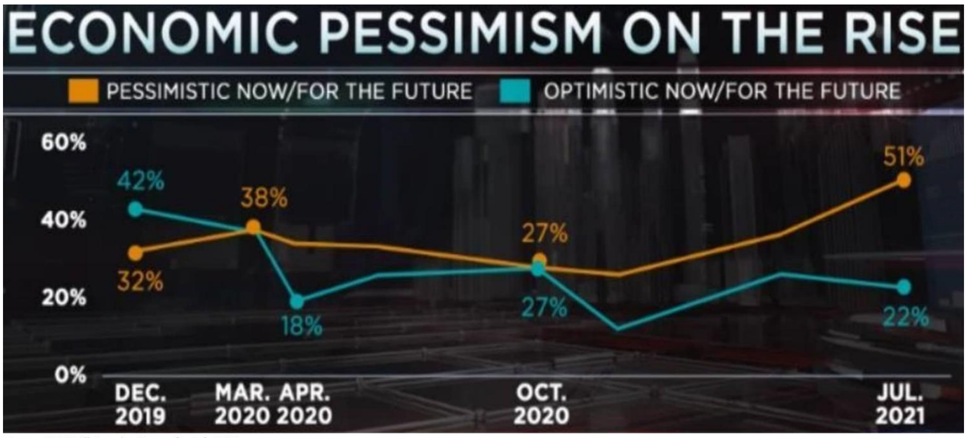
With bonds catching a rally in recent months while the S&P 500 posts a year-to-date gain of 18%, it appears to be the best of times for investors. Cashed up from working at home and with assets in our portfolios rallying, many in this business have fallen into the trap of internalizing last quarter's 6.5% annualized GDP growth and assuming Main Street sees the same rosy scene.

But the person who bags groceries isn't buying it.

CNBC's July All-America survey is remarkable. On the economy, over half of respondents declared they are "pessimistic now and for the future," the highest reading since 2015.

More troubling, that's about double the proportion who said the same thing less than a year ago. I'm afraid to ask: what would be the response of middle class respondents if 401(k) balances were actually going *down*?

Figure 1: CNBC All-America Survey – View on the Economy

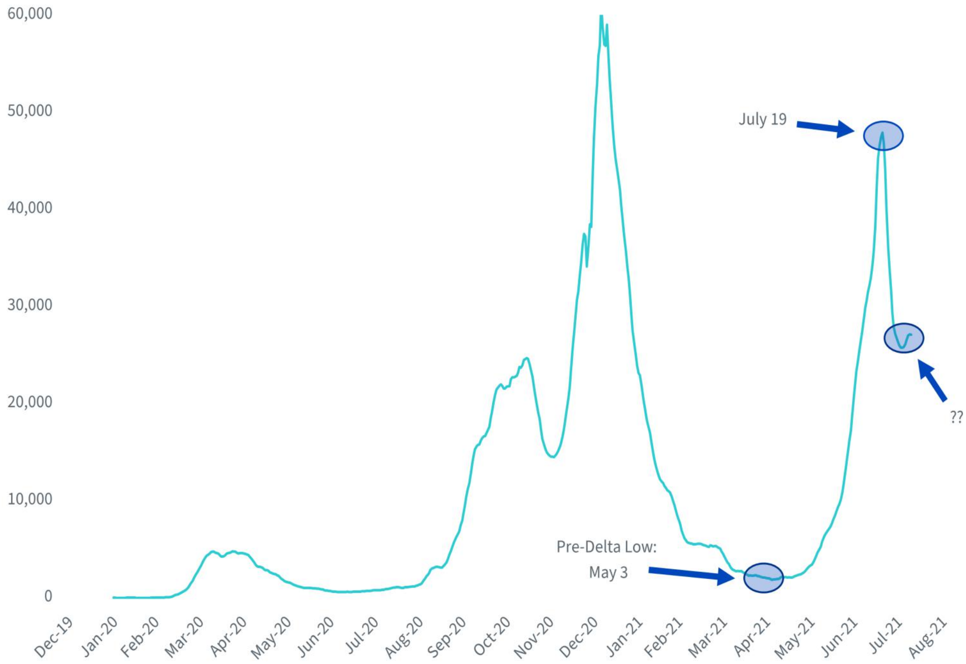


Source: CNBC All-America Survey for July 2021.

What could catalyze problems in the stock market come autumn? The word in epidemiology circles is that the COVID-19 delta variant, in the absence of herd immunity, has a reproduction rate akin to that of chicken pox. The market is hyper-focused on the variant's effect on consumer psychology and everyday activity. If New York City's new COVID passport rule is a trend indicator, some in the market may worry that schools could go virtual again, exacerbating the system's labor shortages and supply chain woes.

In my personal view there could be a more optimistic outcome to our delta variant future, owing to the experience of the first industrialized nation hit with it: Britain. Epidemiologists view this variant as highly contagious relative to prior iterations, so despite most Britons being vaccinated, it was with little surprise that delta sent U.K. cases spiraling in May and June. It started to fizzle down come mid-July (figure 2). Troublingly, the case count decline appears to have stopped in the last week or so, but for now Britain appears to have seen the worst of it.

Figure 2: United Kingdom 7-Day Moving Average, Positive Covid-19 Test Results



Source: Coronavirus.data.gov.uk/details/cases, as of 8/8/2021.

If the Brits' experience were to repeat in the U.S., you can extrapolate something like 2.5 months from trough-to-peak, with the commencement having occurred back in the third week of June. But make sure to account for vaccination rates; about 69% of Britons are at least partially vaccinated, whereas the U.S. rate is 59%, according to Our World in Data. Nevertheless, the worst of delta could come some time around Labor Day. In other words, we may be closer to the end of this wave than the beginning.

Because of this view, the risk of contagion from the Chinese stock market's losses over the last half year are a bigger concern to me at the moment than COVID-19.

While the S&P 500 continues to make all-time highs above 4,400, it is difficult to look the other way when you know that Tencent, China's largest conglomerate, has slumped 36% over a half year.

Figure 3: Tencent Share Price (HKD)

Source: WisdomTree, as of 8/10/21.

Tencent is not alone. Alibaba—China's equivalent of Amazon—has lost 37% of its value, owing to the Chinese Communist Party's flirtations with anti-trust legislation and the "disappearing" in late 2020 of its outspoken, flamboyant founder, Jack Ma.

Together, these giants comprise a quarter of the Chinese stock market.

Figure 4: MSCI China Index, 10 Largest Components

Company	52 Week Low	52 Week High	Last	Decline from 52-Week High	Currency	% Weight in MSCI China Index
Tencent	422.00	775.50	486.20	**-37.3%**	HKD	13.30%
Alibaba Group	174.50	309.40	196.14	**-36.6%**	HKD	13.19%
Meituan	190.40	460.00	239.00	**-48.0%**	HKD	4.57%
China Construction Bank	4.93	6.74	5.49	**-18.5%**	HKD	2.32%
JD.com	236.80	422.80	285.20	**-32.5%**	HKD	2.13%
NIO	12.54	66.99	44.52	**-33.5%**	USD	2.12%
Ping An Insurance Co. of China	64.50	103.60	69.20	**-33.2%**	HKD	1.90%
WuXi Biologics	50.63	148.00	127.50	**-13.9%**	HKD	1.89%
Pinduoduo	69.89	212.60	91.79	**-56.8%**	USD	1.71%
Baidu	146.40	256.60	164.00	**-36.1%**	HKD	1.69%

Source: WisdomTree, as of 8/10/2021.

The risk to U.S. equities is that investors see large Chinese stocks that were trading for 30 times earnings a half year ago now being on offer for a multiple of, say, 15–20 times, calling into question the valuations they are paying for Silicon Valley dynamos and other market leaders.

This is a particularly acute issue in the S&P 500 Growth index, correlated as its major components' business models are with those of the Chinese mega-firms.

Combine Apple, Microsoft, Amazon, Facebook and Google-parent Alphabet and you get to 41% of the S&P 500 Growth index allocated to just those five companies.

Think about this completely unrelated hypothetical: if a German or Japanese banking giant tumbled 30%–50%, while the German or Japanese stock market followed it right on down, would you start to wonder whether your Bank of America stake will keep making new highs?

This is where my mind is right now: while the market is focusing on the delta variant, investors might want to pay closer attention to the effect of Chinese stock market losses on equities in other domiciles.

If Chinese stocks cannot get their act together, the unwanted "October surprise" could be a rerating of U.S. equity valuations in response to now-reduced peer valuations.

I have two WisdomTree ideas for you to investigate.

One is DGRW, the WisdomTree U.S. Quality Dividend Growth Fund. It has no exposure to firms like Facebook and Alphabet, both of which may be viewed as U.S. proxies for some of China's most punished stocks. However, it does have Microsoft and Apple. (For a list of Fund holding and weightings please click *here*.)

Another plan might be to scour for Funds that have had "good" crashes. We have a small-cap Fund that is over 15 years old with average annualized volatility since inception of 13.8%, notably lower than the Russell 2000 Index's 20.2%. It also saved several hundred basis points relative to that index in the 2020 tumble. If you go back to the Lehman fiasco, it fell "only" 39.2% while the S&P 500 and the Russell 2000 declined 55.3% and 58.5%, respectively, between October 9, 2007 and March 9, 2009. (For Standardized Fund Performance, please click *here*.)

Now let me scare you out of the room: it's a Japan fund.

But if you have an open mind to Japanese equities, I encourage you to go back and look at all the corrections and crashes since it launched in 2006. You may possibly find it to be a play for downside risk management, if you think this autumn will bring cold winds. The name is the WisdomTree Japan SmallCap Dividend Fund (DFJ).

Past performance is no assurance of future results and there is no guarantee that any investment will achieve its objectives, generate positive returns, or avoid losses.

Related Funds

+ WisdomTree Japan SmallCap Dividend Fund

+ WisdomTree U.S. Quality Dividend Growth Fund

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

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.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

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.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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 tim.

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.

Small caps : new or relatively young companies that typically have a market capitalization between $200 million to $2 billion.

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

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.