ECONOMIC SLACK IS HERE. STAY DEFENSIVE.

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We have all seen the headlines and heard the anecdotes about industries from construction to restaurants to accounting being in desperate need of workers.

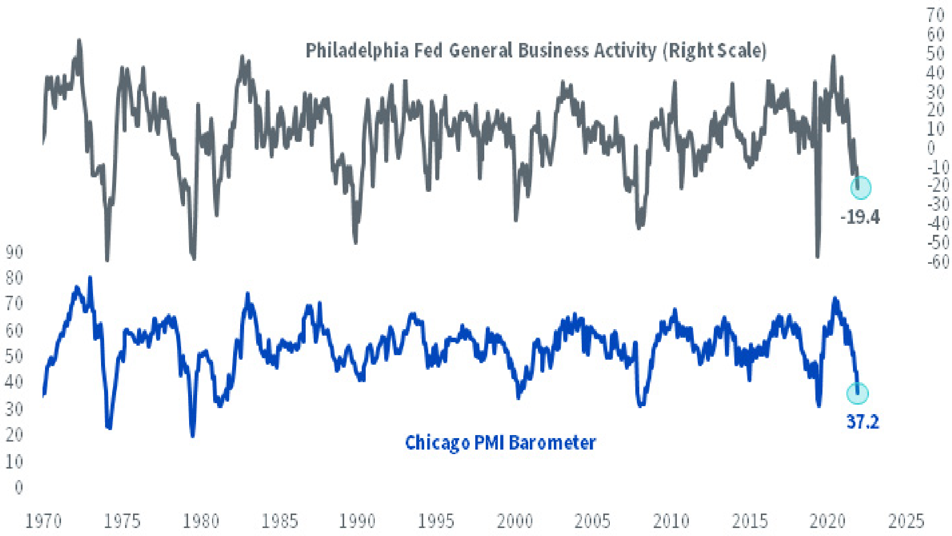
With the labor shortage so well known by so many, it's hard to conceptualize empty spots on the proverbial assembly line.

But it's time to do just that.

Taken at face value, the Fed's 4.4% unemployment forecast for 2023 looks like one of those figures that you come back to 365 days later and scratch your head. We see considerable upside risk to that number.

Both the Philadelphia Fed General Business Activity Index and the Chicago PMI Barometer took another tumble in November. These are, for all intents and purposes, telling us that the economy is in a recession right now. It is hard to conceptualize a three-handle or a four-handle persisting on unemployment amid the waterfalls in figure 1.

Figure 1: Chicago and Philly Fed Gauges in Freefall

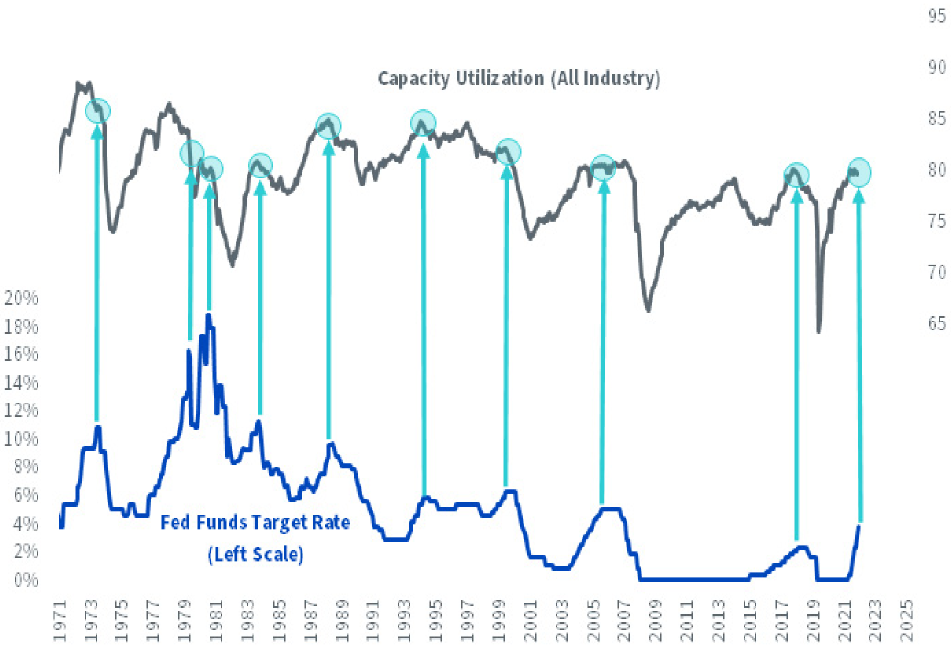


Sources: Refinitiv, Philadelphia Fed, Chicago Fed, as of November 2022.

Granted, the U.S. still has a near-record 10.3 million job openings posted, so there is no doubt we have a nice buffer in the event we catch trouble in 2023.

Nevertheless, it is a reasonable base case to anticipate capacity utilization rolling over right about now, owing to the Fed being in what looks like the 11th hour of its tightening program (figure 2).

Figure 2: Capacity Utilization May Be Topping



Refinitiv, Federal Reserve, as of November 2022 for capacity utilization and 12/2/22 for Fed Funds.

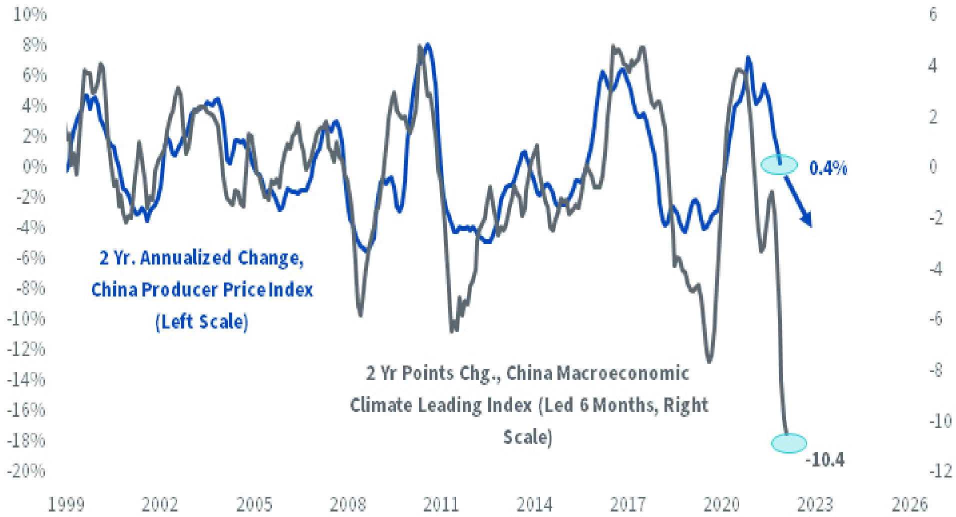
In attempting to determine how much slack is on the docket, you always want to figure out if the Chinese consumer will be playing along. Because of China's never-ending "zero COVID" policy, sentiment there is in the basement (figure 3).

Figure 3: China's Consumer Sentiment Has Tumbled

Sources: Refinitiv, Conference Board, as of September 2022.

China's Macroeconomic Climate Index has also dropped precipitously. That would seemingly portend further downside to producer prices, perpetuating—at least in 2023 and maybe 2024—the quarter-century-old theme of China exporting disinflation.

Figure 4: China's Leading Indicators Point to Declining Producer Prices

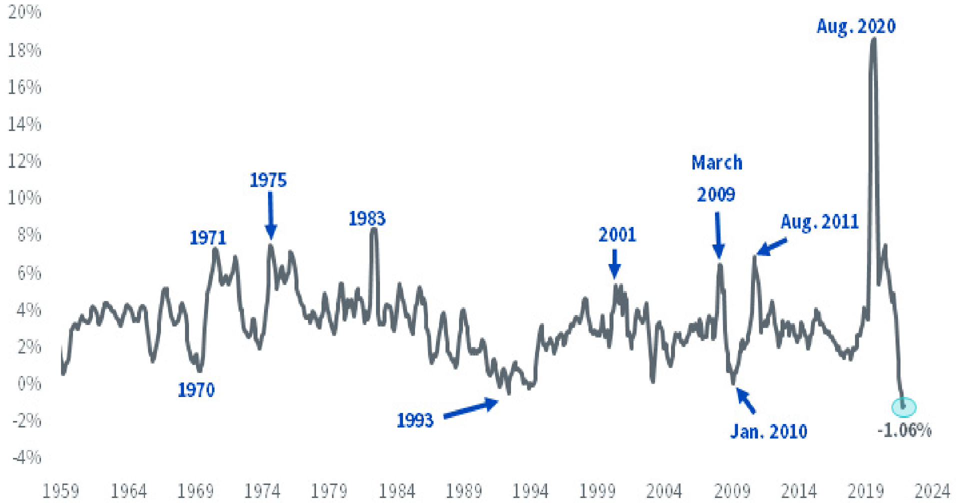


Sources: Refinitiv, National Bureau of Statistics China, as of September 2022.

Finally, some fodder for "Team Transitory," who prognosticated that the inflation spike would last just a few months before fading away. While the massive monetary expansion of 2020 and 2021 was so off-the-charts that it should still be respected, I would be remiss if I didn't point out that it is now in outright decline.

The 1.06% fall in M3 money supply in the six months to October is an unprecedented reading in a series the OECD has tabulated back to 1959.

Figure 5: U.S. Broad Money and Components, M3 Money Supply (6-Mo. Chg.)



Source: OECD, as of October 2022.

For the pain already meted out on stocks in 2022, it still seems some surprises are in store economically.

To me, the logical tack in 2023 is to continue shading toward defensive sectors. Using S&P Global's definition of "defensive," the WisdomTree U.S. LargeCap Dividend Fund (DLN) has 45.4% in such sectors, while the WisdomTree U.S. High Dividend Fund (DHS) has 55.5%. These are both materially above the S&P 500's 36% in defensives.

Using MSCI's characterizations, which call for placing Energy in the defensive basket, the differentials between the two WisdomTree strategies and the S&P 500 are even more stark.

Notice specifically the several percentage point gap between WisdomTree's weights in Consumer Discretionary and those in the S&P 500. If we get around to late 2023 and the labor market is blowing through the Fed's 4.4% unemployment rate forecast, I think that will take people by surprise. I speak to a lot of people in this business daily, and a lot of them are completely content forecasting something like mid-4s on the 2023 unemployment rate.

I suspect they are underestimating the possibility of labor market deterioration.

Figure 6: Defensive and Cyclical Exposures, WisdomTree vs. the S&P 500

Sector	WisdomTree U.S. LargeCap Dividend Fund	WisdomTree U.S. High Dividend Fund	S&P 500	S&P Global		MSCI	
	DLN	DHS		Cyclical	Defensive	Cyclical	Defensive
Communication Services	2.2%	3.5%	8.1%		YES		YES
Consumer Discretionary	5.1%	0.8%	11.7%	YES		YES	
Consumer Staples	15.4%	17.1%	6.9%		YES		YES
Energy	12.3%	22.6%	4.5%	YES			YES
Financials	13.1%	13.7%	11.0%	YES		YES	
Health Care	17.8%	20.1%	15.1%		YES		YES
Industrials	7.8%	3.0%	7.9%	YES		YES	
Information Technology	14.5%	2.6%	26.4%	YES		YES	
Basic Materials	1.8%	1.8%	2.5%	YES		YES	
Real Estate	4.5%	3.7%	2.8%		YES		YES
Utilities	5.5%	11.1%	3.1%		YES		YES
Total	100.0%	100.0%	100.0%				
Sum Cyclical (S&P Global Definition)	**54.6%**	**44.5%**	**64.0%**				
Sum Defensive (S&P Global Definition)	**45.4%**	**55.5%**	**36.0%**				
Sum Cyclical (MSCI Definition)	**42.3%**	**21.9%**	**59.5%**				
Sum Defensive (MSCI Definition)	**57.7%**	**78.1%**	**40.5%**				

Source: WisdomTree, as of 12/2/22. Because definitions of cyclicality/defensiveness can vary, we have included the characterizations of MSCI and S&P Global. Weights as of 10/31/22. Sector weightings are subject to change.

This is not a market for heroes.

I have this itchy notion that we can't end this bear market with an unemployment rate hanging out at 3.7%. Not after the wanton speculation of the 2009–2021 bull.

DLN and DHS provided a hedge in 2022. I'm fine staying the course with them in 2023 as the investing public reassesses risk amid what I believe will be a rolling over in the U.S. jobs market.

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For the top 10 holdings of DLN please visit the Fund's fund detail page at https://www.wisdomtree.com/investments/etfs/equity/dln

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Philadelphia Federal Index : A regional federal-reserve-bank index measuring changes in business growth. It is also known as the "Manufacturing Business Outlook Survey."

Chicago PMI : Measures the performance of the manufacturing and non-manufacturing sector in the Chicago region.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

China Leading Economic Index : In China, the Leading Index is used to forecast future economic trends.

Disinflation : Term used to describe instances of slowing inflation, different from deflation in that price levels are still increasing overall, just at a slower rate.

M3 : A measure of the money supply that includes M2 as well as large time deposits, institutional money market funds, short-term repurchase agreements (repo), and larger liquid assets.

Organization for Economic Cooperation and Developmnt (OECD) : the organization for economic co-operation and development aims to promote policies that will improve the economic and social well-being of people around the world.

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.

Baskets : The composition of an ETF in terms one creation/redemption unit.

Bullish : a position that benefits when asset prices rise.