

# REFRESHING VALUATIONS FOR LARGE-CAP QUALITY

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Increasing portfolio [quality](#) is a theme many investors flock to during recessions.

You might worry that rotation and flows to quality strategies push up [valuations](#) to premium prices, hurting the prospects of forward-looking returns. But WisdomTree has a potential solution. We have a family of quality [dividend growth](#) strategies that combine elements of screening for profitability (high [return on equity \(ROE\)](#) and [return on assets \(ROA\)](#)) and strong earnings growth expectations.

Because of the profitability focus and the [dividend](#) requirement, one of the interesting parts of our [U.S. Quality Dividend Growth Fund \(DGRW\)](#) is that it is trading at [price-to-earnings \(P/E\) multiples](#) that resemble the characteristics of “[value](#)” sides of the market, but with significantly higher quality ratios.

While the [S&P 500 Value Index](#) has a return on equity of 9.4%—below the [S&P 500](#) level of 13.1%—DGRW has an ROE of more than 24%.

## Aggregate Characteristics

Characteristic	DGRW	S&P 500 Index	S&P 500 Value Index
Dividend Yield	2.24%	1.73%	2.84%
Net Buy Back Yield	1.79%	1.52%	1.52%
Shareholder Yield	4.02%	3.25%	4.36%
Price/Earnings (P/E)	22.5	27.9	21.5
Price/Earnings (P/E) Excl. Negative	22.1	25.6	18.3
Estimated Price/Earnings (P/E)	19.7	24.5	19.2
Return on Assets (ROA%)	6.56%	2.82%	1.80%
Return on Equity (ROE%)	24.12%	13.10%	9.44%
Return on Sales %	15.13%	12.43%	9.95%

Sources: WisdomTree, FactSet, as of 10/7/20. You cannot invest directly in an index. Weights subject to change.

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.

Please click [here](#) for standardized and the most recent month-end performance.

For definitions of terms in the table, please visit our [glossary](#).

Let's look at some of the nuance of this strategy.

## Dividends Under Pressure

The broad universe of value strategies and dividend-paying stocks has come under pressure in 2020 as many companies were forced to scale back or cut their dividends.

**Less Likely to Cut Dividends:** Whereas 272 companies, or 13%, of the 1,471 dividend payers in the [WisdomTree U.S. Dividend Index](#) either cut or suspended dividends in 2020, less than 8% of the 300 companies in the [WisdomTree Quality Dividend Growth Index](#) cut or suspended dividends in 2020.

**Quality More Likely to Grow Dividends:** Quality companies also tend to be able to grow dividends faster over time, and they were stress-tested during this pandemic. Whereas 54% of the broad universe of 1,471 dividend payers have grown their dividends in 2020, 64% of the Quality Dividend Growth Index have.

Being less likely to cut dividends and more likely to grow them adds up. The WisdomTree U.S. Quality Dividend Growth Index currently only sees a decline of less than 2% in its total [Dividend Stream®](#), whereas the broad index *Dividend Stream* is down 6.5%.

#### Total Change in *Dividend Stream* by Dividend Action in 2020

Dividend Policy	WT U.S. Dividend Index	WT U.S. Quality Dividend Growth Index
Suspended	-6.5%	-6.6%
Cutter	-3.7%	-0.5%
Grower	3.8%	5.2%
<b>Total</b>	<b>-6.5%</b>	<b>-1.9%</b>

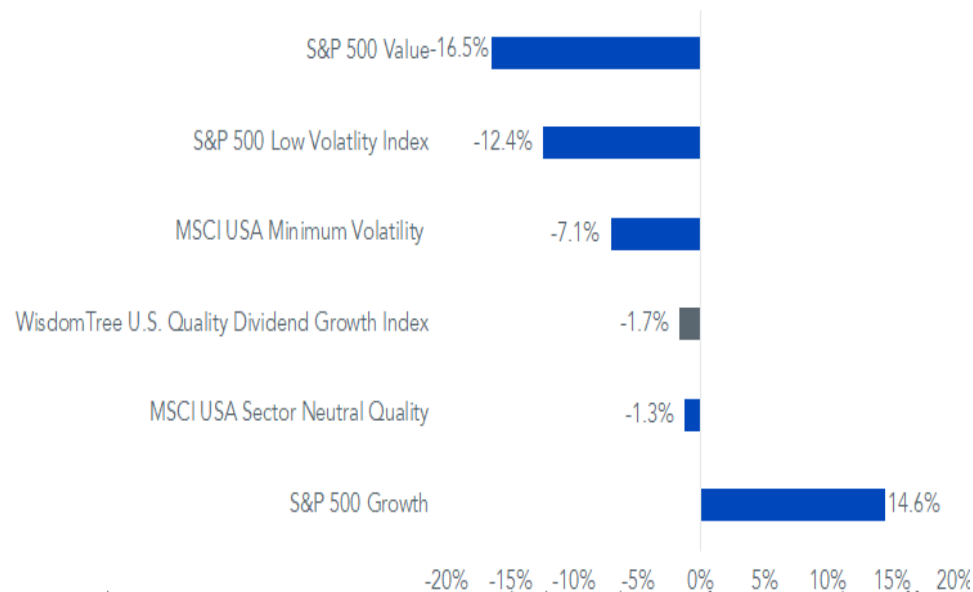
Sources: WisdomTree, FactSet, as of 9/24/20. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but 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. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein. Additional index information is available at [www.wisdomtree.com](http://www.wisdomtree.com).

#### 2020 Factor Returns—Low Risk Lags

In recent years, investors have flocked to “low-risk” funds that track indexes like the [MSCI USA Minimum Volatility](#) and the [S&P 500 Low Volatility](#)—adding \$36.5 billion to such funds between 2017 and 2019<sup>1</sup>.

But these strategies haven’t been a ballast during the coronavirus storm. The MSCI USA Minimum Volatility lagged the S&P 500 by 7.1% this year. The S&P Low Volatility has lagged by more than 12%.

#### Excess Return vs. S&P 500 Index



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

Growth strategies, led by technology shares that benefited from the economic shutdown, have dominated all other factors, with a more than 3,000 [basis point \(bps\)](#) spread between growth and value.

Remarkably, the WisdomTree U.S. Quality Dividend Growth Index only trailed the S&P 500 by 170 bps this year without holding 7 of the 10 largest contributors to S&P 500 performance—many of the non-dividend-paying technology stocks.

For investors concerned about the top-heavy, growth-led run in the broad benchmark, our quality dividend growth strategy—which combines elements of quality and value—looks like an attractive alternative for widespread uncertainty and market volatility.

<sup>1</sup>Jason Zweig, “Some Investors Tried to Win by Losing Less. They Lost Anyway,” Wall Street Journal, 9/18/20.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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](#)

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You cannot invest directly in an index.

## **DEFINITIONS**

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**Valuation** : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Dividend growth** : The growth in trailing 12-month dividends for the specified universe.

**Return on Equity (ROE)** : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

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

**Earnings multiple** : another way of saying price-to-earnings multiple.

**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.

**Dividend Stream** : Refers to the regular dividends per share multiplied by the number of shares outstanding.

**MSCI USA Minimum Volatility Index** : Aims to reflect the performance characteristics of a minimum variance strategy applied to the large and mid cap USA equity universe.

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