

# HOW YOU COULD HAVE AVOIDED LAST YEAR'S CORRECTION

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Last year finally broke the nine-year [bull run](#) in equity markets.

That length has been matched only twice since the 1950s. And most of this bull run was accompanied by extraordinarily low [volatility](#) for equities. In 2017, the [Chicago Board Options Exchange's \(Cboe's\) VIX Index](#)—a measure of the market's expectation for forward volatility—traded at close to 10, which is about half of its long-term average of 20.

And then the end of 2018 happened.

I previously have written about [indicators WisdomTree tracks that saw the writing on the wall](#).

Below, I cover what measures could have been taken to help avoid the downturn in equity markets that we saw in the fourth quarter of 2018.

## Strategies That Worked

The [WisdomTree CBOE S&P 500 PutWrite Strategy Fund \(PUTW\)](#) and the [WisdomTree CBOE Russell 2000 PutWrite Strategy Fund \(RPUT\)](#) track the [Cboe S&P 500 PutWrite Index \(PUT\)](#) and the [Cboe Russell 2000 PutWrite Index \(PUTR\)](#), respectively.

The underlying indexes of the two strategies have an established track record of handling stress and potentially reducing significant risk in your portfolio.

Let's see how they performed last year.

Out of a total 63 trading days in the fourth quarter of 2018, the S&P 500 Index had 38 negative trading days, while the [Russell 2000 Index](#) had 39. A true test of any volatility-reducing strategy lies in its relative performance on negative days. The table below compares PUT and PUTR performance relative to their benchmarks.

	Days When S&P 500 Index Closed Negative	Days When S&P 500 Index Closed Positive
Total number of days	38	25
Days PUT lagged S&P 500	4	22
Average S&P 500 return	-1.10%	1.14%
Average PUT return	-0.86%	0.85%
Average daily downside protection by PUT	0.24%	

Sources: Cboe, WisdomTree. Data as of 12/31/18. Period covered: 9/28/18–12/31/18. 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. 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.

	Days When Russell 2000 Index Closed Negative	Days When Russell 200 Index Closed Positive
Total number of days	39	24
Days PUTR lagged Russell 2000	4	19
Average Russell 2000 return	-1.30%	1.23%
Average PUTR return	-0.99%	0.92%
Average daily downside protection by PUT	0.31%	

Sources: Cboe, Bloomberg, WisdomTree. Data as of 12/31/18. Period covered: 9/28/18–12/31/18. 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. 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.

My quick takeaways:

- **PUT outperformed the S&P 500 on 34 of 38 negative days.**
- On average, it delivered a [downside protection](#) of **~24 basis points (bps)** on each of those down days.
- Similarly, **PUTR outperformed the Russell 2000 on 35 of 39 negative days**, and it did so with an average downside protection of **~31 bps** per day.

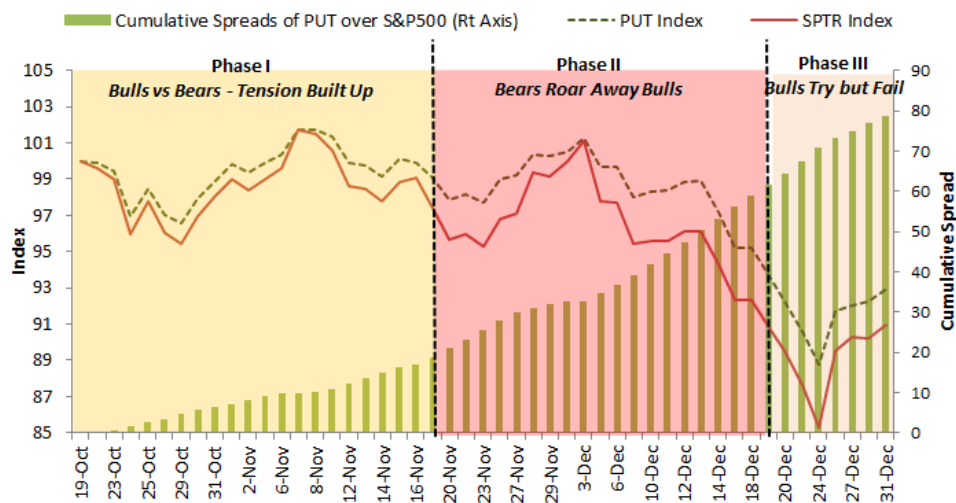
## A Deeper Look

Let's take this a step further and examine how the two strategies performed after they sold their first [option](#) for the quarter. As a refresher, both strategies are designed to collect [premiums](#) by selling an [at-the-money](#) European-style put option with monthly maturity. Monthly options typically expire on the third Friday of every month, and therefore the first time both of these strategies rolled into a new position was January 19.

The chart below shows the three phases of the market's boom and bust for the fourth quarter of 2018 (top for PUT and bottom for PUTR).

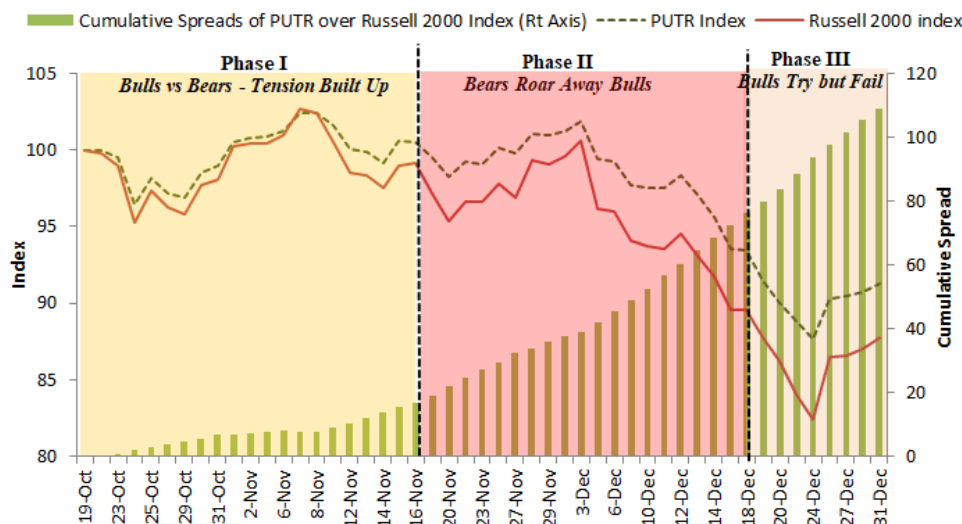
- **Phase 1 (mid-October through mid-November):** On October 19, both strategies roll their first option of the quarter.
- **Phase 2 (mid-November through mid-December):** On November 16, both strategies roll their second option of the quarter.
- **Phase 3 (mid-December through the end of 2018):** On December 21, both strategies roll their third option of the quarter.

#### Performance of PUT vs. S&P 500 Index During Q4 2018



Sources: Cboe, Bloomberg, WisdomTree. Data as of 12/31/18. Period covered: 9/28/18–12/31/18. 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. 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.

#### Performance of PUTR vs. Russell 2000 Index During Q4 2018



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In both instances, the following is evident:

- In Phase 1, as markets became volatile, both strategies gradually started to build outperformance over their respective benchmarks.
- In Phase 2, by rolling into the second option of quarter when the VIX had spiked (owing to the correction in October 2018), both strategies collected richer premiums, which helped their total return build over their benchmarks. This spread helped sustain and add to their outperformance as their benchmarks continued to fall.
- Finally, in Phase 3, as both strategies sold their third option for the quarter, the buildup of previous outperformances and elevated volatility ensured that both strategies outperformed even when there was a mild rally in equities toward year's end.

## Conclusion

There is a popular saying: "When the going gets tough, the tough gets going." I think similarly true colors of any risk-reduction strategy are not revealed on days when markets are hunky-dory; rather, they are visible on volatile and stressful days.

***By relatively holding up in both the first and fourth quarters of 2018, both WisdomTree's PUTW and RPUT have established track records as possible investment solutions for an investor's portfolio during tough times.***

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You cannot invest directly in an index.

## **DEFINITIONS**

**Bullish** : a position that benefits when asset prices rise.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;.

**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.

**Cboe Russell 2000 PutWrite Index (PUTR)** : An Index designed to track the performance of a hypothetical strategy that sells a monthly at-the-money (ATM) Russell 2000 Index put option. The written Russell 2000 put option is collateralized by a money market account invested in one-month Treasury bills.

**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.

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

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

**Premium** : When the price of an ETF is higher than its NAV.

**“At the money”** : option’s strike price is identical to the price of the underlying security.