

QUALITY GROWTH SHINES

Matt Wagner – Associate Director, Research
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How quickly narratives shift.

A sharp rise in [interest rates](#), which pummeled growth stocks, was the dominant storyline last year.

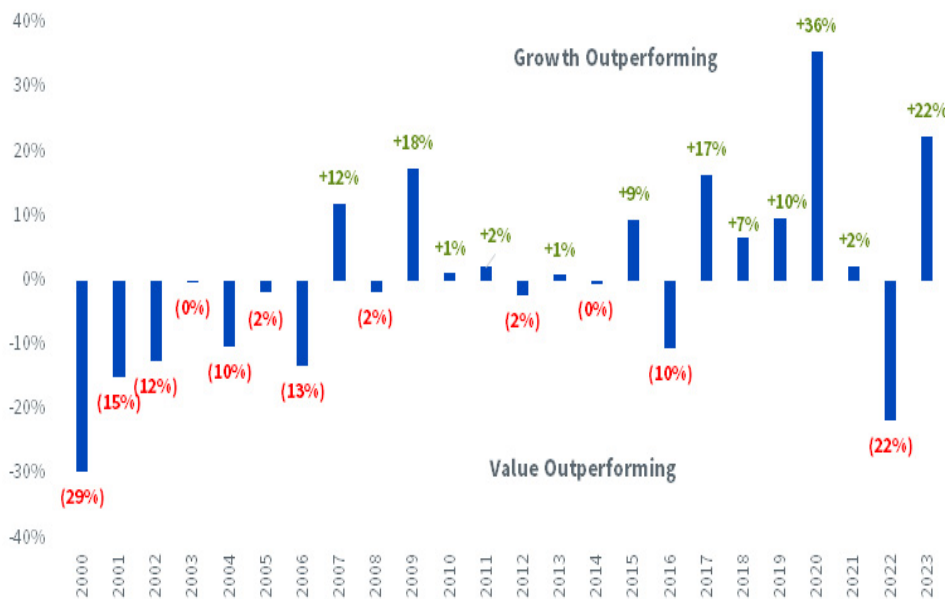
The theory was that a rise in interest rates disproportionately impacts the valuations of high-growth companies, which earn a greater percentage of their value from uncertain, distant [cash flows](#).

Short-term interest rates (1-12 months) have climbed this year as the [Federal Reserve](#) continues to hike interest rates, but longer dated (5-30-year) yields are roughly unchanged.

In short, the interest rate backdrop has hardly budged from last year, as measured by the intermediate to long-term rates that tend to have a bigger impact on equity valuations.

Without the tailwind of a significant drop in interest rates, what explains the 22% year-to-date outperformance of [growth](#) relative to [value](#)?

Growth vs. Value Relative Performance



Sources: WisdomTree, Russell, returns 1/1/23-7/21/23. Value: Russell 1000 Value Index. Growth: Russell 1000 Growth Index. Past performance is not indicative of future returns. You cannot invest directly in an index.

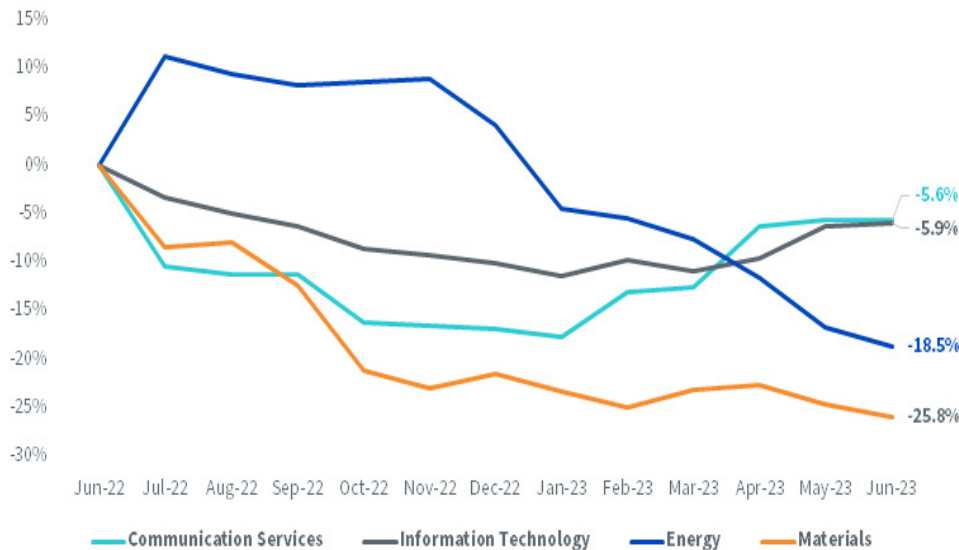
Enter two new dominant narratives:

- [Artificial intelligence \(AI\)](#) and the profit tailwinds for companies that are likely to capitalize on new technological innovations, primarily in the Information Technology and Communication Services sectors

- Expectations for an economic slowdown—that has not yet materialized—has contributed to a slump in cyclical sectors, particularly for companies in the Energy and Materials sectors

The below chart shows the change in forward 12-month profit expectations for select growth (Communication Services and Information Technology) and value (Energy and Materials) sectors. Profits have declined across most sectors since the middle of last year, but the decline has been most pronounced in cyclical/value sectors.

Changes in Profit Expectations from Mid-2022

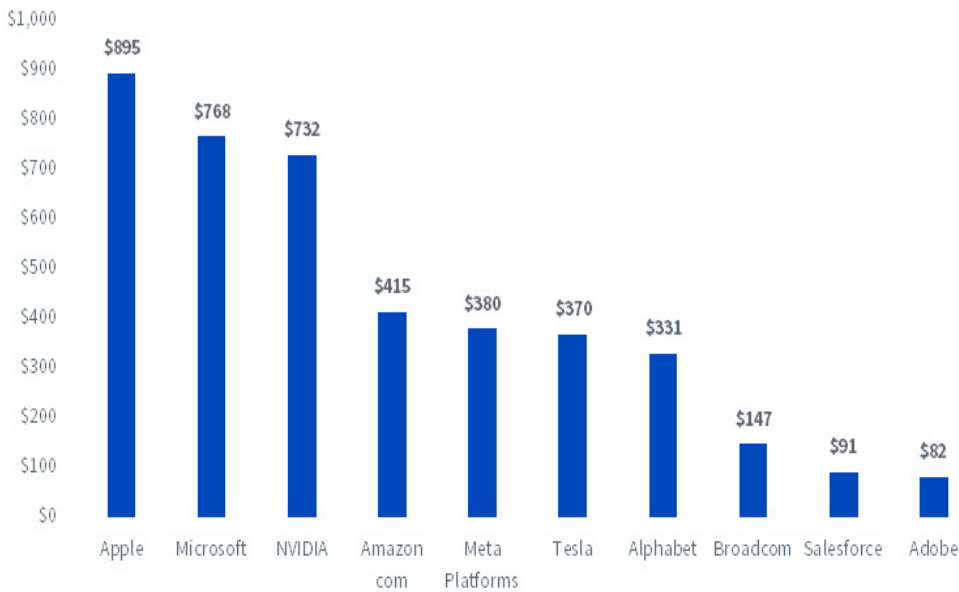


Sources: WisdomTree, FactSet, S&P, 6/30/22–6/30/23. Profit expectations based on forward 12-month earnings. Sector earnings measured by constituents of the S&P 500 Index. You cannot invest directly in an Index.

The [WisdomTree U.S. Quality Growth Index](#), which was launched at the end of November 2022, has been over-weight in the companies that market participants anticipate are well-positioned to benefit from the AI revolution and have earnings that are expected to be less adversely impacted by a potential [recession](#).

Three companies—Apple, Microsoft and NVIDIA—have been the clear winners this year, adding hundreds of billions to their already significant market capitalizations.

Largest Increases in Market Cap YTD (\$Billion)



Sources: WisdomTree, FactSet, S&P, as of 7/21/23. Companies based on the S&P 500 Index. You cannot invest directly in an Index.

Index Construction

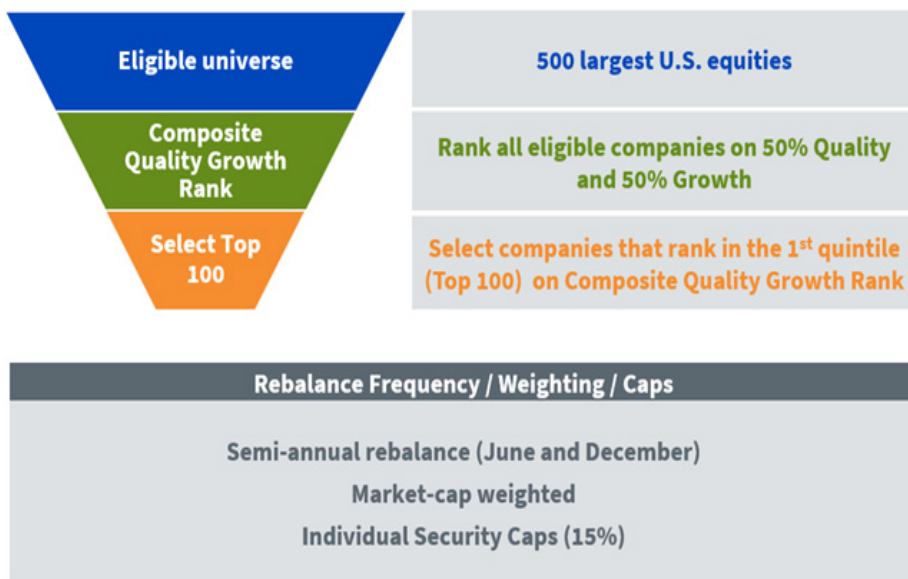
The WisdomTree U.S. Quality Growth Index is a [market capitalization-weighted](#) Index of companies with [quality](#) and growth characteristics. The top 500 U.S. companies by market cap are ranked on a composite score of two fundamental factors: growth and quality, which are equally weighted.

The Index is comprised of the 100 U.S. companies (1st quintile) with the highest composite scores.

Growth factor: The growth factor is determined by a company’s ranking based on a 50% weight in its median analyst earnings growth forecast, a 25% weight in its trailing five-year [EBITDA \(earnings before interest, taxes, depreciation and amortization\)](#) growth and a 25% weight in its trailing five-year sales growth.

Quality factor: The quality factor is determined by a company’s ranking based on a 50% weight in its trailing three-year average return on equity and 50% weight on its trailing three-year average return on assets.

Investment Process



The Index is intended to be a high-conviction, relatively concentrated growth portfolio aimed to be over-weight in the largest quality growth companies. As a result, the Index has a high percentage of its weight (58%) in the top 10 holdings.

The top seven holdings in the Index also happen to be the same companies that we saw with the greatest gains in market cap this year, or a group more often being referred to as the “Magnificent Seven.”

Index Top Holdings

Name	Sector	Weight
Apple Inc.	Information Technology	13.1%
Microsoft Corporation	Information Technology	11.2%
Alphabet Inc. Class A	Communication Services	5.8%
NVIDIA Corporation	Information Technology	5.4%
Amazon.com, Inc.	Consumer Discretionary	5.0%
Tesla, Inc.	Consumer Discretionary	4.5%
Meta Platforms Inc. Class A	Communication Services	3.5%
Visa Inc. Class A	Financials	3.4%
UnitedHealth Group Incorporated	Health Care	3.1%
Mastercard Incorporated Class A	Financials	2.6%
Total		57.7%

Source: WisdomTree, as of 6/30/23. Holdings and weights subject to change. You cannot invest directly in an Index.

Performance Attribution

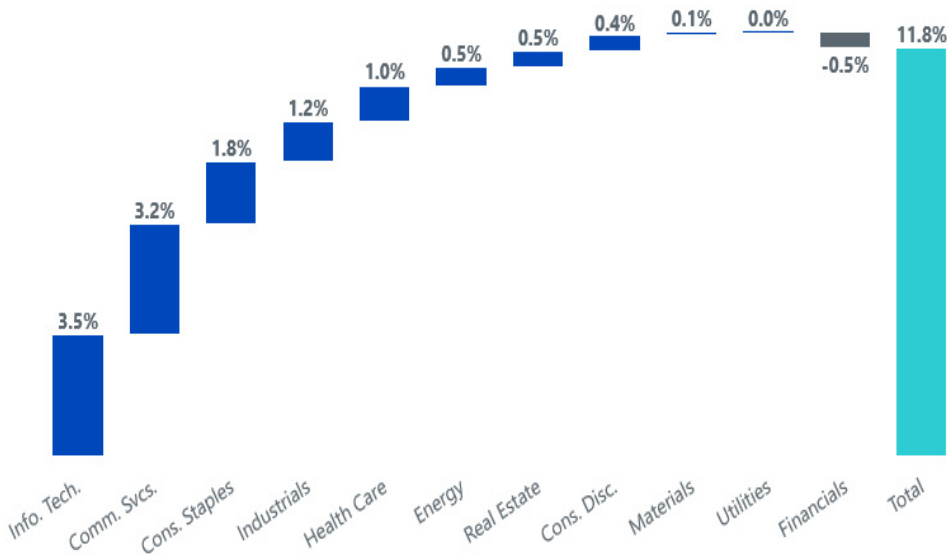
The WisdomTree U.S. Quality Growth Index has outperformed the [Russell 1000 Growth Index](#) by over 11% year-to-date, through 6/30/23.

Over half of the outperformance (57%) can be explained by positive attribution from the outperforming Information Technology and Communication Services sectors.

The Index has also benefited from what it didn't hold—under-weight allocations to the lagging Consumer Staples, Industrials, Health Care, Energy and Real Estate sectors combined to contribute 5% of positive attribution.

The Index's outperformance has been spread broadly across sectors with positive attribution coming from 10 of 11 sectors (only the Financials sector detracted 0.5%).

Year-to-Date Attribution



Sources: WisdomTree, FactSet, Russell, as of 6/30/23. Attribution shows the contribution to outperformance by sector for the WisdomTree U.S. Quality Growth Index relative to the Russell 1000 Growth Index. You cannot invest directly in an Index. Past performance is not indicative of future returns.

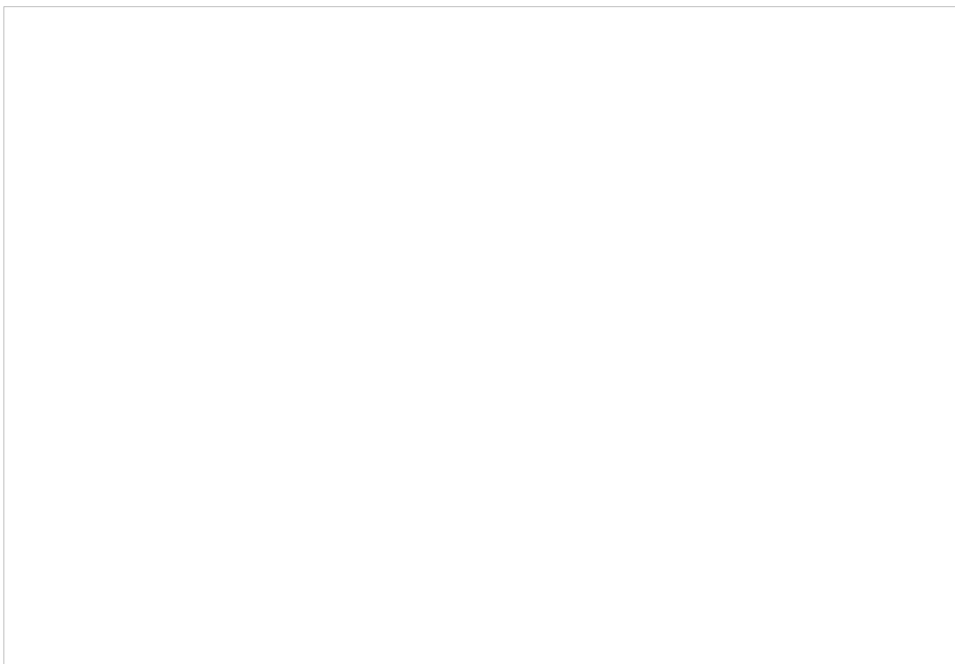
Conclusion: When will the Narrative Shift?

The question on every investor’s mind is whether the narratives driving the narrow leadership of the Magnificent Seven will continue to resonate for the remainder of this year, and into next.

Timing that is anyone’s guess.

The WisdomTree U.S. Quality Growth Index has a rules-based methodology that reconstitutes on a semi-annual basis each June and December. The design of the Index is to not bet on individual names, or a basket of several names, over the long run, but to represent a relatively high-conviction allocation to 100 companies with high profitability and growth characteristics.

Quality Growth Shines



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.

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DEFINITIONS

Interest rates: The rate at which interest is paid by a borrower for the use of money.

Cash flows: a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

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

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 time.

Artificial intelligence: machine analysis and decision-making.

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

Market capitalization-weighting: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

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.

Earnings before interest, taxes, depreciation, and amortization (EBITDA): The net income of a company with interest, taxes, depreciation, and amortization added back to it.

Russell 1000 Growth Index: A measure of the large-cap growth segment of the U.S. equity universe, selecting from the Russell 1000 Index.