# WISDOMTREE INTERNATIONAL MULTIFACTOR: NOT THE LOW VOLATILITY YOU'RE USED TO…

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"Everybody has a plan until they get punched in the mouth."

-"Iron" Mike Tyson

To say that recent performance in global markets has been humbling would be an understatement. While the world grapples with the challenges of the global pandemic, we've continued to focus on the things we can control. One theme that we think will increasingly come into focus later this year is the idea of risk management and re-examining where and how investors generate returns. While beta had been a great trade on the way up, it's been equally unpleasant on the way down. This is why we believe a multi factor approach to markets could make sense, particularly in the developed international space.

While we apply it globally, our methodology seeks to provide investors with balanced exposure to factors such as value, quality, momentum and low correlation to drive returns in excess of the market.

On top of the stock selection, we are also firm believers in the ability of our dynamic currency model to determine the appropriate levels of currency risk to manage volatility and boost returns.

While our research shows that developed market currencies tend to mean revert, they unquestionably add volatility to international portfolios. Therefore, our currency model aims to balance the alpha potential of timing currencies correctly with the volatility reduction benefits of being hedged when risk is not in favor. Below, we try to explain the key drivers of our strategy's return in some of the most volatile periods since 2008.

**Implicit Tilt to Low Volatility**

Since its inception in August 2018, WisdomTree International Multifactor Fund (DWMF), while down approximately 12%, has outperformed the MSCI EAFE Index by more than 3% annualized at NAV and has had a beta of 0.79[1] versus the index. In risk-adjusted terms, DWMF's Sharpe ratio also exceeds that of the broad market index[2]. For standardized performance of DWMF, please click here.

Despite not using low volatility as an explicit stock-selection factor, we do believe it can improve a strategy's risk-adjusted characteristics and therefore use it as part of the weighting mechanism. Furthermore, some of our factor definitions, like risk-adjusted momentum, reward lower volatility companies and implicitly tilt DWMF toward the low volatility factor. (For more on our multifactor methodology, please refer to this piece.)

In the performance attribution analysis below, we can show that as of March 31, 2020, the stocks underlying DWMF, segmented by quintile, have contributed 129 basis points (bps) to the total outperformance. It's also worth highlighting that, as a result of its methodology, DWMF has been consistently over-weight in the lowest volatility quintile, which has been the best-performing category in the developed international universe. At the same time, the methodology has resulted in it being under-weight in the higher volatility quintiles, which in turn have lagged the market.

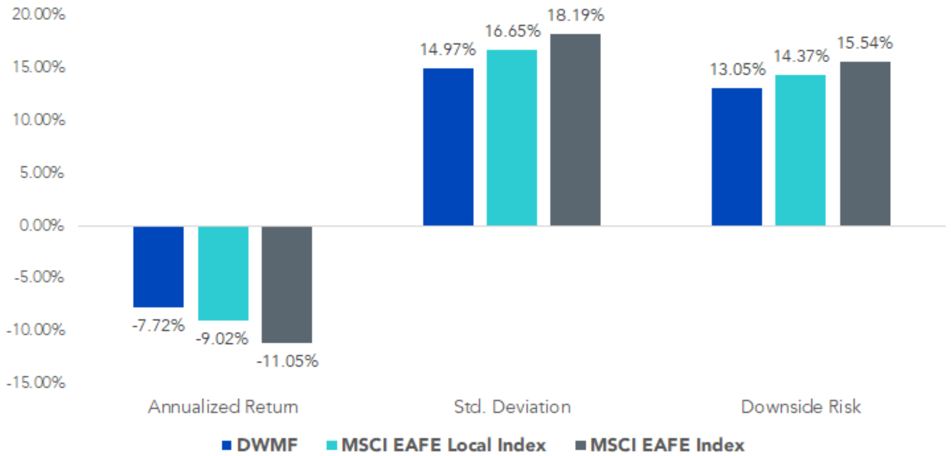
| WisdomTree International Multifactor Stocks vs MSCI EAFE Index<br>Volatility Quintile Attribution (08/31/2018 - 03/31/2020) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Category | Attribution Components | | | | Average Category Weights | | | Category Performance | |
| | Allocation | Stock Selection | Interaction | Total Attribution | Stocks Weight | Benchmark Weight | +/- Wgt | Stocks Return | Benchmark Return |
| 1st Quintile (Lowest Volatility) | 0.65% | 1.00% | 0.58% | 2.23% | 52.76% | 38.04% | 14.72% | -6.84% | -8.78% |
| 2nd Quintile | 0.09% | -1.35% | -0.04% | -1.30% | 25.12% | 22.89% | 2.22% | -13.92% | -10.26% |
| 3rd Quintile | 0.27% | 0.37% | -0.44% | 0.20% | 14.59% | 19.10% | -4.50% | -11.89% | -13.16% |
| 4th Quintile | 0.48% | -0.61% | 0.21% | 0.08% | 5.28% | 12.89% | -7.61% | -17.56% | -14.82% |
| 5th Quintile (Highest Volatility) | 0.04% | 0.21% | -0.16% | 0.08% | 2.24% | 7.08% | -4.83% | -13.20% | -14.09% |
| **Total** | **1.51%** | **-0.38%** | **0.15%** | **1.29%** | | | | **-9.77%** | **-11.05%** |

Sources: WisdomTree, FactSet. Data as of 3/31/20. Returns shown are average annual returns.

For purposes of displaying attribution, data shown is for the stocks underlying DWMF, segmented by quintile. Past performance does not guarantee future results, and actual fund performance will vary. Average weights refer to the average weight over the analysis period. Allocation refers to the portion of return which is attributable to a category being over-weight versus the benchmark. Stock selection refers to the portion of return which is attributable to the equities held versus the benchmark. Interaction refers to the portion of return attributable to the effects of how the selection and allocation effects interact with each other within the portfolio versus the same effects in the benchmark. Weights subject to change. You cannot invest directly in an index. Index performance does not represent actual fund performance.

In terms of risk management, DWMF shows a 3% improvement in standard deviation compared to the broad benchmark, along with lower downside risk[3]. This can be attributed to the implicit low volatility tilt in the stock selection and the dynamic currency hedge overlying the stock position.

**Return & Risk Characteristics**




Sources: WisdomTree, Zephyr StyleADVISOR. Data from 8/31/18 to 3/31/20. You cannot invest directly in an index.

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. Performance data for the most recent month-end is available at wisdomtree.com.

Over the past 19 months, the U.S. dollar (USD) has slightly strengthened versus a basket of global currencies.[4] Therefore, the MSCI EAFE Local Index has outperformed its USD version. DWMF's dynamic currency hedge has also contributed positively to relative performance versus both the MSCI EAFE and MSCI EAFE Local Indexes. DWMF also shows attractive downside protection versus both versions of the MSCI EAFE Index.

**Beta & Down-Capture**

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### Balanced Exposure vs. Low Volatility Strategies

Finally, DWMF provides investors with a low volatility tilt while maintaining more consistent country and sector exposures compared to the broad MSCI EAFE universe, thanks to its balanced factor exposure and its embedded +/- 5% sector and country bands.

While it has provided comparable results during the most recent period, traditional low volatility methodologies tend to have more significant sector and country deviations. Both the MSCI EAFE Minimum Volatility and S&P BMI International Developed Low Volatility Indexes are significantly over-weight in defensive sectors and under-weight in cyclical sectors, while also being under-weight in France, Germany and the UK in favor of Japan and Switzerland.

[1]Sources: WisdomTree, StyleADVISOR as of 3/31/20.

[2]Sources: WisdomTree, StyleADVISOR. DWMF Sharpe Ratio: -0.66; MSCI EAFE Index Sharpe Ratio: -0.73, as of 3/31/20.

[3]Downside risk measures volatility in periods where return is below the mean. It addresses shortcomings of standard 4deviation, which makes no distinction between upside deviations and downside deviations.

[4]Source: Bloomberg, as of 3/31/20.

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You cannot invest directly in an index.

## DEFINITIONS

**Beta** : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

**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.

**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 tim.

**Momentum** : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**Low Correlation** : Characterized by assets that have a relatively lower correlation vs the market over time. This term is also associated with the Low Correlation Factor which associates these stock characteristics with excess returns vs the market over time.

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

**Mean reversion** : The concept that a series of returns has a tendency to return to its average level over longer periods, even if shorter periods can exhibit wide swings.

**Alpha** : Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.

**Hedge** : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

**Low Volatility** : Characterized by lower standard deviation of price over time. This term is also associated with the Low Volatility Factor, which associates lower volatility stocks with better risk-adjusted returns vs the market over time.

**MSCI EAFE Index** : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

**Sharpe ratio** : Measure of risk-adjusted return. Higher values indicate greater return per unit of risk, specifically standard deviation, which is viewed as being desirable.

**Risk-adjusted returns** : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.

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

**Standard deviation** : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

**MSCI EAFE Local Currency Index** : A market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan, with performance measured in local currency term.

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

**MSCI EAFE Minimum Volatility Index** : The Index optimizies the MSCI EAFE universe for the lowest absolute risk using a given set of constraints. .

**Cyclical sectors** : Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.