"DOLLAR IZE" YOUR PORTFOLIO: COMBINING DOLLAR BULL STRATEGIES WITH STOCKS & BONDS

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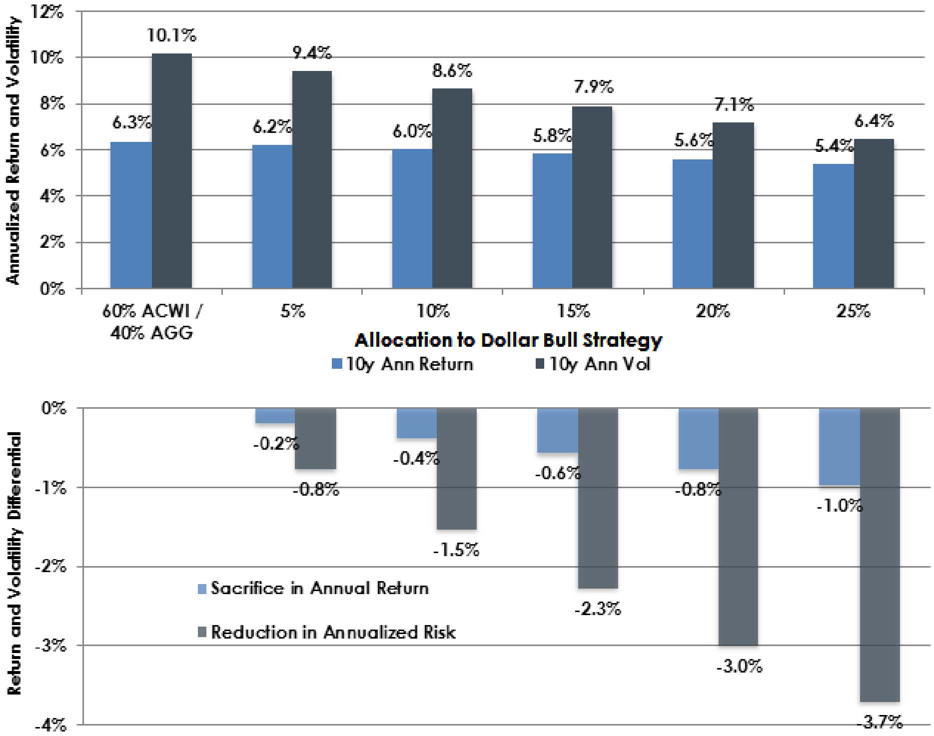
One of our highest-conviction ideas for 2015 is the ongoing strength of the U.S. dollar against foreign currencies. While this trend actually started in 2011, we believe that it has the ability to persist for several more years. Our view is primarily predicated on what we see as the likely drivers of dollar strength and their similarities to catalysts behind past periods of prolonged dollar strength. Most notably, the long-anticipated policy and economic divergences between the U.S. and other developed market economies are becoming reality. While a strong dollar can be beneficial for Americans traveling abroad, how can U.S. investors take advantage of this trend in their portfolios today? In our view, the most straightforward way would be to incorporate currency strategies that benefit from a rise in the U.S. dollar. However, the most common topic we've been discussing with investors is where a bullish dollar strategy[1] fits in their portfolios. As we show below, dollar bull strategies can provide a variety of benefits to a traditional portfolio of stocks and bonds. **Low to Negative Correlations with Most Major Asset Classes** While we previously highlighted the efficacy of dollar bull strategies when paired with international equity positions, the U.S. dollar has historically exhibited low to negative correlations with a variety of other asset classes.[2] As we show in the table below, domestic bond, equity and commodity returns have exhibited a modestly negative correlation over the past 10 years. In asset allocation, investing in noncorrelated assets is a central tenet of diversification.

Asset Class Correlation vs. U.S. Dollar as of 11/30/14

	1 Year	3 Years	5 Years	10 Years
S&P 500 Index	-0.43	-0.51	-0.61	-0.54
Barclays U.S. Aggregate Index	-0.23	-0.19	-0.15	-0.34
MSCI ACWI Net Ex USA	-0.74	-0.80	-0.79	-0.71
Bloomberg Commodity Index	-0.90	-0.66	-0.74	-0.65

Sources: Bloomberg, WisdomTree, as of 11/30/14. Past performance is not indicative of future results.
You cannot invest directly in an index.

For definitions of indexes in the chart, please visit our glossary. Inherently, the value of diversification stems from two themes: Does the investment move counter to other assets in the portfolio (negative correlation), and if so, does it do so with enough magnitude to make a meaningful impact (i.e., volatility)? While the relationship between the dollar and domestic equities/bonds will cycle over time, it has generally been very low or negative over the last 10 years. While viewing individual portfolio components in isolation is informative, understanding how all pieces fit together in a portfolio is really what matters to investors. **Traditional 60% Equity/40% Bond Portfolio** Over the last 10 years, a period in which the U.S. dollar was roughly unchanged (the currency component added only 1.4% per year), the incorporation of dollar bull strategies into diversified portfolios provided significant risk reduction and return retention for the overall portfolios. Starting with a portfolio made up of 60% global equities and 40% U.S. bonds[3], we analyzed the value of incrementally adding the dollar bull strategy into the portfolio. As shown in the chart below, a portfolio including a 10% allocation to a dollar bull currency strategy preserved more than 94% of the annual returns, while reducing portfolio risk by 15%. A 20% allocation would have resulted in 88% of annual return, while reducing risk by almost a third.[4] **10-Year Risk vs. Return, 11/30/04–11/30/14 Impact of Adding Dollar Bull Strategies into Balanced Portfolios**



Sources: Bloomberg, WisdomTree, as of 11/30/14.
The equity and bond allocations were reduced pro rata with each allocation to the dollar bull strategy. For example, a 10% dollar bull allocation reduced the equity weight to 54% and the bond weight to 36%. The MSCI All Country World Index seeks to encompass the global equity and is roughly balanced between U.S. and non-U.S. equity markets.
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Additionally, Sharpe ratios improved incrementally until the dollar strategy comprised 50% of the portfolio. While it is impractical to expect that an investor would allocate 50% of a portfolio to a dollar bull strategy, it does suggest that incremental allocations to dollar bull strategies can deliver valuable diversification benefits. **More Recent Period of Dollar Strength** Looking more narrowly at the last three years, we find the analysis yields similar results in terms of return retention and risk reduction. Given higher asset returns and lower volatilities in recent years, the return sacrifice for incorporating dollar bull strategies is a little bit greater, and the absolute risk reduction is a little bit less. But the basic diversification premise holds, and we strongly consider that investors look for opportunities to incorporate dollar bull strategies into their portfolios. **3-Year Risk vs. Return, 11/30/11–11/30/14**

3- Year Period	Return (%)	Volatility (%)	Return Difference (%)	Risk Difference (%)
60% ACWI / 40% AGG	10.07%	6.49%		
5%	9.80%	5.97%	-0.3%	-0.5%
10%	9.54%	5.45%	-0.5%	-1.0%
15%	9.27%	4.95%	-0.8%	-1.5%
20%	8.99%	4.45%	-1.1%	-2.0%
25%	8.72%	3.97%	-1.4%	-2.5%

Sources: Bloomberg, WisdomTree, as of 11/30/14. Past performance is not indicative of future results. You cannot invest directly in an index.

[1]Proxied by the G-20 Liquidity Weighted Currency Composite, which tracks the performance of 20 of

the most liquidly traded currencies versus the U.S. dollar. [2]Sources: Bloomberg, WisdomTree, as of 11/30/14. [3]Global equities proxied by MSCI ACWI Net; U.S. bonds proxied by the Barclays U.S. Aggregate Index. [4]Source: Bloomberg, as of 11/30/14.

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DEFINITIONS

Bullish : a position that benefits when asset prices rise.

Correlation : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

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

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

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.