THE FIVE FLAVORS OF ALPHA IN WISDOMTREE MODEL PORTFOLIOS

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10/30/2020

Model portfolios have created quite a buzz. As the fastest-growing component of the intermediary-sold product landscape, model assets are expected to exceed $5 trillion by 2023 (double that of 2018 AUM).[1]

Asset managers have noticed. Morningstar reports that more than 600 third-party models were activated on their platform over the last 18 months—significantly outpacing prior periods.[2]

Why the popularity?

Model portfolios generally, and the WisdomTree's Modern Alpha® approach specifically, offer advisors the potential to generate various flavors of alpha.

The five I highlight are modern, performance, institutional, conversational and operational alpha.

Modern Alpha®

In comparison to traditional passive investing, active management often carries higher cost, less transparency in your portfolio and the risk of human judgment. But it can also mean an outperformance potential. Modern Alpha® combines the positives of the passive and active investment approaches to enhance the investment experience. It also serves as the foundation of how our ETFs are constructed.

In 2013, we pioneered the first Modern Alpha® ETF asset allocation model portfolios. These strategies provide the performance potential of traditional "core/satellite" approaches utilized by active managers, but delivered at a lower cost using more disciplined, rules-based factor tilts.

Today, we have expanded our Model Portfolio offerings to help investors pursue their investment objectives for growth, income and wealth preservation. Modern Alpha® remains at the core of what we do and enhances our ability to generate performance alpha.

Performance Alpha

Alpha is often generalized as achieving excess returns relative to a benchmark. An example is the WisdomTree Global Multi-Asset Income Aggressive Model Portfolio beating its benchmark by 175 basis points (bps), at net asset value, annually since inception.[3]

Performance alpha, for the context of this blog post, goes beyond just relative numbers. It includes fees that drag on performance, relative to a no-cost benchmark, such as net expense ratios and strategist fees.

Net expense ratios are the fees of the underlying model constituents—ETFs and mutual funds—paid by investors as holders of the strategy. The model portfolio expense ratio is the weighted average net expense ratios of its underlying fund constituents. Fidelity's portfolio solutions team sampled more than 4,000 advisor-created asset allocation model portfolios and found the average net expense ratio was 64 bps![4] Way too much, in my opinion, and more than double the expense ratio of most WisdomTree Model Portfolio strategies.

Strategist fee, as it relates to model portfolios, is an additional expense charged on top of the net expense ratios as a management fee. Many asset managers with their own proprietary funds don't charge a strategist fee. They are comfortable only collecting revenue off the net expense ratios and are monetarily inclined to use only proprietary products in their models.

Other asset managers, such as ETF strategists, do not have proprietary funds, so their compensation relies on charging a strategist fee.

WisdomTree is unique in electing to use both WisdomTree and non-WisdomTree ETFs in our Model Portfolios, to ensure a more factor-underlined[diversified] portfolio, without charging a strategist fee for the benefits of our clients.

Institutional Alpha

Institutional alpha refers to the vast resources an advisor has at their disposal when utilizing an asset manager for model portfolios. As I mentioned in a prior post about leveraging our expertise, advisors can lean on WisdomTree's deep bench of investment professionals to [provide their clients with institutionally managed Model Portfolios in a cost-effective manner](#).

We can be seen as an extension of the advisor's already-thin research capabilities and leveraged to provide tailored solutions to their clients' unique situations and goals. Various ways our asset allocation team works with advisors include fund comparisons, one-on-one portfolio consultations and personalized [outsourced chief investment officer (OCIO)](#) services.

Investment support is table stakes for advisors considering outsourcing to a third-party asset manager. WisdomTree strives to go above and beyond that threshold, and "conversational alpha" is a testament to that effort.

Conversational Alpha

This flavor of alpha refers to the support WisdomTree provides to financial advisors that is geared to enhancing their communications with their end clients.

Do you (or your advisor) relate to any of these questions?

Will my clients think I am lazy if I use third-party models? Are they going to then question the value I bring to the table?

How do I introduce WisdomTree to my clients? How do I ensure my clients understand that I am still the quarterback running the show?

How do my clients view third-party models? How can I leverage these insights to retain existing clients and win new ones?

If so, you are not alone.

WisdomTree recently completed the most in-depth research study of its kind to better understand the perception of model portfolios from both an advisor's and end client's perspective.[5]

We learned that the variances between what investors believe and reality are astounding. It was obvious to us that the benefits and value of models are not being positioned properly by the advisor.

As a result, we developed a full suite of materials to help advisors engage with clients more effectively. Specifically, we crafted talking points, analogies, scripts and other resources to aid conversations.

Our mission is to help advisors understand investors' perceptions of models and how to communicate it properly—which will ultimately help them grow their business, hence "conversation alpha."

Operational Alpha

The last flavor of alpha is operational. We believe using third-party models in an advisor's practice could provide benefits for them and their clients.

While conducting the research study reference above, advisors told us that third-party models can help their practice in many ways (% who agreed):

- Improves the efficiency of my practice (92%)
- Provides a defined investment process to assist with potential increased regulatory scrutiny (90%)
- Enables me to easily scale my business (89%)
- Applies technology to improve the services I offer my clients (88%)

There are many potential benefits to adopting a models-based practice. The institutional and operational alpha I referenced can be achieved through outsourcing to a third-party asset manager. Performance alpha is what we hope to achieve using our Modern Alpha® approach, and the last flavor, conversation alpha, is provided through our robust advisor support.

Are you an advisor who is interested in learning more? Visit our [Model Portfolio home page](#) or reach out to your dedicated WisdomTree registered representative.

[1] Model Portfolio Market Reaches $2.7 Trillion USD, Growing 19% Annually, According to Broadridge

[2] "2020 Model Portfolio Landscape," Morningstar. Data as of 6/30/20.

[3] Source: WisdomTree. Benchmark: 80% MSCI ACWI Value, 20% Bloomberg Barclays U.S. Aggregate Bond Index. The inception date of these Model Portfolios is 12/31/16. Click here for standardized performance.

[4] Sources: FIAM Portfolio Solutions (4,122 Portfolio Reviews and Portfolio Quick checks conducted between 7/17/18 and 7/17/19) and Morningstar.

[5] 2020 WisdomTree Model Portfolio Study.

Important Risks Related to this Article

Performance is historical and does not guarantee future results.

WisdomTree Model Portfolio information is designed to be used by financial advisors solely as an educational resource, along with other potential resources advisors may consider, in providing services to their end clients. WisdomTree's Model Portfolios and related content are for information only and are not intended to provide, and should not be relied on for, tax, legal, accounting, investment or financial planning advice by WisdomTree, nor should any WisdomTree Model Portfolio information be considered or relied upon as investment advice or as a recommendation from WisdomTree, including regarding the use or suitability of any WisdomTree Model Portfolio, any particular security or any particular strategy. In providing WisdomTree Model Portfolio information, WisdomTree is not acting and has not agreed to act in an investment advisory, fiduciary or quasi-fiduciary capacity to any advisor or end client, and has no responsibility in connection therewith, and is not providing individualized investment advice to any advisor or end client, including based on or tailored to the circumstance of any advisor or end client. The Model Portfolio information is provided "as is," without warranty of any kind, express or implied. WisdomTree is not responsible for determining the securities to be purchased, held and/or sold for any advisor or end client accounts, nor is WisdomTree responsible for determining the suitability or appropriateness of a Model Portfolio or any securities included therein for any third party, including end clients. Advisors are solely responsible for making investment recommendations and/or decisions with respect to an end client, and should consider the end client's individual financial circumstances, investment time frame, risk tolerance level and investment goals in determining the appropriateness of a particular investment or strategy, without input from WisdomTree. WisdomTree does not have investment discretion and does not place trade orders for any end client accounts. Information and other marketing materials provided to you by WisdomTree concerning a Model Portfolio—including allocations, performance and other characteristics—may not be indicative of an end client's actual experience from investing in one or more of the funds included in a Model Portfolio. Using an asset allocation strategy does not ensure a profit or protect against loss, and diversification does not eliminate the risk of experiencing investment losses. There is no assurance that investing in accordance with a Model Portfolio's allocations will provide positive performance over any period. Any content or information included in or related to a WisdomTree Model Portfolio, including descriptions, allocations, data, fund details and disclosures, are subject to change and may not be altered by an advisor or other third party in any way.

WisdomTree primarily uses WisdomTree Funds in the Model Portfolios unless there is no WisdomTree Fund that is consistent with the desired asset allocation or Model Portfolio strategy. As a result, WisdomTree Model Portfolios are expected to include a substantial portion of WisdomTree Funds notwithstanding that there may be a similar fund with a higher rating, lower fees and expenses, or substantially better performance. Additionally, WisdomTree and its affiliates will indirectly benefit from investments made based on the Model Portfolios through fees paid by the WisdomTree Funds to WisdomTree and its affiliates for advisory, administrative and other services.

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

View the online version of this article here.

DEFINITIONS

Modern Alpha : Modern Alpha® combines the outperformance potential of active with the benefits of passive—to offer investor strategies that are built for performance.

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.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

Active : Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.

Basis point : 1/100th of 1 percent.

Mutual Funds : An investment vehicle made up of a pool of moneys collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and other assets.

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

Diversification : A risk management strategy that mixes a wide variety of investments within a portfolio.

Outsourced chief investment officer : A form of investment outsourcing where investment decisions are made for an investor by a third-party professional.