
IS YOUR LONG/SHORT STRATEGY WORKING?

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Many equity investors started the year concerned about [valuations](#), and now with increased [volatility](#), heightened trade rhetoric and a [flattening yield curve](#), more investors are looking for ways to potentially protect their portfolios in case of a larger sell-off. Many strategic asset allocators will remain heavily invested in equities and bonds, through the ups and downs, but allocating a portion of your portfolio to [alternative](#) strategies, such as [long/short](#) equity, may help smooth out the returns at the extremes.

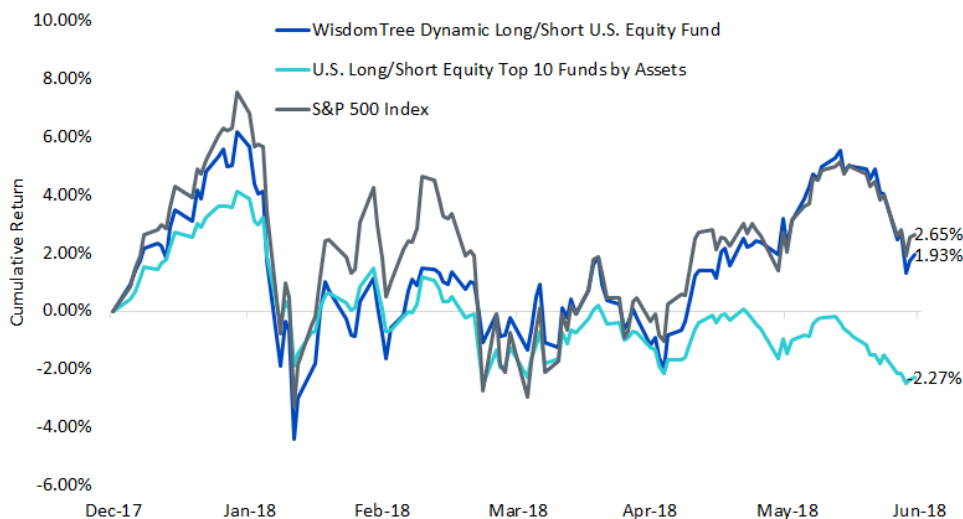
[WisdomTree Dynamic Long/Short U.S. Equity Fund \(DYLS\)](#)

A little over two and a half years ago, WisdomTree launched two Funds that use a factor-specific process to add value through stock selection combined with a dynamic risk model that adjusts net equity market exposure monthly using hedging instruments. One of these Funds, DYLS, is designed to have net exposure on the market that ranges from being fully invested (i.e., no [hedge ratio](#) applied) to fully market neutral (i.e., fully [hedged](#)). When underlying [fundamentals](#) are strong, there is no hedge ratio applied. When fundamentals become mixed, a partial hedge is applied, and when fundamentals are weak, a full market hedge seeks to protect investors from downdrafts in the equity market while still delivering excess returns through security selection. WisdomTree expects the net [beta](#) over time will likely average somewhere between .6 and .7 in terms of how often we believe the hedges will be in place.

We are very pleased with the live results since DYLS's inception in December 2015. The Fund came out of the gate in its market-neutral position, which turned out to be a great call at the start of 2016. Since that time, aside from a few months, the Fund has spent the majority of its time fully invested, which also proved correct, and it let the fund capture most of the 2017 U.S. equity market return.

We all know that how you protect your returns in down markets or when volatility is increasing by limiting [drawdowns](#) (that is, when many expect their allocation to alternative strategies to really add value) is important. In the figure below, we compare DYLS against the 10 largest competing funds in the Morningstar U.S. Long/Short Equity Category. As you can see, year-to-date, many of these funds have failed to add value in this period of heightened volatility.

Year-to-Date Performance



Sources: WisdomTree, Morningstar, for the period 12/31/17–06/30/18. Data based on daily returns.

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.

For standardized performance of DYLS, please click [here](#).

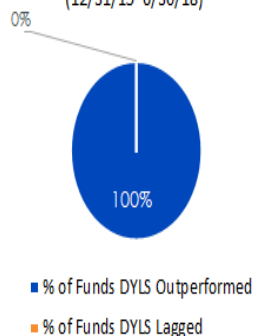
As a result of the positive trend in profitability, DYLS was fully invested to start 2018, even though valuations looked a little stretched on our indicator. Although it was the right call to be fully invested in 2017, it proved challenging when the market sold off in late January. The profitability indicator moved to the half-hedged position in March and then back to being fully invested since April, which allowed the strategy to move back into positive territory compared with the S&P 500 Index.

On the other hand, the Morningstar Category found it difficult to keep up with the [S&P 500 Index](#) and DYLS, underperforming by 4.92% and 4.20%, respectively. And some of the largest funds by assets in the category have done worse than the composite above. This recent underperformance, coupled with the categories high management fees, is not a recipe for success in our mind. Instead, we prefer a [liquid](#), transparent, lower-cost substitute that can dynamically adapt to the market environment, such as DYLS.

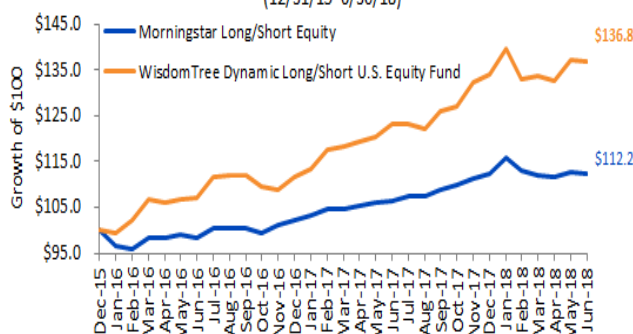
While it is still a short-term period, we are further encouraged that over the two-and-a-half-year period DYLS has been live, the Fund has been able to beat 100% of the long/short funds in its peer group based on total return.

Our friend at Bloomberg, Eric Balchunas, recently commented on a podcast that alternatives and “hedge fund lite” strategies are the next frontier for the ETF world, but he implied that one had to wait for the notable and reputable long/short managers to enter the space. WisdomTree believes DYLS is a compelling proposition in the marketplace already, and one does not have to wait to see if these other firms will actually enter the market.

DYLS Percentage of Peers Outperformed
(12/31/15–6/30/18)



WisdomTree and Median Peer Performance
(12/31/15–6/30/18)



Fund/Index/Category	Ticker	Exp. Ratio	Inception Date	Average Annual Total Returns as of 6/30/18									
				NAV Returns (%)					Market Price Returns (%)				
				1-Year	Common Period	3-Year	5-Year	10-Year	1-Year	Common Period	3-Year	5-Year	10-Year
WisdomTree Dynamic Long/Short U.S. Equity Fund	DYLS	0.48%	12/23/2015	10.9%	13.3%	N/A	N/A	N/A	10.8%	13.8%	N/A	N/A	N/A
S&P 500 Index				14.4%	14.4%	11.9%	13.4%	10.2%	14.4%	14.4%	11.9%	13.4%	10.2%
Morningstar Long/Short Equity				5.5%	4.7%	N/A	N/A	N/A	5.5%	4.7%	N/A	N/A	N/A

Sources: Morningstar, WisdomTree, for the period 3/31/08–6/30/18. "Common period" refers to 12/31/15–6/30/18 due to availability of Morningstar Category performance data. 12/23/15 represents the DYLS inception date. 231 investments included in peer group for Morningstar Long/Short Equity Category.

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 www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times. 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, 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.

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Important Risks Related to this Article

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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](#).

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You cannot invest directly in an index.

DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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

Curve-flatten : a relative-value position that benefits if the spread between short and long maturity securities declines.

Alternative Investment : An investment that is not one of the three traditional asset types (stocks, bonds and cash). Alternative investments typically include hedge funds, managed futures, real estate, commodities and derivatives contracts.

Long (or Long Position) : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Hedge Ratio : The specified percentage of currency exposure being hedged, with 0% indicating that none of the currency exposure is being hedged and 100% indicating that all of the currency exposure is being hedged.

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.

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.

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.

Drawdowns : Periods of sustained negative trends of return.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.