THE GREAT ROTATION MAY JUST BE GETTING STARTED

Jeremy Schwartz — Global Chief Investment Officer
01/28/2022

The year began with a sharp reversal in the relative performance of sectors and styles. In our view, we may still be early in this rotation.

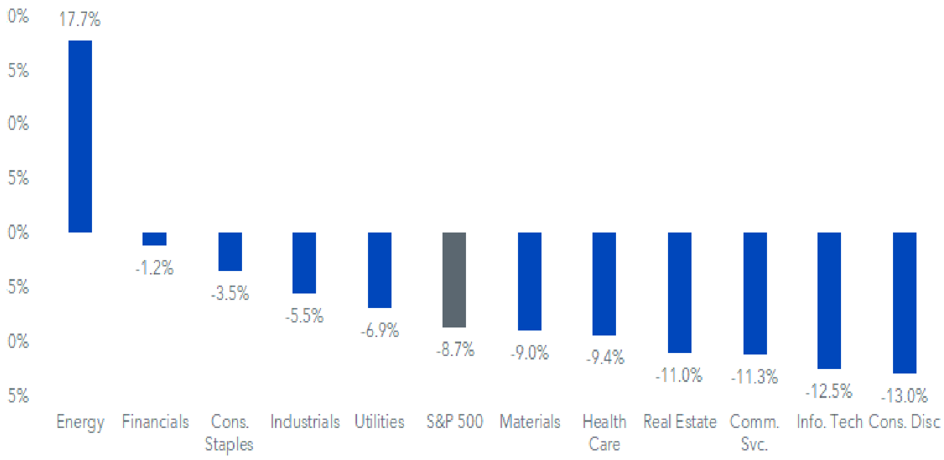
Mega-caps and growth styles have been particularly sharp underperformers, while value-oriented and high dividend strategies have outperformed.

From a sector standpoint, Technology and the parts of the Consumer Discretionary sector that have a technology focus (Amazon, as example), are down the most. Energy is leading the market higher, and Financials and Consumer Staples are proving to be defensive assets during the rotation.

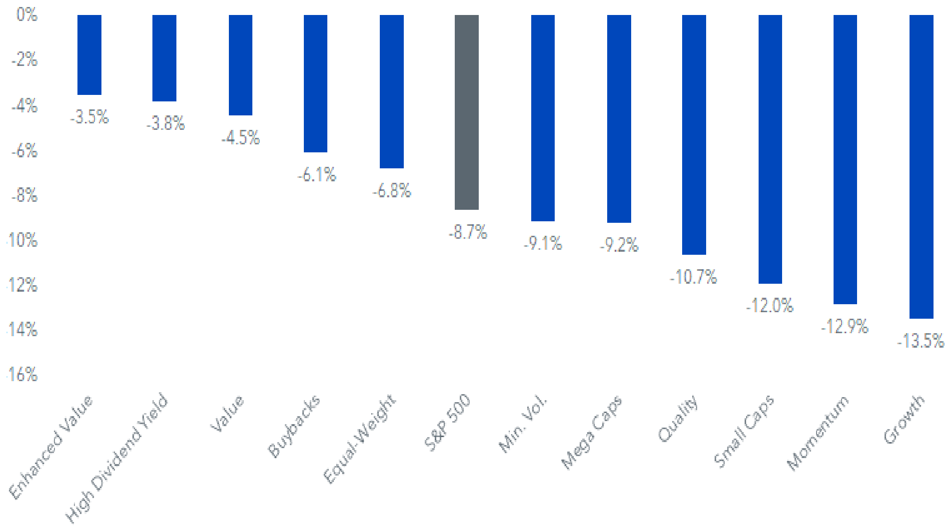
When you look at factor index performance, it may be surprising to see that Minimum Volatility and Quality are not outperforming the market. One would typically expect these factors to hold up well during periods of volatility. Given the MSCI factor definition and weighting process for these indexes, it is rewarding many of the same technology and growth stocks that have come under pressure recently. Those are also the same stocks that had become low volatility.

Netflix, a pandemic darling, found its way into the MSCI Minimum Volatility Index—unfortunately, its disappointing earnings and 20% fall last week will not likely let it remain in the min vol index.

Year-to-Date Sector Index Returns, as of 1/26/22



Year-to-Date Factor Index Returns, as of 1/26/22



Sources: WisdomTree, FactSet, S&P, MSCI. **Enhanced Value:** MSCI USA Enhanced Value Index. **High Dividend Yield:** MSCI USA High Dividend Yield Index. **Value:** Russell 1000 Value Index. **Buybacks:** S&P500 Buyback Index **Equal-Weight:** S&P 500 Equal-Weight Index. **Min. Vol.:** MSCI USA Minimum Volatility Index. **Mega Caps:** S&P 500 Top 50 Index. **Quality:** MSCI USA Sector Neutral Quality Index. **Small Caps:** Russell 2000 Index. **Momentum:** MSCI USA Momentum Index. **Growth:** Russell 1000 Growth Index. Returns based on index total returns. You cannot invest directly in an index. Past performance is not indicative of future returns.

For definitions of terms in the chart above please visit the glossary.

What caused this market rotation? In a recent blog post, "The Most Important Charts for 2022," we talked about inflation being the top theme for 2022.

Stocks are great long-term inflation hedges, as companies pass along their cost increases to consumers with higher prices. Companies with the most pricing power (those with higher profit margins and better return on capital metrics) should hold up better over an inflationary cycle.

But the Fed's reaction to inflation and tighter monetary policy has caused the volatility that we are seeing in high-duration growth assets, where cash flows are coming in many years to the future. Our view is that the market still has more adjusting to do, and the Fed very well may have to become even more hawkish than the market expects.

There are two issues for growth stocks.

First, higher discount rates and interest rates from the Fed—that is one factor that kickstarted some of the rotation.

But second is earnings trajectories. Netflix sank on questions about its future earnings and whether subscriber growth will be the same in the face of higher competition.

Peloton sank because the market for its bikes became saturated and they had to halt production.

Cloud stocks like Zoom did well as companies and people flocked to Zoom calls, but will competition heat up and will they be able to continue with broader penetration and revenue growth?

A combination that works particularly well for this macro environment is stocks priced at discounted valuations, that are not reliant on far-out cash flows. That is exactly what we see with quality dividend growth stocks—which have been set apart from the standard quality indexes described earlier.

Over the last three months, our Quality Dividend Growth Fund (DGRW)—has returned 0.31% at NAV while the large blend category of 1,435 stocks was down 5.26% and the benchmark for the category was down 6.44%.

After the start of 2021, when higher beta assets ripped higher, the quality stocks had lower betas. But over the long-run, we can see that DGRW has benefited from its over-weight to quality names as it ranks in the 30th percentile over the past 5-years:

Fund and Category Return/Rankings

Total Return %	1-Month	3-Month	YTD	1-Year	3-Year	5-Year
DGRW Return (NAV)	-4.30%	0.31%	-5.72%	15.30%	18.18%	15.27%
Category Return (NAV)	-7.47%	-5.26%	-8.38%	12.72%	17.75%	13.94%
Index Return (NAV)	-8.77%	-6.44%	-9.45%	11.60%	19.60%	15.58%
Percentile Rank	N/A	N/A	N/A	23	53	30
# of Invest. in Cat.	1,453	1,435	1,459	1,372	1,242	1,110

Source: Morningstar, as of 1/26/22. Category is large blend. Index is Morningstar US Large-Mid Index. Returns over 1-year are annualized. **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.** 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.

For the most recent standardized performance, 30-day SEC yield and month-end performance click here.

Again, what matters is valuations during this environment of tighter interest rate policy and higher interest rates.

We believe a combination of higher profitability and defensive assets priced at 'value-like' valuation multiples should hold up well in 2022's inflation induced volatile market.

Fundamentals Comparison

	WisdomTree U.S. Quality Dividend Growth Fund (DGRW)	S&P 500 Index	Russell 1000 Value Index	S&P 500 Value Index	Russell 1000 Growth Index	S&P 500 Growth Index
Dividend Yield	2.12%	1.36%	1.92%	2.01%	0.75%	0.73%
Net Buyback Yield	1.77%	1.51%	1.23%	1.38%	1.40%	1.64%
Shareholder Yield	3.89%	2.87%	3.15%	3.38%	2.14%	2.36%
Trailing Price-to-Earnings (P/E)	21.4x	23.5x	18.7x	20.4x	33.4x	27.8x
Trailing Price-to-Earnings (P/E) excl. Negative Earners	21.4x	22.6x	17.3x	19.1x	30.3x	27.6x
Estimated Price-to-Earnings (P/E)	18.5x	20.4x	16.3x	17.0x	28.3x	25.5x
Return on Assets (ROA)	8.60%	3.99%	2.72%	3.03%	10.95%	6.61%
Return on Equity (ROE)	28.80%	18.25%	13.45%	14.03%	34.04%	29.77%
Return on Sales (ROS)	16.94%	16.24%	14.25%	13.19%	19.25%	23.90%
Leverage	3.3x	4.6x	4.9x	4.6x	3.1x	4.5x

Sources: WisdomTree, FactSet, S&P, Russell, 1/26/22. You cannot invest directly in an index. Past performance is not indicative of future results.

For definitions of terms in the chart above please visit the glossary.

Is it Over?

Some market watchers believe we are at peak Fed hawkishness—and inflation will subside. Perhaps they will prove correct. WisdomTree Senior Investment Strategy Advisor Jeremy Siegel is on the most hawkish end of the curve, thinking the Fed will have to end the year with a 2% Federal Funds Rate. That is why on CNBC on Monday, he suggested the Nasdaq could very well enter bear market territory and have a continued rough patch this year.

For those who believe we've already seen a dramatic repricing of value indexes, note this 30-year chart of the Russell Value versus Growth indexes on a total return basis.

This chart looks like a double bottom formed in 2020 and 2021 at similar points to the double bottom that occurred in 1999 and 2000. While this relative performance chart shows some reversal, the bounce for value versus growth in 2021 was even greater than what we saw over the last few weeks, while the 2022 bounce occurred in a shorter time frame.

Still, the last 15 years has been a steady march higher for growth indexes compared to value indexes.

Russell 1000 Value Index vs. Russell 1000 Growth Index

Sources: WisdomTree, Russell, 12/31/1990–1/26/2022. Returns measured by index total returns. You cannot invest directly in an index. Past performance is not indicative of future returns.

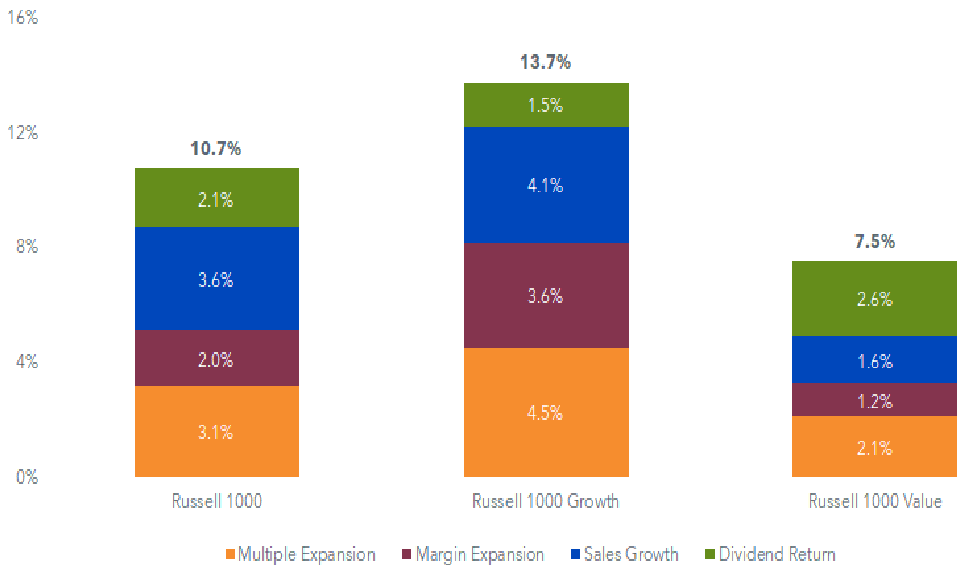
When we breakdown the drivers of performance over the past 15 years, we see the growth outperformance came from premium fundamental growth in sales and profit margins.

It was also driven by multiple expansion as the price-to-earnings multiples of growth stocks were propelled far higher than increases from its value counterpart.

One area where we saw greater contribution to return from value indexes was from the dividend return, where the value index had about an 111 basis points advantage.

With investors now focused on sky-high valuations in certain pockets of the market, growth stocks may be headed for multiple contraction in the coming years. This potential headwind could magnify the impact of the dividend return element of total returns, which is why we favor reasonably priced quality dividend growers in the current market environment.

Return Decomposition: 12-31/06—12/31/21



Sources: WisdomTree, FactSet, Russell. You cannot invest directly in an index. Past performance is not indicative of future returns.

Important Risks Related to this Article

Please read the prospectus carefully before investing.

There are risks associated with investing, including the possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

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.

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Mega Cap : Market Capitalization over $100 Billion.

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 tim.

Inflation : Characterized by rising price levels.

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.

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

Discount : When the price of an ETF is lower than its NAV.

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

Macro : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Basis point : 1/100th of 1 percent.