WHAT MAKES THIS FUND ONE OF THE BEST-PERFORMING U.S. MULTIFACTOR STRATEGIES?

Alejandro Saltiel — Head of Indexes, U.S.
10/11/2018

This post was originally published on 07/10/2018 by: Christopher Carrano

The 10 largest Multifactor exchange-traded funds (ETFs) in the market hold over $10.5 Billion in assets and saw $1.8 billion of net inflows over the last fifteen months[1]. In the beginning of that time frame, specifically 6/29/2017, WisdomTree entered itself into the fray launching the WisdomTree U.S. Multifactor Fund (USMF). **We are pleased to announce that since its inception, USMF outperformed all 10 of these Multifactor ETFs on both an absolute and risk-adjusted basis.** In fact, of these 10 ETFs, USMF exhibited the third lowest volatility, with the 2 lower volatility ETFs achieving their risk reduction at the cost of being the worst 2 in performance.

In the below table we highlight median statistics, showcasing just how dominant USMF's first fifteen months have been.

Average Annual Returns 6/29/2017–9/28/2018				
	Total Return	**Standard Deviation**	**Sharpe Ratio**	**Avg 1 Yr Active Share**
WisdomTree U.S. Multifactor Fund (USMF)	20.31%	10.18%	2.00	87.42%
Top 10 AUM Multifactor ETF Median	15.47%	11.17%	1.41	64.97%
S&P 500 Index	18.31%	11.54%	1.59	0.00%

Source: Wisdomtree, Bloomberg as of 9/29/2018. Sharpe Ratio does not deduct the risk-free rate.

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.

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 standardized performance of USMF, please click here.

87% Active Share and High Value Added

We added Active Share to the above table, because we believe it's an important aspect of USMF. Our Multifactor Strategy at its core is a stock picking strategy, informed by the factors Value, Quality, Momentum and Low Correlation. Given that our conviction in our factor-based stock selection model is high, we view more active share as increasing the chance for better fundamentals, superior returns, and less volatility than the market. This is also one reason why we incorporate sector neutrality and the low correlation factor, to help mitigate sector and market risk, and to magnify the effects of our high conviction stock picking.

Multifactor Transparency: How Does USMF Select Stocks?

We often hear that Multifactor ETF's are too complicated and non-transparent. So, in the spirit of our commitment to being transparent, we wanted to walk through our 2 biggest single stock winners, both from an exclusion and inclusion standpoint. The below table shows a breakdown of our scoring system with 100% being the best possible score and 0%

being the worst. We perform these calculations on all 800 stocks in our universe, and then select the top 200 stocks with the best aggregate Multifactor Score. Learn more about the strategy underlying each factor score.

Screening Date	Company Name	Value	Quality	Momentum	Low Correlation	Multifactor Score	Included In USMF
8/31/2018		59%	33%	6%	79%	52%	No
5/31/2018		57%	37%	4%	78%	52%	No
2/28/2018	General Electric	57%	27%	2%	62%	45%	No
11/30/2017	Company	58%	50%	8%	72%	57%	No
8/31/2017		44%	44%	49%	28%	52%	No
5/31/2017		40%	55%	76%	13%	55%	No
8/31/2018		72%	75%	81%	80%	91%	Yes
5/31/2018		71%	81%	97%	81%	98%	Yes
2/28/2018	HollyFrontier	81%	68%	37%	69%	79%	Yes
11/30/2017	Corporation	81%	58%	40%	57%	72%	Yes
8/31/2017		82%	39%	14%	72%	65%	No
5/31/2017		86%	41%	5%	76%	63%	Yes

Source: WisdomTree, FactSet as of 8/31/2018. Past performance is not indicative of future results.

Please click here for the holdings of General Electric Company and Holly Frontier Corporation in USMF.

- General Electric- As many know, GE has experienced a terrible performance over the last five quarters, and two months, dropping a little over 50% in value with an average weight in the S&P 500 over that time frame of .70%. From excluding this single stock, USMF has added roughly 115 basis points (bps) of outperformance vs the S&P 500 over the period. We can see at our first screening on 5/31/2017, GE's Momentum score was decent at 76%, but mediocre Value and Quality scores, along with a low Low Correlation score kept it from inclusion. Since then, given its fall in price, GE's value and low correlation scores have become more attractive, while its quality and momentum scores have continued to deteriorate, resulting in it being excluded from the basket. This is a good example of how our composite Multifactor scoring keeps us away from "value traps[2]".

- HollyFrontier Corporation- This less-known energy company had an average weight of .56% in USMF since its inception while being absent entirely from the S&P 500. It has added roughly 50 bps to USMF's relative outperformance vs the S&P 500. While some of its Value score has been lost over time, moving from 86% on 5/31/2017 to 72% on 8/31/2018, we have seen its quality score almost doubled, its momentum score go from 5% to 81%, and have even seen its low correlation score rise. This stocks Multifactor score is now in the top 10% of the investment universe. In many ways, this stock has been every investors dream, riding a deep value stock as it becomes a momentum stock with increasing quality. Interestingly, right around the time of 2018 stock market volatility is where we see momentum and low correlation begin to rise, as the market was down more than 7.5%, and HollyFrontier continued its consistent gains posting a positive .85% return, showing resilience in today's market environment.[3]

Conclusion

USMF's biggest losers due to stock selection were no surprise to us. Big name companies like Amazon, Microsoft and Netflix tend to have high correlations to the market and unfavorable valuations, which means their risk-adjusted momentum and quality metrics would have to be among the best in our universe to be included. However, USMF has shown over the past year that allocating more money to a company simply because it's larger doesn't have to be the status quo. In fact, at a time when those companies generally have been outperforming, USMF has still beat the market by over 2.0% annually, as well as the majority of other Multifactor ETFs beyond just the top 10 by AUM.

[1]Bloomberg as of 9/28/2018

[2]A value trap is a stock that appears cheap from a relative valuation perspective.

[3]Bloomberg, period referred to is 1/26/2018–3/29/2018

Important Risks Related to this Article

WISDOMTREE®

There are risks associated with investing, including possible loss of principal. Investing in a Fund exposed to particular sectors increases the vulnerability to any single economic, political or regulatory development. This may result in greater share price volatility. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of USMF please visit the Fund's fund detail page at https://www.wisdomtree.com/investments/etfs/equity/usmf

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.

IMPORTANT INFORMATION

DEFINITIONS

Absolute Return : A measurement of an asset's return without considering risk.

Risk-adjusted basis : When calculating the return, we refines the return by measuring how much risk is involved in producing that return.

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

Active Share : Active share is a measure of the percentage of holdings in a fund's portfolio that differs from the benchmark index.

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.

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

Basis point : 1/100th of 1 percent.

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.

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.