2022 REBALANCE OVERVIEW: U.S. CORE INDEXES

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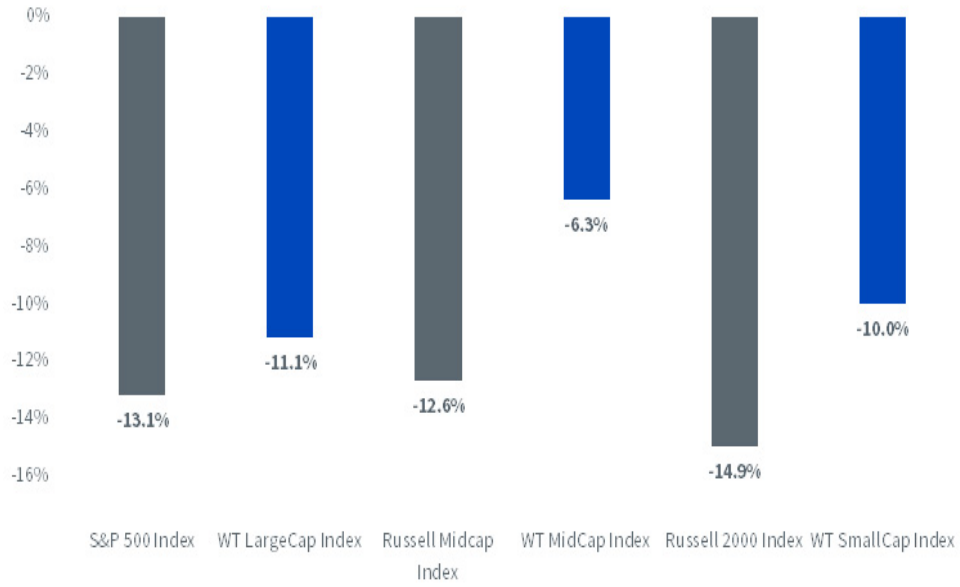
After a rocky start to the year, U.S. equities were repeatedly buffeted by a series of economic headwinds. From Russia's invasion of Ukraine to aggressive Fed rate hikes and the de facto collapse of cryptocurrencies, what little U.S. equities managed to recuperate by the end of Q1 2022 was effectively wiped out and so much more by December.

A fair share of the market's woes were driven by the spectacular decline of growth stocks. Mega-cap growth giants suffered the most, with both Tesla Inc. (TSLA US) and Meta Platforms (META US) tumbling over 60% year to date.

Our Domestic Core Equity family of Indexes consists of the WisdomTree U.S. LargeCap, Mid Cap and SmallCap Indexes—all of which outperformed their respective benchmark indexes as shown below.

These earnings-weighted Indexes were designed to have high correlation to broad-based market returns while mitigating exposure to expensive growth stocks—exactly the type of stocks that have struggled in 2022.

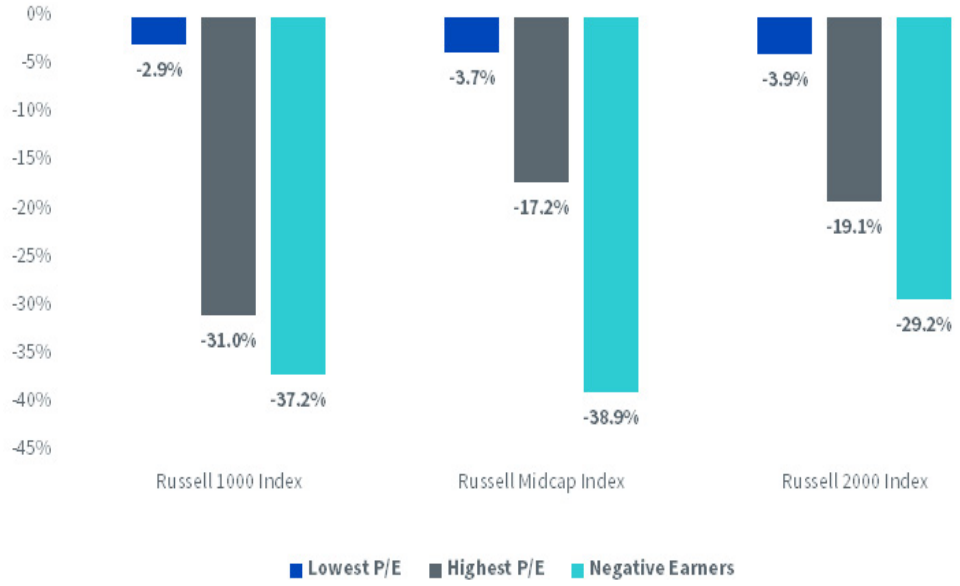
Year-to-Date Performance, WisdomTree U.S. Core Indexes vs. Broad-Based Benchmarks



Sources: WisdomTree, S&P, FTSE Russell, 12/31/21—11/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

Looking at returns for the Russell large-cap, mid-cap and small-cap indexes, companies with high valuations and low (or negative) earnings vastly underperformed those with the lowest price-to-earnings (P/E) ratios.

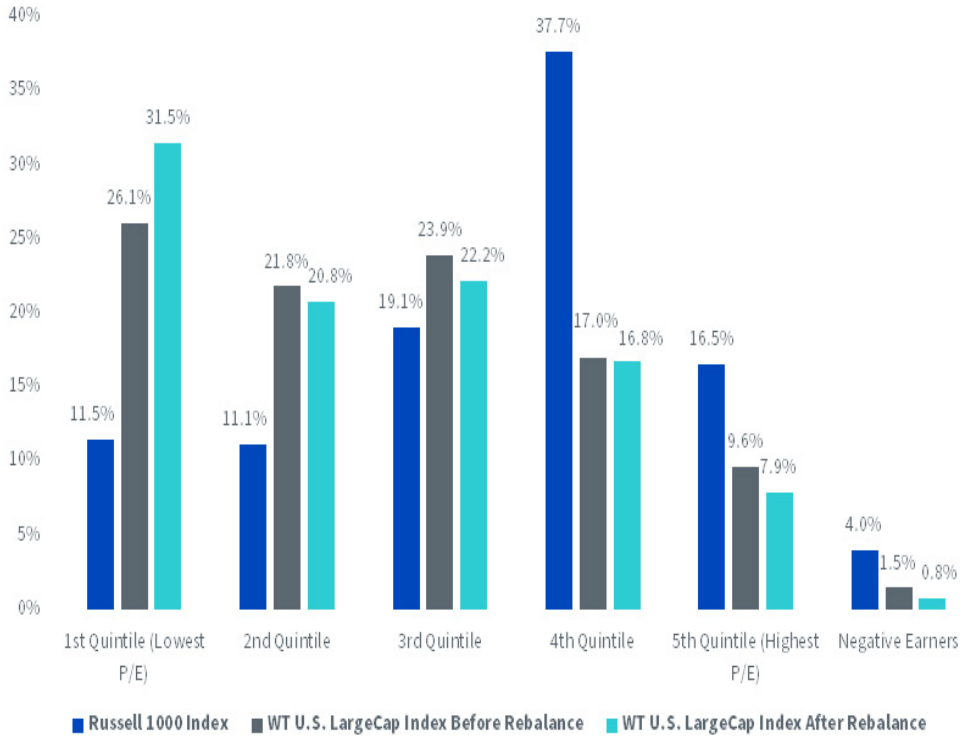
Year-to-Date Earnings Returns Attribution, Russell Benchmarks



Sources: FTSE Russell, 12/31/21—11/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The WisdomTree Domestic Core Equity Indexes, by design, systematically reduce exposures to companies with high valuations. After this year's rebalance, the Indexes further increased exposures to companies in the lowest P/E quintile and lowered exposures to companies in the highest P/E quintile.

WisdomTree U.S. LargeCap Index vs. Russell 1000 Index Weights, P/E Quintiles



Sources: WisdomTree, FTSE Russell, as of 12/14/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

WisdomTree U.S. Core Indexes

At their launch, the WisdomTree U.S. LargeCap, MidCap and SmallCap Indexes challenged the industry norm of market cap-weighting by allocating weights based on fundamental

metrics such as earnings. This method of stock selection and weighting has resulted in enhanced returns and lowered P/E ratios compared to traditional market cap-weighted portfolios.

As we head into 2023, high market valuations continue to pose a major risk to investors. The market outlook for next year remains uncertain, and Street earnings estimates have been steadily lowered through the second half of this year. Utilizing a strategy that lowers multiples for large caps by over five turns, mid-caps by over 10 and small caps by over 20 could serve investors well.

This year's rebalance saw our Domestic Core Equity Indexes further reduce their P/E ratios and improve other fundamentals as well. Notably, the WisdomTree U.S. SmallCap Index (WTSEI) improved its return on equity by almost 5% and brought its P/E ratio below 10x, at a standout discount well below historical levels. Including WTSEI, all Indexes improved their return on assets and return on equity as shown below.

Rebalance Fundamentals Changes

	Related ETF	Company Count	P/E	ROA	ROE
WTEPS After Rebalance	EPS	500	14.2x	4.1%	21.6%
WTEPS Before Rebalance		498	15.9x	3.3%	19.4%
S&P 500 Index		503	20.0x	4.3%	19.8%
WTMEI After Rebalance	EZM	584	8.3x	4.5%	24.1%
WTMEI Before Rebalance		567	9.8x	4.1%	21.2%
Russell Midcap Index		1955	29.7x	1.6%	7.8%
WTSEI After Rebalance	EES	918	8.1x	3.9%	19.7%
WTSEI Before Rebalance		930	10.8x	3.0%	14.9%
Russell 2000 Index		817	20.6x	3.1%	14.5%

Sources: WisdomTree, S&P, FTSE Russell. WisdomTree Indexes, as of 12/14/22, benchmark indexes, as of 11/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The year's biggest winner was the Energy sector, which (measured by the S&P 500 Energy Index) trounced the broad S&P 500, delivering a whopping 71.98% of excess returns year to date, while maintaining the lowest P/E ratio of all sectors as profits kept pace with price gains.

All WisdomTree core Indexes increased allocations to the Energy sector, with the WisdomTree U.S. LargeCap Index (WTEPS) increasing its weighting by over 4%.

On the other hand, all Indexes shed weights from the Financials sector, which dropped roughly 2%. Information Technology had a more modest reduction across the Indexes.

Rebalance Sector Change

	Change		
Final Weights	WT U.S. LargeCap Index	WT U.S. MidCap Index	WT U.S. SmallCap Index
Communication Services	1.6%	0.1%	0.6%
Consumer Discretionary	-1.2%	0.0%	3.9%
Consumer Staples	-0.9%	-0.8%	-2.0%
Energy	4.4%	1.6%	0.9%
Financials	-2.3%	-2.5%	-1.7%
Health Care	-0.7%	-1.4%	-0.7%
Industrials	0.0%	2.5%	-1.6%
Information Technology	-1.3%	-0.5%	-1.0%
Materials	0.0%	0.8%	0.7%
Real Estate	0.5%	1.4%	1.6%
Utilities	0.0%	-1.2%	-0.7%

Sources: WisdomTree, FactSet, as of 11/30/22. You cannot invest directly in an index.

On an individual holdings basis, the WisdomTree U.S. LargeCap Index has its biggest under-weight allocations to Apple, Microsoft and Amazon. A 5% single holding cap forces Apple—the most profitable company in the U.S.—to be under-weight relative to its 6.5% weight in the S&P 500.

Exxon Mobil and Alphabet (combining its Class A and Class C shares) are the biggest over-weight holdings for the Index at around 1.3% each.

Top 20 Holdings, S&P 500 vs. WisdomTree U.S. LargeCap Index

		Index Weights		
Name	Sector	S&P 500 Index	WT U.S. LargeCap Index	Difference
Apple Inc.	Information Technology	6.52%	5.02%	-1.50%
Microsoft Corporation	Information Technology	5.55%	4.15%	-1.40%
Amazon.com, Inc.	Consumer Discretionary	2.50%	1.00%	-1.50%
Alphabet Inc. Class A	Communication Services	1.77%	4.72%	2.95%
Berkshire Hathaway Inc. Class B	Financials	1.68%	1.56%	-0.12%
Alphabet Inc. Class C	Communication Services	1.59%	0.00%	-1.59%
Tesla Inc	Consumer Discretionary	1.51%	0.64%	-0.87%
UnitedHealth Group Incorporated	Health Care	1.49%	1.01%	-0.49%
Johnson & Johnson	Health Care	1.36%	1.32%	-0.05%
Exxon Mobil Corporation	Energy	1.35%	2.67%	1.31%
NVIDIA Corporation	Information Technology	1.24%	0.47%	-0.76%
JPMorgan Chase & Co.	Financials	1.18%	1.75%	0.57%
Procter & Gamble Company	Consumer Staples	1.04%	0.72%	-0.32%
Visa Inc. Class A	Information Technology	1.03%	0.80%	-0.24%
Home Depot, Inc.	Consumer Discretionary	0.97%	0.85%	-0.12%
Chevron Corporation	Energy	0.96%	1.67%	0.71%
Mastercard Incorporated Class A	Information Technology	0.89%	0.50%	-0.38%
Eli Lilly and Company	Health Care	0.85%	0.38%	-0.48%
AbbVie, Inc.	Health Care	0.83%	1.19%	0.36%
Pfizer Inc.	Health Care	0.82%	1.86%	1.04%

Sources: WisdomTree, FactSet, as of 11/30/22. You cannot invest directly in an index. Holdings subject to change.

As recession fears continue to loom amidst continued rate hikes from the Fed, it is abundantly clear that the pandemic-era days of easy money are long behind us. Expensive and unprofitable stocks—the largest of which dominate the large-cap landscape—are being crushed, weighing down the market.

By emphasizing and allocating weights using fundamental metrics as opposed to the commonly accepted method of weighting by market cap, the WisdomTree Domestic Core Equity family of Indexes magnifies the effect of earnings on performance while effectively managing valuation risks.

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.

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You cannot invest directly in an index.

DEFINITIONS

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

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Cryptocurrency : a digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend.

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.

Russell Midcap Index : The Russell Midcap Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

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.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

S&P 500 Energy Index : Market capitalization-weighted measure of the performance of companies in the S&P 500 Index that are in the energy sector.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.