# Beyond traditional factors: an innovative approach to enhancing equity returns

Published 20 February 2025

**Pierre Debru**
Head of Research, WisdomTree Europe.

## Key Takeaways

- By leveraging a 60/40 portfolio to equity-like volatility levels, the WisdomTree Efficient Core strategy delivers a higher Sharpe ratio compared to traditional equity investments.
- Like classic equity factors, such as Value and Momentum, the WisdomTree Efficient Core strategy exhibits low correlation with other equity factors, making it a potential replacement or complement to existing equity strategies.
- Over time, the WisdomTree Efficient Core strategy can maintain strong participation in market gains while also mitigating drawdowns, offering a slightly defensive profile.

- Related Products WisdomTree US Efficient Core UCITS ETF - USD Acc, WisdomTree Global Efficient Core UCITS ETF - USD Acc Find out more

When it comes to trying to outperform the equity markets, investors must usually rely on doing their own stock picking, investing in an active manager strategy, or using a systematic equity factor strategy. Whether they realise it or not, in all cases they engage in factor investing, as academic research and empirical data have consistently showed that much of the excess returns generated by active funds or stock picking in general can be traced back to systematic tilts toward well-documented equity factors such as Value, Momentum, Quality, and Minimum Volatility.

This is not a bad thing, as factor investing offers many potential advantages to investors. Factors provide systematic, repeatable sources of return by harnessing long-term premia that persist across market cycles. They also enhance diversification, as different factors tend to behave differently across the business cycle – some being more cyclical, others more defensive, and some acting as all-weather strategies. By thoughtfully combining factors such as Value, Minimum Volatility, or Quality, investors can construct more efficient equity portfolios with improved risk-adjusted returns.

## The WisdomTree Efficient Core strategy: a new tool to enhance equity portfolios

Building on this idea, what if investors could access an additional source of return premia—one not based on stock-specific characteristics but on a fundamental market dynamic? The well-documented diversification benefits between equities and bonds create a powerful mechanism for improving risk-adjusted returns when structured efficiently.

By leveraging a traditional 60/40 portfolio to match the volatility of equities, investors can achieve a higher Sharpe ratio while maintaining a risk level similar to that of pure equity investments. This approach systematically captures the bond-equity diversification premium, functioning as a new 'factor' in its own right—one that can serve as both a complement to existing equity exposures and a potential replacement for traditional equity allocations.

## How does WisdomTree Efficient Core work?

WisdomTree has developed the Efficient Core strategy, a unique investment framework designed to maximise the benefits of the bond-equity diversification premium. The strategy consists of:

- **Equity Exposure**: 90% allocated to a diversified ESG-screened basket of large-cap stocks.
- **Bond Exposure**: 60% allocated to a diversified basket of government bond futures, spanning maturities from 2 to 30 years.
- **Cash Collateral**: 10% cash, serving as collateral for the futures contracts.

By dynamically combining equity and bond exposures in a leveraged, risk-balanced structure, the Efficient Core approach enhances the traditional 60/40 portfolio while preserving equity-like characteristics. In essence, this Efficient Core functions as a new equity factor—one rooted in the bond-equity diversification premium—offering investors an alternative or complementary way to enhance their equity exposure.

## A new way to outperform equities

Figure 1 highlights that the WisdomTree US Efficient Core strategy (a portfolio investing 90% to physical US large cap equities and 60% to a portfolio of 5 US Treasury Bond future contracts) behaves like other equity factors by delivering similar outperformance and an improved Sharpe ratio.

## Figure 1: Performance statistics for US equity factors and WisdomTree US Efficient Core (Dec 2000 to January 2025)

*Source: WisdomTree, Bloomberg. 31 December 2000 to 31 January 2025. Includes backtested return. You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.*

Beyond outperformance, one of the defining characteristics of equity factors is their low correlation with one another. This diversification benefit is a critical advantage in portfolio construction. Figure 2 demonstrates that the excess returns of the WisdomTree US Efficient Core strategy exhibit similarly low correlations with traditional equity factors, reinforcing its potential as a distinct factor-like strategy.

## Figure 2: Correlation of excess returns between US equity factors and WisdomTree US Efficient Core

| | Min Volatility | Quality | Small Cap | High Dividend | Value | Momentum | WisdomTree US Efficient Core |
|---|---|---|---|---|---|---|---|
| Growth | -39% | 18% | -7% | -76% | -57% | 39% | 7% |
| Min Volatility | | 27% | -20% | 68% | -6% | 1% | 49% |
| Quality | | | -16% | 5% | -20% | 3% | 24% |
| Small Cap | | | | -12% | 44% | 1% | -17% |
| High Dividend | | | | | 30% | -26% | 24% |
| Value | | | | | | -27% | -21% |
| Momentum | | | | | | | 8% |

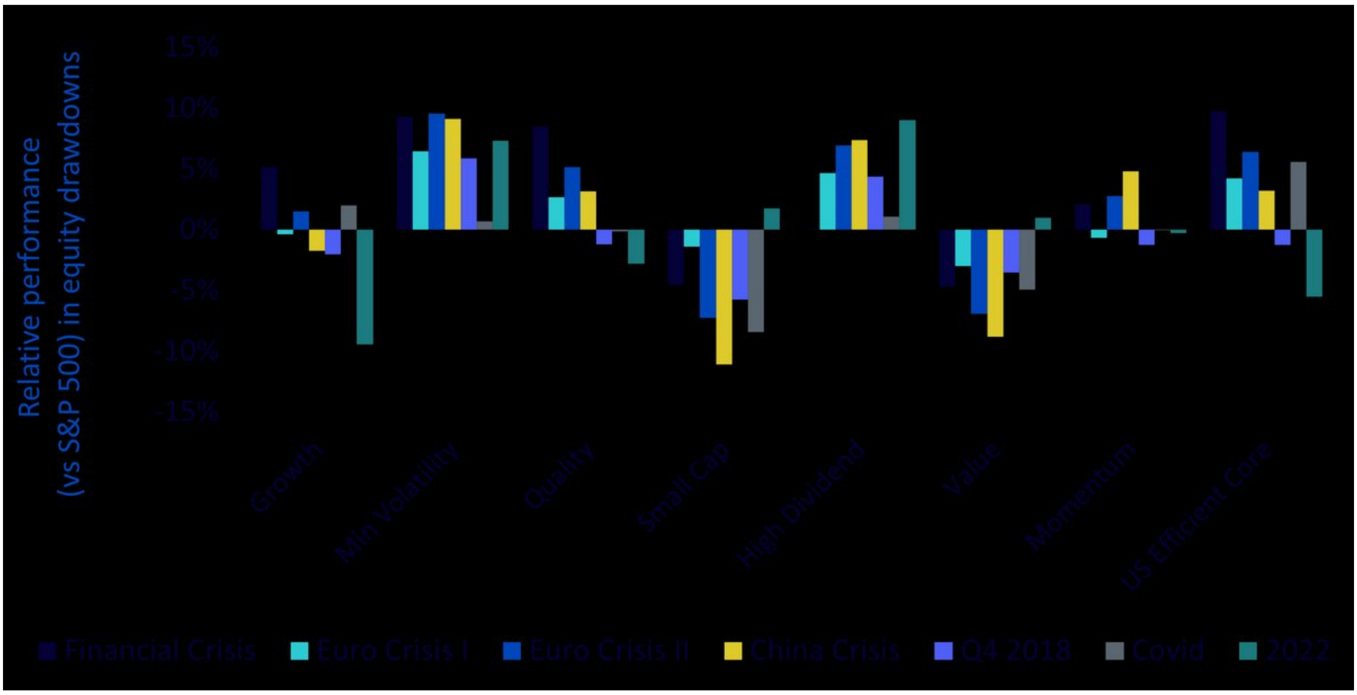
Source: WisdomTree, Bloomberg. 31 December 2000 to 31 January 2025. Includes backtested return. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

## A defensive approach to outperformance

As discussed, different equity factors behave differently across market cycles. Minimum Volatility tends to be defensive, outperforming during equity drawdowns, while Value is more cyclical and performs well early in the cycle. If WisdomTree Efficient Core acts as a new factor, understanding its behaviour across different market environments is essential.

A useful way to assess this is by analysing performance in major equity market drawdowns. Figure 3 highlights the relative performance of various equity factors and WisdomTree US Efficient Core during the seven largest equity market declines since 2000. The results show that, while Minimum Volatility remains the most defensive, consistently reducing drawdowns across all periods, cyclical factors such as Value and Small Caps tend to struggle. WisdomTree US Efficient Core, however, demonstrates a balanced defensive tilt—outperforming in five of the seven downturns and effectively mitigating losses.

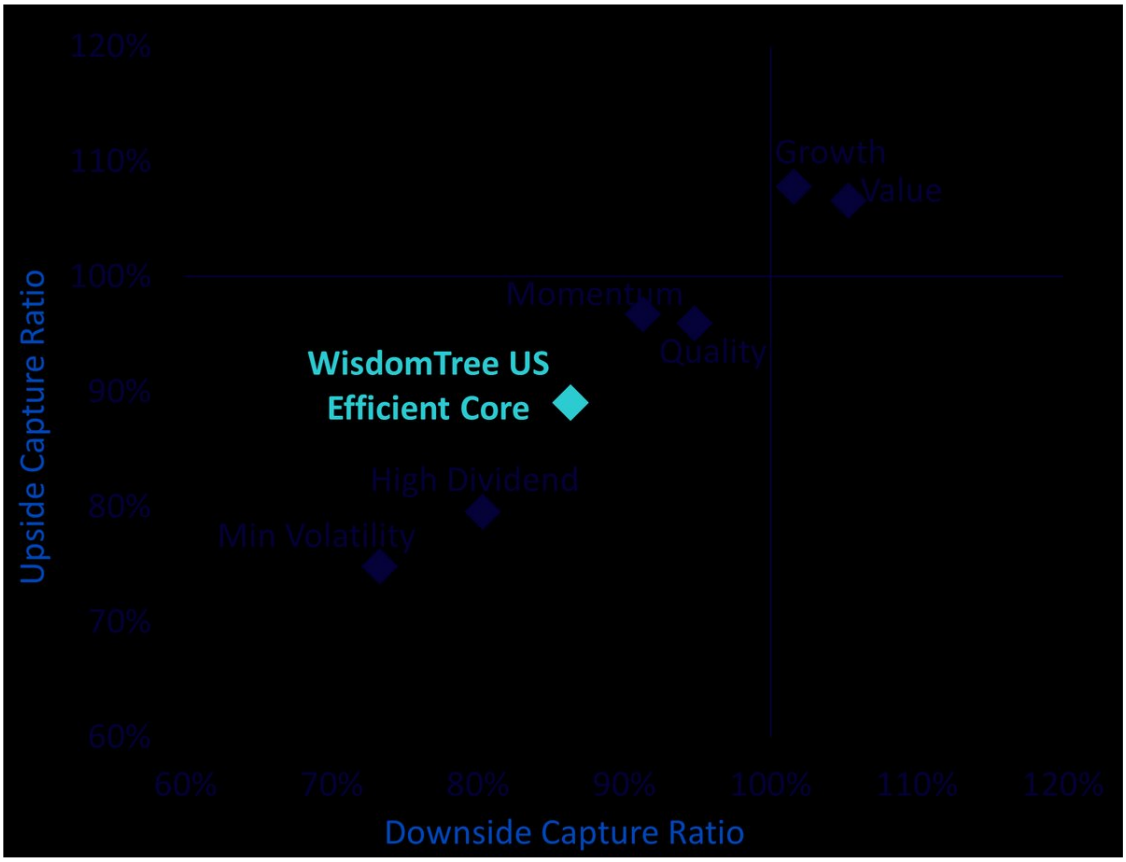
## Figure 3: Relative performance of US equity factors and WisdomTree US Efficient Core in drawdown periods




Source: WisdomTree, Bloomberg. 31 December 2000 to 31 January 2025. Includes backtested return. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

Another way to assess defensiveness is through upside and downside capture ratios, which measure how much a strategy participates in market gains versus losses. Figure 4 illustrates that, while WisdomTree US Efficient Core is slightly defensive, it is less so than Minimum Volatility. Notably, its upside/downside asymmetry is particularly strong, with an upside capture ratio of 89% and a downside capture ratio of 86%, reinforcing its ability to enhance returns while preserving capital.

## Figure 4: Upside and downside capture of US equity factors and WisdomTree US Efficient Core




Source: WisdomTree, Bloomberg. 31 December 2000 to 31 January 2025. Includes backtested return. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

## Conclusion: a smarter way to approach equity investing

The WisdomTree Efficient Core strategy introduces a new dimension to equity investing, leveraging the bond-equity diversification premium to create a new solution for equity outperformance. With comparable long-term returns to equities, a higher Sharpe ratio, and built-in defensive characteristics, WisdomTree Efficient Core serves as both a potential complement to equity portfolios and replacement for traditional equity exposures.

Just as Value, Momentum, and Minimum Volatility offer unique return characteristics, the WisdomTree Efficient Core strategy brings a new, systematic approach to enhancing equity investing. As market conditions evolve, incorporating this strategy into portfolios could provide investors with a more resilient and efficient path to long-term outperformance.

Footnotes:

- Minimum volatility is proxied by MSCI USA Min Volatility Gross total return index.
- Quality is proxied by MSCI USA Quality Sector Neutral Gross total return index.

- Momentum is proxied by MSCI USA Momentum Gross total return index.
- High Dividend is proxied by MSCI North America High Dividend Gross total return index.
- Small Cap is proxied by MSCI USA Momentum Gross total return index.
- Value is proxied by MSCI USA Enhanced Value Gross total return index.
- Growth is proxied by MSCI USA Growth Gross total return index.

Definitions for the drawdown periods

- Financial Crisis (16 July 2007 to 9 March 2009)
- Euro Crisis I (15 April 2010 to 5 July 2010)
- Euro Crisis II (2 May 2011 to 4 October 2011)
- China Crisis (15 April 2015 to 11 February 2016)
- Q4 2018 (21 September 2018 to 27 December 2018)
- COVID-19 Crisis (19 February 2020 to 23 March 2020)
- 2022 (3rd January 2022 to 12 October 2022)

## Important Risks Related to this Article

# IMPORTANT INFORMATION

**Marketing communications issued in the European Economic Area ("EEA"):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

This marketing communication has been prepared for professional investors, but the WisdomTree products set out in this document may be available in some jurisdictions to any investors, subject to applicable laws and regulations. As the product may not be authorised or its oering may be restricted in your jurisdiction, it is the responsibility of every person or entity to satisfy themselves as to the full observance of the laws and regulations of the relevant jurisdiction. Prior to any application investors are advised to take all necessary legal, regulatory, tax and investment advice on the suitability and consequences of an investment in the products. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be aected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an oer for sale nor a solicitation of an oer to buy any product or make any investment.

An investment in exchange-traded products ("ETPs") is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could dier materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

**WisdomTree Issuer ICAV**

The products discussed in this document are issued by WisdomTree Issuer ICAV (“WT Issuer”). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland (“CBI”). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities (“UCITS”) under the laws of Ireland and shall issue a separate class of shares ("Shares”) representing each fund.

The Fund is described in a Key Information Document (KID) or Key Investor Information Document (KIID) for UK investors, and the prospectus of WT Issuer (“WT Prospectus”). A copy of the WT Prospectus and the KID / KIID is available, for EEA/UK only, in English at www.wisdomtree.eu. Where required under national rules, the KID will also be available in the local language of the relevant EEA Member State. Investors should read the WT Prospectus before investing and should refer to the section of the WT Prospectus entitled »Risk Factors¼ for further details of risks associated with an investment in the Shares.

The summary of investor rights associated with an investment in the fund is available in English on WisdomTree Europe¼s website. WisdomTree Management Limited may decide to terminate the arrangements made for the marketing of its collective investment undertakings. In such circumstances, shareholders in the aected EEA Member State will be notified of this decision and will be provided with the opportunity to redeem their shareholding in the fund free of any charges or deductions for at least 30 working days from the date of such notification.

**Notice to Investors in Switzerland – Qualified Investors**

This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree¼s website: **https:** //www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports

Some of the sub-funds referred to in this document may not have been registered with the Swiss Financial Market Supervisory Authority ("FINMA"). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

**For Investors in France:**

The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the oering, sale and delivery of Shares in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

**For Investors in Malta:** This document does not constitute or form part of any oer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the

Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

**For Investors in Monaco:** This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.