

WisdomTree's toolbox for trading Trump and rising rates

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The market has remained relatively optimistic on the prospect of a pro-growth Trump agenda, even as equity valuations look stretched. It could be the ideal time to dig deeper into the various style opportunities on offer: WisdomTree's Quality Dividend Growth, Equity Income and SmallCap Dividend strategies offer distinct ways to invest in the US in 2017. This brief explores the potential valuation and style opportunities available following the December annual rebalance.

Aggressively positioning on Trump: WisdomTree US Quality Dividend Growth (DGRA)

With Trump's agenda expected to comprise of corporate tax cuts, infrastructure spending and jobs creation, we believe a cyclical, growth-oriented basket is one way to position around an accelerating US economy. We think DGRA offers this, with a concentrated basket containing consumers, industrials and technology sectors respectively, as shown in Figure 1.

Alongside this are attractive fundamentals resulting from screening for quality. Figure 2 showcases the 2016 performance decomposition for WisdomTree's strategies versus market-cap benchmarks, as a means of understanding the underlying return drivers and performance potential for the year ahead. At 2.9%, DGRA offered a higher dividend return than the S&P 500, despite earnings contracting in 2016. Companies were able to maintain significant cash distributions despite poor financial performance, which we think is indicative of their strong cash generating ability and deep balance sheets of the underlying constituents. Our view is that this is unlikely to change for 2017 and dividend returns, underpinned by a reinvigorated US economy and reversal in earnings, will remain a key performance driver. We believe this will be accompanied by higher valuation premiums over the S&P 500, especially given the high profitability (ROE of 26%), low leverage, and the recent rebalance into greater quality stocks. With the market-cap benchmark unlikely to see improving fundamentals, even at rebalance (largest stocks likely to remain largest stocks), we believe DGRA offers a more compelling investment proposition for aggressively positioning around Trump and rising rates.

Cautiously positioning around Trump: WisdomTree US SmallCap Dividend (DESE)

WisdomTree's US SmallCap Dividend (DESE) offers similar cyclical exposure as DGRA but at the same time is more diversified by maintaining some allocation in utilities, telecoms, energy and real estate. The solid post-rebalance fundamentals underpinning the strategy at the end of 2016 should offer a strong case for DESE to deliver in 2017, relative to a market-cap exposure.

Whilst both small cap strategies delivered returns north of 30% over the previous calendar year, momentum played a much more prominent role in defining the return profile for the Russell 2000, as share prices outran their fundamentals. This is evident from the 28% expansion in valuations against earnings contraction of

8%. Unless investors see evidence of meaningful earnings growth over the coming months, the already inflated valuation multiple for the Russell 2000 is likely to constrain further share price appreciation in 2017, and may even be prone to large corrections. This valuation risk is simply not shared by DESE which, by contrast, saw dividends, valuations and earnings in particular all contribute meaningfully to returns. In addition, having recently rebalanced, companies whose share prices appreciated more than fundamentals will have been removed in favour of stocks offering relative value. We believe this positions DESE nicely for the coming year as higher US growth expectations coupled with lower corporate tax we believe will continue to boost small caps over the coming year.

Defensively position if Trump fails: WisdomTree US Equity Income (DHS)

We believe DGRA and DESE will be the key strategies to consider if Trump pushes through his reform agenda and the Fed hikes rates. But plenty of risk is involved, not least the need for Trump to strike compromises or that the Fed delays the rate hike cycle. In which case, there is merit in considering a contrasting style in WisdomTree's US Equity Income (DHS) – a more defensive, income-oriented strategy that offers large exposure to energy, telecoms and utilities. With very little cyclical exposure, DHS is a well-suited strategy for hedging against Trump. Against the S&P 500, which has yet to demonstrate meaningful earnings performance to justify last year's multiple expansion, DHS displayed strong fundamental performance for 2016. The conservative valuation expansion of just 4.7% suggests investors have not priced in expectations to the same extent as market cap peers, and this presents greater opportunity for 2017, but more importantly, makes the strategy less prone to market sell offs. DHS's defensive sector allocation and strong fundamentals may set it up to outperform if US growth and inflation expectations disappoint.

Against a backdrop of policy uncertainty, WisdomTree's range of equity strategies offers investors with contrasting but also complementary styles to pivot and position around the US for 2017.

Investors sharing this sentiment may consider the following ETFs:

- + [WisdomTree US Quality Dividend Growth UCITS ETF \(DGRA\)](#)
- + [WisdomTree US Equity Income UCITS ETF \(DHS\)](#)
- + [WisdomTree US SmallCap Dividend UCITS ETF \(DESE\)](#)

Important Risks Related to this Article

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