

Achieving Transparency & the Four Ps of Due Diligence, Part I

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This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have direct access to these model portfolios.

A recent Ignites post¹ summarized the findings of a comprehensive Morningstar survey² on the explosive growth in model portfolio adoption by financial advisors and wealth managers. It highlighted some of the opportunities that come from the increased use of model portfolios, as well as some of the obstacles and hesitations to even greater adoption.

We've written before about the [many opportunities for advisors that come with model portfolios](#), so we will summarize them here:

- A greater ability to focus on core competencies
- More time for serving and finding clients
- A more consistent investment experience for the end client
- Greater scale and efficiency, all of which can help advisors “build their book” or increase their enterprise value

But what about the obstacles? The Ignites post summarizes them nicely, citing the Morningstar report: “There are no clear standards on how managers report track records and ongoing performance for their paper portfolios, according to a recent report from the Chicago-based fund tracker. This places the onus on advisors to step up their due diligence and rely less on track records and more on their understanding of the processes and people behind the models.”

To summarize, advisors need to focus on **due diligence**, and model portfolio providers need to focus on **transparency**. In this blog post and our next one, we will tackle each issue separately. First up is due diligence.

The “Four Ps” of Due Diligence

If you speak to due diligence (DD) professionals, you will find that almost all of them apply a similar process to evaluating investments. They may call them different things, but they all focus on the following:

- **People:** Who is managing the model portfolio? What is their experience, expertise, tenure and historical track record?
- **Philosophy:** What is the investment thesis? How does this strategy expect to generate returns? Does it make sense? Do we believe that it can succeed consistently over full market cycles?
- **Process:** How is the investment thesis implemented and managed? What are the risk management protocols? How are buy, sell and rebalancing decisions made? Is there historical evidence that the process is disciplined and consistent over time?
- **Performance:** What is the long-term performance over full market cycles? Is the performance consistent with the investment thesis? Does the strategy “work” when it is supposed to and “struggle” when we expect it to? Do the risk/return characteristics of this strategy justify its fees?

Note that “performance” is the fourth and last of the decision criteria. This is because most DD professionals believe that if the first three Ps are in place and appropriately managed, performance will naturally follow.

So how do the [WisdomTree Model Portfolios](#) stack up to this 4P process?

People: The professionals managing the WisdomTree model portfolios have decades of experience in managing multiasset model portfolios. We have been managing live models at WisdomTree since 2013. There are multiple areas of expertise throughout the team, including asset allocation, asset class specialization and quantitative analysis. More than 20 research professionals are dedicated to monitoring and managing our model portfolios.

This team also collaborates with Dr. Jeremy Siegel, professor at The Wharton School and special advisor to WisdomTree.

Philosophy: We build model portfolios targeting multiple specific investment objectives, but those model portfolios all have several common characteristics, which, in combination, represent our overall investment philosophy:

- They tend to be global in nature. We are a global shop, and we believe in global diversification.
- They are open architecture, meaning they include both WisdomTree and third-party strategies. This allows us to take a “core/satellite” portfolio construction approach that we believe optimizes outperformance potential.
- They are diversified on both the asset class and [risk factor](#) levels, which we believe may improve performance consistency over full market cycles.
- They are all ETF-based in an attempt to optimize fees and taxes.
- None of our model portfolios incurs a strategist fee³.

Process: Our model portfolios are run in an institutional manner. It begins with our Asset Allocation (AA) Team, which consists of most of the global research professionals with our parent company and its subsidiaries, in both the US and London. This team meets twice monthly for a wide-ranging discussion

of the global macroeconomic and investment landscape. Out of these meetings comes the WisdomTree “house view.”

The **Model Portfolio Investment Committee (IC)** is a subset of the AA Team, representing the team’s more senior and experienced members. The IC is the voting body for the model portfolios. It meets monthly, discusses model portfolio performances and contemplates potential changes to the model portfolios. It also discusses potential new model portfolios and more strategic issues.

If the IC approves any changes, they are communicated to our **Operations** and **Capital Markets** teams for execution at month-end. All changes are then made publicly available in a variety of formats.

This picture illustrates the “flow” of the portfolio management process:



Performance: All WisdomTree models are evaluated against market benchmarks appropriate to the given portfolio’s investment mandate. Performance is updated monthly and made publicly available in a variety of formats.

In summary, we believe that our institutional approach to managing model portfolios would pass the 4P test for most DD professionals.

In our next blog post, we will tackle the other potential obstacle to increased advisor adoption of model portfolios: **transparency**.

1Source: Jackie Noblett, “Model Market’s Explosive Growth Muddied by Data Gaps,” Ignites, 8/13/20.

2Source: “2020 Model Portfolio Landscape,” Morningstar.

3While WisdomTree does not charge a strategist fee, advisors may have to pay a platform fee, depending on how they access the models.

4Or to the various trading platforms and/or advisors who access the models by way of third-party platforms.

Important Risks Related to this Article

There are risks involved with investing, including possible loss of principal.

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