Achieve a better risk-return profile in US markets with a barbell approach

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Key Takeaways

- The WisdomTree US Quality Dividend Growth UCITS Index (DGRW) focuses on dividend-paying stocks with a history of profitability, which tend to perform well during economic uncertainty or downturns.
- The WisdomTree US Quality Growth UCITS Index (QGRW) provides exposure to growth stocks, including high-quality tech and innovation-focused companies, offering more potential upside during bull markets.
- Pairing the WisdomTree US Quality Dividend Growth Index (DGRW) with the WisdomTree US Quality Growth Index (QGRW) could provide investors with a diversified mix. This strategy may offer a balance between stability, downturn protection, and greater upside in various market conditions.

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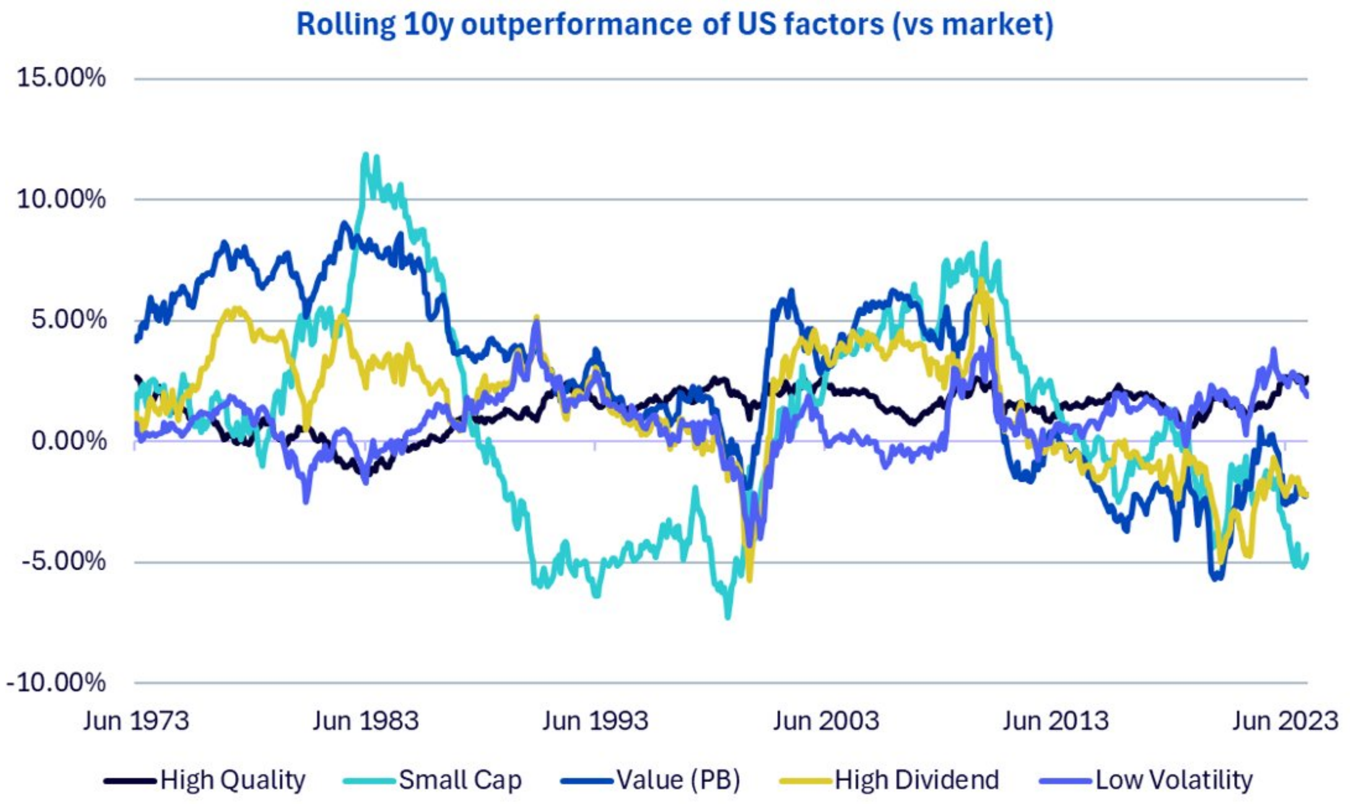
Over the years, Quality as an investing factor has developed a reputation for providing the most consistent performance gains versus the market. Veteran investors, like Warren Buffett, have relied on return on equity as one of the factors to evaluate investments and empirical research by academics, such as Fama and French, also suggests that profitability is one of the key factors behind superior investment returns.

When looking at the returns of High-Quality US stocks versus their Low-Quality1 counterparts, we see a distinct separation in performance, with high quality stocks not only outperforming by close to 4% annualised (12.0% vs 8.1%) over more than 60 years, but also doing so with a much lower volatility of 15.2% versus 17.8% annualised from June 1963 to Aug 2024.

When compared to other factors Quality has also exhibited the most resilience by outperforming much more often than all the other factors over 10 year rolling periods, making it an all-weather factor crucial for core portfolio allocations.



Sources: WisdomTree, Ken French, data as of 31 May 2024 and represents the latest date of available data. Value: High 30% Book to Price portfolio. Size: Low 30% portfolio. Quality: High 30% portfolio. Low Vol: Low 20% portfolio. High Div: High 30 portfolio. "&" Market: all CRSP firms incorporated in the U.S. and listed on the NYSE, AMEX or NASDAQ. Historical performance is not an indication of future performance and any investments may go down in value.

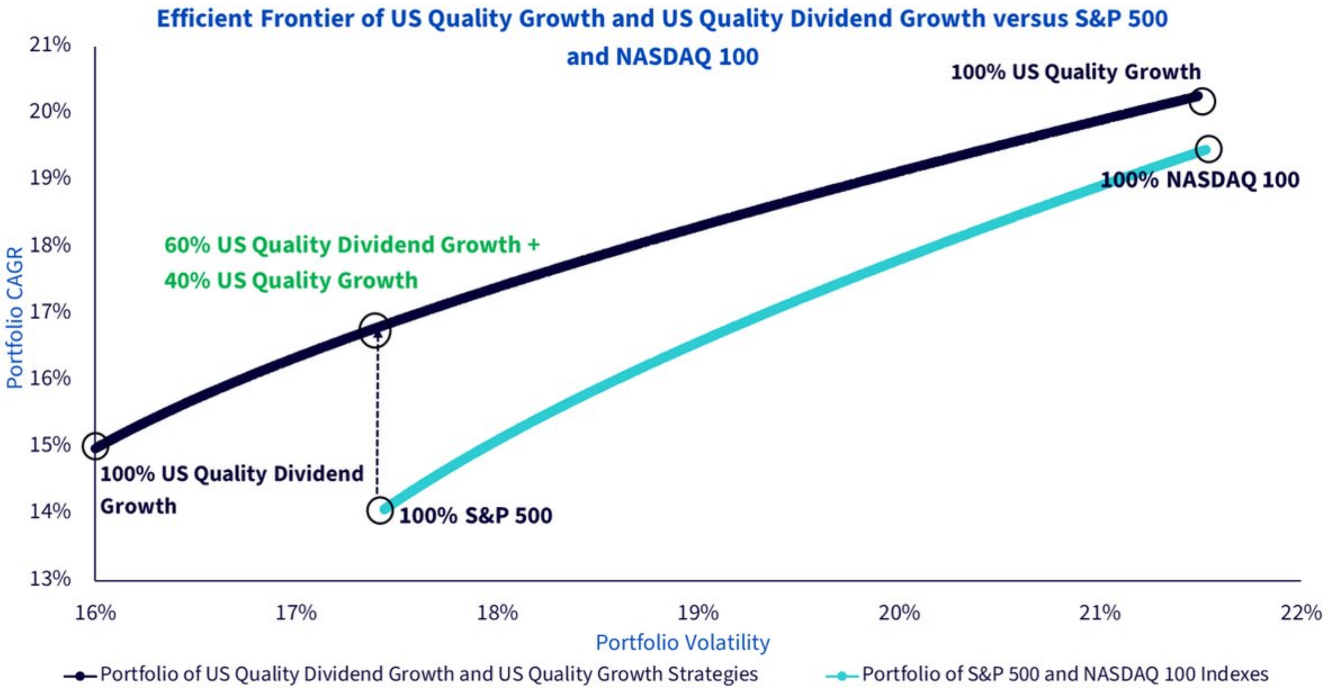
Taking this into consideration, WisdomTree has developed two unique strategies, with Quality as the underlying factor, that provide differentiated exposures to the US market.

- The WisdomTree US Quality Dividend Growth UCITS Index (DGRW) provides access to US listed dividend paying companies, that have high exposure to the profitability-based Quality factor, and estimated earnings growth. The forward-looking approach to growth takes a more nimble view to dividend investing with a focus on companies that can increase their dividends going forward. The strategy aims to provide higher risk-adjusted returns versus traditional benchmarks like the S&P 500.
- The WisdomTree US Quality Growth UCITS Index (QGRW), on the other hand, provides exposure to growth stocks with a focus on High Quality. The strategy accounts for realised sales and earnings growth, and estimated earnings growth for a more robust exposure to growth stocks. The Quality exposure ensures that 'junk' stocks, which do not have the profitability metrics to support sustained growth, and could be vulnerable to large drawdowns, are excluded. With growth stocks from all exchanges in the US market, the strategy aims to provide pure exposure to growth stocks versus proxies of growth such as the NASDAQ 100.

We performed an efficient frontier analysis that demonstrates the superior risk-return profile of the two strategies.

For all levels of volatility, portfolio variations of the WisdomTree US Quality Dividend Growth Index (DGRW) and WisdomTree US Quality Growth Index (QGRW) have historically generated better potential returns than portfolios of S&P 500 and NASDAQ 100.

- A portfolio with **60%** WisdomTree US Quality Dividend Growth (DGRW) **and 40%** WisdomTree US Quality Growth (QGRW) has historically generated 2.75% more annualised returns compared to S&P 500 with the same volatility over the period 30 April 2013 to 30 September 2024.



Source: WisdomTree, FactSet, Bloomberg. Based on backtested data from 30 April 2013 to 30 Sep 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Conclusion

DGRW and QGRW can serve as a balanced approach for investors seeking downside protection and potential growth. DGRW focuses on dividend-paying stocks with a history of profitability, which tend to perform well during economic uncertainty or downturns. On the other hand, QGRW provides exposure to growth stocks, including high-quality tech and innovation-focused companies, offering more potential upside during bull markets.

This combination is likely to create a diversified portfolio that could withstand various market conditions. By blending DGRW's focus on steady dividend payers with QGRW's growth exposure, investors could potentially balance their portfolios to manage risk while still capturing possible growth opportunities.

Source

1 Based on Kenneth French data library data. Stocks selected are above the median market cap among all the US listed stocks, with 'High-Quality' representing the top 30% by operating profitability and 'Low-Quality' representing the bottom 30% by operating profitability.

Important Risks Related to this Article

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