WisdomTree US Efficient Core UCITS ETF: heralding a new era of smart investing

Published 17 October 2023

Pierre Debru
Head of Research, Europe

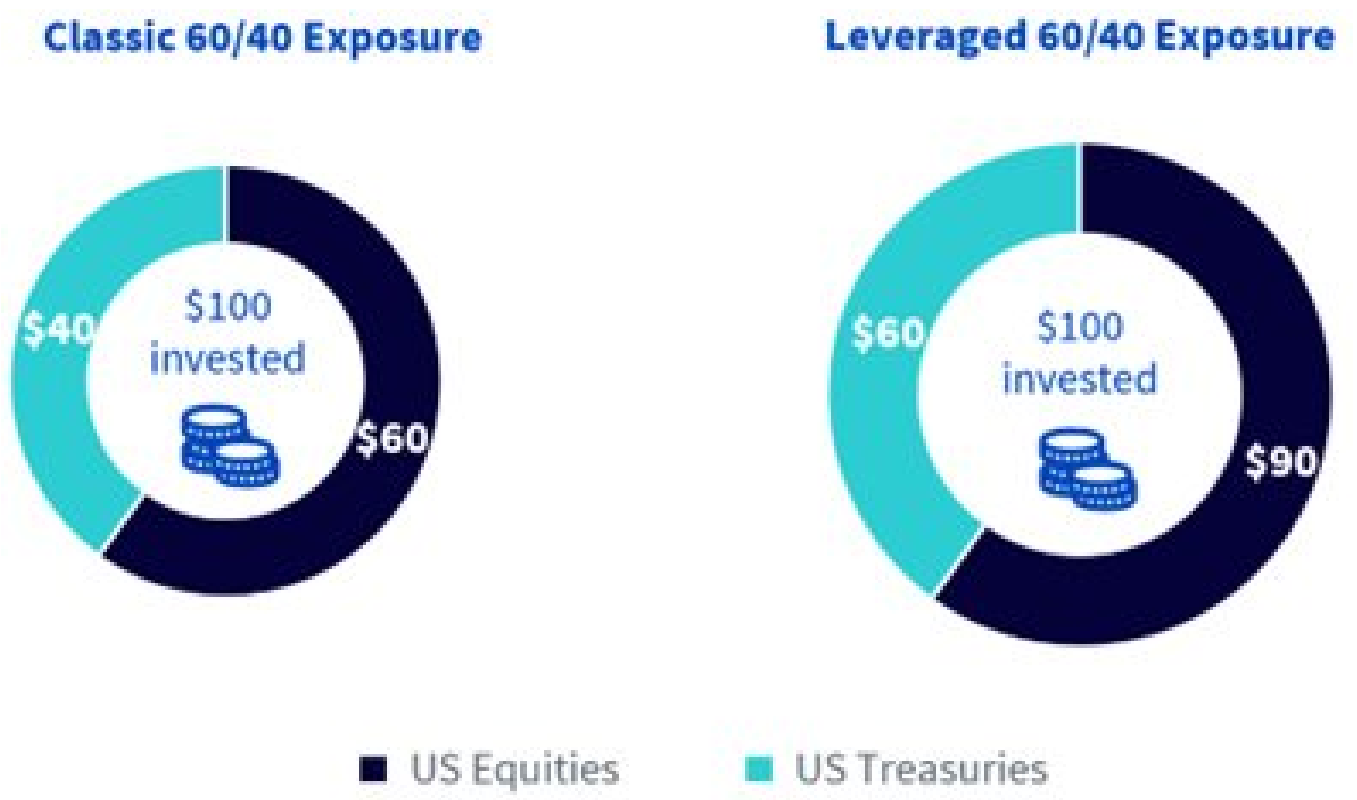
When aiming to improve the risk-return profile of their investments, investors have two main tools at their disposal: diversification and leverage. Diversification uses low-correlation assets to diversify the overall risk and create more efficient portfolios. Leverage can help target the amount of risk that investors are looking for.

Take the example of a US equity/US Treasury portfolio. Adding 40% of fixed income to an equity portfolio helps reduce the volatility from 18.6%[1] to 12.2% and, more importantly, move the Sharpe ratio from 0.38 to 0.46. Incidentally, the return is diminished from 10.3% per annum to 8.9%. By leveraging this new portfolio back to equity-like volatility, investors can keep the Sharpe ratio at 0.43 and, therefore, outperform equities (+11.5%) with a more efficient portfolio. Diversification and leverage really work hand in hand to deliver the most efficient portfolios, as illustrated in more detail in our recent blog, Reduce risk in portfolios without hampering returns – introducing 'Efficient Core'.

While sophisticated investors have been using leverage in their portfolios for decades, the concept of 'Portfolio Scaling' (that is, the practice of combining multiple investment strategies or assets through leverage to generate higher returns and improve diversification) is slowly gaining a larger user base. The WisdomTree US Efficient Core UCITS ETF is WisdomTree's offering to provide a turn-key solution for investors to improve their portfolios.

The WisdomTree US Efficient Core UCITS ETF aims to deliver a 90% exposure to ESG-screened, large-cap US equities and 60% exposure to US Treasury Bonds, effectively delivering a 150% leveraged position to the traditional 60/40 portfolio.

Figure 1: Exposure in the WisdomTree US Efficient Core UCITS ETF



Source: WisdomTree.

The exchange-traded fund (ETF) is comprised of three key exposures:

- Equity: the strategy invests 90% physically in a diversified basket of ESG-screened, US large-capitalisation companies
- Bond: the strategy has a 60% exposure in a diversified basket of 5 US Treasury futures contracts laddered across 2 to 30 year maturities
- Cash collateral: the strategy has roughly 10% exposure in cash, which serves as collateral for the US Treasury future contracts

1. The equity exposure

The strategy invests 90% of its assets quarterly in the S&P 500 net total return.

2. The bond exposure

The strategy achieves a 60% bond exposure by investing in liquid US Treasury futures contracts using the 10% of cash collateral to fund the margin account. The futures portfolio comprises an equal-weight basket of US Treasury futures contracts with maturities ranging from 2 to 30 years . The Index implements a ‘rolling’ methodology to replace the ‘first near futures contract’ (the front month contract) into the ‘second near future contract’, which occurs over a one-day rolling period every quarter.

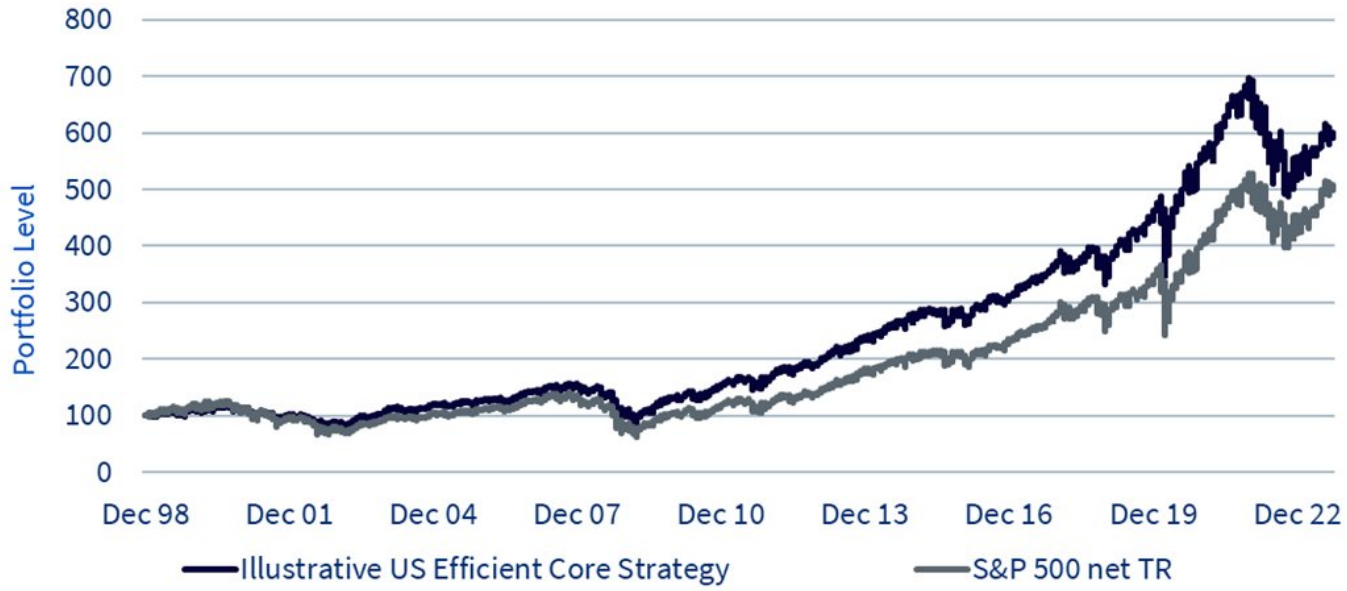
3. The cash collateral

The cash collateral returns the US Secured Overnight Financing Rate.

All weights are rebalanced, and contracts are rolled every quarter on the last business day of February, May, August and November. The strategy allows intra-quarter exceptional rebalancing in case the equity/bond exposures deviate by more than 5% from the target weights.

In Figure 2, we run the backtest of the WisdomTree US Efficient Core UCITS ETF since December 1998, with the caveat that we use the S&P 500 for the equity exposure instead of the ESG-filtered basket we use in the ETF itself to increase the length of the backtesting period. This includes the 20 bps TER. The strategy outperforms a 100% equity investment by 1% a year thanks to its leverage and the diversification brought upon by the bond futures. The volatility is also reduced by almost 3%. This translates into a Sharpe ratio of 0.35 compared to 0.25 for the S&P 500 alone.

Figure 2: Historical backtest of the WisdomTree US Efficient Core UCITS ETF



	WisdomTree US Efficient Core UCITS ETF
Return	
Total return	521.7%
Total return (Annualised)	7.7%
Risk	
Standard Deviation (annualised)	17.0%

Skewness	-12.6%
Daily VAR 95%	-1.6%
Tracking Error (Annualised)	4.3%
Risk Return	
Sharpe Ratio	0.35
Information Ratio	0.22
Treynor Measure	6.93
Beta (ex post)	85.0%
Correlation	98.3%

Source: Bloomberg, WisdomTree. From December 1998 to August 2023. Daily data in USD. Historical performance is not an indication of future performance and any investments may go down in value.

One ETF, two potential uses in portfolios

Such 'Efficient Core' ETFs could be used widely in investors' multi-asset portfolios as:

1.An equity replacement

A core equity solution designed to replace existing core equity exposures. By offering return enhancement, lower risk and a better Sharpe ratio historically compared to a 100% equity portfolio, the WisdomTree US Efficient Core UCITS ETF could be used to replace existing equity exposures.

In Figure 3, we compare the performance of the backtest of the WisdomTree US Efficient Core UCITS ETF with all the ETFs and mutual funds domiciled in Europe that track US equities and have at least a 5-year track record. This includes 647 ETFs and funds in the Morningstar US Large Cap Value peer group, the Morningstar US Large Cap Blend peer group, the Morningstar US Large Cap Growth peer group, and the Morningstar US Equity Income peer group.
The Illustrative US efficient core strategy beats 421 of those 647 funds and ETFs. The strategy is, therefore, in the top 35%. Furthermore, it has a better Sharpe ratio than around half of the funds.

Figure 3: Backtest of WisdomTree US Efficient Core UCITS ETF versus all passive and active funds in Morningstar US Large Cap Peer Groups (Value, Blend, Growth, Equity Income)

Source: Morningstar, WisdomTree. December 1998 to August 2023. in USD. Historical performance is not an indication of future performance and any investments may go down in value.

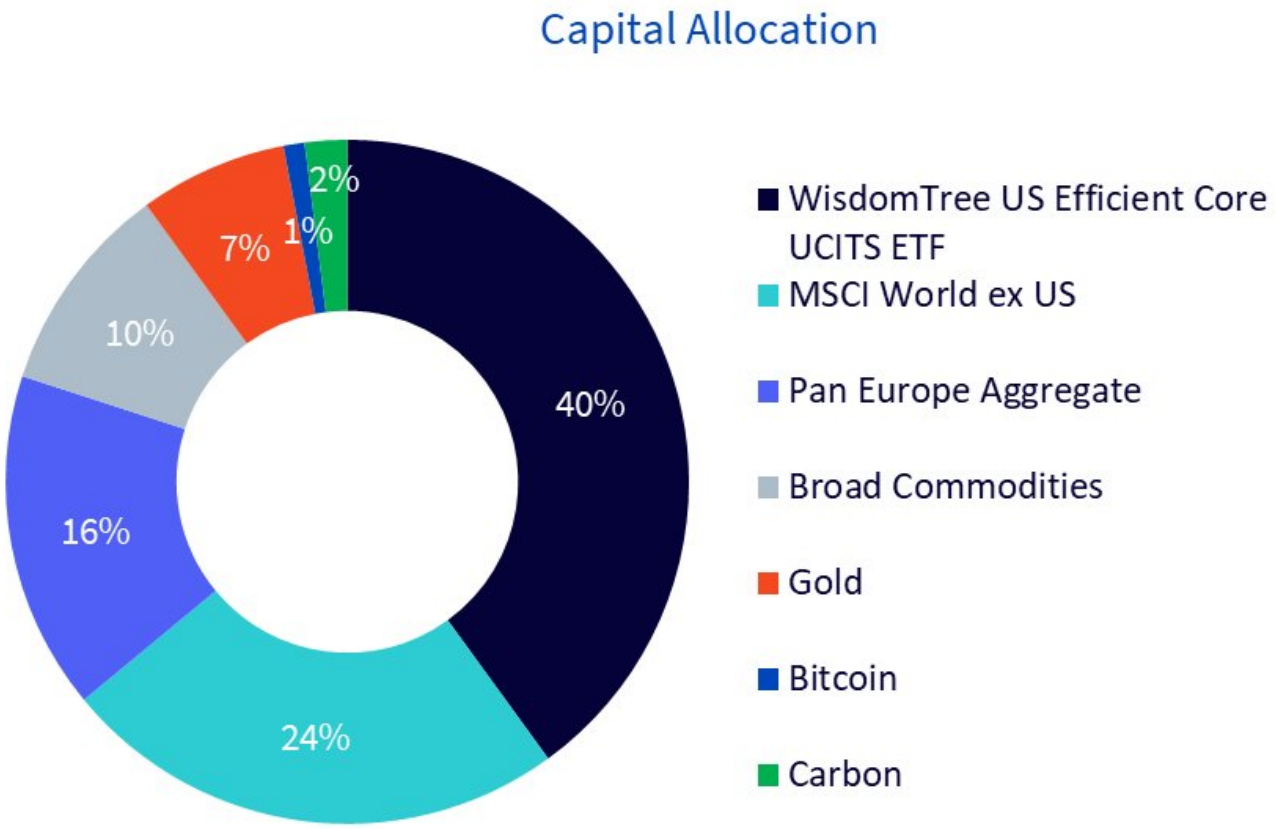
2.A capital efficiency tool

By delivering equity and bond exposure in a capital-efficient manner, ‘Efficient Core’ can help free up space in a portfolio for alternatives and diversifiers. If an investor were to allocate 10% of a portfolio to this strategy, investors would get 9% exposure to US equities and 6% exposure to US Treasuries. This could allow investors to divest 6% from existing fixed income exposures and invest that in alternative assets (such as broad commodities, gold, carbon or other assets). This could be achieved without losing the diversifying benefits of their fixed income exposure.

Using the WisdomTree US Efficient Core UCITS ETF, it is possible to keep both the equity and bond allocation steady while fitting new diversifiers. Figure 4 shows a portfolio where the Efficient Core ETF creates space for commodities and other diversifiers. The Illustrative WisdomTree Efficient Core Model Portfolio invests its US equity exposure in the WisdomTree US efficient Core UCITS ETF, creating 20% of space. That 20% could then be invested in assets like broad commodities, gold, bitcoin and carbon, delivering a very diversified portfolio.

Without leverage, the portfolio would be under-invested in equities. However, from an exposure point of view, thanks to the leverage in the Efficient Core strategy, the portfolio delivers 60% to equities, 40% to bonds and 20% to diversifiers.

Figure 4: Capital allocation and exposures in the Illustrative WisdomTree Efficient Core Model Portfolio



	Capital Allocation	Equity	Fixed Income	Commodities
WisdomTree US Efficient Core UCITS ETF	40%	36%	24%	
MSCI World ex US	24%	24%		
Pan Europe Aggregate	16%		16%	
Broad Commodities	10%			10%
Gold	7%			7%
Bitcoin	1%			
Carbon	2%			2%
Total	**100%**	**60%**	**40%**	**19%**

By offering investors more efficient building blocks, Efficient Core unlocks many possibilities to improve portfolios. The WisdomTree US Efficient Core UCITS ETF could be used to replace existing equity exposure or it could create space in portfolios for well-needed diversifiers.

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.

For professional clients only. 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 affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and affer 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 offer for sale nor a solicitation of an offer 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 offering 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 affiliate, nor any of their respective officers, 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 differ 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. Investors should read the prospectus of WT Issuer (“WT Prospectus”) before investing and should refer to the section of the WT Prospectus entitled 'Risk Factors' for further details of risks associated with an investment in the Shares.

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 WisdomTree's 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 not 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 offering, 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 offer 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.