

Disrupting High Fee Hedge Funds with a Low Cost Long/Short ETF

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For a long time, many investors allocated their portfolios to traditional asset classes only—namely equity and fixed income, often investing on a long-only basis. Over the years, investment researchers hypothesized that diversifying by incorporating international equities, small caps or even emerging market debt could help increase returns and lower risks for the entire portfolio. But as markets became more correlated, nontraditional investments, known as “alternative investments,” have become an increasingly popular way to increase return potential while mitigating risk. But investing in hedge funds is fraught with challenges; in particular, they typically come with very high fees, very high minimums, a lack of transparency and the presence of lockup periods that require long holding periods for the investments, sacrificing liquidity. Ben Carlson, author of the blog *A Wealth of Common Sense*, discussed some of the reasons he believes investors have embraced hedge funds—going beyond traditional return arguments relating to their correlations and risk-adjusted returns.¹ Carlson wrote: *There’s an assumption that you get what you pay for. Higher fees lead to better performance, right? There are funds out there with amazing track records. It’s not like it’s all smoke and mirrors. ... But the chances that you are going to have access to them is slim to none. Yet hope springs eternal. Ego. Most big investors are unwilling to admit that they’ll never be able to invest in this small group of outperforming funds or pick the best emerging managers, but that doesn’t stop them from trying. Further, writing on the shift in the industry in another piece, Carlson said the nature of the hedge fund industry has changed: ... in the 1970s and 1980s [when the industry was getting started] hedge fund managers were mostly looking for home run returns. As more institutions started to allocate to hedge funds the narrative shifted from the managers who tried to knock it out of the park in any type of environment to stock-like returns with bond-like volatility. Following the dot-com crash value investing staged a huge comeback, so fundamental long/short managers did very well by going long cheap stocks and short expensive stocks. This really increased interest in hedge funds and led to an explosion in the number of funds available. The proliferation of hedge funds means there are just fewer opportunities to go around, particularly for funds that have become so big they can no longer utilize strategies that got them to their gigantic size in first place. On a performance basis, Carlson points out that hedge funds: have collectively failed to beat a simple 60/40 stock-bond mix every single year since 2002 while also charging outrageous fees and locking up investor capital in an illiquid fund structure.*²

WisdomTree Brings a Systematic Hedge Fund Approach to Exchange-Traded Funds (ETFs) Many hedge funds do have a worthy goal—to provide a lower risk profile and diversification of traditional stock and bond allocations—but is it worth the challenges we discussed above? WisdomTree brings an alternative strategy to traditional long/short strategies in the ETF structure. These liquid alternative

solutions follow rules-based passive Indexes that we believe capture and reflect the type of strategies that hedge funds typically utilize, but are available to all investors and provide daily liquidity, with lower fees³, transparency and potentially more favorable tax treatment.

Introducing the WisdomTree Dynamic Long/Short U.S. Equity Fund (DYLS) DYLS is designed to track the [WisdomTree Dynamic Long/Short U.S. Equity Index](#)—before fees and expenses. The launch of DYLS gives investors the opportunity to take a dynamic long/short position in U.S. equities. DYLS offers investors:

- A stock selection strategy designed to add alpha in the core long stock portfolio, while hedging market drawdowns with a dynamic hedge on the market that is re-evaluated on market conditions monthly
- A fund that intends to go long a portfolio of stocks and have the ability to hedge market risk through short exposure to the S&P 500 Index when indicators suggest hedging is warranted⁴
- A strategy that provides diversification to traditional long-only asset classes
- Low cost, with access to an alternative investment strategy at 0.48% expense ratio, with no investment minimums, no sales loads, no lockup periods and no redemption fees (ordinary brokerage commissions apply)
- Full transparency of strategy and holdings with intraday liquidity
- No K-1 filing —and all the other benefits of an ETF structure

Learn more about the rules-based strategy underlying DYLS.

¹Ben Carlson, “Why People Invest in Hedge Funds,” A Wealth of Common Sense, 10/11/15.

²Ben Carlson, “My Thoughts on Hedge Funds,” A Wealth of Common Sense, 10/1/15, and James B. Stewart, “Hedge Funds Faced a Test in August, and Faltered,” The New York Times, 9/3/15.

³Lower fees compared to median net fee of the Morningstar long/short mutual fund category. Ordinary brokerage commissions apply.

⁴Future, forwards, swaps or other derivative instruments may be used to provide short exposure to the S&P 500 Index.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. The Fund will invest in derivatives, including as a substitute to gain short exposure to equity securities. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Derivatives used by the Fund to offset its exposure to market volatility may not perform as intended. The Fund may engage in “short sale” transactions and will lose value if the security or instrument that is the subject of a short sale increases in value. A Fund that has exposure to one or more sectors may be more vulnerable to any single economic or regulatory development. This may result in greater share price volatility. The composition of the Index is heavily dependent on quantitative models and data from one or more third parties, and the Index may not perform as intended. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Diversification does not eliminate the risk of experiencing investment loss.