

Diversification? Why Bother?

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Key Takeaways

- The U.S. equity market has been driven by the strong performance of large-cap companies, especially the “Magnificent 7”, due to the AI wave.
- Investors have been skeptical about small caps, international markets and value investing because large-cap growth stocks have consistently outperformed for the better part of the last two years.
- The political events of July 2024, combined with lower inflation, contributed to a potential shift in market trends, with value-oriented funds showing signs of rallying.

For the better part of the last two years, the U.S. equity market has been driven by what seems, at least on paper, to be a very simple story:

- The artificial intelligence (AI) wave, which largely benefitted Nvidia’s share price performance.
- The other six of the so-called “Magnificent 7” companies (Apple, Microsoft, Amazon, Alphabet, Meta, Tesla) delivering relatively strong returns over the same period.

At WisdomTree, it’s gotten to the point where investors have begun to ask:

- Why bother with small caps—large caps have been outperforming for such an extended period.
- Why bother with markets outside of the U.S.—there are no parallel companies globally to the “Magnificent 7,” and that story has been such a strong driver of global equity markets.
- Why bother with the “value” style of investing—as time has continued to pass, 2022, a year when value outperformed growth in U.S. equities, has looked like more and more of a “head fake” since large growth has been doing so well since the end of 2022.

The point is that behavioral finance exists for a reason, and the phrase “performance chasing” exists because it is a powerful force that does, in fact, drive decision-making.

However, the thing about “diversification”—simply put, not putting all of one’s eggs in one basket—is that it may seem like it doesn’t matter until a big, unexpected catalyst cautions us about getting too comfortable with the current trend.

Case Study: July 2024

People are going to remember July 2024. After the presidential debate on June 28, an unprecedented situation unfolded that led to President Biden pulling out of the 2024 presidential race and endorsing Vice President Kamala Harris. There was also the assassination attempt on former President Trump, the Republican nominee. Even without votes being cast, we have been living political history.

Looking at market history, while there are no hard and fast rules, when historic, unexpected things happen, it makes sense to consider if seemingly embedded trends can change.

Prior to July 2024:

- **Embedded Trend:** The largest companies by market capitalization in the U.S. have been driving most of the U.S. equity market's performance. Whatever has happened for the better part of two years, these companies have tended to continue to march higher in terms of their share prices.
- **Tougher Narrative:** Whether people look at the performance of the S&P 500 Equal Weight Index versus the S&P 500 Index or think about such things as small- and mid-capitalization stocks versus large-capitalization stocks, all of these “other areas” that do not emphasize exposure to the largest stocks, full stop, have not been able to outperform. Leading into July, many people were talking about these other areas, but no one could possibly know if or when the trend would change.

Figure 1 sets up the analysis of July by showing the longer-term standardized periods of returns for the underlying Funds:

- **WisdomTree U.S. Quality Growth Fund (QGRW):** The WisdomTree U.S. Quality Growth Fund is designed to track, before fees and expenses, the total return performance of the [WisdomTree U.S. Quality Growth Index](#). This strategy focuses on very large stocks with strong return on equity and return on assets characteristics alongside strong earnings growth characteristics. It is market capitalization-weighted and does not require companies to pay dividends to be included.
- **WisdomTree U.S. Quality Dividend Growth Fund (DGRW):** The WisdomTree U.S. Quality Dividend Growth Fund is designed to track, before fees and expenses, the total return performance of the [WisdomTree U.S. Quality Dividend Growth Index](#). This strategy focuses on companies that pay dividends and have characteristics such as high return on equity, return on assets and earnings growth, which tend to lead to better chances of growing future dividends.
- **WisdomTree U.S. High Dividend Fund (DHS):** The WisdomTree U.S. High Dividend Fund is designed to track, before fees and expenses, the total return performance of the [WisdomTree U.S. High Dividend Index](#). This strategy focuses on companies with high dividend yields that also pay large cash dividends, and the weighting is based on cash dividends being paid per each company's dividend policy.
- **WisdomTree U.S. Value Fund (WTV):** The WisdomTree U.S. Value Fund is an actively managed fund designed to track, before fees and expenses, the total return performance of stocks that have strong value characteristics. One such characteristic that is emphasized is the net buyback yield, which is a way of getting at the idea of total shareholder yield. Companies that are reducing shares outstanding may tend to have other interesting—favorable, in our opinion—characteristics.

Figure 1: Standardized Performance

Fund Name	Fund Ticker	Fund Inception Date	Fund Expense Ratio	YTD	1-Year	3-Year	5-Year	10-Year	Since Fund Inception
WisdomTree U.S. Quality Growth Fund (NAV)	QGRW	12/15/2022	0.28%	22.57%	35.85%	N/A	N/A	N/A	45.67%
WisdomTree U.S. Quality Growth Fund (MP)	QGRW	12/15/2022	0.28%	22.59%	35.88%	N/A	N/A	N/A	45.69%
WisdomTree U.S. Quality Dividend Growth Fund (NAV)	DGRW	5/22/2013	0.28%	11.91%	19.11%	11.51%	14.62%	12.75%	13.17%
WisdomTree U.S. Quality Dividend Growth Fund (MP)	DGRW	5/22/2013	0.28%	11.89%	19.16%	11.51%	14.63%	12.74%	13.16%
WisdomTree U.S. High Dividend Fund (NAV)	DHS	6/16/2006	0.38%	4.87%	10.82%	6.74%	7.18%	7.46%	6.89%
WisdomTree U.S. High Dividend Fund (MP)	DHS	6/16/2006	0.38%	4.86%	10.86%	6.74%	7.19%	7.46%	6.89%
WisdomTree U.S. Value Fund (NAV)	WTV	2/23/2007	0.12%	7.60%	18.91%	8.93%	13.06%	10.87%	8.25%
WisdomTree U.S. Value Fund (MP)	WTV	2/23/2007	0.12%	7.52%	18.92%	8.92%	13.04%	10.87%	8.26%

Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of July 28, 2024. NAV denotes total return

performance at net asset value. MP denotes market price performance. WTV's objective changed effective December 18, 2017. Prior to December 18,

2017, Fund performance reflects the investment objective of the Fund when it tracked the performance, before fees and expenses, of the WisdomTree

U.S. LargeCap Value Index. **Past performance is not indicative of future results. Investment return and principal value of an investment will**

fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be

lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the

respective Fund prospectuses, click the relevant ticker: [QGRW](#), [DGRW](#), [DHS](#) and [WTV](#).

We tend to monitor the performance of different strategies to showcase certain narratives or stories. For most of 2024 so far, there has been one story: [QGRW](#), which emphasizes exposure to the “Magnificent 7” and other large-cap companies with strong quality and growth characteristics, has been the runaway leader. [DGRW](#) has been more stable and less prone to bigger runs, either up or down. And then [DHS](#) and [WTV](#) have been comparatively “out of favor” since they focus on the value side of the ledger and the growth side has been running faster.

But, roughly starting around July 1, 2024, it looks like the picture shifted a bit.

Figure 2: Year-to-Date 2024 Trend Shows It Has Still Been “Growth” over “Value”



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, for the period 1/1/24 to 7/26/24. NAV denotes total return performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results.**

Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the respective Fund prospectuses, click the relevant ticker: [QGRW](#), [DGRW](#), [DHS](#) and [WTV](#).

If we zoom in and only look at July 2024's performance for these four Funds, we see:

- **DHS** has rallied almost 9%.
- **WTV** has rallied in the range of 3%–4%.
- **DGRW** has been fairly stable, not going too far up or down.
- **QGRW** has lagged in the range of about -5%.

One month of performance is just that—one month. We have to continue to monitor things in order to see if what we are witnessing is just a blip and large growth goes back to leadership OR if it's actually time for a sustained value rally in U.S. equities—something we haven't really seen since 2022.

Figure 3: July 2024's Performance Could Indicate a Shift toward Value



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, for the period 7/1/24 to 7/26/24. NAV denotes total return performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results.**

Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the respective Fund prospectuses, click the relevant ticker: [QGRW](#), [DGRW](#), [DHS](#) and [WTV](#).

Because the Magnificent 7 has garnered so much attention over the past two years, we pulled up the top 10 positions in each of these four strategies:

- Neither [DHS](#) nor [WTV](#) have any of the Magnificent 7 visible in the top 10.

Since we are deluged with headlines and commentary regarding how the Magnificent 7 is doing on a daily basis, those investors looking for “something else” to drive the returns of investment strategies may have at least an initial catalyst to look toward [DHS](#) and [WTV](#).

Figure 4: How Much of the Magnificent 7 Feature in the Top 10 Holdings

QGRW		DGRW		DHS		WTV	
Company Name	Fund Weight	Company Name	Fund Weight	Company Name	Fund Weight	Company Name	Fund Weight
Nvidia	11.19%	Microsoft	7.83%	Exxon Mobil	6.91%	Vistra	2.02%
Microsoft	10.80%	Apple	5.04%	AbbVie	5.54%	Exxon Mobil	1.66%
Apple	10.42%	Broadcom	3.95%	Chevron	5.12%	AppLovin	1.64%
Alphabet	6.52%	AbbVie	3.41%	Altria	4.71%	Synchrony Financial	1.20%
Amazon	5.52%	Nvidia	3.32%	IBM	4.08%	Equitable	1.12%
Meta	3.70%	J&J	3.13%	Philip Morris	3.78%	Discover Financial	1.09%
Eli Lilly	3.61%	Alphabet	3.00%	Morgan Stanley	2.92%	Valero Energy	1.06%
Broadcom	3.00%	P&G	2.85%	Citigroup	2.41%	Marathon Oil	1.05%
Tesla	2.76%	Home Depot	2.67%	UPS	1.82%	Marathon Petroleum	1.03%
Visa	2.26%	Coca-Cola	2.53%	Bristol Myers Squibb	1.69%	GoDaddy	1.02%

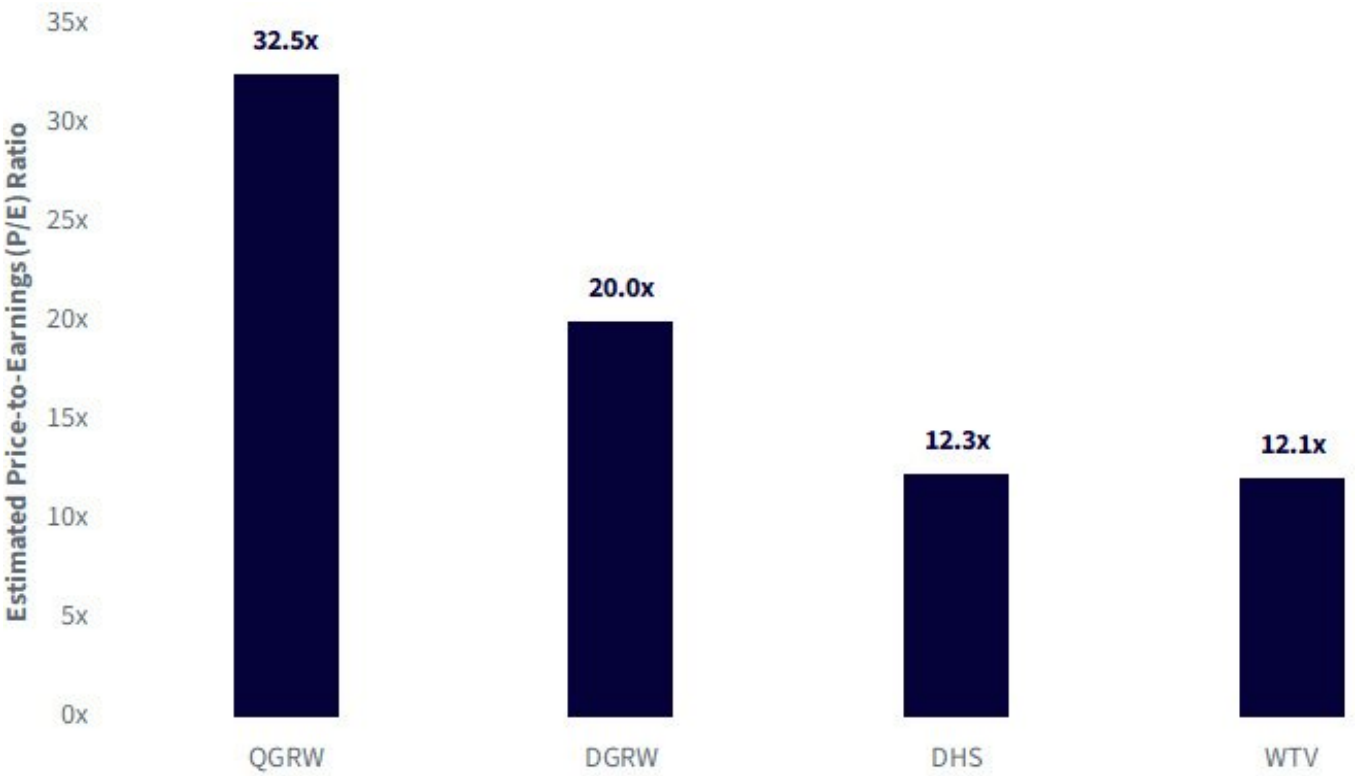
Sources: WisdomTree, FactSet, as of 6/30/24. Holdings subject to change.

Valuation is an often-cited market characteristic, but it's important to realize that history has not shown that markets crash or rally based on it alone. We tend to think about valuation as a way to consider risk levels—higher valuations could be one way to indicate a market is susceptible to a correction after a strong rally, whereas lower valuations could indicate a potential to move positively in light of new, positive information coming to light.

- The biggest contrast is clearly between [QGRW](#), on the higher end of the valuation spectrum, and [DHS/WTV](#), which each have an estimated P/E ratio that looks quite similar at around 12x earnings.

- It's interesting, though, that [DGRW](#), which includes four of the Magnificent 7 stocks, has such a lower estimated P/E ratio than [QGRW](#). We'd note that this could be an impact of tracking an investment strategy that is cash dividend-weighted as opposed to market capitalization-weighted.

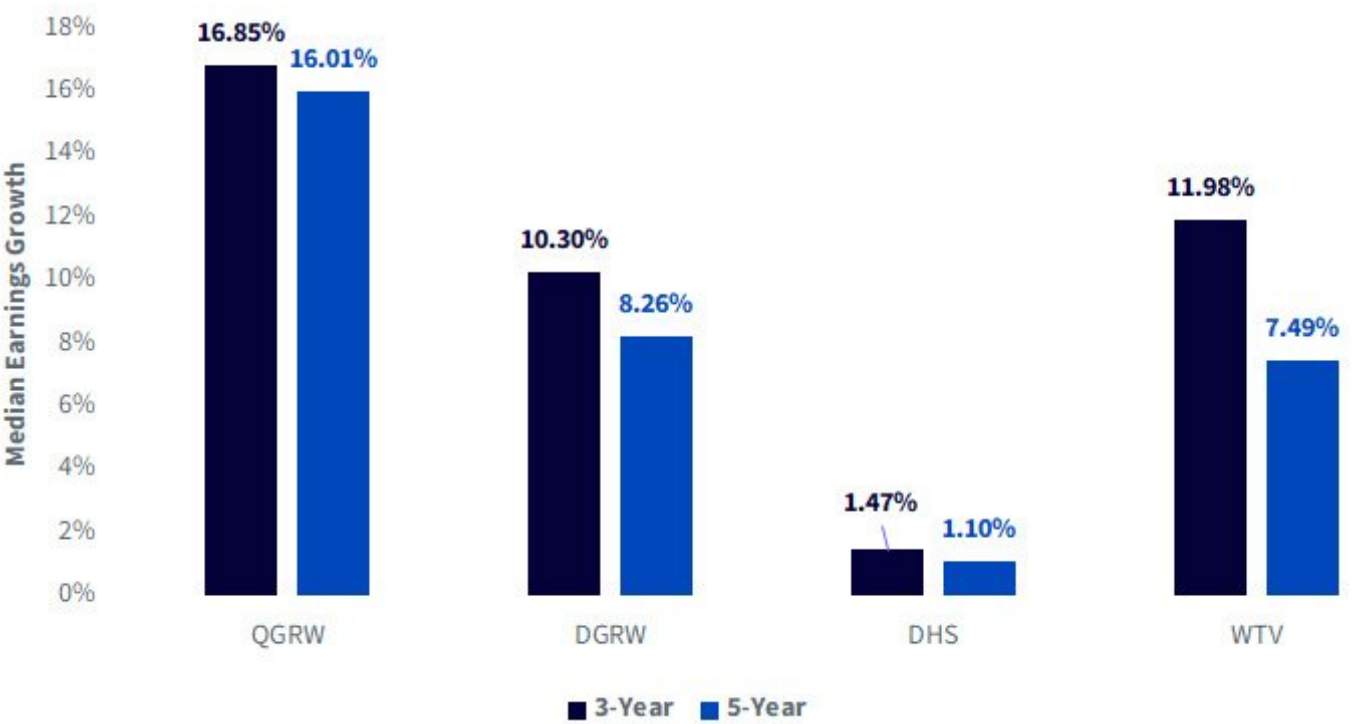
Figure 5: Big Differences in Valuation between “Value” and “Growth” Strategies



Sources: WisdomTree, FactSet, with data accessed in WisdomTree's PATH Fund Comparison tool as of 7/28/24.

Finally, our bottom-line discussion regards whether one has to sacrifice earnings growth to gain exposure to value.

Figure 6: How Much Earnings Growth Gets Sacrificed When Going from Growth to Value



Sources: WisdomTree, FactSet, with data accessed in WisdomTree's PATH Fund Comparison tool as of 7/28/24.

For those investors thinking that the trend of the largest, growth-oriented companies leading markets is ripe for a change, [WTV](#) may be an interesting way to think about something driven by a very different mix of companies. And, to be fair, the relative steadiness of [DGRW](#) has been notable to us in the face of these bigger growth-oriented positions seeming to fall out of favor in July 2024.

Important Risks Related to this Article

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