

Gimme Shelter

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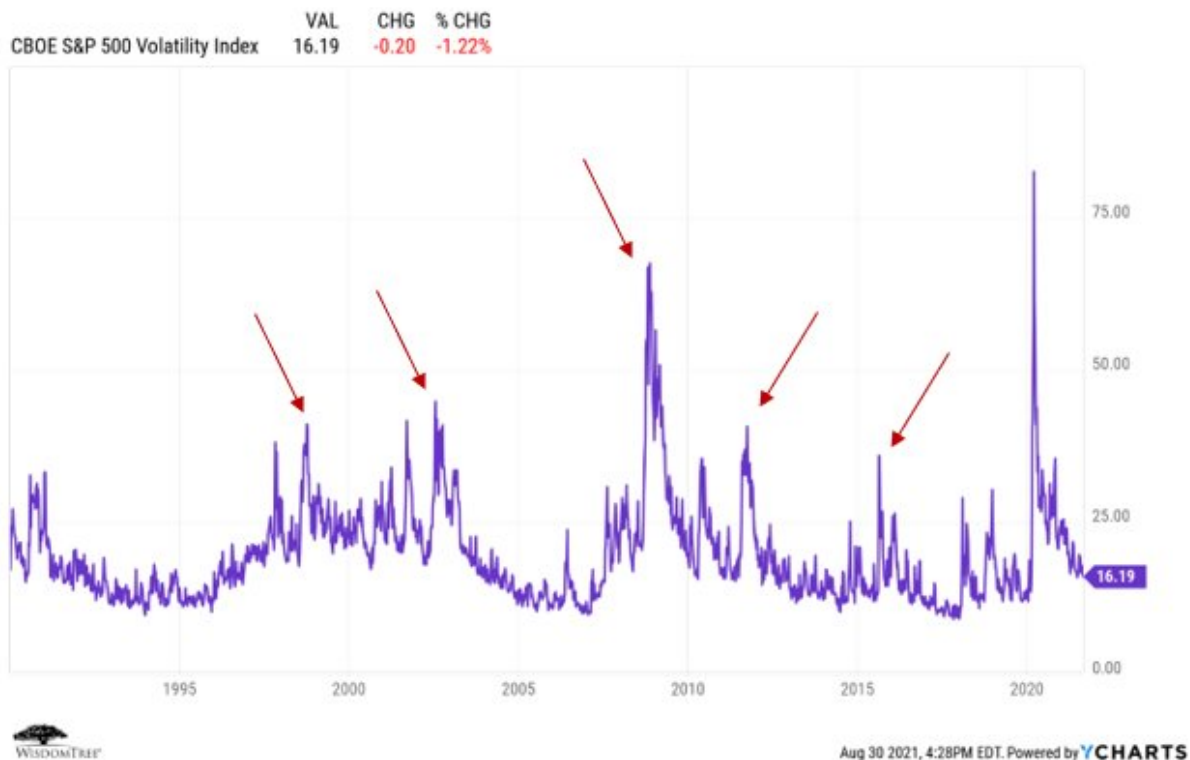
This article is relevant to financial professionals who are considering offering model portfolios to their clients. If you are an individual investor interested in WisdomTree ETF Model Portfolios, please inquire with your financial professional. Not all financial professionals have access to these Model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

*Ooh, a storm is threatening
My very life today
If I don't get some shelter
Ooh yeah I'm gonna fade away*

(From "Gimme Shelter" by The Rolling Stones, 1969. RIP, Charlie Watts)

We frequently caution investors and advisors to not get overly concerned about market movements during the summer months. Trading volume tends to be lighter and so market movements can be magnified.

But September and October frequently are months of dramatically increased volatility. The CBOE S&P 500 Volatility Index (aka, the "VIX") is a widely used metric of broad market volatility. The red arrows in the VIX chart below correspond (from left to right) to September 1998, September 2002, October 2008, September 2011 and September 2015. (The large spike at the far right was, of course, in March 2020 when the COVID-19 lockdowns began.)



Source: YCharts, data through 8/30/21. You cannot invest in an index and past performance does not guarantee future results.

The current VIX level of around 16% is a little lower than the historical average of roughly 18%–20%. That is, investors are displaying a certain level of complacency about the market. Some of that, no doubt, is the summer doldrums, some of it is the fact that the Q2 earnings season was so strong, some of it is a general belief in a global economic recovery, and some of it is optimism about the Federal Reserve (Fed) maintaining its current accommodative stance (strengthened by Fed Chair Jerome Powell's recent Jackson Hole comments) as well as the potential for additional fiscal stimulus.

But there are uncertainties out there: the evolution of the delta and other variants of the COVID-19 virus and its potential impact on schools and lockdowns, inflation potential, fragile geopolitical relationships between the U.S. and China, Russia and Iran and, of course, the events in Afghanistan (which, while fairly insignificant in terms of the global economy and markets, may potentially have an impact on consumer sentiment in the U.S.).

Bottom line—historical precedent and the current facts on the ground suggest that we may see a dramatic spike in market volatility over the next three to four months. Fortunately, we can help.

As part of our **Outcome Focused** Model Portfolio solution set, we offer three **Multifactor** Model Portfolios (U.S., Developed International and Emerging Markets). These risk-factor-diversified all-equity models are managed explicitly as complements to more broadly diversified portfolios, as a means of potentially dampening the overall portfolio volatility.

We wrote recently on the [potential benefits of risk factor diversification](#), and this is exactly what our multifactor models are designed to do. Here is our risk factor “performance quilt” through June 30:

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 YTD
Momentum (-11.18%)	Value (40.93%)	Correlation (17.01%)	Correlation (11.07%)	Value (20.76%)	Quality (13.04%)	LowVol (-24.49%)	Value (46.46%)	Quality (20.13%)	Multifactor (13.97%)	Value (16.8%)	Value (34.73%)	Correlation (20.35%)	Momentum (7.49%)	Value (16.07%)	Quality (27.01%)	LowVol (1.85%)	Quality (36.45%)	Momentum (24.89%)	Value (16.49%)
LowVol (-13.14%)	WTUSMFU (29.54%)	Multifactor (16.92%)	Quality (10.43%)	Multifactor (18.44%)	Multifactor (9.44%)	Momentum (-26.59%)	WTUSMFU (27.26%)	WTUSMFU (15.96%)	LowVol (13.73%)	WTUSMFU (16.17%)	WTUSMFU (32.78%)	Value (14.19%)	Correlation (2.92%)	LowVol (11.8%)	Size (22.75%)	Momentum (0.65%)	Size (29.48%)	Quality (24.83%)	Size (11.91%)
Multifactor (-13.72%)	Size (27.07%)	LowVol (14.67%)	Multifactor (8.59%)	LowVol (17.52%)	Correlation (9.43%)	Multifactor (-29.07%)	Quality (25.37%)	Value (13.89%)	Momentum (11.68%)	Size (15.85%)	Size (32.11%)	Multifactor (13.67%)	Size (2.72%)	WTUSMFU (11.73%)	WTUSMFU (21.95%)	Size (-3.07%)	WTUSMFU (29.04%)	Size (21.84%)	Quality (10.24%)
Quality (-14.37%)	Correlation (26.45%)	Momentum (13.18%)	Value (7.24%)	Momentum (15.75%)	Size (6.49%)	Value (-30.86%)	Size (23.27%)	Size (12.49%)	Correlation (9.94%)	Momentum (15.81%)	Correlation (29.25%)	WTUSMFU (13.14%)	LowVol (2.06%)	Size (10.99%)	Momentum (20.54%)	Multifactor (-3.91%)	Value (28.85%)	WTUSMFU (20.81%)	Multifactor (9.26%)
Correlation (-16.35%)	Momentum (20.23%)	Quality (12.04%)	WTUSMFU (6.46%)	Correlation (15.57%)	WTUSMFU (6.15%)	Quality (-31.94%)	Correlation (21.76%)	Correlation (12.06%)	Quality (5.49%)	Correlation (15.76%)	Momentum (27.29%)	Quality (13.14%)	WTUSMFU (1.35%)	Momentum (10.07%)	LowVol (19.33%)	Correlation (-4.61%)	Correlation (28.04%)	Multifactor (19.51%)	LowVol (9.04%)
WTUSMFU (-22.15%)	Quality (19.49%)	WTUSMFU (11.67%)	Size (4.45%)	WTUSMFU (15.35%)	Momentum (5.4%)	Size (-34.84%)	LowVol (17.38%)	Momentum (11.93%)	Size (2.78%)	Quality (15.4%)	Quality (26.05%)	Size (13.06%)	Multifactor (0.67%)	Correlation (6.61%)	Multifactor (19.32%)	WTUSMFU (-4.64%)	Momentum (27.01%)	Correlation (19.16%)	WTUSMFU (7.95%)
Value (-23.09%)	LowVol (18.93%)	Size (9.14%)	Momentum (2.99%)	Size (14.95%)	LowVol (1.4%)	WTUSMFU (-36.71%)	Multifactor (16.26%)	Multifactor (10.56%)	WTUSMFU (1.84%)	LowVol (13.95%)	LowVol (24.56%)	LowVol (11.39%)	Quality (-0.58%)	Multifactor (6.09%)	Value (17.61%)	Quality (-7.39%)	LowVol (25.42%)	LowVol (11.64%)	Momentum (7.76%)
Size (-23.78%)	Multifactor (16.9%)	Value (8.86%)	LowVol (2.26%)	Quality (14.08%)	Value (0.66%)	Correlation (-36.9%)	Momentum (14.77%)	LowVol (9.54%)	Value (0.29%)	Multifactor (12.82%)	Multifactor (24.18%)	Momentum (10.29%)	Value (-2.3%)	Quality (4.69%)	Correlation (16.53%)	Value (-9.29%)	Multifactor (23.75%)	Value (2.88%)	Correlation (1.5%)

Source: WisdomTree, Factset, 2021 YTD through 6/30/21. The starting universe for the referenced “factor portfolios” is the 800 largest companies listed in the U.S. Securities in the Low Correlation portfolio are selected based on their trailing 6- and 12-month correlation versus the broad market. Securities in the Low Volatility portfolio are selected based on their trailing 12-month standard deviation. Securities in the Momentum portfolio are selected based on their trailing 6- and 12-month risk-adjusted performance. Securities in the Quality portfolio are selected based on stronger current and historical (3 year) measures of profitability compared to their peers in the same GICS industry using four main variables: Return on Equity, Return on Assets, Gross Profits over Assets, Cash Flow over Assets. Securities in the Value portfolio are selected based on more attractive valuation metrics compared to their peers in the same GICS industry using six main variables: Sales-to-Price, Book-to-Price, Earnings-to-Price, Estimated Earnings-to-Price, EBITDA-to-Enterprise Value, Operating Cash Flow-to-Price. Securities in the Size portfolio are selected based on their market capitalization compared to their peers in the starting universe. Securities in the Multifactor portfolio are selected based on a composite score calculated by equally weighting their Low Correlation, Momentum, Quality and Value scores.

The point is not which factors currently are in the lead, but rather the swirling, constantly changing tapestry of leaders. Market conditions can and do change rapidly and are very difficult to predict.

That is why all WisdomTree Model Portfolios are diversified at both the asset class and risk factor levels—we believe it helps to improve the consistency of performance through various economic and market regimes.

While the three WisdomTree multifactor models can be (and are) used as stand-alone portfolios—one of our largest relationships uses the U.S. model as its core equity holding—they were designed as complementary “sleeve portfolios” to allow advisors to increase risk factor diversification without necessarily disrupting the allocations of their existing portfolios.

Additional Potential Benefits

The multifactor models offer other potential benefits beside improved factor diversification. Specifically, improved asset style diversification, better quality, lower valuations and a higher dividend yield.

Let’s look at a comparison of various metrics between the U.S. multifactor model, the S&P 500 Index, and the Russell 3000 Index:

Metric	U.S. Factor Model	S&P 500	Russell 3000
Large Cap Weight (%)	82.5	99.2	88.8
Mid Cap Weight (%)	14.9	0.8	9.2
Small Cap Weight (%)	2.57	0	2.0
Weighted Average Market Cap	342B	541B	434B
Dividend Yield (%)	1.58	1.3	1.23
Return on Assets (%)	4.81	3.63	2.9
Return on Equity (%)	19.58	16.94	13.69
Price to Earnings	20.5x	27.1x	32.4x
Forward Price to Earnings	18.2x	21.9x	23.2x

Sources: WisdomTree and FactSet, data as of 7/31/21. You cannot invest in an index and past performance does not guarantee future results. Factor model results are presented at net asset value.

You can see that the U.S. multifactor model currently is less concentrated in large-cap stocks, is trading at lower valuations (P/E and forward P/E), provides a better dividend yield, and offers an improved quality profile (ROA and ROE) in comparison to both the S&P 500 and Russell 3000 indexes.

Conclusion

As we reach the end of summer, the markets are relaxed and making Panglossian assumptions about the future (“All is for the best in this the best of all possible worlds”). But the fall historically has often slapped the market in the face with big doses of reality and volatility. Perhaps advisors and investors should consider a different approach—“plan for the worst but hope for the best.”

You can learn more about our multifactor models on our [Model Adoption Center](#) on the WisdomTree website.

Important Risks Related to this Article

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns 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. Standardized performance and 30-day SEC yields for the U.S. Factor Model Portfolio's constituent funds is available [here](#).

ETF shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times. WisdomTree Model Portfolio information is designed to be used by financial advisors solely as an educational resource, along with other potential resources advisors may consider, in providing services to their end clients. WisdomTree's Model Portfolios and related content are for information only and are not intended to provide, and should not be relied on, for tax, legal, accounting, investment or financial planning advice by WisdomTree, nor should any WisdomTree Model Portfolio information be considered or relied upon as investment advice or as a recommendation from WisdomTree, including regarding the use or suitability of any WisdomTree Model Portfolio, any particular security or any particular strategy. In providing WisdomTree Model Portfolio information, WisdomTree is not acting and has not agreed to act in an investment advisory, fiduciary or quasi-fiduciary capacity to any advisor or end client, and has no responsibility in connection therewith, and is not providing individualized investment advice to any advisor or end client, including based on or tailored to the circumstance of any advisor or end client. The Model Portfolio information is provided "as is," without warranty of any kind, express or implied. WisdomTree is not responsible for determining the securities to be purchased, held and/or sold for any advisor or end client accounts, nor is WisdomTree responsible for determining the suitability or appropriateness of a Model Portfolio or any securities included therein for any third party, including end clients.

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