Global Equities: Ratcheting up Downside Protection

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Key Takeaways

- The WisdomTree Target Range Fund (GTR) looks to hedge risk while allowing investors to participate in equity market gains, making it a potentially valuable addition to diversified portfolios.
- GTR's use of options strategies, coupled with Treasury investments, provides the potential to participate in the growth of equity markets with limited downside protection over the course of an annual period.
- Recent resets in GTR's options on U.S. large caps, small caps and emerging markets highlight its ability to lock in gains and manage risk as market conditions evolve.

When equities are in a bull market, it is easy to forget about the pain of loss, but the risk of significant loss can be part and parcel of investing. Many investors do not have the risk tolerance to take on 100% equity risk. To offset that risk, investors have primarily used bonds to create balanced or moderate risk levels. However, simply diversifying only amongst stocks and bonds can fall short in some market cycles and fail to cover certain risks, as we experienced in 2022, when rising bond yields and falling equity prices made for a challenging year for almost every type of traditional asset.

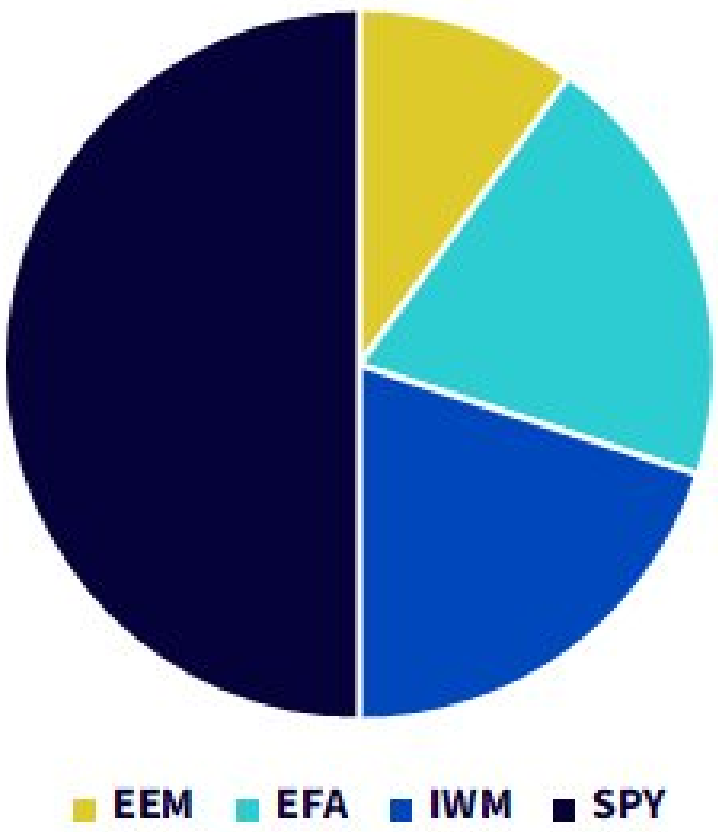
Fortunately, there are options for further diversification. WisdomTree worked with Valmark1 back in 2021 to provide a new solution to help investors achieve long-run portfolio objectives while targeting an explicit floor on their investment losses. The WisdomTree Target Range Fund (GTR) is a unique tool that may be used to enhance a diversified portfolio, providing benefits not available through simple stock/bond diversification.

Target Range Refresh

GTR provides exposure to an allocation of U.S. large caps (SPY), U.S. small caps (IWM), developed market equities (EFA) and emerging market equities (EEM) in similar proportions to how many investors diversify globally. However, instead of simply owning equities outright, GTR buys one-year call options on each underlying ETF at the start of the year that are 15% in-the-money and sells one-year call options that are 15% out-of-the money—while the remainder of the Fund is allocated to a collateral account invested in fixed income instruments. Should markets decline, the Fund's maximum annual loss or "floor" is the amount of capital invested in the call options—minus any proceeds received from selling options to offset the cost.

Assuming the options cost 15 cents to acquire (15% in the money options), 85 cents of every dollar invested in the Fund is in cash instruments. Of note, the roughly 85 cents invested in collateral, primarily Treasury bills, is now adding considerable value compared to when the ETF launched more than three years ago in a lower interest rate environment. While some investors may shy away from options strategies due to the lack of opportunity for dividends or interest, GTR currently has a 30-day SEC yield of more than 3%1, driven by the interest from the collateral investments. This helps complete the unique story of GTR providing upside participation, limited downside protection and income.

WisdomTree Target Range Fund (GTR)



Sources: WisdomTree, Valmark, as of 9/30/24.

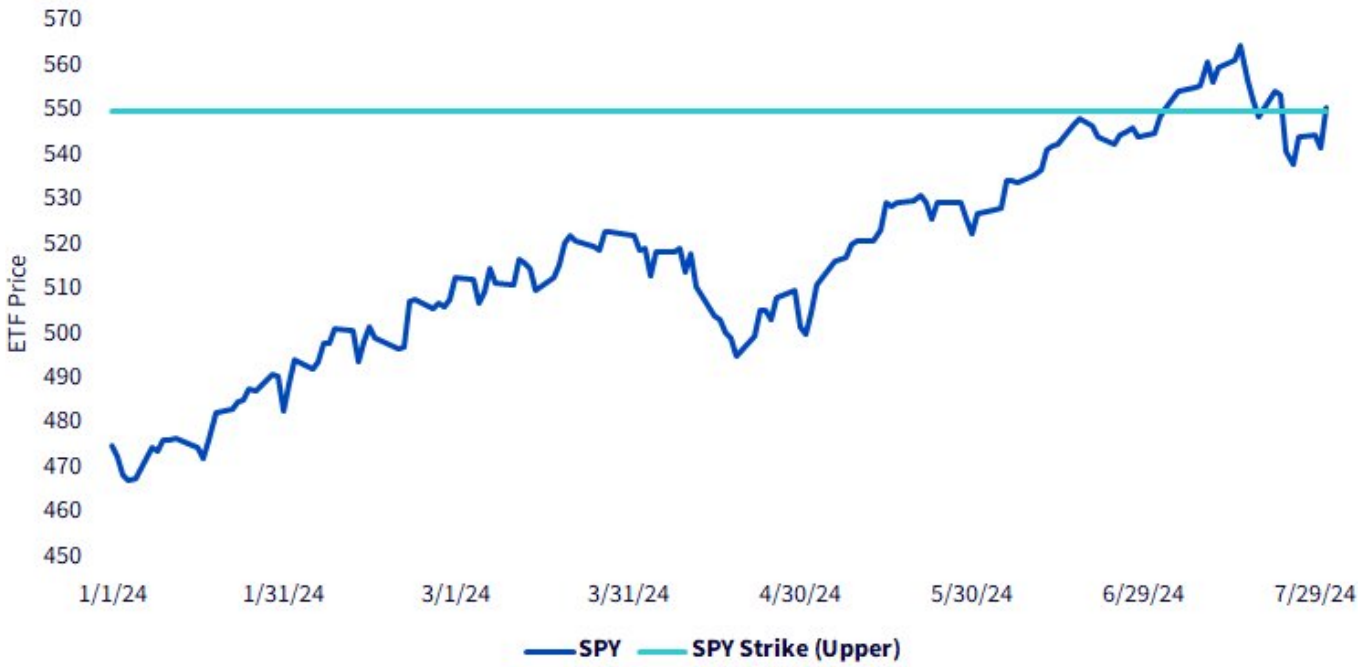
Locking in Gains

When we first launched GTR back in 2021, a key question on investors' minds was what happens to the Fund's downside management if markets rally over the next year before the reset. In theory, an investor could purchase the Fund when markets are higher and expose themself to a higher beta strategy (with more significant downside risk) than an investor who owned it in January. To potentially offset this issue, we decided to create a mechanism whereby investors could lock in gains and ratchet up the "floor" of the strategy. Fortunately, after a strong start to the year, positions in U.S. large caps and small caps were both reset on August 1. On October 1, the options positions in EEM were also restruck to lock in gains.

Restrike in U.S. Large Caps

After a modest correction in April, positions in SPY rallied strongly as expectations for Fed rate cuts were brought forward. As a result, SPY closed the month of July above the strike price of 550. Also as a result, GTR rolled its options to lock in gains and bought calls at 470 and sold calls at 635.

ETF Price vs. Upper Strike Price (SPY)

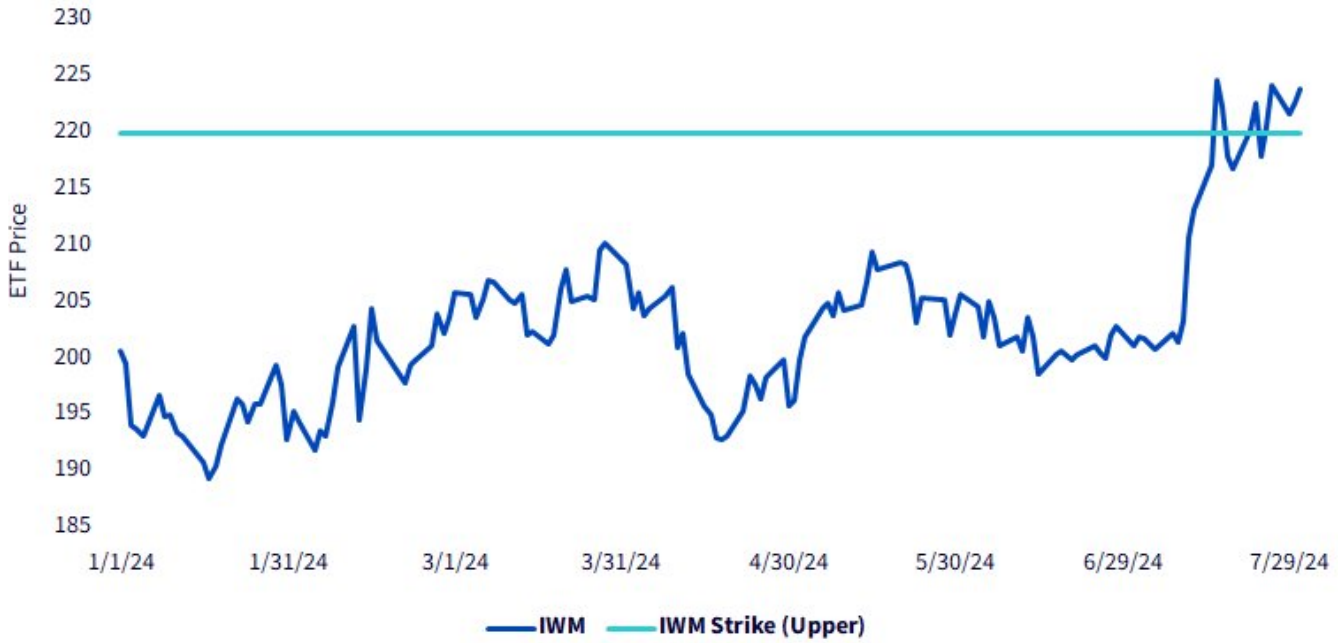


Source: WisdomTree, as of 8/1/24. Past performance does not guarantee future results.

Restrike in U.S. Small Caps

While large caps showed a steady rise, U.S. small caps rallied abruptly due to falling longer-term interest rates. Since small caps tend to be more interest rate-sensitive, the options were rolled into long calls at 191 and short calls at 260. With the benefit of hindsight, we know that taking chips off the table was a smart move, as rates have headed higher and small caps have fallen back below the original upper strike price of 220.

ETF Price vs. Upper Strike Price (IWM)

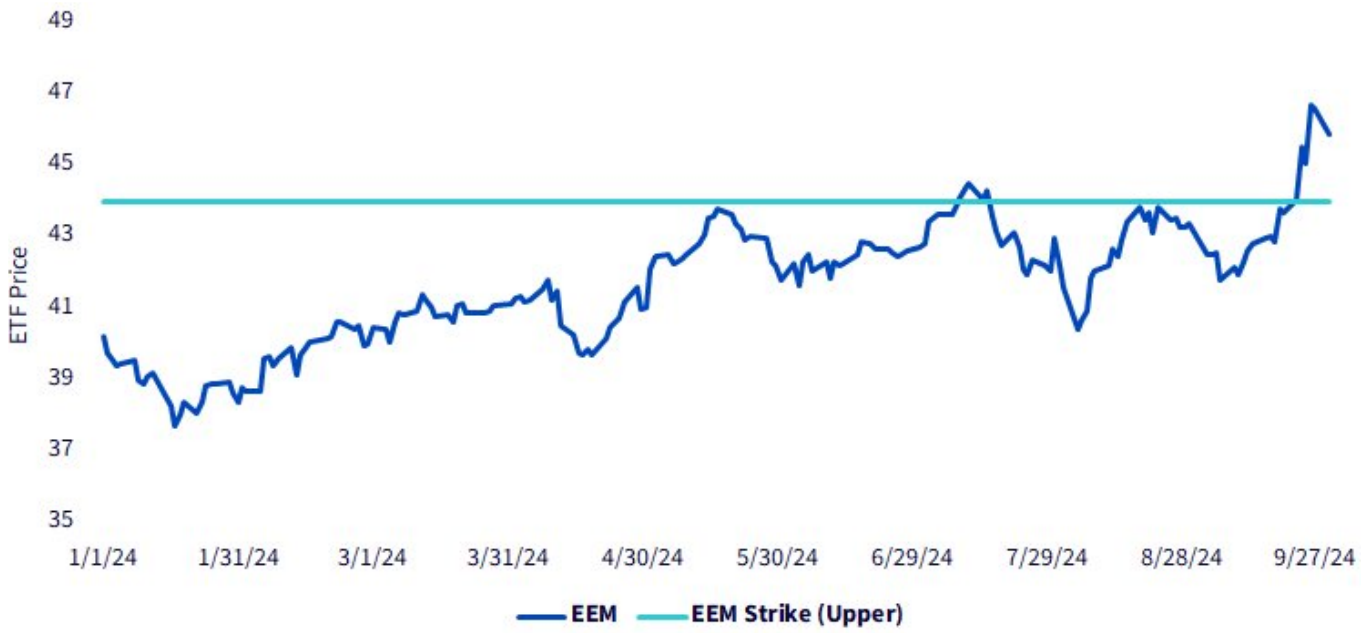


Source: WisdomTree, as of 8/1/24. Past performance does not guarantee future results.

Restrike in Emerging Markets

Finally, in emerging markets, the big story was China announcing stimulus to help stabilize its economy and markets. While not as violent as the rally seen in small caps, Chinese equities pushed broader markets higher, triggering an option reset above 44. On October 1, GTR opened new long call positions at 39 and short calls at 53. While emerging markets remain above the original strike price, concerns about the lasting impact of China's policy announcements have caused markets to retrace.

ETF Price vs. Upper Strike Price (EEM)



Source: WisdomTree, as of 10/1/24. Past performance does not guarantee future results.

Conclusion

While GTR does not necessarily aim to capture 100% of equity market upside, we believe the flexibility built into the methodology to take chips off the table can have a meaningful impact on helping investors compound returns. While the path of markets remains uncertain, we believe strategies like GTR that have clearly defined downside management could add significant value to investor portfolios. We have witnessed advisors using GTR as a long-term strategic holding in a diversified portfolio, a risk management tool, a way to fund a specific goal and a way to get defined risk equity exposure with income.

1 **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 Fund prospectus, please click here.**

Important Risks Related to this Article

For current holdings of GTR, please click here. Holdings are subject to risk and change.

The Fund is actively managed and implements a strategy similar to the methodology of the TOPS® Global Equity Target Range™ Index (the “Index”), which seeks to track the performance of a cash-secured call spread option strategy. There can be no assurance that the Index or the Fund will achieve its respective investment objectives or that the Fund will successfully implement its investment strategy. Moreover, while the Fund seeks to target returns within a prescribed range, thereby minimizing downside investment loss, there can be no guarantee that an investor in the Fund will experience limited downside protection, particularly short-term investors, investors that seek to time the market and/or investors that invest over a period other than the annual period. The Fund’s options strategy will subject Fund returns to an upside limitation on returns attributable to the assets underlying the options. The Fund’s investments in options may be subject to volatile swings in price influenced by changes in the value of the underlying ETFs or other reference asset. The return on an options contract may not correlate with the return of its underlying reference asset. The Fund may utilize FLEX Options to carry out its investment strategy. FLEX Options may be less liquid than standard options, which may make it more difficult for the Fund to close out of its FLEX Options positions at desired times and prices. The Fund’s use of derivatives will give rise to leverage, and derivatives can be volatile and may be less liquid than other securities. As a result, the value of an investment in the Fund may change quickly and without warning, and you may lose money. Investment exposure to securities and instruments traded in non-U.S., developing or emerging markets can involve additional risks relating to political, economic or regulatory conditions not associated with investments in U.S. securities and more developed international markets. These and other factors can make investments in the Fund more volatile and potentially less liquid than other types of investments. Please read the Fund’s prospectus for specific details regarding the Fund’s risk profile.