Global Trade's New Fault Lines: Positioning Portfolios for a Fractured World

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Key Takeaways

- The U.S. has been structurally rewiring trade away from China since Trump's first term—first with tariffs, then through Covid lockdowns and now through tariffs again.
- Japan's exports to the U.S. rose 3.1% year over year in March. The country is neck-and-neck with India for the rank of Trump's most preferred Asian trade ally.
- The VIX volatility index spiked to 60 a few weeks back. Though we expect continued elevated volatility, history rewards contrarians who engage risk assets amid panics.
- The Fed is skewed toward rate cuts, but its timing and magnitude are data-dependent.

China: Trade Risk amid Stimulus

The U.S. represents 15% of China's total exports, or a couple percentage points less than the norm during Trump 1.0. The country has some cards that it has been able to play in recent months. For one, last autumn the state announced a $1.4 trillion stimulus plan that was designed to clean up its local government debt burden. Additionally, just a few weeks ago, $72 billion was injected into a handful of state-run banks to shore up systemic liquidity. There may be room for more stimulus measures too; deflation is that country's primary risk.

These actions may not be enough. Even though Treasury Secretary Scott Bessent has guided the market toward de-escalation in the Sino-U.S. rift, Sam's geopolitically risk-aware models remain skeptical that we are all clear on this front; we maintain under-weight allocations to China in most of our asset allocations.

Japan & India: Still Live Plays

Next door is another story. We are decidedly bullish Japan. Jeff has been talking about that country's expansion of its 401(k)-style retirement program for a few years now. It is a bullish thesis that plays out if Japanese retail truly embraces ownership of the country's equities.

On Japan's trade front, some of the strength in the March print on exports to the U.S. may reflect front-loading ahead of tariff changes, but the 3.1% YoY growth rate is still encouraging.

India is a tech/pharma linchpin, bolstered by warm relations with the EU and its membership in the Quad Security Dialogue with Japan, Australia and the U.S. The IMF just cut the country's GDP forecast to 6.2% for 2025, but we view that as not half bad. With the "R" word—recession—on so many lips, if a country like India can post growth of that kind in this backdrop, that is more than satisfactory for allocators.

India shows up in our Actionable Ideas, though we want to make it clear that our bullishness with regard to the country is heavily due to the Sino-U.S. situation, not valuations. At the close of the quarter, MSCI India was trading for 23 times forward earnings. The WisdomTree India Earnings Fund (EPI) was changing hands at 17 times. We think that six-point spread makes a strong case for our earnings-weighting methodology for those who blush at the country's valuation.

Floating Rate Notes: A Volatility Shield

With the VIX at approximately 35, volatility may prove thematic as 2025 ages. Treasury floating rate notes (FRNs) offer stability. We have consistently emphasized their role in portfolio risk mitigation, especially now that bonds' inverse correlation with stocks is no longer a foregone conclusion. The WisdomTree Floating Rate Treasury Fund (USFR) has beaten aggregate bonds over the last 3-, 5- and 10-year windows, with cash-like volatility. Its 30-day SEC yield is 4.24%.

The VIX Hit 60

April's VIX spike to 60 was one of the largest in recent memory—but history says such panics tend to signal buying windows, not the continuation of bear markets.

We looked back at all episodes where the VIX closed north of 40 since its creation in 1990. Of the 13 surges, 10 of them led to 12-month gains. Across all 13, the median gain in the year after the observation was 25.1%. The worst experience is the year after markets reopened on September 17, 2001, when the S&P 500 lost 14.6% through September 17, 2002.

But when we take the sample set as a whole, panics like this signal opportunity, not collapse.

The S&P 500's swoon has taken it from an all-time high of 6,147 in mid-February to 5,288. Using FactSet's bottom-up consensus estimate of $267 for calendar 2025, that puts the market's multiple at 19.8 times forward earnings, down from 23 or so before trouble struck.

Using forward earnings ex-negatives, our Director of Model Portfolios, Joe Tenaglia, finds the S&P 500's valuation z-score to be 1.5 standard deviations above the historic norm; in contrast, the small-cap S&P 600 is 1.3 standard deviations below it.

Similarly, when we pulled the DataStream aggregation of U.S. small caps on reported earnings for 2024, the group trades at a 26% discount to large caps, a valuation gap we've only seen a few times in the last half century. One of those times was in the late 1990s—and what followed was more than a decade of small-cap dominance throughout the 2000s.

This valuation dispersion is too important to ignore; we are bullish small caps.

The Fed Remains in Wait and See Mode

The Fed's policy is skewed toward more rate cuts as 2025 progresses, but the timing and magnitude are data-dependent. In our view, the Fed looks poised to take a cautious approach. The market anticipates three to five quarter-point reductions, up from a cut or two when the year kicked off.

Equity longs are engaging a market where some risk has already been taken off the table in credit; for example, the ICE BofA US High Yield Index Option-Adjusted Spread got as narrow as 259 basis points (bps) in January and has recently widened out to 416bps. That tells us that much or all of the post-election froth in risk assets has been boiled off.

What Advisors Are Hearing from Us

Many have approached us about using the sell-off to increase international equity positions, but there is a clear aversion to China in the advisor community. For these investors, we have the WisdomTree Emerging Markets ex-China Fund (XC). By nature of putting China at zero, XC enables a natural over-weight in India.

Quality for trouble (WisdomTree U.S. Quality Dividend Growth Fund (DGRW)): We are starting to get some seasoned track records around here. DGRW has shown a lower beta tendency over time; both its up capture and down capture relative to the S&P 500 are 93% in the 10 years through March. In 2025, the S&P 500 is down 12.0%, while DGRW is off 8.6%.

With bonds deciding they may no longer adequately hedge equity risk, there is some consternation about the staying power of the 60/40 stock/bond framework. For investors who are concerned that stocks and bonds could sell off in tandem, we come back to the VIX sitting in the 30s as we point to the WisdomTree Equity Premium Income Fund (WTPI). Because it employs a put-writing strategy, WTPI tends to miss out on chunks of the stock market's upside; the options premiums buffer the pain when markets decline.

Our Views

Our playbook leans into the durable—value with downside protection, quality screens and dividend consistency. We also like small caps on valuation. Japan presents a valuation case as it (successfully) reforms its capital markets and attempts to will retail investors into Japanese equity funds. We think India is going to lay pleasant surprises on this market on the trade front this spring.

Finally, we love the put-writing angle when the VIX is up here in the 30s. The last quarter century has seen many similar spikes on news flow that we believe—and believed—was a lot more dire than most of what we are seeing in 2025. For anyone who raised cash in the last few weeks, now is the time to put it to work.

Important Information and Risks Related to this Article

Unless otherwise stated, all data through 4/22/25.

There are risks associated with investing, including the possible loss of principal. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

EPI: Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. This Fund focuses its investments in India, thereby increasing the impact of events and developments associated with the region which can adversely affect performance. Investments in emerging, offshore or frontier markets such as India are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. As this Fund has a high concentration in some sectors, the Fund can be adversely affected by changes in those sectors. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs.

USFR: Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but may decline in value. Fixed income securities will normally decline in value as interest rates rise. The value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs.

DXJ: Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in Japan, thereby increasing the impact of events and developments in Japan that can adversely affect performance. Investments in currency involve additional special risks, such as credit risk, interest rate fluctuations and derivative investments, which can be volatile and may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

XC: Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks. The Fund's investment strategy limits the types and number of investment opportunities available and, as a result, the Fund may underperform other funds. The Fund's exposure to certain sectors, countries or regions may increase its vulnerability to any single economic or regulatory development related to such sector, country or region. The Fund is non-diversified, as a result, changes in the market value of a single security could cause greater fluctuations in the value of Fund shares than would occur in a diversified fund. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. 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.

DGRW: Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

WTPI: The Fund will invest in derivatives, including S&P 500 Index put options ("SPX Puts"). Derivative investments can be volatile, and these investments may be less liquid than securities, and more sensitive to the effects of varied economic conditions. The value of the SPX Puts in which the Fund invests is partly based on the volatility used by market participants to price such options (i.e., implied volatility). The options values are partly based on the volatility used by dealers to price such options, so increases in the implied volatility of such options will cause the value of such options to increase, which will result in a corresponding increase in the liabilities of the Fund and a decrease in the Fund's NAV. Options may be subject to volatile swings in price influenced by changes in the value of the underlying instrument. The potential return to the Fund is limited to the amount of option premiums it receives; however, the Fund can potentially lose up to the entire strike price of each option it sells. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs.