

Investing for Better Risk Adjusted Returns

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In the asset management industry, assets often follow performance. Funds that beat their benchmarks and the vast majority of their peers tend to have an edge in attracting investor interest and new inflows into their strategies. But investors, and the financial professionals who serve them, also need to be mindful of what risks are taken to generate stellar performance if and when it occurs. For example, sometimes active managers will use leverage. Sometimes active managers will drift from their defined investment style. Others, including index-based strategies, will concentrate holdings in a narrow list of names or a narrow group of sectors. This can result in a fund having a much higher level of volatility than that of the market, which raises the question, after one adjusts for that extra level of risk, was any additional return achieved?

When evaluating investment strategies, investors also need to be mindful of how much risk an investment manager takes. For many investors, the best measure of this risk is the annualized volatility embedded in the strategy that will impact its risk-adjusted return. This is typically done by measuring the standard deviation of the fund's returns, and then measuring returns based upon the risk that was taken. The Sharpe ratio, named after Nobel Prize winner William Sharpe, is one such way to measure return per unit of risk.

Recently, we highlighted how several of WisdomTree's U.S. dividend-weighted exchange-traded funds (ETFs) [beat at least 95% of their peer group over the past five years](#). What makes that performance especially compelling is that those higher returns were generated while WisdomTree's ETFs exhibited *lower* volatility than their cap-weighted peers. Usually, higher returns are associated with higher risk. But when one dividend-weights the market, we often see higher returns generated with less risk, as measured by both beta and the standard deviation of returns. For standardized returns of WisdomTree ETFs [click here](#).

Risk-Adjusted Returns, WisdomTree U.S. Dividend-Weighted Indexes and ETFs, 2011–2016

Fund/Index	Summary Statistics 7/1/2011- 6/30/2016					
	Ticker	Std Dev (%)	Beta	Alpha (%)	Sharpe Ratio	Correlation
WisdomTree Total Dividend Fund	DTD	10.66	0.82	2.61	1.15	0.96
WisdomTree Dividend Index		10.69	0.82	2.92	1.18	0.96
Russell 3000 Value Index		12.73	1.00	-0.40	0.87	0.98
Russell 3000 Index		12.55	1.00	0.00	0.92	1.00
WisdomTree LargeCap Dividend Fund	DLN	10.53	0.84	1.85	1.15	0.96
WisdomTree LargeCap Dividend Index		10.56	0.84	2.12	1.18	0.96
Russell 1000 Value Index		12.57	1.02	-0.85	0.90	0.98
S&P 500 Index		12.10	1.00	0.00	0.99	1.00
WisdomTree MidCap Dividend Fund	DON	12.26	0.82	4.62	1.11	0.96
WisdomTree MidCap Dividend Index		12.27	0.82	4.91	1.13	0.96
Russell Midcap Value Index		13.33	0.91	1.92	0.87	0.98
S&P MidCap 400 Index		14.39	1.00	0.00	0.73	1.00
WisdomTree SmallCap Dividend Fund	DES	14.51	0.84	4.61	0.82	0.96
WisdomTree SmallCap Dividend Index		14.55	0.84	4.68	0.83	0.96
Russell 2000 Value Index		15.84	0.94	0.22	0.51	0.99
Russell 2000 Index		16.58	1.00	0.00	0.50	1.00
WisdomTree High Dividend Fund	DHS	9.77	0.66	6.04	1.41	0.85
WisdomTree High Dividend Index		9.80	0.66	6.44	1.45	0.84
Russell 1000 Value Index		12.57	1.00	0.00	0.90	1.00

Sources: WisdomTree, Zephyr StyleADVISOR, as of 6/30/16. Std Dev = Standard Deviation. Data calculated using NAV prices. Past performance is not indicative of future results. You cannot invest directly in an index.

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. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree 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. EST 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.

Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

For definitions of terms and indexes in the chart visit our [glossary](#).

- The table above quantifies how, over the last five years, each of WisdomTree's U.S. dividend indexes and the ETFs that track them generated higher risk-adjusted returns, based on the Sharpe ratio, than were generated by their comparable cap-weighted benchmark.
- In every case, the beta for both the WisdomTree Index and its corresponding ETF over the past five years was lower than its market benchmark, ranging from .66 to .84.
- In every case over the last five years, all five dividend-weighted indexes and the WisdomTree ETFs that track them exhibited lower standard deviation compared to their benchmark peers, ranging from 1.5 to 2.8 percentage points less annualized volatility.

Stocks, as an asset class, are typically more volatile than bonds. So reducing the volatility of one's equity exposure can help investors remain invested in equities for the long term. One strategy that may potentially reduce volatility is to select stocks that have lower beta, lower annualized volatility or lower correlations relative to the broader market. Another way is to tilt the portfolio toward the lower correlating sectors of the market, which often have been the more defensive sectors of the market—utilities, telecom, consumer staples and health care. Using more mature, dividend-paying companies—and then weighting them by the dividends they pay—is another way one can typically tilt indexes and ETFs that track them toward the more defensive, lower correlating sectors of the market. Certainly, that has been true over the past five years. Combining less correlated sectors or asset classes in a diversified portfolio may help to reduce overall volatility.

Another way to view the reduction in volatility that occurred with WisdomTree's dividend-weighted ETFs is to see how they performed in months when their cap-weighted benchmark indexes generated positive returns and in months when those returns were negative. In the table below, over the last five years, we see in the size segments of the markets that the WisdomTree ETFs have consistently captured between 88% and 91% of their benchmark's upside, while typically capturing between 71% and 84% of the downside. In the case of the [WisdomTree High Dividend Fund \(DHS\)](#), the Fund was able to capture 79.5% of the upside of the Russell 1000 Value Index, while helping to protect investors in down markets, capturing just 53.4% of the Russell 1000 Value Index's downside, from 2011 through 2016.

Fund/Index	Ticker	Up/Down Capture 7/1/2011-6/30/2016							
		# of Months		Average Monthly Return (%)		1-Year (%)		Market Benchmark (%)	
		Up	Down	Up	Down	Best	Worst	Up Capture	Down Capture
WisdomTree Total Dividend Fund	DTD	40	20	2.72	-2.39	28.03	-5.68	90.10	81.37
WisdomTree Dividend Index		40	20	2.75	-2.37	28.59	-5.43	91.28	80.73
Russell 3000 Value Index		40	20	2.97	-3.10	32.69	-9.73	100.65	104.03
Russell 3000 Index		39	21	3.01	-2.78	33.55	-7.84	100.00	100.00
WisdomTree LargeCap Dividend Fund	DLN	40	20	2.70	-2.37	28.17	-5.58	89.61	84.09
WisdomTree LargeCap Dividend Index		40	20	2.72	-2.36	28.57	-5.32	90.72	83.56
Russell 1000 Value Index		39	21	3.04	-2.89	32.71	-9.41	101.36	106.83
S&P 500 Index		39	21	2.99	-2.65	32.39	-6.19	100.00	100.00
WisdomTree MidCap Dividend Fund	DON	41	19	2.93	-2.75	32.96	-5.58	90.39	71.41
WisdomTree MidCap Dividend Index		42	18	2.88	-2.87	33.25	-5.21	91.22	70.70
Russell Midcap Value Index		40	20	3.05	-3.11	33.91	-11.72	94.27	87.09
S&P MidCap 400 Index		38	22	3.30	-3.19	33.50	-9.99	100.00	100.00
WisdomTree SmallCap Dividend Fund	DES	38	22	3.51	-3.24	39.16	-9.07	88.08	73.15
WisdomTree SmallCap Dividend Index		37	23	3.61	-3.10	38.76	-8.94	88.61	73.38
Russell 2000 Value Index		37	23	3.58	-3.79	37.60	-13.35	92.81	94.11
Russell 2000 Index		35	25	3.95	-3.64	40.99	-14.97	100.00	100.00
WisdomTree High Dividend Fund	DHS	36	24	2.95	-1.61	27.53	-2.97	79.51	53.43
WisdomTree High Dividend Index		36	24	2.99	-1.59	28.08	-2.62	80.78	52.47
Russell 1000 Value Index		39	21	3.04	-2.89	32.71	-9.41	100.00	100.00

Sources: WisdomTree, Zephyr StyleADVISOR, as of 6/30/16. Data calculated using NAV prices. Past performance is not indicative of future results. You cannot invest directly in an index.

Conclusion

WisdomTree's dividend-weighted ETFs have outperformed the vast majority of passive and active managers in their peer group over the past five years. But they have also done so over that period with lower beta, lower volatility, and therefore higher risk-adjusted returns than their comparable cap-weighted indexes. In the U.S., WisdomTree has shown that risk and return are not necessarily joined at the hip. Put

another way, it can be possible to generate higher returns than capitalization-weighted indexes while also lowering volatility. Over the last five years, WisdomTree proved it in every major size segment of the U.S. market.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

Diversification does not eliminate the risk of experiencing investment losses.