

Let the Good Times Roll

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Scott Welch, CIMA ®

Chief Investment Officer, Model Portfolios

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.

Let the good times roll

Let them knock you around

Let the good times roll

Let them make you a clown

Let them leave you up in the air

Let them brush your rock and roll hair

Let the good times roll

Let the good times roll, oh

Let the good times roll

(From “[Let the] Good Times Roll” by The Cars, 1978)

Investment Themes for 2021

As described in a previous blog post, WisdomTree has identified [five primary investment themes](#) that we believe have a high probability of playing out over the course of 2021 and beyond—emerging markets, reflation, quality and income, disruptive growth and cyclical rotation.

In this blog piece, we will take a deeper look into this last theme—cyclical rotation. We’ve blogged before that coming out of a [recession, value, small-cap and emerging market stocks historically have outperformed](#). Let’s take a quick look at how that “cyclical rotation” trade has played out over time. We’ll begin with emerging markets:



Source: YCharts, data as of 3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

While the S&P 500 Index has outperformed EM on a cumulative basis since 1990, we see specific periods of time when EM outperformed—typically aligned with the U.S. coming out of recession (the gray bars in the chart).

The current outperformance is more clearly visible if we look at relative performances since the beginning of Q3 2020.



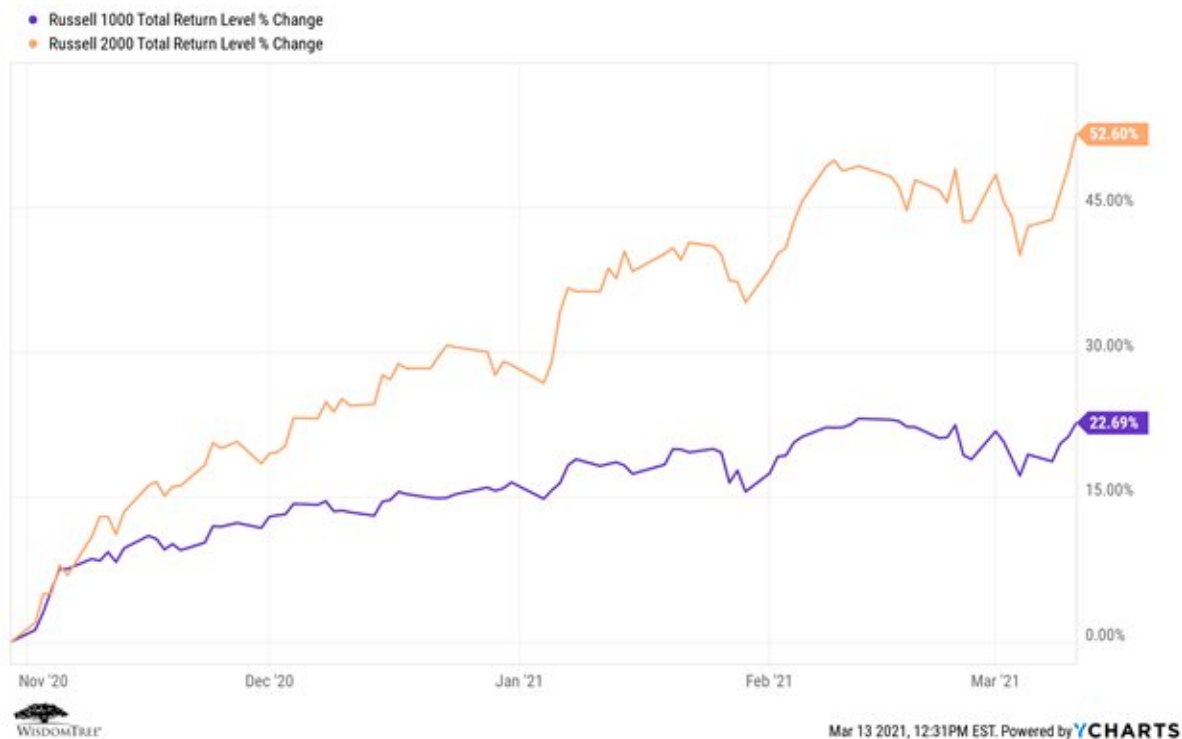
Source: YCharts, data range from 7/1/20–3/2/21. You cannot invest in an index, and past performance does not guarantee future results.

How about small-cap stocks? Let's start with historical performance. We again see that small-cap stocks tend to lead as the U.S. comes out of recession:



Source: YCharts, data as of 3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

The bounce back for small-cap stocks in the U.S. has been especially pronounced since the announcement of the Pfizer COVID-19 vaccine back in early November:



Source: YCharts, data range from 11/1/20–3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

Nor is this strictly a U.S. phenomenon. Here is a comparison of developed international (“EAFE”) small-cap versus large-cap stocks since the beginning of Q3 2020:



Source: YCharts, data range from 7/1/20–3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

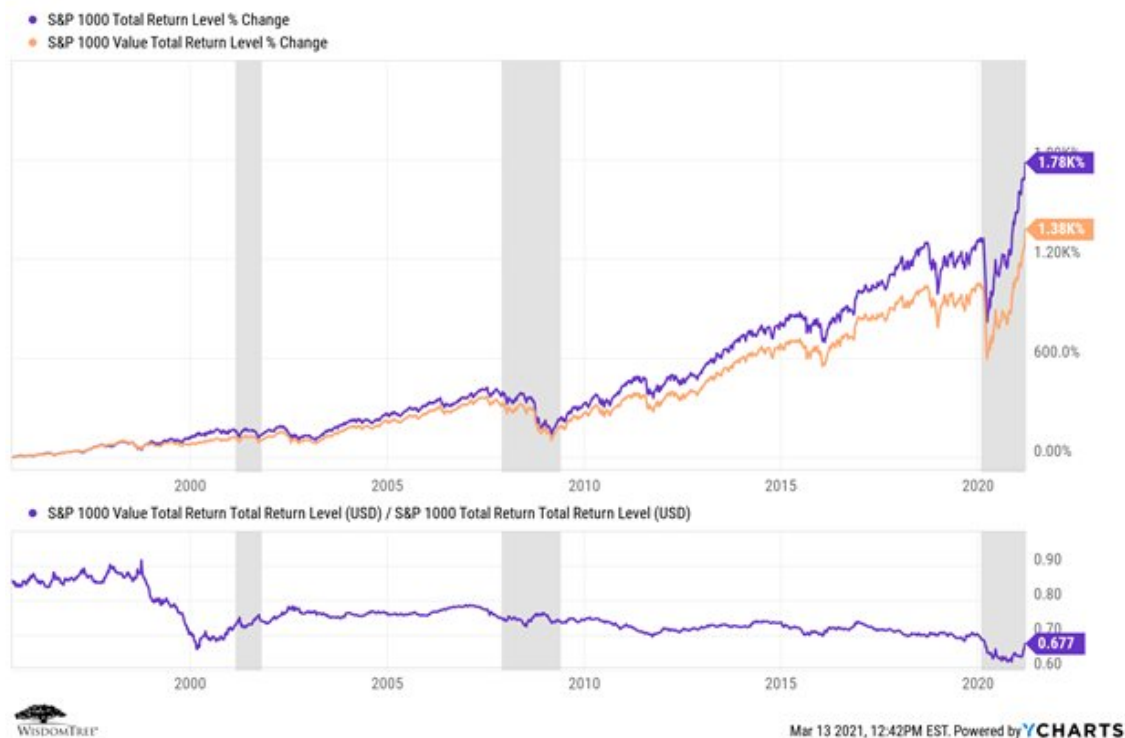
When investing in small-cap stocks, we believe that quality should be an essential screen, given the growing number of “zombie” companies that occupy the small-cap space—companies that are barely generating enough cash flow to cover interest expenses and rely instead on borrowing and other sources of financing to stay afloat.

Finally, let’s look at the performance of value stocks versus the broader market, first historically and then since the beginning of Q3 2020. The picture is somewhat distorted by the incredible outperformance of growth stocks since roughly 2010.



Source: YCharts, data as of 2/7/21. You cannot invest in an index, and past performance does not guarantee future results.

But we see that value stocks have outperformed since the beginning of Q3 2020:



Source: YCharts, data range from 7/1/20–3/12/21. You cannot invest in an index, and past performance does not guarantee future results.

Model Portfolio Implications

At a strategic level, all of the [WisdomTree Model Portfolios](#) have certain common characteristics:

1. Relative to the MSCI ACWI Equity Index (our global equity benchmark), our core equity model is **over-weight** in the U.S. and EM, and **under-weight** in developed international (“EAFE”). This model can be (and is) used as a stand-alone model, and it is also a fundamental “building block” to our various strategic multi-asset models;

2. Also relative to the MSCI ACWI Index, we are **over-weight** in small cap and value stocks. The WisdomTree product set tends to “tilt” this way, based on the various screens we apply to our underlying Indexes. So, even though all our models are “open architecture” in that they include both WisdomTree and third-party strategies, we will normally have inherent small-cap and value tilts to our portfolios.

Furthermore, all the WisdomTree small-cap strategies, across all geographies, have a quality screen—they seek to identify companies with strong balance sheets, profitability and cash flow. This is tangible in our core equity model, where we deploy [DGRS](#), our small-cap quality dividend growth strategy, as our U.S. small-cap allocation, [DLS](#), our International (“EAFE”) SmallCap Dividend Fund, as our international small-cap allocation, and [DGS](#), our Emerging Markets SmallCap Dividend Fund, as our EM small-cap allocation. All three carry explicit quality (“anti-zombie”) screens.

3. Within our core fixed income model, which is both a stand-alone model and a fundamental building block of our various multi-asset models, we recently added an allocation to [ELD](#), our emerging markets local

currency debt strategy. This position aligns well with our both our “cyclical rotation” and our “emerging markets” investment themes¹.

Conclusion

We believe the cyclical rotation back toward small cap, value and emerging markets has “legs” —that is, we believe it will remain in place throughout 2021, and perhaps beyond. We believe this for several reasons:

1. We think the continued rollout of COVID-19 vaccinations, combined with massive fiscal stimulus, will drive a significant economic recovery in the U.S. in the second half of the year. Historically, this “phase” of the economic cycle is when the small-cap, value and emerging markets “[risk factors](#)” have performed well.

2. We are not “anti-growth,” by any means. Growth continues to perform quite well, and one of our primary investment themes for 2021 is the continuation of a “[disruptive growth](#)” trend. But the performance and valuation differential between growth and value stocks and between small-cap and large-cap stocks had grown to historically wide levels. Since the markets historically have exhibited “reversion to the mean” tendencies, we believe this current cyclical rotation back toward small cap, value and emerging markets still has significant room to run.

If we are correct in our outlook, we believe our Model Portfolios are well-positioned to take advantage of and capitalize on what we believe will be significant “tailwinds.” It’s a nice feeling to have the wind at your back and to “let the good times roll.”

¹Model portfolio allocations are subject to change and should not be considered investment advice.

Important Risks Related to this Article

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