Reflation, Flation, What's Your Nation?

Published February 24, 2021

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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.

Conjunction Junction, what's your function?

I got "and," "but," and "or,"
They'll get you pretty far…

Conjunction Junction, how's that function?
I like tying up words and phrases and clauses

(From "Conjunction Junction," School House Rock, 1973)

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:

- Cyclical rotation back toward small-cap, value and emerging market stocks;
- Emerging markets, both in equity and fixed income;
- A focus on quality and income, both in equity and fixed income;
- Disruptive growth; and
- Reflation (higher-than-expected inflation in the second half of the year)

In this blog piece, we want to take a deeper look into this last theme—**reflation**.

While official inflation indicators, such as the Consumer Price Index and the Personal Consumption Expenditures Price Index, are not yet showing any signs of a re-emergence of inflation, the U.S. bond market is preparing for a potential shift in the pricing outlook. In our "Inflate-Gate? Don't Tell That to the Bond Market" blog post a couple of weeks ago, we highlighted how inflation expectations have been noticeably on the rise thus far in 2021.

Source: St. Louis Federal Reserve Bank (FRED), data through 2/10/21.

In addition, investors have witnessed rising price trends in purchasing managers' surveys and, perhaps more importantly, in actual commodities. According to data from the International Monetary Fund, the Global Price Index of All Commodities has experienced a rather noticeable V-shaped recovery of its own, finishing 2020 at its highest level in more than two years… And guess what? According to real-time commodity gauges, both futures and spot prices have continued this ascending trajectory here into the first two months of the new year.

Source: St. Louis Federal Reserve Bank (FRED), data through 2/16/21.

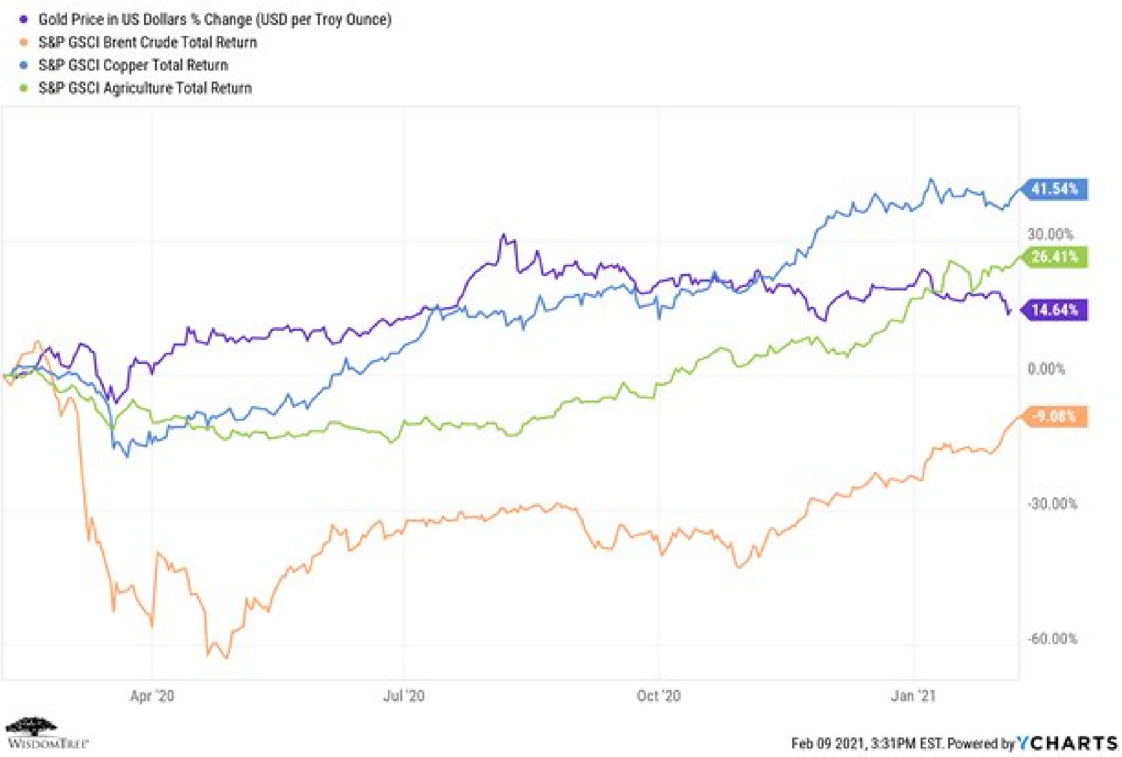
Product and Portfolio Implications

As we discussed a few weeks ago, WisdomTree offers a variety of fixed income product strategies that can help navigate inflation/interest rate risks. Another approach would be to focus exclusively on the commodity sector.

WisdomTree recently completed the reorganization of the WisdomTree Continuous Commodity Index Fund into the WisdomTree Enhanced Commodity Strategy Fund (GCC). The Enhanced Commodity Strategy Fund is organized under the Investment Company Act of 1940, as amended, with no Schedule K-1 that provides broad exposure to a diversified basket of commodities.

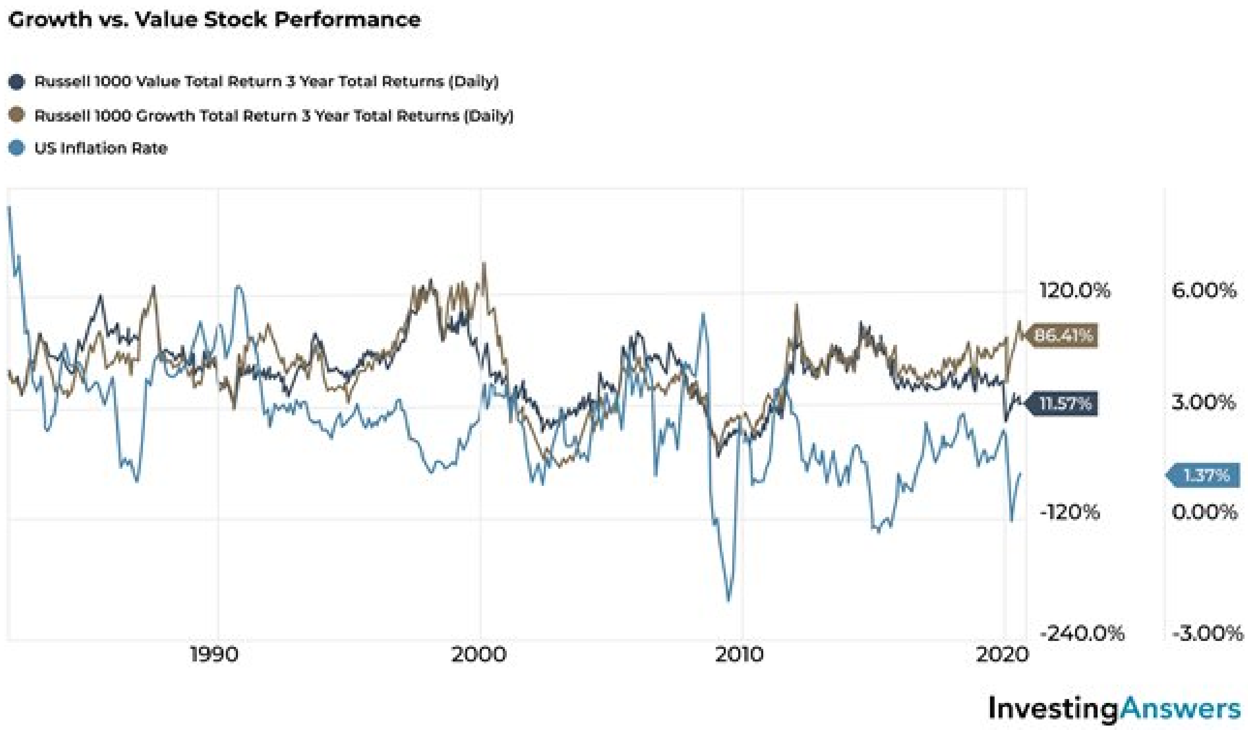
GCC emphasizes a diversified nature of commodities compared to the traditional well-established commodity indexes like the S&P GSCI Index (SPGSCI), which could have as much as 70%–80% of risk driven by exposure to the energy sector. Our approach maximizes this diversification with strategic weights roughly balanced between precious metals, industrial metals, agriculture and energy. In addition, we dynamically manage the futures contract “rolls” to potentially mitigate the headwinds faced by the more traditional use of just the front month contract.

Within the WisdomTree Model Portfolios, specifically within the Siegel-WisdomTree Longevity Model Portfolio and our Endowment Model Portfolios, we took an explicit gold position last March, and that trade worked well for us, though gold has stabilized over the past 2–3 months.



Source: YCharts, data range from 1/1/20–2/9/21. You cannot invest in an index, and past performance does not guarantee future results.

In addition, the Siegel-WisdomTree Longevity Model Portfolio is, by design, over-weight in equities versus fixed income. (We try to maximize current income via yield-focused equities instead of taking on excessive risk in our fixed income allocation.) Historically, equities have shown to be an effective hedge against modestly rising inflation:



Source: ICarelton, Peter. "3 Simple Ways Everyone Can Hedge Against Inflation." InvestingAnswers, updated 1/11/21. You cannot invest in an index, and past performance does not guarantee future results.

In our December Model Portfolio Investment Committee meeting, we made some additional changes. While maintaining our existing gold position within the Siegel-WisdomTree Longevity Model Portfolio, we reallocated from our fixed income position into a broader commodity complex position, specifically GCC. Within our Endowment Model Portfolios, we reallocated out of gold and into GCC to give us a broader exposure to the global commodity complex.

Conclusion

If we are correct in our views on global economic recovery, a weak dollar and a general "reflationary" regime in the second half of 2021, we believe WisdomTree has both the strategies and Model Portfolios to meet your needs and help deliver a differentiated end client investment experience.

Important Risks Related to this Article

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