# Rethinking Long/Short Equity: Building on a Foundation of Stocks, Not Cash

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## Key Takeaways

- Amid rising interest in capital efficiency, the new WisdomTree Efficient Long/Short U.S. Equity Fund (WTLS) introduces S&P 500 exposure as the core of a long/short strategy, aiming to deliver market-anchored alpha.
- By layering an AI-driven long/short overlay on top of a broad U.S. equity exposure, WTLS seeks to capture the spread between winners and laggards without sacrificing participation in overall market growth.
- This approach reimagines traditional market-neutral strategies by leveraging equities' long-term return potential, offering investors a structurally efficient way to pursue alpha alongside compounding beta.

When investors hear "long/short equity," they often picture a market-neutral[1] hedge fund strategy, one that seeks to profit from the difference between a group of long positions and a group of short positions. The typical benchmark is something like short-term Treasuries, and the goal is to deliver positive absolute returns regardless of what the market does.

That framing has its merits, but it also leaves something important on the table: the power of long-term equity ownership. If we start with the insight that equities have historically been the best long-term inflation hedge and wealth generator, the central thesis of Professor Jeremy Siegel's *Stocks for the Long Run,*[2] then there's a compelling opportunity to rethink how long/short strategies are designed. Instead of beginning with short-term investments, what if we begin with *the market itself*?

## Introducing the WisdomTree Efficient Long/Short U.S. Equity Fund

Today, WisdomTree is bringing this modern approach to market with the launch of the WisdomTree Efficient Long/Short U.S. Equity Fund (WTLS).

The Fund applies the long/short framework described below, building on a core allocation to the S&P 500 while overlaying a dynamic, AI-driven long/short equity strategy designed to pursue market-neutral alpha. WTLS seeks total return by investing roughly 90% of its assets in U.S. large-cap equities and

layering on approximately 90% notional exposure to a statistically driven long/short portfolio, resulting in a capital-efficient "portable alpha" structure.

## A New Baseline: The U.S. Equity Market as the Core

In this baseline construction, the foundation isn't a Treasury bill; it's the S&P 500 Index. This represents the return of the broad U.S. equity market: the growth of American business, the innovation of its companies and the compounding that has rewarded patient investors for more than a century.

This base exposure is what most investors want over time: the opportunity to participate in the broad U.S. equity market's rise. But on top of that foundation, we can layer a secondary return source, one that differentiates between stronger and weaker companies within that U.S. equity universe.

The result isn't a replacement for equity exposure. It's a potential enhancement.

## Layering Relative Strength: Long the Leaders, Short the Laggards

The core idea remains familiar: Identify a group of stocks that exhibit strong relative characteristics—whether momentum, earnings revisions or other indicators of improving fundamentals—and go long those names. At the same time, identify another group showing deteriorating fundamentals or negative relative strength and take short positions there.

What's different here is the sophistication of the signal-generation process. Instead of relying on a handful of metrics, the system digests more than 150 equity features spanning valuation, quality, risk, size, profitability, liquidity and investment characteristics. Two complementary models, a linear instrumented PCA framework[3] and a nonlinear autoencoder,[4] extract latent risk factors from this broad feature set and forecast relative performance. These model outputs are then combined in a mean-variance (max-Sharpe Ratio) tangent optimization before being mapped back to individual securities.

The result is a long–short structure that typically holds roughly 300 longs and 300 shorts drawn from the top 2,000 U.S. stocks above a liquidity and price threshold.[5] Gross exposure remains high (about 100% long/~88% short), while the net exposure varies only modestly. Monthly rebalancing keeps the portfolio aligned with the evolving factor landscape and respects practical constraints, such as short-borrow fees.[6]

Crucially, the return engine still comes from the spread between strong and weak companies: the historical tendency for winners to keep winning and laggards to continue underperforming. But unlike a traditional standalone long/short equity fund, this is designed as a *layered exposure* on top of a broad U.S. equity allocation, isolating a source of potential alpha while neutralizing the risk of missing out on broad equity market returns.

## From Market-Neutral to Market-Anchored

Traditional long/short portfolios are market-neutral by design, seeking alpha in isolation from beta. This new approach is market-anchored: it embraces beta as the foundation of wealth creation and uses relative-performance insights to generate potential alpha on top.

That distinction has profound implications. Instead of comparing performance to short-term Treasuries, this strategy measures success relative to the equity market itself. It asks not, *"Can we make money in any environment?"* but rather, *"Can we make more of the market's return by emphasizing the right stocks and avoiding the wrong ones?"*

## Potential Benefits: Efficiency, Diversification and Compounding

Because the overlay can be implemented using liquid derivatives or a notional long/short basket, it's capital-efficient: the investor's base exposure remains fully invested in equities. This design allows for the potential to enhance returns without requiring additional cash outlay.

Conceptually, it creates three complementary drivers of performance:

**1. Market Return:** The broad growth of U.S. equities.

**2. Relative Return:** The spread between strong and weak stocks.

**3. Structural Efficiency:** The ability to express both within one integrated framework.

Over time, the goal is to produce a return stream that compounds alongside the market but with an added layer of systematic alpha.

## A Modern Expression of "Stocks for the Long Run"

Professor Siegel's enduring message has always been that equities are the asset class of long-term prosperity. By re-engineering the traditional long/short model around that principle, investors can stay rooted in the market while pursuing excess returns through disciplined, rules-based differentiation.

This is long/short reimagined for the age of factor intelligence, not a substitute for equity exposure, but a way to make *the equity exposure itself* work smarter.

[1] Market neutral refers to a strategy with a methodology designed to minimize sensitivity to movements in the general equity market.

[2] Source: J.J. Siegel, Stocks for the Long Run (6th ed.), McGraw-Hill, 2022.

[3] PCA (principal component analysis) is a way to compress a huge set of features (in this case, 153 stock characteristics) into a smaller number of "hidden factors." It finds the strongest patterns or clusters of movement in the data. These hidden factors explain why many features tend to move together.

[4] An autoencoder has two halves: 1) Encoder: squeezes a big set of inputs (like 153 equity features) down into a much smaller set of "latent factors." 2) Decoder: tries to rebuild the original data from those compressed factors. The only way the model learns to compress well is by identifying the most important patterns in the data.

[5] The 300 long and 300 short positions is a rough guideline. Due to such factors as the assets under management in the strategy, this figure may be adjusted.

[6] Shorting equities includes a cost based on borrowing the actual shares in the companies being shorted.

## Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. The Fund invests in a basket of equity securities of large capitalization U.S. companies generally weighted by market capitalization. The Fund expects to invest most of its assets in the securities of U.S. companies and is therefore, more likely to be impacted by events or conditions affecting the United States. The Fund invests in derivatives to gain exposure to U.S. equity securities. The return on a derivative instrument may not correlate with the return of its underlying reference asset. The Fund's use of derivatives will give rise to leverage. 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. While the Fund is actively managed, the Fund's investment process is heavily dependent on quantitative models and the models may not perform as intended. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.