Risk Screens Pay Off during Bumpy July

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For most of 2021, quantitative measures that screen for risk have been counterproductive as we've been experiencing a “junk rally”.

WisdomTree developed a composite risk screen (CRS) comprising multiple measures of profitability/quality combined with risk-adjusted momentum.

In the large-cap value category (the Russell 1000 Value Index), the riskiest decile outperformed the least risky decile by over 1,000 basis points (bps) year-to-date through July.

In small caps the difference has been even larger at almost 1,600 bps of outperformance for the riskiest stocks.

But July saw a very different dynamic play out with more volatile markets.

While the Russell 1000 Value eked out a small gain of 0.8% in July, the two riskiest deciles experienced declines ranging from 2.7% to 3.7%.

In small caps (the Russell 2000 Value Index), the riskiest companies underperformed by more extreme amounts in July: the riskiest decile lost 11.7% and the least risky decile actually gained 1.1%.

Composite Risk Score Decile Returns

		Russell 1000 Value Index		
	Category	July	YTD	Since 5/31/06
Lowest Risk	1st Decile (Top Comp. Risk Scr.)	1.97%	13.31%	7.09%
	2nd Decile	4.03%	17.78%	12.44%
Highest Risk	9th Decile	-2.72%	15.24%	5.63%
	10th Decile (Low Comp. Risk Scr.)	-3.65%	23.98%	2.06%
	Index	0.80%	17.98%	8.02%

		Russell 2000 Value Index		
	Category	July	YTD	Since 5/31/06
Lowest Risk	1st Decile (Top Comp. Risk Scr.)	1.09%	17.26%	8.98%
	2nd Decile	-1.05%	19.66%	8.54%
Highest Risk	9th Decile	-5.64%	30.63%	3.70%
	10th Decile (Low Comp. Risk Scr.)	-11.66%	33.20%	6.99%
	Index	-3.58%	22.16%	7.64%

Sources: WisdomTree, FactSet. Data as of 7/30/21. You cannot invest directly in an index. Past performance is not indicative of future returns. Composite Risk Score is calculated by an equally weighted score of the Quality and Momentum Factors. Quality Factor is determined by static observations and trends of return on equity (ROE), return on assets (ROA), gross profits over assets and cash flows over assets. Scores are calculated within industry groups. Momentum Factor is determined by stock's risk adjusted total returns over historical periods (6 and 12 month). Composite Risk Scores were developed to mitigate the impact of "value traps" by identifying companies deemed most at risk of cutting or cancelling their dividend payments. Companies with lower composite risk score stand greater risk of cutting their dividend payments and can be excluded from WisdomTree indexes according to their respective methodology. Please see Glossary for definition of terms.

While one month does not guarantee a changing trend, it is our belief that over the long run, the risk screens we've applied to our dividend-weighted Indexes and corresponding ETFs could result in a smoother ride for the portfolios. It is good to see that play out during a more difficult month for the markets.

The longer-run returns since the inception of WisdomTree's Indexes about 15 years ago (5/31/06) showcase the outperformance of the top two deciles on these risk measures and underperformance for the bottom two deciles of risk.

We do not expect the high beta rally of the first six months of 2021 to continue indefinitely. With fears of the delta variant starting to pop up, and where we are broadly in elevated market multiples after such large gains, now looks like a good time to embrace valuation-sensitive Indexes that also control for measures of risk. To see this type of attribution interactively, we encourage you to use our Index attribution tool.

The WisdomTree U.S. LargeCap Dividend Fund (DLN), which seeks to track the price and yield performance, before fees and expenses, of the WisdomTree U.S. LargeCap Dividend Index, is one of our 5-star rated Funds (by Morningstar rating as of July 30, 2021)1 due to both its strong long-term returns, but importantly also lower risk than traditional value benchmarks.

The valuation metrics we see in DLN are as "value-like" as the Russell 1000 Value index, but with profitability metrics that rival and even exceed the traditional core index benchmarks. This is a great combination in our view for the large-cap space.

Characteristic	DLN	Russell 1000 Value	Russell 1000
Dividend Yield	2.45%	1.86%	1.25%
Net BuyBack Yield	0.80%	0.39%	0.64%
Shareholder Yield	3.25%	2.25%	1.89%
Price-to-Earnings	20.65	24.12	31.12
Price-to-Earnings ex. Negative	20.56	19.82	26.16
% Negative Earnings	0.32%	8.81%	7.64%
Estimated Price-to-Earnings	16.86	17.48	22.86
Return on Assets	3.39%	2.15%	3.12%
Return on Equity	19.33%	10.91%	14.75%
Return on Sales	18.31%	13.04%	14.69%

Sources: WisdomTree, FactSet. Data as of 7/30/21. You cannot invest directly in an index. Past performance is not indicative of future results.

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.

This information must be preceded or accompanied by a prospectus; click here to view or download prospectus. We advise you to consider the Fund's objectives, risks, charges and expenses carefully before investing. The prospectus contains this and other important information about the Fund. Please read the prospectus carefully before you invest.

Performance data for the most recent month-end and standardized performance click here.

For definitions of terms in the table, please visit the glossary.

1Overall Morningstar Rating based on risk-adjusted returns that combines three-, five-, and 10-year ratings. As of July 30, 2021, there were 1,136, 1,007, and 739 funds in the Large Value category for the respective three-, five-, and 10-year periods.

Important Risks Related to this Article

Past performance is not indicative of future results.

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

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

There are risks of investing in value stocks such as the potential that a particular stock may not rise to its anticipated intrinsic value and could decline further in value.

The Morningstar Rating™ for funds, or “star rating,” is calculated for managed products with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars, and the bottom 10% receive one star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three- and five-year Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns.