

Where to Turn If the Market Has Come Too Far, Too Fast

Published January 5, 2017

Luciano Siracusano III

Chief Investment Strategist

Christopher Carrano

Vice President of Strategic Research at Venn by Two Sigma

Since the presidential election on November 8, the [S&P 500 Index](#) has rallied an impressive 5%. Investors appear to be discounting the impact that lower tax rates, less regulation and new fiscal policies may have—well ahead of their potential implementation. Over that same time frame, the CBOE Volatility Index (VIX) dropped from almost 19 to just over 12, and the 10-Year yield went from 1.85% to 2.34% after being as low as 1.36% on July 8. In fact, the two weeks ending November 18 marked the third largest increase in the 10-Year yield over the last 30 years.

The sudden advancement of these three risk-on indicators may leave some people asking, “Have we come too far too fast?” With additional interest rate hikes on the horizon and aggressive discounting of President-elect Donald Trump’s policies already taking place, some investors may be looking for good ideas about how to dial down some of their equity risk. One contrast we find noteworthy has been the underperformance of gold during this four-week stock market and U.S. dollar rally. An alternative strategy that has outperformed the traditional market hedge, gold, by 10.5%¹ since November 8 is the [WisdomTree CBOE S&P 500 PutWrite Strategy Fund \(PUTW\)](#).

The WisdomTree CBOE S&P 500 PutWrite Strategy Fund (PUTW) PUTW, which seeks to track the [CBOE S&P 500 PutWrite Index \(PUT\)](#), writes at-the-money S&P 500 Index put options every month while simultaneously holding one- and three-month U.S. Treasury bills to cover maximum possible losses. With interest rates now rising, the Fund has the potential to generate positive returns from its short-term Treasury exposure, but the predominant source of total return comes from the option premiums PUTW receives from writing puts. As the S&P 500 Index falls below the strike price of the puts, so too will the value of the Index’s contracts, but its descent would be cushioned by premiums. Essentially, a loss in the S&P 500 becomes the S&P 500 loss plus premiums. This generally provides a measure of downside protection for the strategy compared to a long-only S&P 500 position. The magnitude of this downside protection depends on the amount of volatility in the market, meaning higher volatility coincides with higher premiums and lower volatility the opposite. In other words, if the VIX starts to head higher, the efficacy of put writing increases.

On the flip side, if the S&P 500 rallies, premiums will still be the predominate source of return, creating potential underperformance to the equity market, given that the Fund never holds any stocks. [For](#)

[standardized returns of the WisdomTree CBOE S&P 500 PutWrite Strategy Fund](#), please click here.

Writing Puts as a Long-Term Strategy

While no one can predict how or when the Trump rally will end, writing puts is more than just a tactical strategy. WisdomTree believes it can help lower the overall volatility of an investor's equity exposure while generating long-term returns that have historically approached equity returns. Since the real-time inception of the CBOE S&P 500 PutWrite Index in June 2007, it has achieved similar returns to both gold and the S&P 500 with a lower standard deviation and a higher Sharpe ratio. It is important to note that it achieved this with a correlation of 0.86 to the S&P 500, whereas as gold showed essentially no correlation at all to the broader equity market. We believe it is this story—downside protection while maintaining the look and feel of the equity market—that makes put writing such a credible part of a portfolio and a potential shock absorber over time. While gold may still play a role as a noncorrelated part of a larger portfolio, we are mindful that gold can lag broader asset classes as nominal and real interest rates rise in the U.S. and as the dollar increases in value relative to foreign currencies.

	PUT Index Inception	Cumulative Return		Average Annual Return as of 11/30/2016			Since PUT Index Inception	Summary Statistics Since Inception*		
		Since Presidential Election as of 12/7/2016	YTD as of 12/7/2016	1-Year	3-Year	5-Year		Standard Deviation	Sharpe Ratio	Correlation to S&P 500 Total Return Index
CBOE S&P 500 PutWrite Index	6/20/2007	2.49%	7.92%	6.83%	7.15%	8.76%	5.96%	11.88	0.46	0.86
Gold (Spot)		-7.97%	10.64%	10.18%	-2.17%	-7.64%	6.37%	19.84	0.30	0.04
S&P 500 Total Return Index		4.98%	11.95%	8.06%	9.05%	14.43%	6.31%	15.62	0.38	1.00

Sources: WisdomTree, Bloomberg, Zephyr StyleADVISOR, as of 12/7/16. Summary statistics use the latest month-end since inception (6/29/07) as a starting date. Past performance is not indicative of future results. You cannot invest directly in an index.

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.

Conclusion

At WisdomTree, we believe the alternative asset class serves an important role in driving improved risk-adjusted returns. We are aware that some investors find alternatives somewhat inaccessible, which is why we brought to market a put writing strategy that is systematic and passive in nature, wrapped in the exchange-traded fund vehicle at 38 basis points. [To learn more about PUTW, the WisdomTree CBOE S&P 500 PutWrite Strategy Fund](#), please click here.

Unless otherwise noted, data source is Bloomberg, as of December 7, 2016 .

1Sources: WisdomTree, Bloomberg, 11/8/16–12/7/16. Returns calculated using net asset value (NAV). PUTW returned 2.49% and gold returned -7.97% over this period.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. The Fund will invest in derivatives, including S&P 500 Index put options ("SPX Puts"). Derivative investments can be volatile, and these investments may be less liquid than securities, and more sensitive to the effects of varied economic conditions. The value of the SPX Puts in which the Fund invests is partly based on the volatility used by market participants to price such options (i.e., implied volatility). The options values are partly based on the volatility used by dealers to price such options, so increases in the implied volatility of such options will cause the value of such options to increase, which will result in a corresponding increase in the liabilities of the Fund and a decrease in the Fund's NAV. Options may be subject to volatile swings in price influenced by changes in the value of the underlying instrument. The potential return to the Fund is limited to the amount of option premiums it receives; however, the Fund can potentially lose up to the entire strike price of each option it sells. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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.