

Why We Prefer Quality for the Long Term

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Jeremy Schwartz, CFA

Global Chief Investment Officer

Last week's Behind the Markets podcast featured a discussion with Paul Esposito, senior portfolio manager at Prestige Wealth Management Group and chair of their investment policy committee. Paul is responsible for global capital market research, formulating both strategic and tactical asset allocation recommendations as well as conducting fund manager due diligence. Prestige is a full-service registered investment advisor (RIA) that offers investment management, estate planning, tax planning, accounting services and financial planning. Their goal is to be a client's personal CFO to grow and preserve their wealth.

Prestige just conducted a strategic review of how they manage their investment portfolios.

Prestige's number one principle is to be a tax-conscious, long-term strategic investor. They infuse macro-economic and tactical elements into portfolios, but they select factors optimized for long-term returns. Prestige has used factors like quality, value, momentum and size to some degree over time.

But the bigger shift Prestige recently made was to move away from traditional mutual fund portfolios.

More importantly, Esposito described Prestige as migrating away from being a "Dimensional" shop, subscribing to the Fama-French three-factor model view of the world with factor over-weights to size and value. Dimensional Fund Advisors is predicated on the academic financial market research of Eugene Fama and Kenneth French; hence, the comparison.

Esposito sees the world as very debt-laden, with demographic declines favoring slower long-term economic growth rates around the world, particularly in Europe and Japan. The magnitude of that debt is deflationary, in his view, which pressures economic growth.

Given the long-term economic backdrop that Prestige is anticipating, the firm is embracing quality and momentum strategies as anchors to an all-weather portfolio.

The value factor has disappointed over the last 12 years. While Prestige sees some elements of value catching up to growth in the short run on the vaccine news and reopening of the economy, over the longer term, they see the pandemic accelerating strategic shifts that can lead to further growth in revenue and dividends in the quality factor space.

In particular, Prestige has favored the quality dividend growth strategies of companies that can deliver revenue and earnings growth rates above GDP growth, and they are instilling that strategically into portfolios. Esposito described new profitability tilts Dimensional Fund Advisors added to their fund portfolios as an

attempt to correct for some of the value traps in small caps, but they did not go far enough, in his view, to access the quality factor exposure more directly.

Prestige has also much more aggressively moved away from traditional mutual funds, which can deliver large capital gains distributions and tax consequences for investors even in years when those funds experience negative performance or very modest gains. These capital gains were a real conundrum for Prestige, particularly in small caps, emerging markets and actively managed value funds. Esposito described these gains distributions as adding “insult to injury” in these cases and another reason his firm has shifted to [quality dividend growth ETFs](#).

Portfolios Focused on U.S. Markets

Esposito described his firm focusing on the U.S. markets and ignoring international allocations as due to the U.S. being the best house on the block compared to other international economies like Europe or Japan, from debt levels to fiscal and monetary policies and better demographics. Prestige also thinks they get international exposure from S&P 500 companies that have almost half of their revenue coming from overseas. With retirees domiciled in the U.S. and liabilities being U.S. dollar-driven, they also do not want some of the currency risk or volatility cycles that come with foreign markets.

This was a great conversation on how one WisdomTree client has strategically changed their factor models. You can listen to the full conversation below.

Behind The Markets Podcast: Paul Esposito

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