Will Defensive, Anti-Momentum Strategies Rise Up in 2018?

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One of the more interesting things that happened in asset management in 2017 regarded factors. While the concept of factors associated with risk-adjusted outperformance has existed for decades, in 2017 investors saw the ability to allocate either to individual factors or to multifactor strategies enter the mainstream in a big way. Investors will likely continue to evaluate different factors in order to gain unique insights into where the equity market may go next.

2017: Momentum and Then Everything Else

If we array MSCI's five USA factor indexes—what many view as the baseline starting point of factor discussions—we see that in 2017 the MSCI USA Momentum Index returned nearly 38%.1 The next-best index—the MSCI USA Sector Neutral Quality Index—returned only 22.5%.2 This is a massive gap. In fact, the four factor indexes outside of momentum were all within a range of less than 4% of one another.

Value: In a Way, the Opposite of Momentum

Sometimes it is worth exploring strategies that aren't really among the "worst" performers but are also far from the best. The WisdomTree U.S. High Dividend Index and the WisdomTree U.S. Dividend ex-Financials Index are two such strategies. While these were up 12.1% and 14.3%, respectively, in a year where the S&P 500 Index was up 21.8%, clearly there was little reason to draw much attention in this direction.3

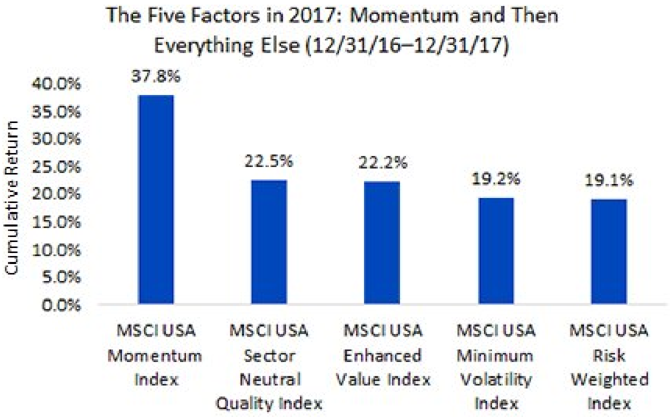
However, it is notable that these strategies are right in line with the S&P 500 Value Index and Russell 1000 Value Index benchmarks. In a way, these strategies could be thought of as the opposite of momentum and growth—the avenues that generated some of the best outperformance in 2017.

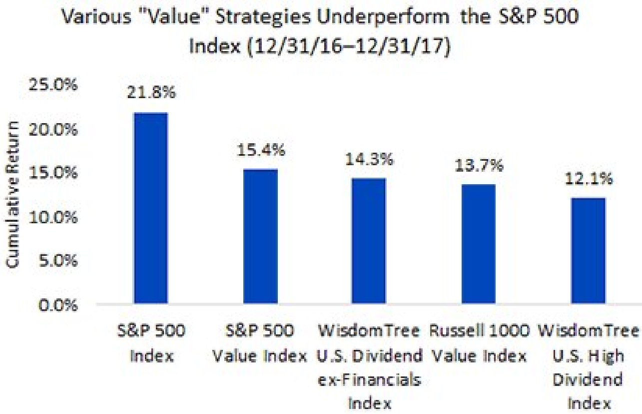
"Value" Doesn't Mean the Same Thing for All Indexes

Some might ask, why did the MSCI USA Enhanced Value Index outperform both the S&P 500 Value Index and the Russell 1000 Value Index in 2017? The answer: the MSCI USA Enhanced Value Index is tilted back toward being sector neutral to the MSCI USA Index,4 which will tend to mitigate the risk of, say, being very under-weight in the Information Technology sector during a year (like 2017) in which it delivered very strong performance. A typical value strategy would not make this adjustment.

In our view, focusing on the opposite of what delivered the strongest performance in 2017 could be a different way to think about 2018.

Dare to Think Differently and Diverge from Momentum in 2018





Sources: WisdomTree, Bloomberg, with data for the period 12/31/16–12/31/17. Past performance is not indicative of future results. You cannot invest directly in an index.index.

WisdomTree’s Annual Rebalance Redefines the “Value” Paradigm with a Dividend-Yield Focus

The tie that binds both the WisdomTree U.S. High Dividend Index and the WisdomTree U.S. Dividend ex-Financials Index together is a focus on higher-yielding dividend payers.

- On an annual basis, the WisdomTree U.S. High Dividend Index screens and sorts across all regular dividend payers and locates the top 30% on the basis of dividend yield for inclusion. Weighting is then by WisdomTree’s measure of the *Dividend Stream®* (dividend per share x number of shares outstanding).
- Also on an annual basis, the WisdomTree U.S. Dividend ex-Financials Index screens and sorts across all large-cap regular dividend payers outside of the Financials sector and locates the top 10 stocks by dividend yield in each sector. Weighting is then by dividend yield, making the Index look very similar to an equally weighted approach.

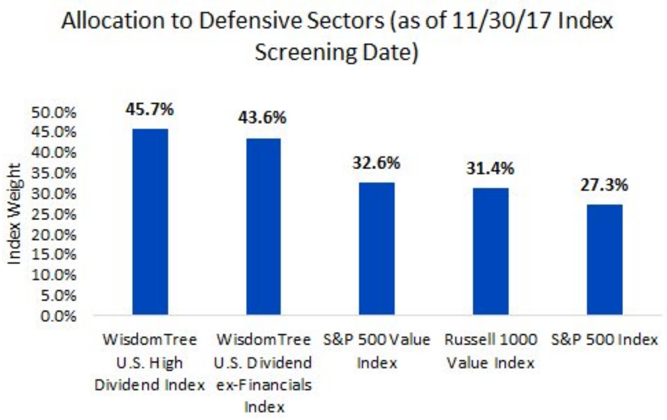
Since stocks with higher yields tend to have a better chance at inclusion within these Indexes and falling prices are one way to gain higher yields, there has tended to be an anti-momentum bias to these exposures. At each rebalance, these methodologies can pick up stocks with rising dividend yields and falling price levels.

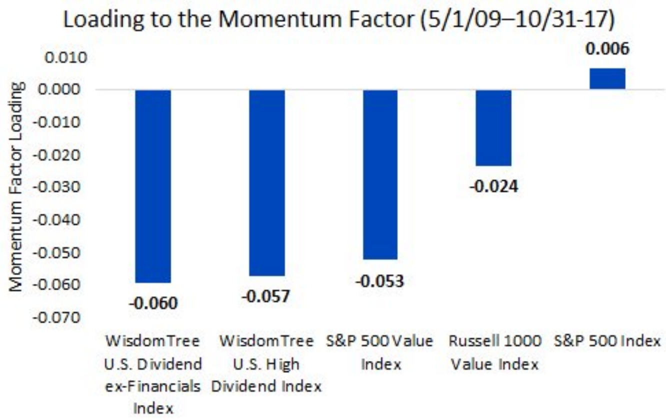
Focus on Dividend Yield also Has Led to Defensive Equity Exposure

Now, we recognize that some years are like 2017, where volatility is very low and the more defensive exposure you have (Consumer Staples, Health Care, Telecommunication Services and Utilities sectors), the worse you tend to do on a relative basis against a benchmark like the S&P 500 Index, since higher-growth, more cyclical sectors went on a run.

But, although companies such as Facebook, Amazon, Netflix and Google (FANG stocks) are changing the way people are living their daily lives, the growth/momentum/cyclical part of the U.S. equity market cannot lead indefinitely. The WisdomTree U.S. High Dividend Index and the WisdomTree U.S. Dividend ex-Financials Index are ways to get a completely different exposure to U.S. equities. This different way of doing it was not rewarded in 2017, but for those thinking that the U.S. equity rally could be getting long in the tooth, these strategies may add more value in 2018.

Quantifying the Defensive Sector, Anti-Momentum Tilts





Sources: WisdomTree, Bloomberg and Kenneth French Data Library, with data for allocation to defensive sectors as of the 11/30/17 Index screening date for the WisdomTree U.S. High Dividend Index and the WisdomTree U.S. Dividend ex-Financials Index. Loading to the momentum factor is calculated from 5/1/09 because this is the beginning of live calculation of the WisdomTree U.S. Dividend ex-Financials Index. Period is based on data availability as of this writing. You cannot invest directly within an index.

1Source: Bloomberg, from 12/31/16 to 12/31/17.
2Source: Bloomberg, from 12/31/16 to 12/31/17.
3Source: Bloomberg, from 12/31/16 to 12/31/17.
4Source: “MSCI Enhanced Value Indexes Methodology,” MSCI, 5/15.

Important Risks Related to this Article

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