Q&A

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WisdomTree US Efficient Core

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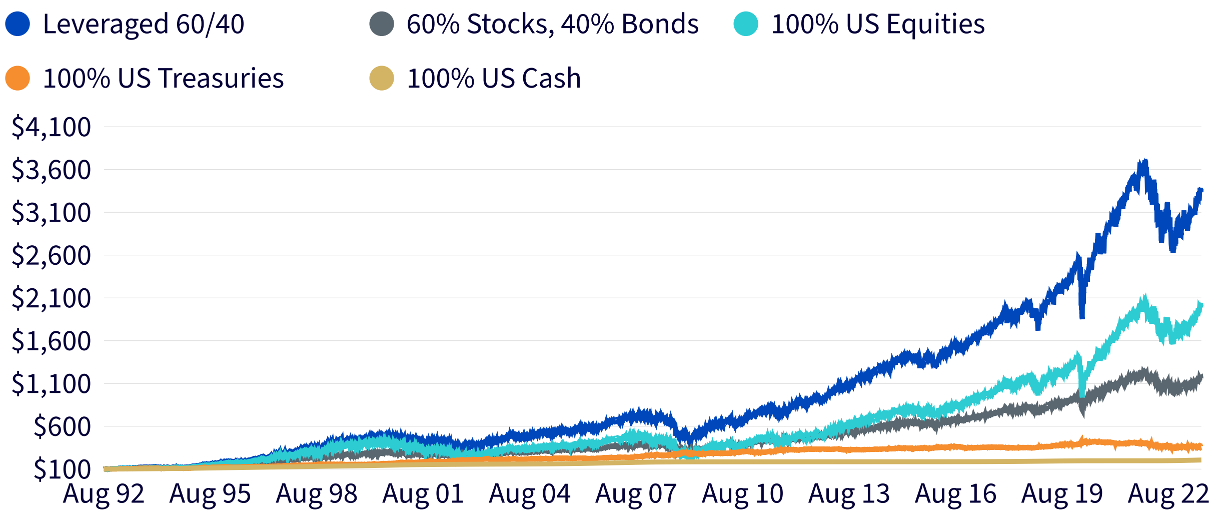
Investors often grapple with the decision between low-cost building blocks or improved risk-return profile. The WisdomTree US Efficient Core strategy is designed to provide both.

By leveraging the traditional 60/40 portfolio, we aim to offer a portfolio with equity-like volatility, but with the superior Sharpe ratio of a 60/40 portfolio[1]. Historically and over the long term, this resulted in:

+ Better long-term performance and a higher Sharpe ratio than a pure equity portfolio
+ Improved diversification leading to smaller drawdowns during volatile markets



	Annualized Returns	Volatility	Sharpe Ratio	Max Drawdown
• 100% US Equities	10.21%	18.6%	0.42	-55.2%
• 100% US Treasuries	4.21%	4.7%	0.39	-18.7%
• 100% US Cash	2.37%	0.2%	0.00	-0.2%
• 60% Stocks, 40% Bonds	8.28%	10.4%	0.57	-31.2%
• Leveraged 60/40	12.06%	16.2%	0.60	-46.7%

Source: WisdomTree, Bloomberg, as from 31 Aug 92 to 31 Jul 23. Stocks are represented by S&P 500 net Total Return. Bonds are represented by the Bloomberg US Treasury Total Return Index. The 60/40 portfolio is a combination of 60% the S&P 500 and 40% US Treasury, rebalanced back to 60/40 annually. The levered 60/40 portfolio invests 150% each month in the 60/40 portfolio, and borrow 50% each month at a cost of one to three month T-bill. This is inspired by the original research from Cliff Asness, "Why Not 100% Equities", The Journal of Portfolio Management, 1996. **Historical performance is not an indication of future performance and any investments may go down in value. You cannot invest directly in an index.**

1 This is a concept first defined by Clifford S Asness in "Why Not 100% Equities: A Diversified Portfolio Provides More Expected Return per Unit of Risk". 1996.

The WisdomTree US Efficient Core UCITS ETF was designed to help investors create more optimal portfolio blends and magnify portfolio exposures through the same concept that drives their asset allocation. While this ETF do not borrow to gain additional exposure, it uses futures contracts to enhance the capital efficiency of the ETF.

1. What is Efficient Core?

The US Efficient Core strategy delivers an investment into large-cap equities with a risk management overlay provided by fixed income, specifically US Treasuries. This exposure is achieved by investing 90% in equities and 10% in cash collateral. The strategy also incorporates 60% bond exposure through a laddered portfolio of US Treasury futures contracts.

2. What are some of the characteristics?

The US Efficient Core strategy aims to enhance total returns while mitigating volatility and drawdown through investment in a laddered strip of US Treasury futures. Since 90% of the strategy is invested in the 500 largest US companies by market capitalization, this strategy is highly correlated to the equity market, but, thanks to the fixed income overlay, the Sharpe ratio and drawdown can be meaningfully improved.

3. How does US Efficient Core compare to minimum volatility portfolios?

Minimum and low-volatility strategies are designed to offer downside protection during market downturns, but they also have lower upside participation during bull markets. By comparison, the Efficient Core strategy could offer higher upside capture while maintaining similar down capture.

This strategy generally has a higher beta than low and minimum volatility portfolios, but similar average annual volatility. A common criticism of minimum volatility strategies is that they are interest rate sensitive and to diversify interest rate risk in our Efficient Core strategy, we invest in laddered Treasury futures contracts.

4. What drives the efficiency of these portfolios?

The mix between US equities and US Treasuries (and their low average correlation) drives the efficiency of these portfolios. Historically, US Treasuries have served as a reliable hedge against selling pressure on risk assets.

5. How did we construct the strategy?

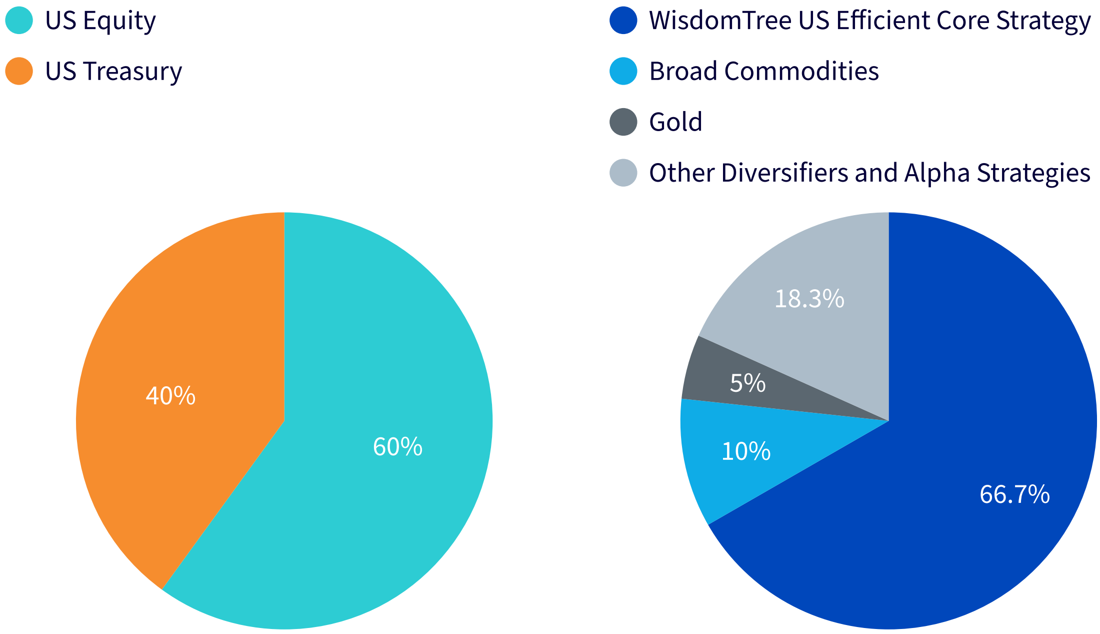
+ **Equity Component:** 90% ($90 exposure for every $100 invested in the ETF) invested in a portfolio of 500 large-cap US stocks, weighted by market capitalization to provide broad exposure to US Equities.
+ **Cash Component:** For every $100 invested in the ETF, $10 is held in short-term collateral that earns returns comparable to U.S. Treasury bills.
+ **Bond Futures Ladder:** To help magnify the benefits of the asset allocation, $60 of bond futures are overlaid on top of the $90 of equity exposure and $10 of cash collateral.
    - Treasury futures are laddered (equal-weighted) across the 2-, 5-, 10- and 30-year segments of the yield curve to diversify interest rate risk.
    - Average effective duration for the fixed-income portion will typically be 7–7.5 years and is generally meant to offer the duration profile of traditional aggregate bond indexes.

Bottom line: The combined exposure can, in our view, be employed in a way to add more fixed-income diversification to a straight equity portfolio or to create capital efficiency and “free space” for diversifiers.

6. How should investors approach this strategy in their portfolios?

+ **Equity replacement:** A low fee, core equity solution can serve as an efficient replacement to existing core equity exposures. By offering return enhancement, improved risk management and diversification potential compared to a 100% equity portfolio, this index could also be used to complement existing equity exposures.
+ **A capital efficiency tool:** By offering equity and bond exposure in a capital-efficient manner, the index can help free up space in the portfolio for alternatives and diversifiers.

In a classic 60/40 portfolio there is often no space left for diversifiers. Should an investor wish to add broad commodities, gold or other alpha strategies, they would usually need to sell some bond or equity positions. However, in an Enhanced portfolio, for example, using the WisdomTree US Efficient Core strategy only 66.7% of the capital is used to achieve the 60% equity and 40% bond exposure. This approach leaves one-third of the portfolio for diversifiers enabling the Sharpe ratio of the Enhanced portfolio to be improved without sacrificing potential returns.



Source: WisdomTree. **For illustration purposes only.**

7. How might Efficient Core perform during different market scenarios?

Efficient Core is likely to perform best during periods of sustained equity market gains combined with falling interest rates, similar to the conditions we observed in 2019. The opposite is also true: rising yields and falling equities are likely to generate negative returns. However, compared to a portfolio of 100% equities, Efficient Core may outperform on the downside as long as losses on the bond futures ladder are less than losses on a 100% equity allocation.

8. How is the fixed income overlay managed for the strategy?

The strategy gains exposure to fixed income via treasury futures contracts by investing in a ladder across the yield curve. It equal-weights contracts of 2-, 5-, 10- and 30-year durations. These contracts are rolled over before their expiration in March, June, September and December.

9. How does the strategy manage risk?

The WisdomTree US Efficient Core strategy is set to rebalance quarterly to its 90/60 target exposure. The strategy also employs a 5% rebalance trigger. If the strategy deviates from the targeted 90% equity and 60% US Treasury exposure by 5%, the strategy will be rebalanced back to target allocations.

10. Is it possible for the strategy to break?

Despite its use of accounting leverage, the ETF cannot incur losses exceeding the principal amount invested. However, the use of leverage does magnify both gains and losses and, as a result, making the strategy potentially more volatile.

Fund Information: WisdomTree US Efficient Core UCITS ETF

Ticker	Exchange	ISIN	Bloomberg Code	Listing Currency	Base currency	TER%
NTSX	LSE	IE000KF370H3	NTSX LN	USD	USD	0.20
WTEF	LSE	IE000KF370H3	WTEF LN	GBx	USD	0.20
NTSX	Borsa Italiana	IE000KF370H3	NTSX IM	EUR	USD	0.20
WTEF	XETRA	IE000KF370H3	WTEF GY	EUR	USD	0.20

TER: Total expense ratio.

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