LOOKING BACK…3 ETFS YOU SHOULD HAVE BOUGHT IN 2019

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Financial markets experienced one of their best years in recent history in 2019. All major asset classes had positive returns, and, in most cases, double digit returns. Investors might assume that investing in the "market" would've been the best way to reap the benefits of such an environment. But WisdomTree, through its systematic approach of seeking innovative, higher risk-adjusted returns by deviating from traditional market cap weighting, was able to exploit certain investment factors (or themes) that outperformed in 2019.

How did we do it? Below are some of the key themes we implement in our strategies that resulted in outperformance.

1. **Focusing on Quality through over-weighting Profitability**

   In 2019, the WisdomTree Global Quality Dividend Growth UCITS ETF delivered 33.17% return, 5.50% above its benchmark, the MSCI World Index [1]. Its European counterpart, the WisdomTree Eurozone Quality Dividend Growth UCITS ETF delivered 32.65%, an outperformance of 7.18% over its own benchmark, the MSCI EMU Index [2]. This performance placed both ETFs [3] in the top 3% among both active and passive Mutual Funds and ETFs in their large-cap blend Morningstar categories [4].

   Those ETFs invest systematically in growing, profitable companies, as proxied by the historical 3 years average of the Return on Equity and the Return on Assets, while maintaining valuation discipline. By harnessing the quality factor in a systematic way, the ETF delivered steady outperformance over time.

   Where did last year outperformance come from? Over the last year, the highest quintile of quality companies (by return on equity) in global developed markets [8] delivered a performance of 39%, outperforming the MSCI World by 11.3%, as highlighted in Figure 1. The lower quintile delivered only 21.4%, an underperformance of -6.3% versus the MSCI World. The significant over-and under-weights in these categories (in reference to the highest quintile in the table below), has allowed it to generate significant excess returns.

   Interestingly enough, WisdomTree Global Quality Dividend Growth UCITS ETF was underweight US in 2019, by around 10%, but despite the US outperforming most equity markets in the world, the ETF managed to outperform the benchmark by 5.50% through stock selection alone.

FIGURE 1: 2019 PERFORMANCE ATTRIBUTION OF THE WISDOMTREE GLOBAL QUALITY DIVIDEND GROWTH INDEX VERSUS THE MSCI WORLD INDEX

	Attribution				Weights		Group Returns	
	Allocation	Selection	Interaction	Total	WisdomTree	MSCI World	WisdomTree	MSCI World
1st Quintile (Highest ROE)	3.7%	0.3%	0.4%	4.4%	59.8%	26.9%	40.2%	39.0%
2nd Quintile	0.1%	-0.1%	-0.1%	-0.1%	19.5%	21.2%	24.9%	25.0%
3rd Quintile	0.4%	2.0%	-0.8%	1.6%	10.3%	16.7%	34.2%	22.6%
4th Quintile	0.7%	-0.9%	0.6%	0.3%	4.5%	17.8%	17.8%	22.7%
5th Quintile (Lowest ROE)	0.6%	-3.0%	2.6%	0.2%	1.5%	11.1%	-2.8%	21.4%
Negative Return	-0.2%	-0.3%	0.3%	-0.2%	0.0%	2.5%	0.9%	32.8%
N/A	0.0%	-0.8%	0.3%	-0.4%	4.4%	3.9%	2.0%	23.8%
Total	5.3%	-2.8%	3.4%	5.8%				

Allocation: Positive (or negative) excess return generated when the strategy has overweighed (or underweighted) a benchmark segment. Segment is understood as sector, country, group of stocks with similar characteristics

Selection: Positive (or negative) excess return generated by reweighting or adding (removing) stocks from a given segment

Interaction: Residual Excess return when allocation and selection are taken into account

Source: WisdomTree, Bloomberg. Data from 31st December 2018 to 31st December 2019. ***Historical performance is not an indication of future performance and any investments may go down in value. You cannot invest in an index. Negative Return category represents companies with negative trailing 12-month net income. N/A category represents unavailable Return on Equity data.***

2. **Increasing the yield of traditional benchmarks by shifting exposure across maturity buckets, countries and sectors**

   The WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF (Euro Agg Enhanced) delivered a 9.04% return, 3.06% more than its benchmark: the Bloomberg Barclays EUR Aggregate Index [7]. The European government bond focused strategy, WisdomTree EUR Government Bond Enhanced Yield UCITS ETF (Euro Gov Enhanced) delivered a 9.19% return, 2.42% more than its benchmark the Bloomberg Barclays EUR Aggregate Treasury Index [6]. This very strong performance placed both ETFs in the top 5% among both active and passive Mutual Funds and ETFs in their Morningstar categories [7].

   Both ETFs only gain exposure to investment grade bonds but they seek to enhance their yield by shifting exposure across sectors, levels of interest rate risk, and credit risk using the universe of bonds available within their benchmark. These strategies provide a timely solution considering negative yielding debt hit unprecedented levels of over $17 trillion globally in 2019. When traditional market capitalisation weighted approaches gain exposure to large portions of this negative yielding debt, our strategies rebalance monthly towards higher yielding investment grade bonds while constrained by tracking error, country/sector weight limits, duration.

   The ETFs will overweight or underweight certain parts of the yield curve relative to their index for a given country or sector to optimise for yield and pre-defined risks monthly. For example, the overweight allocation to Italian Government Bonds in the 1 to 5-year maturity buckets was a large contributor to yield in December 2019 as was the overweight to Corporate BBB rated Bonds in the 10+ maturity bucket. From a performance standpoint, this overweight to Italian government bonds in the 1 to 5-year maturity bucket and the underweight to German government bonds in the 10+ maturity bucket were some of the top contributors to excess return over the benchmark in the Euro Gov Enhanced strategy for the same period.

3. Leveraging expert knowledge in paradigm shifting technologies

The WisdomTree Artificial Intelligence UCITS ETF (WTAI) delivered 47.71% over 2019. This is 8.7% more than the Nasdaq 100 Data Index, 17.63% more than the Global STOXX Artificial Intelligence Data Index and 19.39% more than the Nasdaq Yewno Global AI and Big Data Index.

In some ways, 2019 represented a continuation in markets trends, with a few of the largest firms associated with disruptive technologies delivering incredible returns and achieving trillion-dollar market capitalisations. To us, however, this represents the emergence of an opportunity. There is little question that "data is the new oil"—it represents the fuel companies like Facebook, Amazon, Netflix and Google are using to expand their reach and their influence. Currently, the toolkit to help practitioners make sense of massive stores of data is Artificial Intelligence (AI), and we see the demand for this toolkit as having the potential to grow exponentially in the years to come.

WTAI is designed to track the returns of the NASDAQ CTA Artificial Intelligence Index, which utilises a tiered approach in order to ensure exposure across much of the AI value chain. Specifically, there are:

+ **Engagers:** Companies that are directly selling applications of the AI toolkit to customers who can then benefit from using them.
+ **Enablers:** Companies that are building the hardware, such as semiconductors and sensors, that improve the functionality and capability of the AI experience.
+ **Enhancers:** Companies that are large diversified businesses that do many things with AI, but for whom selling AI to customers is not their entire business model.

The approach benefits from the fact that experts in the field at the Consumer Technology Association (CTA) are semi-annually reviewing the market to determine if changes need to be made to any of these groups in order to ensure the purity of exposure to the AI megatrend.

During 2019, the most significant contributing sub industries to the returns of this strategy were semiconductors, application software and systems software. In total, these three sub industries comprise roughly 75% of the total exposure in the strategy, with semiconductors the clear largest at 40%. This sub industry delivered incredible returns during 2019, and while we recognise the inherent cyclicality that it may exhibit, we'd also note that currently, AI models need to be trained in very large datasets requiring significant computational power. Semiconductor companies provide that power, and CTA is not selecting across all semiconductors—it is selecting those that are designing the specific chips that are best positioned to drive the future of AI innovation, in their view.

What works one year is however not always a good harbinger of the year to come. The increased volatility in the markets that we have observed over the last few weeks does mark a strong departure from the recent past. We will continue to monitor the above strategies and others during 2020 keeping you inform of what continues to do well and what does not.

Unless otherwise stated, all data is from WisdomTree and Bloomberg as of December 31, 2019.

1. Source: WisdomTree. Bloomberg. As of end of December 2019. Returns relative to MSCI World Net Total Return Index

2. Source: WisdomTree. Bloomberg. As of end of December 2019. Returns relative to MSCI EMU Net Total Return Index

3. Exchange Traded Funds

4. Source: WisdomTree. Morningstar. As of end of December 2019. The peer group is comprised of USD denominated, oldest share class of all mutual funds and ETFs within the Global Equity Large Cap Blend category for WisdomTree Global Quality Dividend Growth UCITS ETF and is comprised of oldest share class of all mutual funds and ETFs within the Eurozone Equity Large Cap category for WisdomTree Eurozone Quality Dividend Growth UCITS ETF .

5. Source: WisdomTree. Bloomberg. As of end of December 2019. Returns relative to Bloomberg Barclays EUR Aggregate Total Return Index

6. Source: WisdomTree. Bloomberg. As of end of December 2019. Returns relative to Bloomberg Barclays EUR Aggregate Treasury Total Return Index

7. Source: WisdomTree. Morningstar. As of end of December 2019. The peer group is comprised of the oldest share class of all mutual funds and ETFs within the EUR Government Bond category for WisdomTree EUR Government Bond Enhanced Yield UCITS ETF and is comprised of the oldest share class of all mutual funds and ETFs within the EUR Diversified Bond category plus iShares Core Corporate Bond ETF (EUR) and Xtrackers iBoxx EUR Corp Bond ETF for WisdomTree EUR Aggregate Bond Enhanced Yield UCITS ETF.

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