Adam: **00:00:37** Looks like we're only going to see half that commercial this week.

Jeremy: **00:00:40** I was starting to jive with it. It was -- I agree. You know, what does happen if growth collapses. .

Backgrounder

Adam: **00:00:44** Yeah man. We're going to leave everyone in suspense. We may give you the remaining minute after the show if you stay tuned with disclaimers, which are always the most exciting. Welcome Jeremy Schwartz to ReSolve Riffs. It's been -- it's crazy we haven't had you on already.

Jeremy: **00:01:04** Thank you so much. A pleasure being here. Good holiday weekend. Good to be here.

Adam: **00:01:11** Yeah. You bet. I'd actually forgotten that Monday is a holiday. So, that is exciting to think about. You're calling me in Florida. Right? You've been there for a little while. You were down there with Jeremy -- Dr. Siegel, and you were running some programs down there?

Jeremy: **00:01:27** Yeah. Professor Seigel and I, we did the CFA Society here in Miami a few weeks ago. Unfortunately, I had to go back, back north. But I grew up down here and we had the long weekend. We came down yesterday for this, for the kids, take a few extra days, and see the family. But it's always nice to get out of the cold, come down to the beach.

Adam: **00:01:51** Yeah. It is awfully nice in Florida this time of year to escape because I think you get a lot of sort of slush and sleet and gray and just kind of miserable in the February on the East Coast. I know because I lived a lot further north. I grew up in Newfoundland. So, pretty gritty island off the East Coast of Canada. So, I know all about rain, drizzle, fog, sleet, snow, and cold for eight or nine months of the year. So, it's awfully nice to be here in the sun. Just for those who don't know, Jeremy is Global CIO for WisdomTree Funds. Jeremy also runs a podcast called Behind the Markets. Jeremy, how many years have you been running out? It's got to be, like, five or six, maybe more.

Jeremy: **00:02:37** I think the podcast officially -- we started off as a radio show, and we're still a radio show on Sirius 132. Sirius partnered with Wharton to do it. The first three years, we had to be exclusive to Sirius, you know, their whole subscription model.

Adam: **00:02:51** Right.

Jeremy: **00:02:51** We get Howard Stern type ratings on Behind the Markets. But you know, they were -- you had to pay a subscription to be on, but then Wharton renegotiated last -- and so then three years into it we started being able to do our own podcast from it. So, we did turn it to podcast. We're live every Friday. So, podcast usually comes out Friday evening, Saturday morning. I think we're now tending towards Saturday morning as our release. But, yeah, it's been a fun thing. No payments involved. Just trying to learn something new every week, have good guests, and it's been a fun experience.

The Focus of Dr. Siegel

Adam: **00:03:25** Yeah. As a passion project. And you got -- you're lucky enough to have Professor Siegel on the show most episodes, right? He comes on and he gives some commentary on what he's watching in the markets, maybe he's been talking to some people he knows at the Fed, etc, and offer some guidance. What has Professor Siegel been focused on lately?

Jeremy: **00:03:47** Yeah. Wharton asked Siegel to host the show, so he did one episode. He had Bob Schiller after he won the Nobel Prize. And he's like, I quit. You know, he's not used to being, like, the host. Like, he wants to come on, do his commentary most of the time. And luckily the Wharton people knew of our relationship. We've been working together for 20 years, and WisdomTree let me do it and didn't stop it, so it's all been good. Yeah, we actually had a Fed president last week. We had our Philadelphia Fed president, Patrick Harker, who was the dean of Wharton. It's actually how I met Professor Siegel 20 years ago at Wharton. It's a small world enough that the dean of Wharton went to become the Philly Fed president.

But Harker came on -- you know, Siegel's been on I'd say the dovish side really recently. I mean, he was very, very -- he called for the inflation in May of 2020, before anybody was calling for inflation. He said there's going to be much more inflation than we had, huge money supply. He's in the Milton Friedman School of Monetary, you know, what drives the money supply is what drives inflation. And so the explosion of the money supply he knew was going to come out. And then when that started going in reverse, and now we have the money supply contracting. You don't have anyone at the Fed talking about the fact that it's actually going down. You haven't had it go down in 90 years. Like it contracted in the great depression. Otherwise, it hasn't. You want it growing 5% a year. It's contracting. So, that's a big concern in our book. The Fed's not as concerned, but they've been sticking with this narrative that inflation's a real stubborn issue at the moment.

And so Harker wanted to get above five. He didn't quite explain why five is the magic number. He sort of agreed with everything Siegel had to say on sort of the real time housing stuff, coming down on money supply being somewhat of a concern. That you don't want to crush workers, that there's a structural deficit in workers. You can't do that through demand without putting too much demand. It's like, why take this anti-labor take and sort of try to crush the worker a bit. That's not a great take for the Fed, yet they're still going at it.

Adam: **00:06:02**

Yeah. Right. We had your colleague, Jeff Weniger down here a few weeks ago presenting to the CFA Society. And he was pretty staunchly bearish on the economy, led I think primarily by his view on what rates we're going to do to housing. And so for those who don't know, Jeff is Head of Equity Strategy for WisdomTree. And I have to say, man, he put on a great show. He, besides being thoughtful and articulate and clearly very passionate about his work, the energy that goes into his presentations, it's like a thermonuclear explosion. It's crazy, man. Like, he must burn 1500 calories in a 45-minute presentation. I don't know if you notice that but it's just incredible.

Jeremy: **00:06:55**

And you know what? It's not even effort. That's just his natural style. I mean, it's sort of like Siegel too. Like, when you put Siegel on stage he turns into a different human being. Like he's kind of soft, reserved. Then you put him on stage, and he loves teaching, and so he gets very energetic. And Jeff -- what's funny, I actually grew up with Jeff. Like, we were -- His dad was our elementary school basketball coach in ... So, it's nice that we reconnected at WisdomTree. But his Twitter presence, he's definitely been the housing doom, people called it doom porn on -- for housing on what's going around. And it's interesting like, you say, like, is there something that could save us from the housing real doomsday scenario. Maybe there's not that many houses available anywhere. I mean, what you hear anecdotally is that there's a -- not a lot of supply in many markets.

And so prices aren't going down as much as you might think after they went up 40%. You might think a 10% correction is natural with how high mortgage rates have gone. But the supply, lack of supply, is keeping things from really going down more. But, yeah, he's definitely just been great to work with. And if you don't follow Jeff Weniger on Twitter, you definitely should. He's got great charts. All he does is think about charts all day long.

Adam: **00:08:19**

Agree. And he does post some great charts with great color and context and great threads. And he hosts those great sessions every Wednesday night, Tuesday night or most anyways, the Twitter -- the live Twitter streams?

Jeremy: **00:08:33**

We've been doing Twitter Spaces often on Mondays, I think, has been a rare occasion. Sometimes mostly 05:00 PM Eastern on Mondays. It's sort of a nice way to start the week. You could do ReSolve Riffs to close the week. You do Twitter spaces with Jeff to start the week on Mondays.

Adam: **00:08:50**

Yep. That sounds like two great bookends for the week. And, yeah, when he was here, we had a lunch with a group of about 12 or 13 advisors. And toward the end, we went around and asked everybody their views on how this inflation growth dynamic was going to play out. And I think about two thirds of the people that were there were in Jeff's camp, that this pretty draconian increase in rates by the Fed over the last nine, 12 months is going to, with a lag, crush growth, crush employment, and drag down housing, etc, and drag down earnings, and we're going to have a pretty ferocious bear market and recession. I was on the, I guess, opposite end of that thinking that… because one of the things that is different about the current economic situation is that by virtue of them shutting the economy down in 2020, they fire-hosed a huge amount of dollars into -- directly into people's checking accounts.

And if you examine the size of aggregate checking deposits across the different income quintiles, even at the lowest quintile demand deposit in aggregate are currently at about 150% of where they were in 2019. So, right across the income spectrum, households are just -- they're still flush with cash. They are picking up their spending on credit cards. We certainly observed that. But I think people are feeling more confident about sustaining spending because they just got a lot more money sitting in savings accounts than they were ever used to before the pandemic. So, I think we got to contend with this, you know, novel source of spending this time around that maybe makes some of the indicators that we were used to using to signal recessionary conditions less effective.

Jeremy: **00:11:07** I mean -- so everybody refinanced their house at two and a half to three percent. So, all the mortgages are very low. And now we're actually earning income. So, I mean, you have to think about where you keep your cash much more than you ever had to do. I mean, this is the first time I've ever gone to my checking account like, on a regular basis, say, oh, I got too much cash here. I got to move it over to treasuries because I got over 5%. And like your cash is costing you, in another words, just saying that is your checking account is now costing you 5% because they're not paying you. And the savings accounts are not paying you anywhere close to 5% either. So, you got to be careful about how you manage all those savings is one of the big things we're talking about extensively.

But I mean, that point that you make, Adam, is exactly what we said was going to create the inflation of all that money in people's checking accounts. Now what's interesting is in aggregate, we somewhat think as an inflationary issue, we're getting close to that money not having the inflation pressure it did. And that's to say you had this 40% surge, okay. Then you want it growing 5% a year. So, your natural money supply should have been from March 2020, we're getting to almost where it should have grown 15%. So, the inflation that's come out through the system plus that 15%, you're not far from all of that money that's come in. So, the above trend is what -- sort of the above money supply explosion above what the long-term trend is, you might only be a few percent away.

We're trying to do some more precise calculations on it, but we think that big inflationary spike or impulse of the money in the system is behind. But your point on, hey, there's still a lot of people who have a lot more cash than they always would have. And they still have a job. They haven't actually been laid off from a job. There is still this structural shift downwards. All the talk about a structural shift downwards in workers. So, that should boost real wages. The people are making more and they should. And you can say, hey, maybe that is the case for we don't have a real recession. And you can say I think the equities they haven't -- given what's happened in rates in two weeks, you might… You know, I was describing most of the move, certainly, tech leading the way, the rebound of the growth area of the market in the first four weeks of the year was coinciding with rates collapsing.

You say how much was rates collapsing? Now, well, oh, wait, maybe the economy is not going to be recession, maybe earnings are not going to collapse, and equities are diverging a little for rates for the last two weeks, although this week it was a little bit more dicey. But the equities are holding in, given the sharp rise in yields in the last 10 days.

Adam: <u>**00:13:55**</u> Yeah. No, I agree. I mean, I've been looking at the performance of equities, especially growth equities relative to duration in the fixed income markets. And there's now a pretty large gap there where especially growth equities look really rich to rates. So, something's going to happen. Right? Either rates are going to have to fall pretty dramatically or equities are going to have to correct pretty substantially to catch down to where the rates markets would imply that they should probably be trading. So, I know some traders that I like to follow are short *twos and Spoos*, right, in which… so, continuing to call for higher rates for longer, a more persistent inflationary dynamic, more persistent growth and employment dynamic.

And the path dependency here is getting really interesting because we continue to see resilience in terms of animal spirits. In other words, investors continue to tighten credit spreads, they continue to drive equity higher, loosen financial conditions. It just makes the Fed's job harder. Right? And if we start to see a continuation of what we've begun to see the last few weeks as maybe a resurgence in certain areas of the market from a pricing pressure standpoint, then that could really put the Fed in a box. And the Fed may have to get even more aggressive, both in terms of reiterating its QT intentions, talking the market higher in terms of rate expectations, terminal rates, and resetting equity investors' expectations for any kind of pivot in the near future. So, the next few months, I think, is going to be really interesting for equity markets to see which gives first, rates or growthy type equity assets.

Jeremy: <u>**00:15:54**</u> Yeah. I'll say I've been a little surprised growth held in there as much in the last two weeks. I'm with you. I mean, growth -- in one of Jeff's charts he probably showed at your CFA event was -- I know he's been showing, like, the chart of the NASDAQ moving with the 10 year, basically, that most of the NASDAQ coincided with the 10 year. Now the question is in these large value growth regimes, so last year was a major year for value and even within value a major year for sort of the shortest duration, high dividend type value stocks, even way more than traditional value metrics. It was a career year for dividends.

Now in some of the rotation, is it -- they often in this growth to values, it's not just a one year trade, it often will be a longer term cycle. And I say this first move was all driven by re-pricing of rates. And so the discount rate changing almost all of equities I'd say last year, wasn't an earnings look. It was just a rate driven re-pricing. Now the question is for the longer part of the cycle is, can their earnings continue to dominate, right? Part of the last decade where growth crushed value was, call it 2012, 2013. They were really cheap coming out of the financial crisis. And then they had massive outperformance in earnings and massive multiple expansions. Right? Now multiples are starting to go the other way. There's probably more to go in my view, that they're not quote-unquote cheap. But then will -- can their earnings continue to compound above the rest of the market like they were for a decade.

Adam: **<u>00:17:28</u>** Yeah.

Jeremy: **<u>00:17:29</u>** The history kind of questions that if they can.

Adam: **<u>00:17:32</u>** Yeah. No. I'm in the same camp. And I'm certainly much more skeptical about the prospects for growth to reassert its leadership in the next cycle the same way that it did in the previous cycle. Not that we want to get positioned too aggressively on one side or the other, but to me that seems like the less likely scenario.

Jeremy: **<u>00:17:58</u>** Yep. We tend to be -- you know, at WisdomTree, we have a whole cross-section of the market. So, whether it's thematics or value. We started with roots in value and believe that it's being high dividend oriented, it's going to be beneficial. And when I think about where are multiples today, people worry about the S&P at 19, 20 times earnings, they worry that the 225 that people were doing bottom up assessments on the S&P is going to be 200 or below, like Mike Wilson and Morgan Stanley is like 180, 185, something like that.

Adam: **<u>00:18:30</u>** Wow.

Jeremy: **<u>00:18:30</u>** And you could buy though large parts of the US market at 11 times earnings, whether it's high dividend stocks, small cap stocks, mid cap dividend payers, you can buy -- there's a lot of baskets at 11 to 12 times earnings. We have a number of them. And so you don't just have to be in the S&P at 20 times earnings, which is, you could say more risk from a valuation perspective than an 11 times earnings basket. I think that's going to be more defensive in the downturn.

Adam: **<u>00:19:03</u>** Yeah. I mean, it just seems prudent to diversify your duration risk within your equity portfolio. Right? So, how do you do that? You just -- you shift some of your portfolio from cap weighted into even equal weight or perhaps even better valuated or some kind of quality value combination weighted. Jeff was saying when he was down here that 22 was the best year for WisdomTree flows in a very long time. I guess that coincides with investors recognizing that they should probably have more exposure to lower duration, higher quality, lower EE companies?

Jeremy: **00:19:46**

So, it's interesting. It was true on both. It was definitely true at an aggregate level, at a firm level, it's true within equities where some of the things -- you know, we launched the firm in 2006, so a number of our funds are coming up on 17-year anniversaries here in June. So, we first launched back then and there was a number of those original, some of our largest funds had their best years for inflows. Two of them had their best years for inflows since we launched. So, it was definitely a year people were recognizing it and you had high dividend stocks that were very positive, mid single digit positive last year when the S&P was down 20. Right? So, it was a very good year for performance, a very good year for flows.

But what was really even gangbusters was we talked about the 5% you could earn in cash, and sort of having a floating rate instrument for treasuries was a huge asset. And so now our largest fund at the firm is a fixed income fund and over 10 billion of flow last year. So, it was a huge year for fixed income. I think some people were thinking and even I was thinking, Siegel was thinking, hey, the Fed might start cutting rates sooner. It seems like that's getting pushed back so that there's even more interest in that, even to start the year and perhaps just as a new way to think about that shortest duration securities were making with some waves in fixed income as well as equities.

Adam: **00:21:10**

No, I agree. And so, I mean, as you guys are having internal conversations, where do you see the current opportunity set that maybe many investors are just not focused on?

Jeremy: **00:21:24**

Well, Adam, I'm going to give a nod to you and what you focus on because I think there's a lot of people having undercounted the role of alternatives and inflation hedges and what you guys have branded as *return stacking* opportunities I think is a real large opportunity. I mean we call things capital efficient at our firm. We're doing some things with stock and bond combinations and then adding in diversifiers like commodities, managed futures that you guys all do a lot with. I think that is, to me, it's one of the big trends. I think there's a lot more to be done in that space. We had launched some things with stock and bonds. We did stock and gold as another combination a few years ago. I think we plan to do more in that spirit over time.

But I think rethinking asset allocation is -- and forever the 60/40 worked. And you now need I think you saw with inflation some different -- needing different characteristics. I tend to be, I think commodities have a bigger role than people have given credit for and could do more with commodities. But I know you guys do a lot of research on the trend in commodities being more important than just a static long-only commodities allocation. But you could argue even for a long-only, given that inflation was a key risk and that people are under counting. And you say, hey, there could be more geopolitical risk that commodities can be a useful diversifier to stocks and bonds, if there's some outlier risk.

Adam: **00:22:58** You know, I mean, obviously, I agree, but just to focus in on the role of passive commodity exposure, I tend to agree. You know, we've read a lot about and deploy products that employ this global risk parity concept. Right? But we're trying to get equal exposure to equities that do well in typically, like a growth environment, benign inflation environment, bonds that typically do well in a lower growth environment or disappointing growth environment, disinflationary. So, between stocks and bonds, there's really nothing that kind of works in an inflationary environment. Boy did we see an example of how that plays out in 2022. Meanwhile, obviously, passive commodities are a very direct hedge against that kind of inflationary environment and act as a potential great third leg of the stool. Right?

Even if you don't want to have them in the same kind of weight as you would hold for your core equities and bonds. Even a 10 or 20% allocation to commodities can go a long way to providing balance in those kinds of inflationary environments. And as you say, stacking kind of a trend strategy on top of any of the sleeves of your portfolio to try and take advantage of that potential for capital efficiency, can really offer a boost. So, obviously, a huge fan. Maybe, I was a huge fan when you guys launched your first capital efficient ETF. You know, between us, maybe we should sort of explain what these structures look like. Right? So, without you naming names, what might a prototypical stock/bond capital efficient portfolio look like?

Jeremy: **00:24:43** You know, and some of the academic research goes back to the legendary Cliff Asness from AQR. You know, he wrote a paper in the 1990s. I forget the exact year. But the title of the paper was something like *a levered 60/40 is better than a 100% equity*, something to that effect that… and what's interesting is when he did his study, he had 70 years of data, his goal was to say what combination of a leveraged 60/40 would get you the same volatility as the 100% stock allocation. And the leverage ratio he applied was 155%. And when we launched, we launched a 90/60 combination, which was almost exactly the paper that Cliff wrote. And funny enough, I hadn't seen the paper when we launched it. So, I came in not having seen the paper, but it was a nice coincidence.

Adam: **00:25:32** How gracious of you to credit him anyways.

Jeremy: **00:25:35**

It was pretty funny timing there. But the -- so, the 150% leverage, we ended up replicating his study afterwards, sort of reproducing his study. And there's all these commentaries about studies failed to replicate out of sample, but his paper worked better in the 30 years after he published it than in the 70 years he did the study. It actually worked way better, stock -- the leverage 60/40 did way better from '97 onwards after he wrote it. But the way this leveraged 60/40 works, in our case, is you would basically take a basket and so the 90/60 is one and a half times the 60/40. And we get leverage through futures.

So, you essentially buy a proxy of the S&P 500. We have our own type baskets. And so you'd buy -- for $100, you put $90 in stocks, and then you'd use the 10 dollars of cash collateral to essentially fund a futures position. You know, you could do it with -- I mentioned we did some things with gold. So, you could basically buy gold futures on top of stocks, or you could do it with, in this case of a treasury ladder, 60% allocated across futures. And so you're basically using futures and the leverage embedded in futures to do these two things.

Now I think that combination is a good combination for taxable investors. Like a lot of the ways things have been done in this way from I'd say some of the traditional '40 Act firms in the US is they would buy bonds and then they would add a swap on top very often, there's a few different firms that do that. And then there's some nice tax advantages of using the equities as the underlying and then the bond futures. The bond futures have a nice taxation element where you're not paying income on the bond, you're paying the 60/40 futures taxation. And so there's some nice elements of doing that as for the structure, you did equity underlying and futures on top of it for a levered 60/40 position.

But you know, the idea there is -- now if you -- and if you put it -- the magic of that one and a half times 60/40, you could put two thirds as much in that, still get a 60/40, and then you have a third freed up for whatever else you want to add. Whatever your -- if you just put it in cash and you actually earn the cash rate, you're basically in the same spot as a 60/40. So, the question is, *can you outperform cash*, becomes your question. So, what can you do with that third to outperform cash? Because the cost of the future, essentially, the leverage in the future, the cost is the cash rate. And so any diversifier like a managed futures strategy that can outperform cash or that owns cash as the underlying, then does futures trading around it, managed futures are in some ways the ideal complement because you're owning cash, you're adding these diversifiers that are trying to outperform cash. But you could do anything that -- you could say, I just want the same exposure and have the cash option value. I just want to be able to spend more. That's another thing you do. But anything that does that is how to think about it.

Adam: **00:28:52**

Yeah. No, that's well explained. And yeah, I mean, it's just what's so great is you've got -- if you got a 90/60 portfolio, well, 90/60 times two thirds is 60/40. Right? So, two thirds of a 90/60 portfolio gets you a full investment in the 60/40 portfolio and you've got one third of the portfolio real estate that's available for you to invest in diversifiers, like you said. Right? So, you could invest it in cash, cash has no volatility, it's effectively uncorrelated to the 60/40 portfolio, but it's not really providing any diversification. As you say, things like managed futures, which are structurally uncorrelated to the 60/40 portfolio, not all the time, but on average, have volatility and therefore have an opportunity to actually generate higher returns.

But the total portfolio volatility is not nearly as large as you'd expect from adding stocks, bonds and managed futures to the portfolio, because the managed futures are uncorrelated to a stocks and bonds portfolio. So, you've got this nice uncorrelated or diversifier, and as a bonus, the managed futures typically are one of the very few strategies or asset classes that tend to do very well during inflationary shocks. So, you're adding a sleeve that may be able to help protect the portfolio, the stock-bond portfolio, where the stocks and bonds are both vulnerable to that inflation shock. Right? So, again, just a really good, a really good option. In the equity oriented world, what do you think investors are most overlooking?

Jeremy: **00:30:40**

Well, the question, are they going to return to growth so quickly? You know, if you look within our themes that we have. We certainly have a basket, our European team in particular, started doing a lot with thematics. With the ChatGPT news, you could imagine if you had to guess our top performing thematic this year, it's definitely the AI fund, you know. The AI strategy is tops with ChatGPT going mainstream. So, that's getting priced in pretty well across the AI type of stocks. You know, I think --

Adam: **00:31:12**

You may not know this, it's tough to ask the global CIO a question, a specific question about the constituents of any of the underlying products. But I'm just curious if you know what kind of companies are under the hood of an AI portfolio. Right? Is it that they tend to be completely novel companies that are relatively new and are taking advantage of some of the huge leaps and advances in AI tech, like ChatGPT, or, I mean Microsoft has bought a slog of the AI tech? Does it mostly -- can take kind of Microsoft and Google who, let's face it, are responsible for a huge amount of the research and own a large proportion of the IP in the space.

Jeremy: **00:32:00**

Well, we do run our own indexes at WisdomTree. And so I have a little bit of knowledge of what's going on under the hood. And so that this is one that our team and our team in Europe had started before the team in the US, focusing on this space. But our team has thought very much, like, what powers all of AI is semiconductors. So, there is large position in semiconductors across of AI. So, you need the chips to create the computing technology on it. There's a combination of the software providers. And classically AI is software. And so there'll be a bunch of different application companies across all sorts of software implications, and that's probably a quarter of the basket.

There's hardware and things like for, you know, everybody talks about Tesla as one of these sort of the premier AI companies and there's all sorts of, you say, hardware that goes into this. There's obviously a set of robotics and industrial type companies. And so there's a combination of some of the established companies. You'd say some of the robotics companies would be part of it, but there's the software companies as well as the semis are the types of companies that would go into this underlying.

Adam: **00:33:19** Gotcha. Good. So, AI is a theme. What else do you think is exciting for investors to take a look at?

Jeremy: **00:33:27** Well, that's certainly where things are going. I'd say they should still be thinking largely about value. I mean, I don't know that the value rotation is quite over. And so I like -- we've been talking US small caps at 11 times earnings is a place to be. International value, eight to nine times earnings if you think the value rotation is still early in the phase. Part of everybody's going for growth, that was a US S&P 500 tech phenomena, but the international value places I think is another really useful place. And people are thinking about the sort of China reopening as bullish for commodities or for China and there was been a lot of money and moving to broad emerging markets. But even sort of European exporters are tied to the China reopening.

And actually one of our baskets of European exporters was up double digits and more than broader national because I think of the China connection that they're -- It's less of a -- in some of our economists view, less of a massive infrastructure opening from China. But, hey, China tourists are going to go around the world and start consuming again. And this is good for Japan, this is good for Europe. There's ways to play China reopening that are not just China tech, which was under a lot of pressure and certainly has seen the most interest in the reopening story.

Adam: **00:34:57** Yeah. Japan also seems like a really interesting opportunity. It wasn't so long ago that we were looking at Japanese small caps, even Japanese large caps operating at a very significant discount to their historical PE's. Typically Japanese equities trade at a premium on a PE basis to other countries, but relative to their history, they look relatively cheap. Is Japan an area of emphasis?

Jeremy: **00:35:26** Well, you must have been just talking to Jeff because Jeff talks about this all the time about the, you know the, we talked about the TINA trade in the US, the TINA being *there's no alternative* to stocks, that bond yield were so low that you had to be in stocks. Well, where is that adage still true. It's definitely still true in Japan.

And if you compared -- if you actually -- there's all different ways you could measure the equity premium. You know, I think that our favorite way would be the earnings yield versus the TIPS yield, because stocks have real assets, earnings and growth inflation over time.

But if you did a more simple metric like the stocks versus the two year yield or something like that or the nominal yield, you could say, hey, maybe the earnings yield is getting close to the two year -- it's getting very close to the two year yield in the US. You know, Japan yields are basically still zero. You know, their 10 year is still being capped at 50 basis points, shorter terms or even smaller yields. But you could look at, you know, with our dividend weighted approach, you're single digit PE's, nine to 10 PE's. So, 10% earnings yields with basically no bond yield to speak of. Right? That is a real equity premium.

And again, their currency devalued with the rates. I mean, basically, it was a play on the Fed versus their central bank keeping rates pegged at -- they're capped at 25. They moved to capped at 50 on their 10 year bond yields. Their stocks maybe they'll change it more with the change in leadership coming up in a few months. But there's still a huge equity premium, and I think they're still again tied to the Chinese reopening. So, they've got some positive catalysts combined with this outlier earnings yield spread, huge equity premium. And they're actually focusing on corporate governance for the first time. It's been a 30 year bear market in many ways from the peak of the bubble in '89 when they were like a 100 PE. Now they're a tenth of the PE when you look at their value stocks. So, it's still a place. Jeff and I are some of the few people who like to talk Japan and think there's value there.

Adam: **<u>00:37:36</u>** Well, I mean, the leadership of corporate Japan is a completely new generation from what it was in the 90's at the height of the Keiretsu model, they dismantled a lot of that. Japanese industry is a lot more agile, a lot less interconnected now and arguably positioned to be a lot more competitive going forward, both tech and just industrials. Right? They know they got to be competitive against China. They know they're not going to compete on the cost of labor. So, they've invested a lot in innovation and productivity, and they're polished up and ready to dance, I think. What about the currency?

Jeremy: **<u>00:38:19</u>** You know, it moved around a lot last year. I mean, it's definitely a function of -- it was a play on the Fed and the rates. Right? So, the more the 10 year in the US, there was a huge yield gap. And there's still, I mean, it's still -- we're not quite at four and they're not quite at 50, but call it three and a half percent on the 10 year and higher at the short end because they're basically negative. And so you know, you've got basically a 5% gap. There's a 5% carry, which is also saying, this is another one of those interesting things. I've been talking about hedging currency for Japan, one of the few people in the US who talks about this at all. There's like two of us who talk about it. I'm like one of the two people who talk about it. And it's been true since 2010, but there's a 5% carry trade to hedge the Yen because of again, negative rates, positive rates.

So, the un-hedged has to catch up by 5%. The Yen has to go up by 5% to just catch up to the hedge. And so the ECB's been raising rates, but there's still a positive carry trade in the Euro too. But there's a whole question of why when you go in Japan, Warren Buffett bought Japan a few years ago. I don't if you remember when he bought these--

Adam: **00:39:38** Yeah, I do remember that.

Jeremy: **00:39:40** -- six Japanese trading companies. Did he go unhedged or hedged when he bought Japan?

Adam: **00:39:47** Presumably he went hedged?

Jeremy: **00:39:48** Why would you? Why would you bet on the Yen? He thinks these stocks are cheap. Why would you say the Yen is part of the story? So, how did he hedge his position? He started -- he floated a bunch of bonds. So, he did even in a way where he basically bought these things, *flow to the Yen bonds* at zero, and used all that capital to buy these things. So, he basically bought it with not even putting up any capital essentially, and with the zero rate. What a deal for him. These things have gone up a lot, but you know, by issuing the debt in Yen as the Yen fell, you know, he has to pay back less. Right? So, he was fully hedged by issuing the bonds. But US investors can take advantage of that too by just doing currency hedge. You don't have to -- your thesis could be the stocks are cheap. I don't need to make a bet on the currency. I think more people should be hedged than they are.

I think the dollar -- the S&P has a weak dollar bias to it. I don't see enough people talk about this, Adam, that there is a -- more and more of our earnings are global multinational earnings. And you saw it through earnings reports. I mean, Mike Wilson said there was an 8% earnings headwind because of the 15% strong dollar at one point last year. Now okay, so some of that reversed, and maybe tech's going to get a little bit of an earnings bounce because of that. But why double down? If you're going to go international, why double down if the S&P already has a weak dollar bias to it? You don't need further weak dollar bias. You just buy the stocks and these companies might become more competitive if you have a strong dollar. You don't need to rely on a weak Euro or you don't need to rely on a weak dollar/strong Euro to be going overseas. Just say, the stocks are cheap, be hedged, that's my -- I think more people should be hedged than they are.

Adam: **00:41:36** Yeah. And I mean, you guys were one of the very first companies to come out with these hedged ETFs. Right? You know, people can buy a hedged Japanese equity ETF and super liquid and a really interesting diversifier for, probably, most portfolios. Do you guys do anything with India? I'm hearing a lot about India as a potential investment thesis.

Jeremy: **00:41:58** It's funny, you say, because I had two calls on India this week, people asking about India. So, two -- I think some of its, flows are going back towards emerging markets. It's one of the things you've seen year to date, the last 90 days. People are going to emerging markets. People are saying maybe the US's long decade is not going to continue until EM's, one of those places. But they're also a little skittish on, *is China the place to be*? So, like, one of the discussion points was should I have a strategic allocation to EM, but also diversified from -- China tends to be a third of most indexes. India's population's surpassed China, if it hasn't already, sort of young demographics. The thing I say about India is that people know it's one of the best growth stories, so they pay up for it. I mean, it's not a cheap market.

Adam: **00:42:48** Yeah. It's priced. Yeah.

Jeremy: **00:42:49** Mid 20s you know, is PE on MSCI India. You have the Adani story that's circulating and a lot of those were expensive stocks, so they were close to 6% of the cap weighted indexes to start the year. Interestingly, with our earnings index, they were less than a percent to start the year. So, seven to eight times less because they were expensive stocks. So, like in an earnings weighted approach the PEs are only 12. So, you actually get a, like, 10 point discount when you go to earnings weighting India, which I think if you're going to go to India, I like that a lot because you get the value sensitivity. You don't have to worry about it being more expensive. It basically brings you back underneath MSCI's PE ratio. So, it's very value centric.

It also very broader markets in the sense of, cap weight India with MSCI has about 100 companies. If you go to a broader universe like what we talked about around 400 companies. So, it's a useful way to think about the broader opportunity set with a value sensitive idea. And for sure, I mean, now India's outperformed over the last five, six years. This year, when EM is screaming, it's basically flat because I think some of this Adani news. But --

Adam: **00:44:01** Yeah, definitely.

Jeremy: **00:44:02** -- beyond that, I think of a long-term demographic growth story. It could benefit from some of the moving away from China over time. It's one of the more local economy stories within emerging markets. So, I'm very bullish long-term on India's demographic profile. Then the question is, what are you paying for it? And so think about an evaluation sensitive approach there.

Adam: **00:44:27** Do you think the Adani story is maybe also raising questions about the accounting reliability and the audit reliability in India? I know there's obviously been some skepticism or maybe caution about taking the accounting data from Chinese firms at face value through the same kind of reticence for India, do you think?

Jeremy: **00:44:50**

It's interesting. I mean, these are, like, the same stories you hear over and over throughout history. And it also goes to, like, why people gave me a hard time of, why focus on dividends as evaluation metric? Well, you know, one thing you can't do, you can't restate your dividend. You know, there's something about dividends at face value that cuts through all the accounting clutter. And actually before we had all this SEC -- and it was a way that companies throughout the, call it the 19th century showed that they had earnings was they paid out the dividend. And I think in some emerging markets, the dividend -- that you pay a dividend is an important metric.

Now and when we first started our broad emerging market indexes, that is -- the dividend payment was a very important sign. For small cap emerging markets in particular, the last 15 years, non-payers, was about 20% of the market, were down 2% a year when, like, high dividend EM stocks were positive 7 or 8% a year. So, it's a big red flag in the EM markets if you can't pay the dividend. Now India punitively taxes dividends, so they don't pay that many of it. So, this is one market where you can't, at least when we went to that market, we wanted it to be a broad approach and we went with an earnings concept. But I'd say, yes, there's some fears today.

Dividends are one way to think about it, not having to worry about that fear, but often people get overly hyped about a few specific issues. We had the same thing with China and … I want to say. It doesn't mean that all of the earnings are bad in China. There was a few scenarios where there's some questionable practice. Just like in the US, there'll be a number of questionable practices. But in general the firms auditing the books, are the same accounting firms that are auditing our books. So, it's not all that different for China. And I think the standards -- and yes, there's different standards in every country, but I don't have a massive fear about the accounting in India.

Adam: **00:46:59**

So, I want to dig into your points about dividends in emerging markets because I think if I recall that investing based on dividend sorts, has not been particularly robust in the US over the long term, right? There's been no -- from a total return standpoint, there's been no advantage to dividend sorts the way that they typically are for, say, earning sorts or even book-to-price sorts. So, correct me if I'm wrong on that, but then what I want to focus on is, is that also the case in foreign markets and emerging markets or, and, in especially emerging markets? So, am I hearing you say that seeking out dividend paying companies or loading on dividends in emerging markets has historically meaningfully outperformed on a … return basis?

Jeremy: **00:47:53** And particularly in small caps interestingly enough. But that's live. I mean, for the last 15 years that we've been live, you've seen -- we could show -- we have an attribution too on our website where you could look at the cap weight index, our index and see that the -- in the last 15 years, the non-payers were negative a few percent a year when the … stocks were positive 7%, 8%. So, very big outperformance across EM, small caps in particular, but even EM large caps in some ways as well. You know, the long-term on dividends, Siegel -- this comes back to my research with Siegel for some of his books. He did, you know, when I helped him with his book called *The Future For Investors,* it came out in 2005. And the final chapter of that book was called *The DIV Directives.* He does believe in dividend outperformance.

There was a -- we did a 50 year study of the S&P 500 that sorted the S&P into quintiles going back to the S&P's inception, and it did show out performance. And it was a, call it, 200 basis points for the top quintile. Now after we published the book, the last 15 years, it's been a growth market. Right? So, right as we publish the research, it completely turns for you that growth starts to dominate for the next 15 years. But it's -- All right, so it's not as powerful, the earning, we also in that book, we showed a PE sort and the dividend sort. And, yes, the PE sort was more powerful, so the excess returns were higher. The risk adjusted returns were very good for the top -- it tend to be lower beta stocks in the highest yielding quintiles. Now going into the '08-'09, you had low PE, high dividends, were all the banks and the financials. So, you**,** going to that, it wasn't as you got a headwind right away from the financial crisis after the book came out.

Adam: **00:49:45** Remember, *The Dividend Aristocrats* was full of companies like Bank of America, AIG, GE, right, all these companies that ended up absolutely getting massacred in '08 that had never cut their dividend, that had grown their dividend for, like, 50 years straight or something.

Jeremy: **00:50:02** Every value metric has its issues. Like, so price-to-book you know, why do they pick price-to-book in '93? Well, probably when they did their test, price-to-book looked like one of the best. And then now price-to-book has been, like, one of the worst for the last 15 years, even worse than dividends you could say over that period. And price-to- book has declined meaningfully in terms of, now companies no longer have assets on their balance sheets. They have a lot of intellectual intangible capital that's not sitting on the balance sheet. So, the tech companies will never have a low price-to-book and consumer --

Adam: **00:50:37** … capitalizes on a need, which a few of the companies are now doing for sorts, which I think makes a lot of sense in the modern context. Yeah.

Jeremy: **00:50:44** Yeah, you need to do all sorts of adjustments to start adjusting that intangible capital. But even also in -- where book value, but also that makes these companies look more profitable. If you start capitalizing these R&D expenses, it's less earnings hit today, more of a smoothed out earnings cycle the next five years. So, a lot of these companies it might be unprofitable tech become profitable tech actually.

Adam: **00:51:07** Right.

Jeremy: **00:51:08** So, it's kind of an interesting discussion there.

Adam: **00:51:12** Yeah. I always wondered about dividends because I think there's a strong dividend preference too, and that maybe -- That may die off as some of the older generations kind of move on. But certainly, among many boomers and before them, the silent generation, there was definitely a strong dividend preference. And I wonder if maybe that there's a -- there might have been a discount because you would demand just a -- they would require a lower total return because of their preference for the dividends. Right? But maybe that's no longer the case or that's kind of dwindling now.

Jeremy: **00:51:52** Well, I think last year, we'll question whether or not it all ways gone away. Because you now saw it was back to the basics of 25% outperformed over the S&P last year for --

Adam: **00:52:02** Yeah. Yeah. Yeah.

Jeremy: **00:52:03** -- high dividend US stocks. But so some things you think go away and then they come back. But it's just another value metric and each one has their intricacies. I mean, think about now the S&P growth value. I don't know if you saw this paper I did on the recent rebalance of S&P, but the S&P rebalanced and they added momentum to their growth index. Okay. And so they have this three factor model for growth and value that is -- and the intersection of their growth and value scores can impact their value scores. So, what became very negative momentum and such very negative growth, was tech. And what became very positive momentum was energy. And so what got sold from their value index is the cheapest stocks. And what went into their value index is the most expensive stocks.

Adam: **00:52:56** Wow.

Jeremy: **00:52:57** Amazon is now a value stock according to S&P. And Exxon and Chevron are growth. In particular, pure growth are now all the energy stocks and none of the tech stocks. I mean, that's a little overstatement. But --

Adam: **00:53:11** Unintended consequences galore.

Jeremy: **00:53:13** Right? So, there's all sorts of, and that's the premier S&P branded value/growth cuts that can have. Now the high dividend stocks are like I keep saying 11 to 12 PE.

You only get one point discount across large, mid and small cap S&P cuts because of that intricacy of momentum in their growth score, impacting everything.

Adam: **00:53:36** Incredible. Incredible. Wow. I also wanted to pick your brain about the new Biden taxes on buybacks. Any thoughts on whether that's going to shift capital distribution choices? If so, what impact do you think it's going to have?

Jeremy: **00:53:59** Buybacks are interesting. This is like pol-- people love to hate on buybacks. The politicians like to pick on buybacks, companies are buying back their own stock versus investing in CapEx or giving it to their employees. And they get a reputation of companies, they're only doing it to offset their stock option issuance that they -- and there is a truth that when buybacks really accelerated after stock options became popular, and you saw it when Microsoft paid its first dividend in 2003, they canceled their stock option policy, they started doing restricted stock. So, there's definitely a connection between stock options and buybacks. But I also think, you know, there's this question, do companies waste their buybacks? What we find is that most of the buybacks are happening because companies think their stocks are cheap.

And some of the ways we're looking at buybacks today, I need to refresh these numbers, but the last time I looked at it, like, two thirds of the gross buybacks were what we would call value stocks, like very cheap stocks that, you know, that they were -- the companies were expressing a sign that these stocks were cheap. And we do have some strategy to focus on dividends and buybacks together. And we were writing on it today, actually. And they have, again, like, a 10 to 11 PE in aggregate, and 8 to 9% buyback yield. So, they're buying significant amounts of stock back. So, not just small amounts. Those are like 8 to 10% on average. So, some are way more than that. But in theory, I mean, we'd like people not to have any advantage on these taxes. I mean, there's a whole question of even dividends being disadvantaged versus you're encouraged to finance with debt because interests are fully tax deductible versus you do equity capital, pay a dividend that's not tax deductible.

And now, hey, we've already taxed your earnings and we're going to further tax if you buy back your stock. Like, the tax system has all sorts of inconsistencies and yes, people prefer to defer capital gains. And so the buyback is tax advantaged versus a dividend you could say. It's just a tax advantaged dividend, is one of the ways you could think of a buyback. So, politicians say, hey, there's some money to grab. Let's tax the buyback a little bit more. Well, that's kind of a -- there's all sorts of things they could tax. And taxes do change incentives, whether or not that tax incentive is high enough to completely change the buybacks. If it's coming out of their pockets, it's different than if a shareholder pays the dividend tax. In theory, there's a total amount of capital returned and it shouldn't matter, but companies will respond to incentives and maybe they, at the margin, impact their thoughts and encourage dividends more than buybacks.

Adam: **00:56:53** Yeah. I mean, I do wonder about I know … Miller, we know mechanically that buybacks are exactly the same as dividends from a cash distribution standpoint. I do wonder about how the different distributions are used. Like we were talking about earlier, right, there is this dividend preference among a whole segment of the population where they design portfolios to try to just live off their dividends and not touch their capital. Right? And there isn't the same kind of phenomenon for buybacks.

So, I do wonder if a much larger percentage of dividend cash flows or dividend distributions are withdrawn from the market, whereas the vast majority of buyback is redeployed in the market, then that would exert some kind of positive pressure at the margin for just added demand to equity, structurally over time. And if they disincentivize buybacks relative to dividends, more companies switch to dividends, fewer buybacks, whether that means that there'll be less buying pressure at the margin going forward depending on how companies decide the tradeoffs look like.

Jeremy: **00:58:20** That is interesting. I wonder how many people reinvest their dividends and how much take it and live off of it. It's a very interesting question to get a study on, is what is the automatic reinvestment versus people who take the cash and do other things with it.

Adam: **00:58:35** Yeah. I don't know. I've always been curious about that because I know everyone says they're exactly the same, there's no concern. Stop it. But I do think that they're used in slightly different ways by different kinds of investors and that actually might make a difference at the margin over time.

So, what is WisdomTree focused on right now? Are you guys hoping to launch some new products? If so, what themes are you exploring or sorts or directions or new asset classes, alts, etc.? Anything really interesting that you want to talk about?

Jeremy: **00:59:07** You know, I'd say we're focused in many ways on the future of finance, even away from ETFs. So, I think we have, our ETF lineup is very robust globally, and I think a lot of our innovation might actually come in what we're calling the token form. We're actually launching tokenized funds in a wallet called *WisdomTree Prime*. So, right now, there's a wait list but the app should be rolling out in the coming months. I've got it on my phone playing around with it and there's things like gold and cash. But basically tokenizing all sorts of things from real world assets, treasuries, equities, gold, and other things in there. And so I think that's -- and we talk about sort of savings, spending, investing.

So, it's a sort of new ecosystem in this digital wrapper. We're still obviously going to -- we believe in ETFs. I mean, 30 years from now, ETFs will be just like ETFs are, mutual funds still actually much bigger than ETFs long at -- 30 years after ETFs. For us, ETFs will still be dominating far in the future, but we do believe in this tokenized wrap race, as innovating for us, as a new thing. So, yes, we're going to continue to innovate, probably do a handful of traditional ETFs this year in the US. But you'll see a lot from us in this token form, and sort of exciting updates coming from that front.

Adam: **01:00:37** Wow. Yeah, that is really interesting. I mean, that's a very new direction. So, look forward to seeing how that plays out. Jeff was mentioning some of those new directions when we were chatting over dinner. So, yeah, very cool. Jeremy, where can people find you? I want to let you go, you're on vacation, the last few days. Where can people find you? Say more about your podcast. What are you focused on personally right now?

Jeremy: **01:01:04** Well, thanks for the opportunity to be here on ReSolve Riffs. You can find me on Twitter @JeremyDSchwartz. You could see us on our Behind the Markets Podcast every weekend, Saturdays, you'll see those podcasts dropping. Sirius XM if you're in the car on Fridays at noon. So, that's in the car on Sirius 132. You know, and at WisdomTree.com, our blog has a ton of great content and you can get Siegel's comments every week if you're not listening to the podcast. Some of that's overlapping, but you get Siegel's comments. And there's a broad team of people who, Jeff, as Adam has talked about, is producing there, but we've really daily and even more sometimes depending on what's going on. But you get a lot of great insights on the WisdomTree blog. And you know, appreciate the opportunity to be here with all your listeners, Adam.

Adam: **01:01:57** Man, I just want to plug your blog too because I think it's some of the best practitioner oriented but academic quality research that you can get out there for free. You know, most of the time, you got to pay for journal subscriptions. And a lot of times convoluted and it's more academically oriented than practitioner focused. So, yeah, huge props to your team for publishing really relevant, timely, well-constructed research that people can actually use today to build better portfolios. So, well done on that. Jeremy, thank you so much. Enjoy the last few days of your vacation in the south, and maybe we'll get together when we're in Philadelphia.

Jeremy: **01:02:36** I would love for you to come visit, look forward to it.

Adam: **01:02:39** Thank you.