

# WisdomTree Research

## Fundamental Investment Grade Indexes Rebalance [May 2018]

### WisdomTree Fundamental U.S. Corporate Bond Index (WFCIG)

### WisdomTree Fundamental U.S. Short-term Corporate Bond Index (WFCIGS)

WisdomTree Fundamental U.S. Corporate Bond Indexes are structured to screen the available universe of investment-grade corporate bonds for sufficient liquidity and fundamentals, and then tilt toward those bonds with attractive income and valuation characteristics.

On May 31, 2018, the WisdomTree Fundamental U.S. Corporate Bond Index ("WFCIG") and the WisdomTree Fundamental U.S. Short-term Corporate Bond Index ("WFCIGS") rebalanced in accordance with their [Index methodologies](#). Respectively, the Indexes serve as the underlying benchmarks for the WisdomTree Fundamental U.S. Corporate Bond Fund ("WFIG") and the WisdomTree Fundamental U.S. Short-Term Corporate Bond Fund ("SFIG").

#### KEY REBALANCE HIGHLIGHTS

- With the May 2018 rebalance, the index yield and duration increased for both WFCIG and WFCIGS with limited changes in sector exposures.
- During the rebalance, WFCIG and WFCIGS selected companies in each sector that have better cash flow, employ lower leverage, and are more profitable.
- Each corporate bond Index offered yields and durations comparable to its market cap benchmark, with continued strategic over-weights in Telecom and Health Care, and under-weights in Energy.
- The next quarterly rebalance for both Indexes is scheduled for August 2018.

#### INDICATIVE INDEX STATS

Post-rebalance, there were minimal changes to yield and duration for WFCIG and WFCIGS. WFCIG is expected to yield 3.91% and its duration increased 0.4 years to 7.1 years. The yield for WFCIGS was boosted 12 bps to 3.20% and its duration extended 0.3 to 2.5 years.

INDEX STATISTICS	Projected Index		Current Index		Benchmark	
	WFCIG	WFCIGS	WFCIG	WFCIGS	COA0	CVA0
Yield to Worst	3.91%	3.20%	3.81%	3.08%	3.94%	3.31%
Duration	7.1	2.5	6.7	2.2	7.1	2.8
Minimum Par Size (\$Mil)	350	350	350	350	250	250
Issuer Cap	5%	5%	5%	5%	-	-
# of Bonds	3134	1217	3060	1194	7717	3058

Sources: WisdomTree, Bloomberg, Merrill Lynch, with data as of 5/23/2018. COA0: BofA Merrill Lynch U.S. Corporate Index, which tracks the performance of U.S. dollar denominated investment grade corporate debt securities issued in the U.S. CVA0: BofA Merrill Lynch 1-5 Year U.S. Corporate Index, which represents the subset of COA0 with remaining term to final maturity of less than 5 years. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. Projected Index represents the projected index after rebalance. Current index represents the latest index before rebalance.

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### INDEX SECTOR BREAKDOWNS

WisdomTree's investment-grade corporate bond Indexes experienced few changes in sector weights after rebalancing. Within WFCIG, the largest changes in exposure were a 1.2% increase in Health Care and a 0.90% decrease in Technology. Within WFCIGS, the largest changes in exposure were a 1.2% increase in Industrials and a 1.0% decrease in Technology.

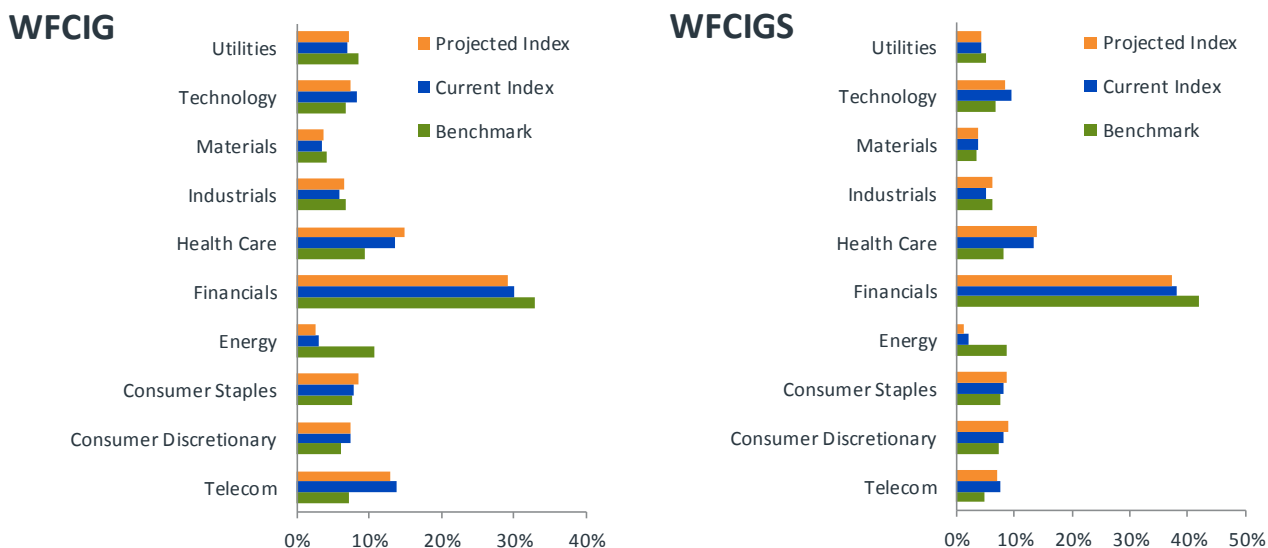
### Most Significant Sector Changes After Rebalance

WFCIG			WFCIGS		
<b>Top 3 Exposure Increases</b>			<b>Top 3 Exposure Increases</b>		
1	Health Care	1.2%	1	Industrials	1.2%
2	Industrials	0.7%	2	Consumer Discretionary	0.8%
3	Consumer Staples	0.6%	3	Health Care	0.7%
<b>Top 3 Exposure Reductions</b>			<b>Top 3 Exposure Reductions</b>		
1	Technology	-0.9%	1	Technology	-1.0%
2	Financials	-0.8%	2	Financials	-0.9%
3	Telecom	-0.8%	3	Energy	-0.8%

Sources: WisdomTree, Bloomberg, with data as of 5/31/2018. You cannot invest directly in an index. Exposures subject to change.

Compared to the market cap benchmark, WFCIG remains significantly under-weight Energy (-8.3%) and over-weight Telecom (+5.7%), while WFCIGS is under-weight Energy (-7.2%) and over-weight Health Care (+5.8%).

### Sector Breakdown Comparisons, Before and After Rebalance



Sources: WisdomTree, Bloomberg, Merrill Lynch, with data as of 5/31/2018. You cannot invest directly in an index. Exposures subject to change. WFCIG benchmark represented by COA0. WFCIGS benchmark represented by CVA0.

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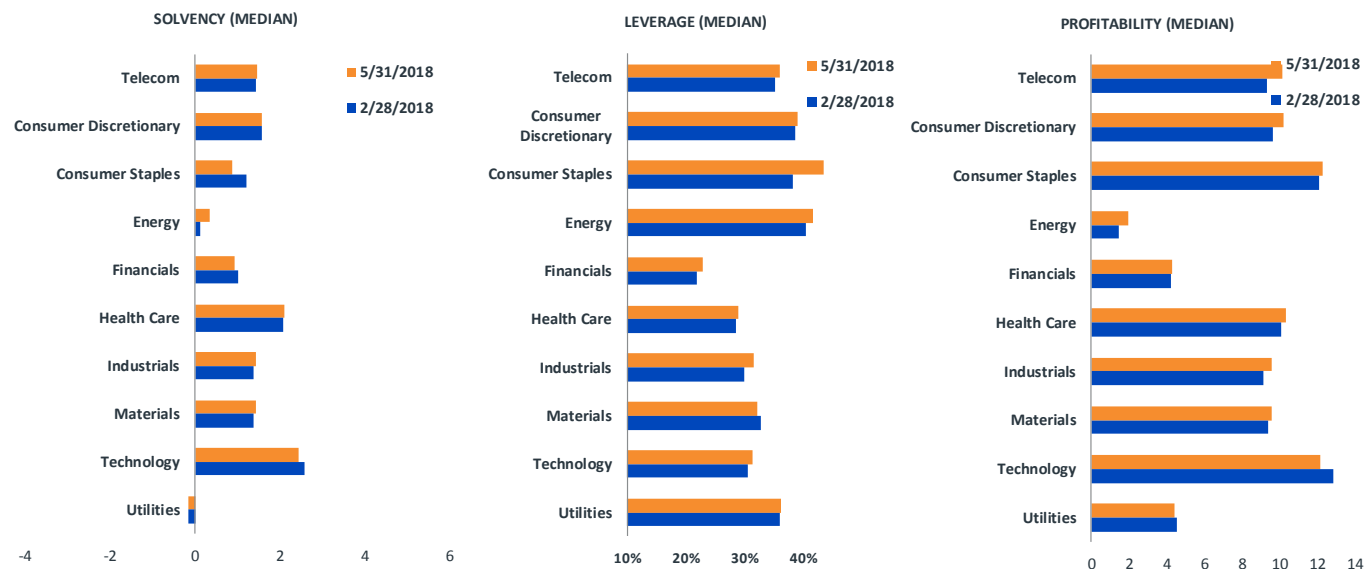
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### CHANGES IN FUNDAMENTAL FACTORS

For investment-grade corporates, we use free cash flow over debt service as a measure of solvency, total debt over total assets as a measure of leverage, and return on invested capital as a measure of profitability.

Over the past three months, we generally saw minor deterioration in cash flows across most sectors. Notably, cash flows in the Consumer Staples and Technology sectors decreased the most relative to their peers, while Energy and Materials saw the most improvement. Most sectors saw relatively mute changes in leverage relative to a quarter ago. Leverage in the Consumer Staples sector increased modestly. Overall profitability changes were mixed. Consistent with last quarter, the Technology sector saw their profitability fall the most. Profitability measures in the Energy, Industrial and Telecom sectors increased modestly. Overall, fundamentals were broadly similar for all sectors when compared to February 2018.

### Changes to Fundamental Factors by Sectors (Public Universe)



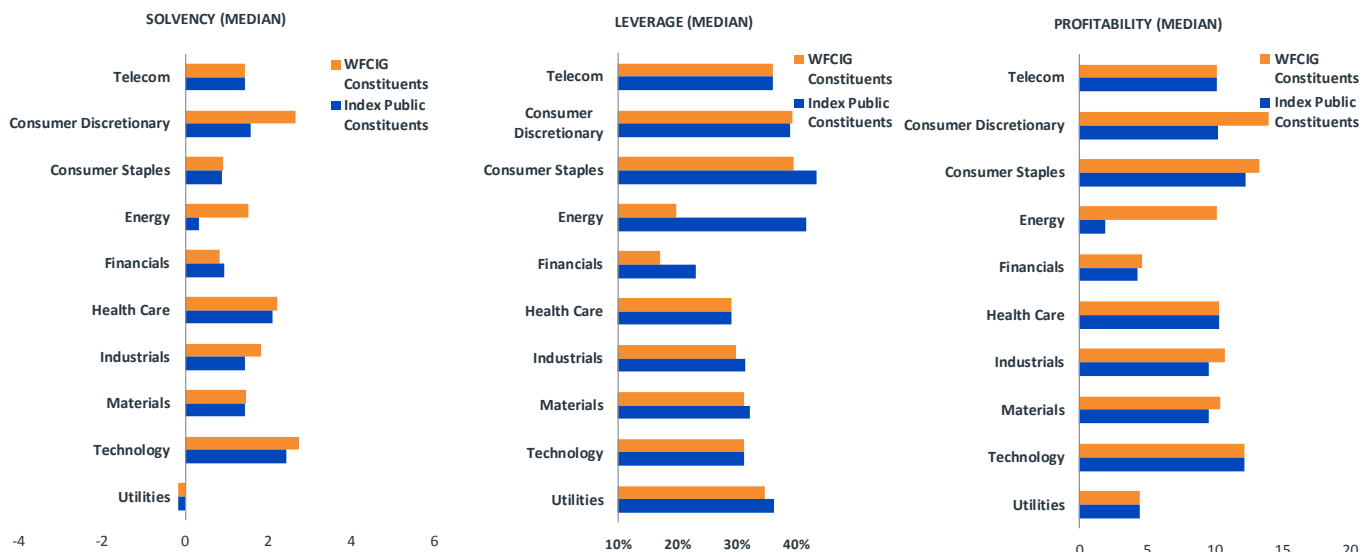
Sources: WisdomTree, FactSet, Bloomberg, with data as of 5/31/2018. Free cash flow over debt service is used as a measure of solvency. Subject to change.

At each rebalance, we eliminate the bottom 20% of companies in each sector with the lowest fundamental factor scores. As a result, WFCIG and WFCIGS select companies in each sector that have better cash flows, employ lower leverage, and are more profitable relative to the benchmark.

### Comparison of Fundamental Factor Medians by Sectors – Fundamental Index vs Market Cap Universe

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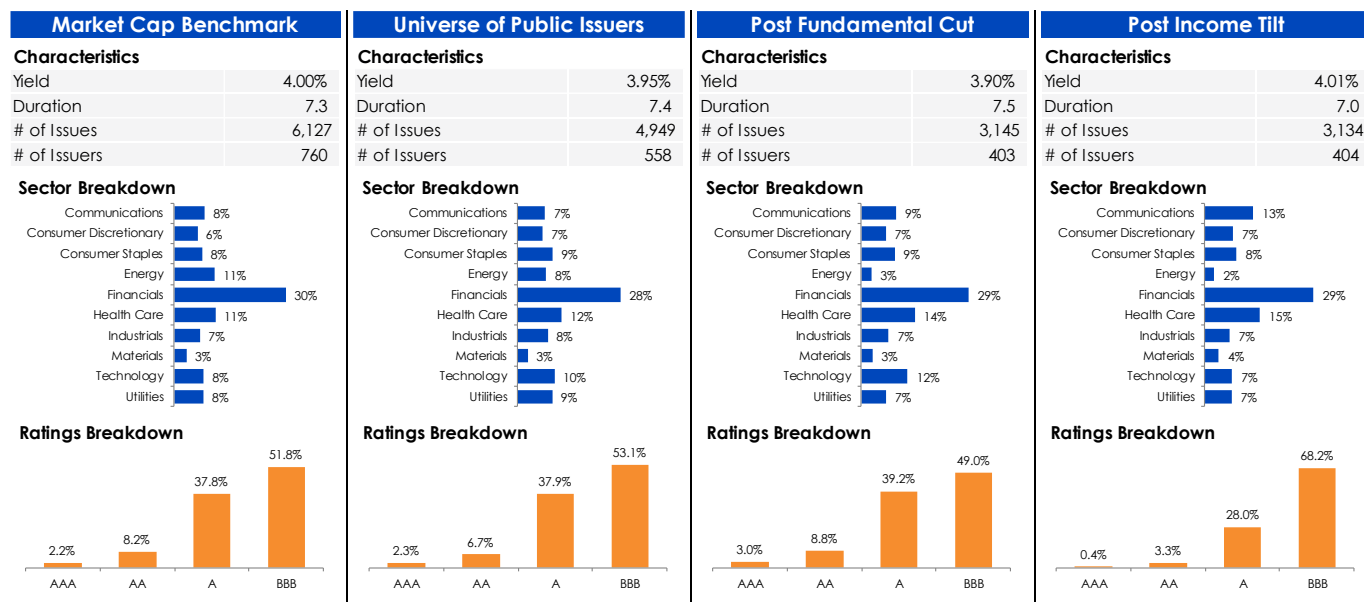
Sources: WisdomTree, FactSet, Bloomberg, with data as of 5/31/2018. Free cash flow over debt service is used as a measure of solvency. Index Public Constituents represents a subset of the Bloomberg U.S. Corporate Bond Index that excludes those with private parent companies. The Bloomberg U.S. Corporate Bond Index is a rules-based market value-weighted index engineered to measure the investment-grade, fixed-rated, taxable corporate bond market rated, taxable corporate bond market.

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### UNIVERSE BREAKDOWN SHOWCASING REBALANCE PROCESS

In the following panels we show the indexing process for WFCIG. To review, we start with a broad investment-grade corporate universe with minimum size and years-to-maturity constraints, and calculate the combined factor scores for public companies based on fundamental factors. For each broad sector, we cut the bottom 20% of the companies with the lowest factor scores, and then tilt toward those with the most favorable risk-adjusted income characteristics.



Sources: WisdomTree, Bloomberg, data as of 5/23/2018, the weight determination date of the rebalance process. Past performance is not indicative of future results. You cannot invest directly in an index. Market Cap Benchmark defined as the Bloomberg U.S. Corporate Bond Index, a rules-based market value-weighted index engineered to measure the investment-grade, fixed-rated, taxable corporate bond market. Universe of Public Issuers represents a subset of the Market Cap Benchmark that excludes those with private parent companies. Post Fundamental Cut is the portfolio that remains after cutting the bottom 20% by fundamentals. The Post Income Tilt represents the final index after adding in the income tilt. Exposures subject to change.

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### Glossary:

**Cash Flow:** a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

**Duration** is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates. Effective duration is a calculation used to approximate the actual, modified duration of a callable bond. It takes into account that future interest rate changes will affect the expected cash flows for a callable bond.

**Credit Quality** is the underlying credit worthiness of a bond, reflecting its risk of default. Credit quality is typically represented by the credit ratings of a bond that are assigned by rating agencies such as Moody's or Standard & Poor's.

**Yield to worst:** The rate of return generated assuming a bond is redeemed by the issuer on the least desirable date for the investor.

**Investment Grade:** A rating given to a municipal or corporate bond. It is a relatively favorable rating by either Moody's or Standard & Poor's indicating a higher chance an issuer performs interest and principal obligations as promised by the terms of the debt issuance.

**Liquidity:** The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.

**Fundamentals:** Attributes related to a company's actual operations and production as opposed to changes in share price.

**Rebalance:** An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

**Yield:** The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

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