

Analysis of the 2016 Earnings Index Family Rebalance

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At WisdomTree, we believe strongly in relative value¹ rebalancing. The act of rebalancing constituents of an Index to their fundamental² values is important, given our belief that stocks often overshoot their underlying fundamentals. Consequently, investors run the risk of paying too much for stocks that have become more expensive compared to their fair value. A disciplined strategy of reweighting allocations back to more attractively valued stocks, through the annual rebalance process, is an important element in managing market valuation risks.³

Typically, this results in the following:

- + **Companies whose share prices appreciated at a faster rate than their fundamental improvement would typically see a reduction in their constituent weight during the rebalancing process.**
- + **Companies whose share prices did not appreciate or even dropped, but whose fundamentals were maintained or improved, would typically see an increase in their constituent weight during the rebalancing process.**

At the beginning of 2016, the market was worried about the U.S. and global economies as well as growth prospects, which drove markets and interest rates lower. Although the U.S. equity markets bottomed out on February 11, interest rates didn't find their floor until July 8.⁴ Since then, when interest rates bottomed along with fears about economic growth, equity markets accelerated their upward trend, being led by mid- and small-cap equities.

Particularly in November, after the election results were finalized, equity markets went into overdrive, with mid- and small caps meaningfully outperforming the broader markets on the prospects of lower taxes, less regulation and higher economic growth. This strong performance after the U.S. election marks a good time to rebalance and take chips away from some of the really big winners and add weight to the stocks at lower multiples, the underperformers.

¹ Relative value: The relationship between a particular attribute, e.g., a dividend, and the firm's share price compared to that of another firm.

² Fundamentals: Attributes related to a company's actual operations and production as opposed to changes in share price.

³ Valuation risk: The risk of buying or over-weighting a particular stock that has appreciated significantly in price relative to its dividends, earnings or any other fundamental metric.

⁴ U.S. equity market refers to the S&P 500 Index; interest rates are the 10-Year Treasury yield.

WISDOMTREE'S TOTAL EARNINGS STREAM⁵

The discussion of the change in the underlying exposures starts with the factor that drives all the weights of securities in the earnings Indexes—the behavior of the *Earnings Stream*.

FIGURE 1: GAUGING THE EARNINGS STREAM OVER TIME (AS OF 11/30/16 INDEX SCREENING)

Sectors in WisdomTree Earnings Index (WTEI)	11/30/2007	11/30/2008	11/30/2009	11/30/2010	11/30/2011	11/30/2012	11/30/2013	11/30/2014	11/30/2015	11/30/2016	Growth: 11/30/2015-11/30/2016	Growth: 11/30/2007-11/30/2016
Consumer Discretionary	\$87.50	\$79.10	\$52.60	\$89.63	\$110.94	\$117.97	\$135.59	\$132.45	\$137.88	\$150.75	9.3%	72.3%
Consumer Staples	\$78.60	\$83.70	\$77.92	\$86.17	\$96.12	\$92.91	\$103.11	\$99.34	\$99.13	\$101.09	2.0%	28.6%
Energy	\$119.40	\$162.50	\$53.70	\$87.21	\$130.50	\$119.27	\$111.84	\$117.31	\$54.84	\$17.15	-68.7%	-85.6%
Financials	\$248.00	\$110.30	\$72.11	\$133.07	\$155.45	\$167.96	\$214.39	\$243.83	\$260.00	\$254.00	-2.3%	2.4%
Health Care	\$83.00	\$94.30	\$84.22	\$89.72	\$101.99	\$100.54	\$105.85	\$110.34	\$115.14	\$130.73	13.5%	57.5%
Industrials	\$107.70	\$105.30	\$59.19	\$83.19	\$105.71	\$113.97	\$117.66	\$141.66	\$129.71	\$123.54	-4.8%	14.7%
Information Technology	\$103.80	\$124.80	\$90.28	\$152.26	\$183.32	\$191.81	\$192.20	\$200.18	\$207.92	\$205.00	-1.4%	97.5%
Materials	\$36.00	\$39.00	\$14.76	\$30.04	\$45.36	\$33.26	\$36.54	\$38.72	\$31.88	\$32.75	2.7%	-9.0%
Telecommunication Services	\$21.60	\$22.90	\$15.01	\$25.05	\$24.04	\$16.25	\$20.17	\$25.16	\$22.29	\$36.24	62.6%	67.8%
Utilities	\$33.60	\$32.70	\$26.87	\$33.50	\$32.51	\$27.12	\$31.43	\$34.45	\$35.60	\$33.46	-6.0%	-0.4%
Total Earnings Stream	\$919.50	\$854.60	\$546.66	\$809.84	\$985.92	\$981.07	\$1,068.79	\$1,143.43	\$1,094.39	\$1,084.71	-0.9%	18.0%
YoY Earnings Growth (%)		-7%	-36%	48%	22%	0%	9%	7%	-4%	-1%		

Sources: WisdomTree, Standard & Poor's, for the period 11/30/07–11/30/16. Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

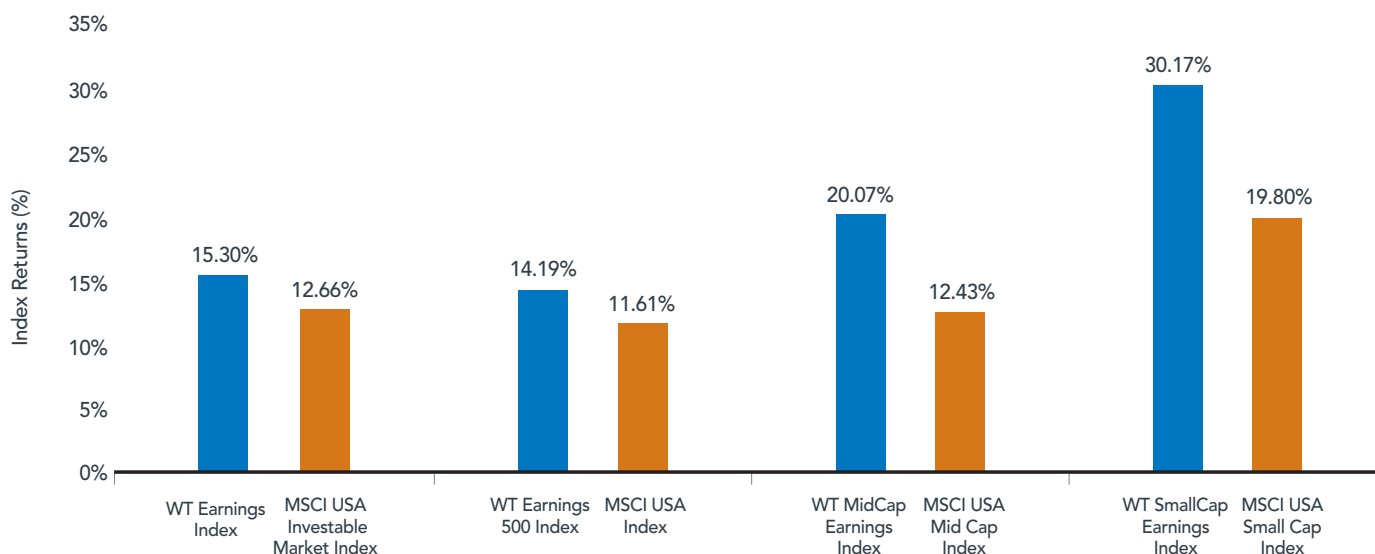
- + **Earnings Stream Contracted Slightly in 2016:** *The Earnings Stream* fell just under 1%, ending at \$1.08 trillion, which is almost 18% higher than the 2007 *Earnings Stream* and about 100% higher than the 2009 stream.
- + **Telecommunications Services Led Percentage Growth:** The aggregate *Earnings Stream* for the sector increased by \$14 billion or over 60%. AT&T, Level 3 Communications and T-Mobile were the largest contributors to the growth.
- + **Energy Sector Earnings Continued to Decline:** After a 50% decline in earnings last year, the sector's aggregate *Earnings Stream* fell an additional 68%, which is an 85% cumulative decline over the past two years. Large decreases from Exxon Mobil, Chevron and Halliburton contributed to the decline in earnings and reduction in weight allocated to this sector in the WisdomTree Earnings Index.
- + **Information Technology Leaders:** The Information Technology sector saw its U.S. *Earnings Stream* grow the fastest over the last nine years: approximately 97.5% cumulative growth from 2007 through 2016. Even with the impressive cumulative growth, the Information Technology sector also saw earnings slightly decline since the last rebalance. Apple saw its earnings fall by over \$8 billion (or about 15%) last year, but it still remained the most profitable U.S. company by far.

⁵ *Earnings Stream*: Defined as cumulative earnings over the prior four fiscal quarters for each component in the Index, using S&P's "Core Earnings" concept

TAKING STOCK OF PERFORMANCE—SMALL CAPS LEAD THE WAY

In addition to analyzing the 2016 *Earnings Stream*, we consider the equity market performance in the United States across various size cuts. In the figure below, we analyze the 2016 calendar year for the WisdomTree Earnings Indexes and compare each to a comparable market capitalization-weighted benchmark.

FIGURE 2: SMALL CAPS LED THE WAY IN U.S. EQUITY MARKETS FOR 2016



Sources: WisdomTree, Bloomberg, MSCI, for the period 12/31/15–12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

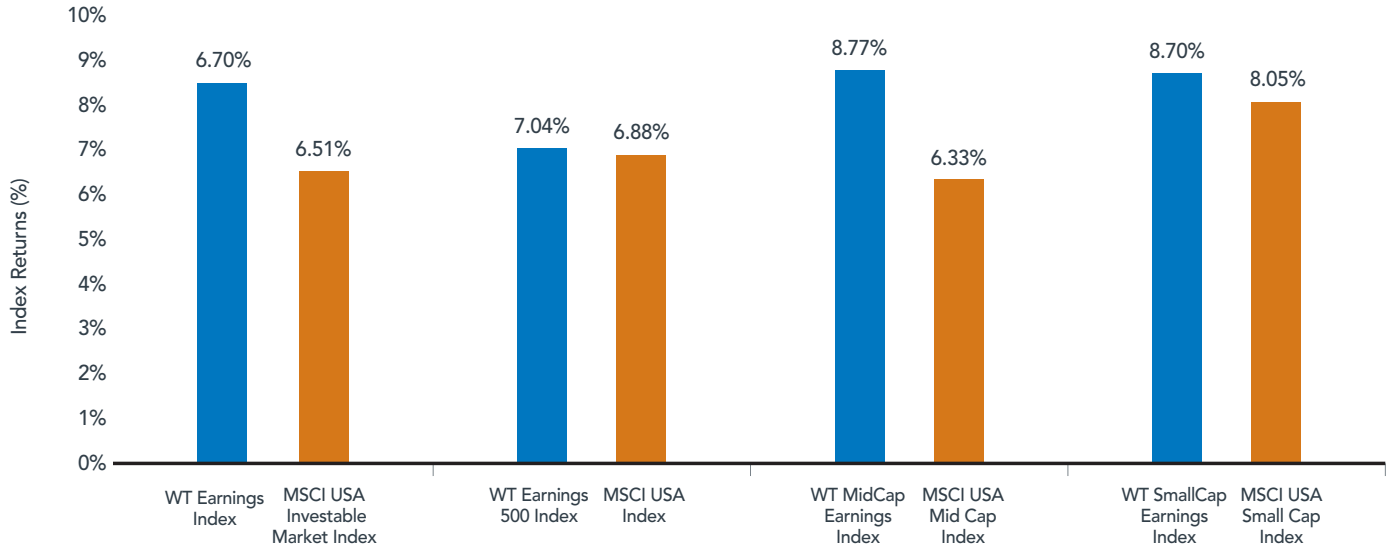
+ WisdomTree Earnings Indexes Led Their Market Capitalization-Weighted Counterparts across the Size Spectrum:

The WisdomTree Indexes beat their respective market capitalization-weighted benchmarks, represented by the relevant MSCI USA indexes, for the period displayed above. Similar to what we have seen over the past 10 years for the WisdomTree Earnings Indexes, outperformance for the small and mid-caps was the largest.

+ Small Caps Lead the Way with over 30% Returns:

The WisdomTree SmallCap Earnings Index had a particularly strong year, up over 30%. This strong performance marks a good time to rebalance and take chips away from some of the really big winners and add weight to the stocks at lower multiples, the underperformers.

FIGURE 3: INDEX PERFORMANCE SINCE COMMON INCEPTION



Sources: WisdomTree, Bloomberg, MSCI, for the period 2/1/07–12/31/16. For the WisdomTree Earnings Index and the MSCI USA Investable Market Index (IMI), the performance is from 6/5/07–12/31/16 due to MSCI USA IMI's live inception date of 6/5/07. WisdomTree MidCap Earnings Index and MSCI USA Mid Cap Index performance is also from 6/5/07–12/31/16 due to MSCI USA Mid Cap Index's live inception date of 6/5/07. Past performance is not indicative of future results. You cannot invest directly in an index.

+ **Nearly a Decade of Outperformance:** With only a month left until the WisdomTree Earnings Indexes' 10-year anniversary, we are excited to see the outperformance displayed above. As previously mentioned, the outperformance over the full period is most noticeable in the mid- and small-cap segments of the market. The consistent outperformance of WisdomTree Indexes over the longer time period reinforces our belief in fundamentally weighted indexing.

HOW EXPENSIVE ARE THE U.S. EQUITY MARKETS?

U.S. equity market participants find themselves adjusting to somewhat of a different reality as we enter 2017. Price-to-earnings (P/E) ratios⁶ are elevated, in some cases above 20x. When viewed through the longer lens of history, this appears high, but when viewed in the context of interest rates being extremely low, the case becomes less clear.

Higher valuations today mean a more challenging environment for future returns. Investors will not continue to pay ever-greater amounts for each dollar of earnings, and it becomes harder and harder for that P/E ratio to continue to rise. Stated differently, the market needs more positive earnings growth to continue gains. In this environment, we believe there are rewards for focusing on lower-valued parts of the market.

WISDOMTREE'S EARNINGS STRATEGIES ARE DESIGNED TO MITIGATE VALUATION RISK

As mentioned earlier, each one of our WisdomTree Earnings Indexes incorporates an annual rebalancing mechanism that functions to lower P/E ratios in a disciplined manner. Because our strategies have a historical track record extending nearly 10 years, one can look at the WisdomTree Earnings 500, MidCap Earnings and SmallCap Earnings Indexes and see P/E reductions occurring each year as a result of the following:

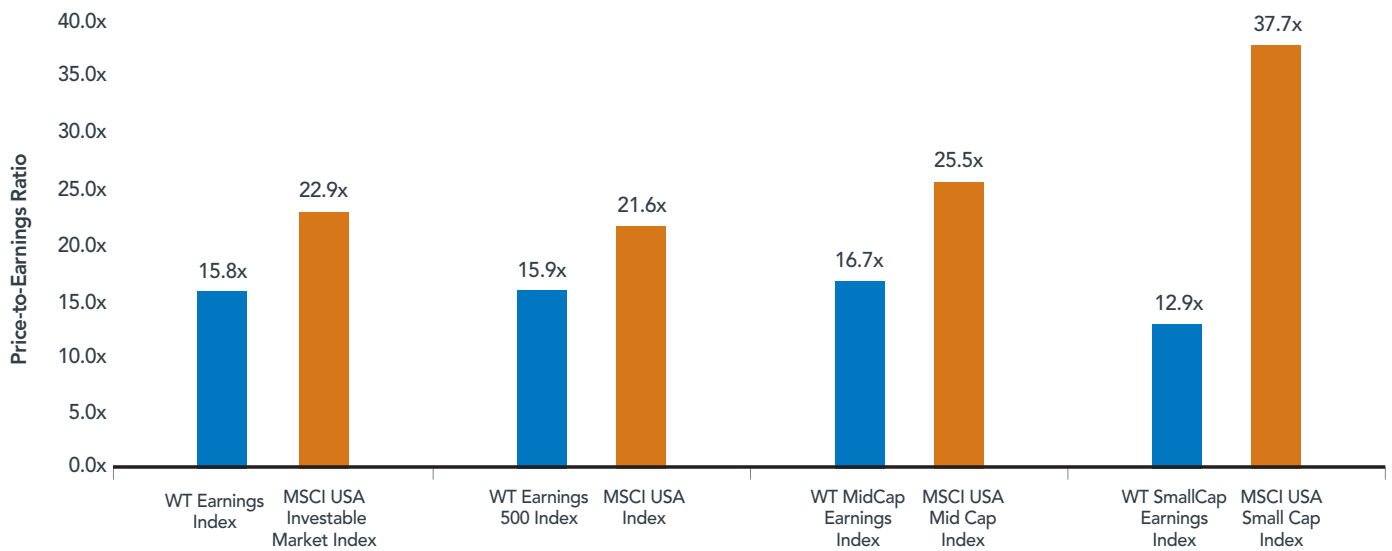
- + **Eliminating Firms with Negative Earnings:** This is most important within the WisdomTree SmallCap Earnings Index, as this is the area of the market where profitability tends to be less stable over time. In general, constituents with negative earnings drag down the earnings per share of the overall Index, at times causing the P/E ratio to rise not because prices are rising but rather because of the denominator, earnings per share, falling.
- + **Tying Increased Weight to Increasing Earnings:** Over the course of a given year, we know that share prices rise and fall. Top-performing stocks see their weights increase relative to other Index constituents, whereas bottom-performing stocks see their weights decrease. If there is no rebalancing mechanism that ties exposures back to fundamentals, the Index will tend to hold more and more of the outperformers and fewer and fewer of the underperformers regardless of underlying company fundamentals. WisdomTree's annual rebalancing process breaks this cycle—strong share price performance that isn't driven by strong earnings growth is a recipe for decreased Index weights at the WisdomTree annual rebalance. Strong earnings growth but weak share price performance typically leads to increased Index weight at the annual rebalance.

⁶ Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

ILLUSTRATING EARNINGS WEIGHTED VALUATION DISCOUNTS ACROSS TIME

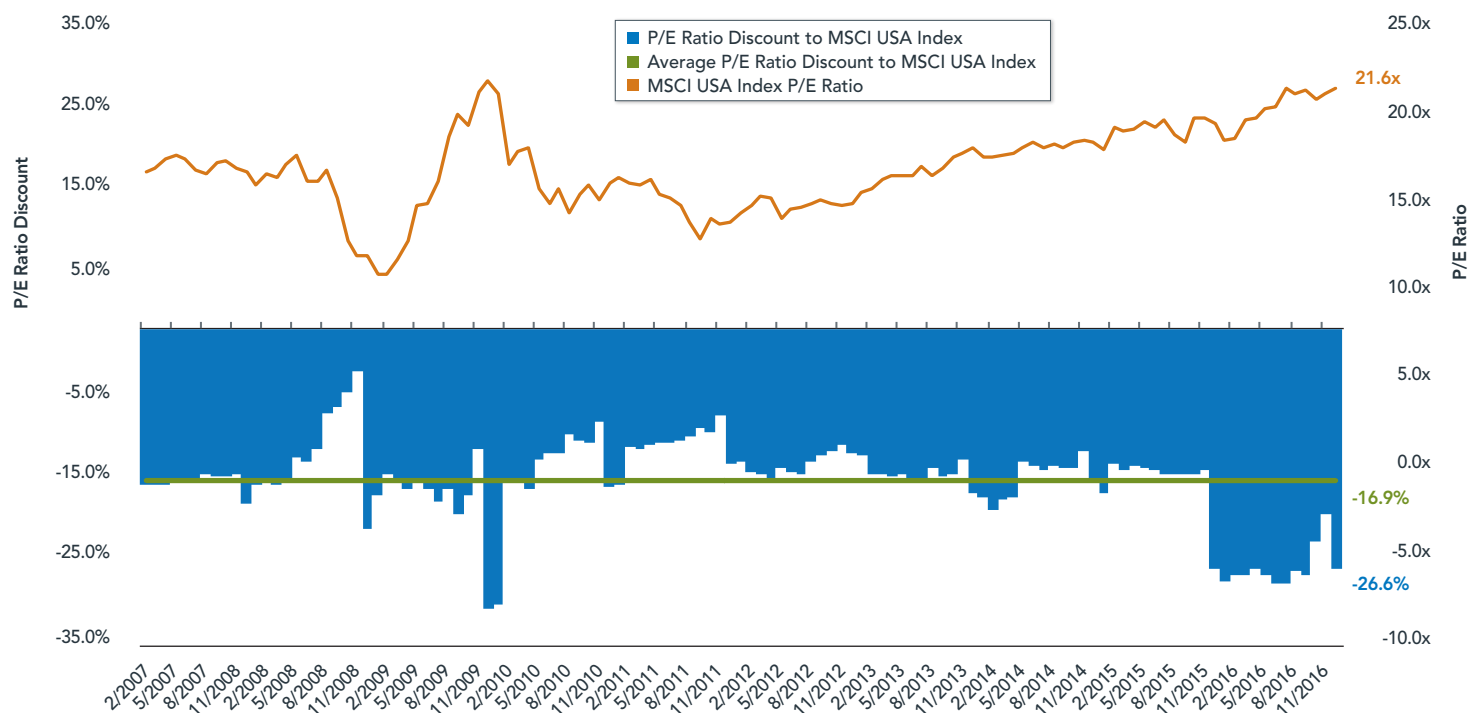
This rebalancing process typically leads to a lower P/E ratio relative to market capitalization-weighted approaches. First, we show the current discount as of year-end, and then we show the historical discount over time. Importantly, as the U.S. equity market has become more expensive, the valuation discount has increased.

FIGURE 4: CURRENT VALUATIONS FOR WISDOMTREE EARNINGS INDEXES



Sources: WisdomTree, Bloomberg, MSCI, as of 12/31/16. Subject to change. Past performance is not indicative of future results. You cannot invest directly in an index.

FIGURE 5: WISDOMTREE EARNINGS 500 INDEX P/E DISCOUNT



Sources: WisdomTree, MSCI, for the period 2/1/07–12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

+ Market P/E Ratio Approaching 10-Year Highs: The WisdomTree Earnings 500 Index began its live calculation on February 1, 2007. Since that point, the highest trailing 12-month P/E ratio that we saw (on a month-end basis) for the MSCI USA Index was 22.2x, as of December 31, 2009. As of December 31, 2016, we were at 21.6x, which is fairly close. The December 31, 2009, spike upward in the trailing 12-month P/E ratio was less related to an upward trend in prices and more related to the global financial crisis and the trough in earnings as the environment began its recovery. At present, the situation is less about sharp declines in earnings (absent the Energy sector) and more about rising price levels that have persisted for multiple years.

+ P/E Ratio Discount at or near Greatest Levels: From February 1, 2007, to December 31, 2016, the average discount of the WisdomTree Earnings 500 Index to the MSCI USA Index was 16.9%, meaning that the WisdomTree Index tended to be 16.9% less expensive, on average.

+ As of December 31, 2016, the WisdomTree Index was 26.6% less expensive—a figure that is around 10 percentage points lower than the average discount. Until recently, this level was only approached around December 2009 and indicates to us that the WisdomTree Earnings 500 Index is seeing its methodology add as great a relative value discipline as we have seen over its history relative to the MSCI USA Index, which is market capitalization-weighted and therefore does not have a relative value discipline baked into its methodology.

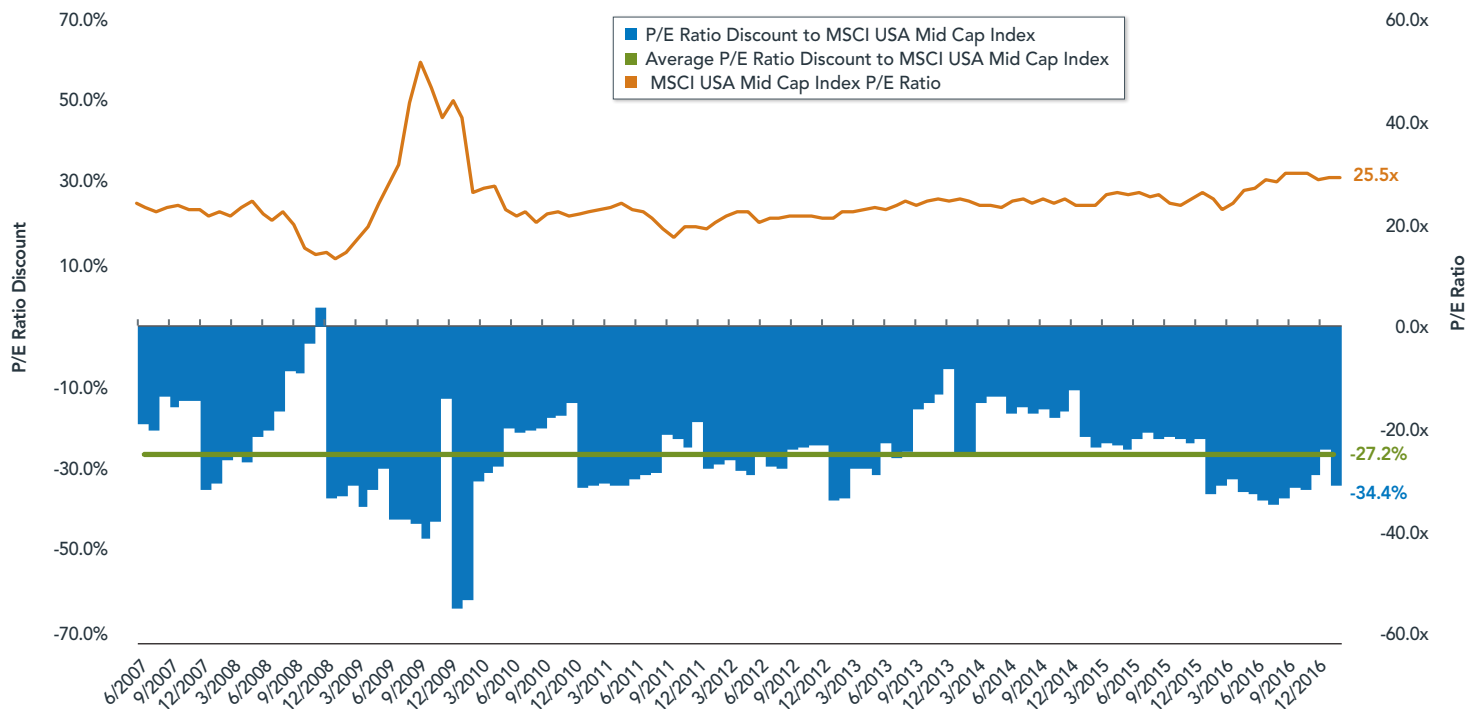
VALUATION RISK TYPICALLY GREATER AMONG MID- AND SMALL CAPS:

As mentioned earlier, we think investors have a tendency to get excited about future growth potential and risk bidding up security prices past their fundamentals. We believe this risk tends to be greater in the mid- and small-cap space where you have higher growth expectations and more speculative companies, or companies that are not profitable.

Although profitability may fluctuate throughout the year, at each annual rebalance WisdomTree requires companies to be profitable before inclusion. This requirement keeps the weight to firms that we believe tend to be more speculative and of lower quality at zero. This requirement, along with a forced discipline to sell high and buy low at regular intervals based on fundamentals, is critical to the WisdomTree Indexes exhibiting lower P/E ratios across time compared to their market cap-weighted peers.

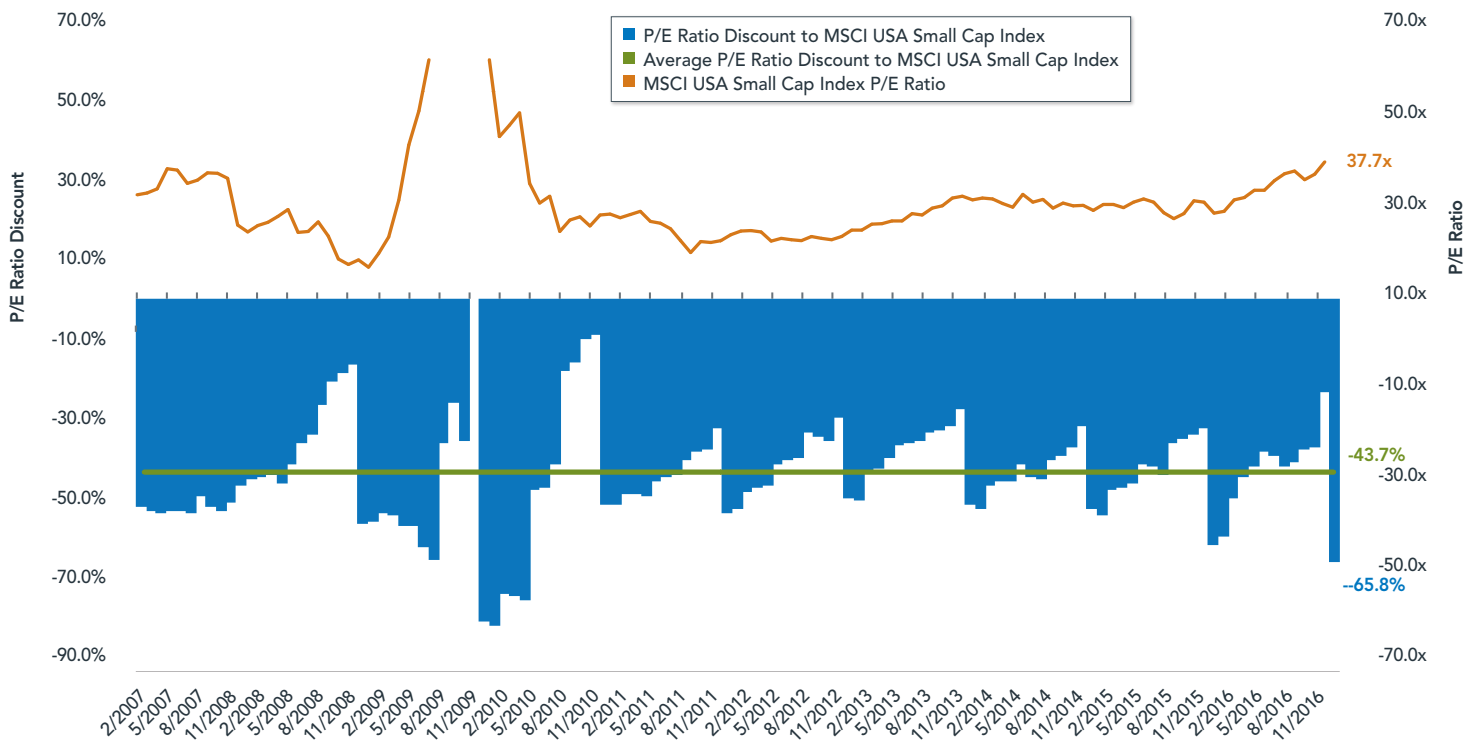
Also, this rules-based process typically results in a greater P/E ratio discount compared to what has been witnessed in the large-cap segment. The average WisdomTree P/E discount for mid-caps was 27% and over 43% for small caps, compared to around 17% for large caps.

FIGURE 6: WISDOMTREE MIDCAP EARNINGS INDEX P/E DISCOUNT



Sources: WisdomTree, MSCI, for the period 6/30/07–12/31/16. Start date of 6/30/07 was chosen because of the live index inception date for the MSCI USA Mid Cap Index. Past performance is not indicative of future results. You cannot invest directly in an index.

FIGURE 7: WISDOMTREE SMALLCAP EARNINGS INDEX P/E DISCOUNT



Sources: WisdomTree, MSCI, for the period 02/01/07–12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

ROUNDING OUT THE VALUATIONS PICTURE FOR THE WISDOMTREE EARNINGS INDEXES

Now that we have taken a deeper dive into the impact of P/E ratios and how WisdomTree Earnings Indexes display a high sensitivity toward this ratio, we think it is important to consider a broader set of valuation ratios. In the table below, we showcase how the relative rules-based rebalance also allowed WisdomTree Earnings Indexes to display more attractive quality measures relative to their comparable market cap-weighted benchmarks.

FIGURE 8: WISDOMTREE'S VALUATION ADVANTAGE OVER MARKET CAP-WEIGHTED BENCHMARKS

Index	Dividend Yield	Net Buyback Yield	Shareholder Yield	P/E Ratio	Estimated P/E Ratio	Long-Term Growth Expectations	Return on Equity	Return on Assets	Leverage
WisdomTree Earnings	2.04%	2.59%	4.63%	15.8x	15.6x	8.70%	16.31%	3.19%	5.1x
S&P 1500	1.97%	1.96%	3.93%	21.6x	18.0x	10.20%	12.94%	2.95%	4.4x
MSCI USA IMI	1.94%	1.74%	3.68%	22.9x	18.6x	10.65%	12.09%	2.72%	4.4x
WisdomTree Earnings 500	2.10%	2.70%	4.81%	15.9x	15.4x	8.53%	16.69%	3.18%	5.2x
S&P 500	2.03%	2.12%	4.15%	21.1x	17.7x	10.14%	13.52%	3.02%	4.5x
MSCI USA	2.00%	2.01%	4.01%	21.6x	18.0x	10.66%	13.29%	2.94%	4.5x
WisdomTree MidCap Earnings	1.53%	1.56%	3.10%	16.7x	16.7x	10.22%	13.99%	3.40%	4.1x
S&P 400	1.51%	0.67%	2.18%	26.1x	20.8x	9.63%	9.32%	2.61%	3.6x
MSCI USA Mid Cap	1.57%	0.97%	2.54%	25.5x	19.1x	12.26%	10.02%	2.27%	4.4x
WisdomTree SmallCap Earnings	1.36%	2.18%	3.54%	12.9x	16.3x	11.46%	13.23%	3.57%	3.7x
S&P 600	1.22%	0.79%	2.01%	30.7x	21.7x	14.17%	7.71%	1.95%	4.0x
MSCI USA Small Cap	1.50%	0.01%	1.51%	37.7x	24.5x	10.59%	6.16%	1.46%	4.2x

Sources: WisdomTree, MSCI, Standard & Poor's, as of 12/31/16. Subject to change. Long-term earnings growth expectations are a compilation of analyst estimates of the growth in operating earnings expected to occur over the next full business cycle, typically three to five years. Leverage is assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative. Past performance is not indicative of future results. You cannot invest directly in an index.

- + **Higher Shareholder Yields⁷:** We see that in every instance, the WisdomTree Indexes displayed a higher shareholder yield, primarily driven by higher net buyback ratios.⁸ Although dividend yields⁹ were similar across Indexes, we believe the focus on profitability allows the WisdomTree Indexes to display higher net buyback yields. It is no surprise to us that the shareholder yield advantage increases as you move down the size capitalization spectrum.
- + **More Attractive Quality Valuation Ratios:** WisdomTree Indexes display a higher quality bias relative to their equivalent market cap-weighted benchmarks. This was displayed through both higher return on equity¹⁰ and return on assets¹¹ ratios. Again, the fundamental advantage is most pronounced within the mid- and small-cap segments, where profitability seems to matter most.

⁷ Shareholder yield: A data point that references the combination of dividend yield and buyback yield.

⁸ Net buyback yield: A company's net share buyback is the difference between the capital raised by issuing new shares and the money the company spent on buying back any outstanding shares. A positive net share buyback means that more was spent on buying back existing shares than received from issuing new shares. Net buyback yield is the amount of a company's net buybacks divided by its market capitalization. Please note that net buyback yield does not represent a dividend paid by the company

⁹ Dividend yield: a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

¹⁰ Return on equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

¹¹ Return on assets (ROA): Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

CONCLUSION

With rising equity prices, coupled with a slight contraction in the aggregate earnings of the market, it is critical to be mindful of valuations like P/E ratios. Of all the Indexes WisdomTree calculates, the lowest relative P/E ratios tend to be found in the WisdomTree Earnings Indexes. Following this rebalance, we saw these portfolio characteristics reinforced, resulting in a lowering of valuation metrics such as the P/E ratios and a raising of the quality measures like return on equity.

Certainly, some of President-elect Trump's focus on cutting corporate tax rates and allowing companies to repatriate offshore cash might cause a positive impetus and stimulus for earnings growth in 2017. But after a surge in prices after the election, we believe this rebalance back to valuations comes at a perfect time and can help manage valuation risk if future earnings growth falls short of expectations.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, please call 866.909.WISE (9473) or visit wisdomtree.com. Investors should read the prospectus carefully before investing.

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read a Fund's prospectus for specific details regarding a Fund's risk profile.

WisdomTree Earnings Index: A fundamentally weighted index that measures the performance of earnings-generating companies within the broad U.S. stock market. WisdomTree Earnings 500 Index: A fundamentally weighted index that measures the performance of earnings-generating companies in the large-capitalization segment of the U.S. stock market. Companies in the Index are incorporated and listed in the U.S. and have generated positive cumulative earnings over their most recent four fiscal quarters prior to the Index measurement date. The Index comprises the 500 largest companies ranked by market capitalization in the WisdomTree Earnings Index. WisdomTree MidCap Earnings Index: A fundamentally weighted index that measures the performance of the top 75% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed. WisdomTree SmallCap Earnings Index: A fundamentally weighted index that measures the performance of earnings-generating companies in the small-capitalization segment of the U.S. stock market. The Index comprises the companies in the bottom 25% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed. S&P 500 Index: A market capitalization-weighted benchmark of 500 stocks selected by the Standard & Poor's Index Committee, designed to represent the performance of the leading industries in the United States economy. S&P MidCap 400 Index: Provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an ongoing basis. S&P SmallCap 600 Index: A market capitalization-weighted measure of the performance of small-cap equities within the United States, with constituents required to demonstrate profitability prior to gaining initial inclusion. MSCI USA Index: Designed to measure the performance of large- and mid-cap segments of the U.S. market. MSCI USA Investable Market Index: Designed to measure the performance of the investable universe of the U.S. market. MSCI USA Mid Cap Index: Designed to measure the performance of the mid-cap segment of the U.S. market. MSCI USA Small Cap Index: Designed to measure the performance of the small-cap segment of the U.S. market.

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