The Case Remains: Japanese Small Caps Are Attractive

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The last 10 years have been a difficult environment for international stocks, but that doesn't mean you should give up on the asset class. The WisdomTree International Equity Index, in U.S. dollar terms, returned just 1.28% per year for the decade. This was better than the MSCI EAFE Index, which returned just 0.75% per year for this period, but the S&P 500 returned almost 7% per year over the same period.[1]

One of the negative factors over this period was U.S. dollar strength and foreign currency weakness, which eroded the returns in U.S. dollar terms. If we looked at just the stocks in the WisdomTree International Equity Index, they returned 3.16% per year, meaning foreign currency was a drag of -1.82% per year.

Interestingly, over this difficult period for international stocks, international small-cap[2] stocks had a premium return, by almost 300 basis points per year compared to the large-cap segment.[3] Often one might think of small-cap stocks as being more aggressively positioned, and in a period of mediocre returns, this might have been a more challenging environment.

FIGURE 1: INTERNATIONAL EQUITY PERFORMANCE

Index	WisdomTree Index Inception Date	1-Year	3-Years	5-Years	10-Years	Since WisdomTree Index Inception
WisdomTree International Equity Index	**6/1/2006**	**3.21%**	**-0.91%**	**6.66%**	**1.28%**	**2.87%**
MSCI EAFE Index		1.00%	-1.60%	6.53%	0.75%	2.02%
WisdomTree International LargeCap Dividend Index	**6/1/2006**	**2.98%**	**-1.80%**	**5.75%**	**0.75%**	**2.26%**
MSCI EAFE Index		1.00%	-1.60%	6.53%	0.75%	2.02%
WisdomTree International SmallCap Dividend Index	**6/1/2006**	**7.75%**	**2.87%**	**11.15%**	**3.81%**	**5.40%**
MSCI EAFE Small Cap Index		2.18%	2.10%	10.56%	2.95%	3.68%
WisdomTree Europe SmallCap Dividend Index	**6/1/2006**	**2.26%**	**2.96%**	**15.67%**	**3.54%**	**5.58%**
MSCI Europe Small Cap Index		-2.07%	0.51%	12.80%	3.19%	4.79%
WisdomTree Japan SmallCap Dividend Index	**6/1/2006**	**11.94%**	**9.22%**	**10.88%**	**4.67%**	**3.85%**
MSCI Japan Small Cap Index		7.57%	7.28%	10.16%	3.19%	1.99%
MSCI Japan Index		2.38%	2.49%	8.17%	0.54%	0.80%

Sources: WisdomTree, MSCI, as of 12/31/16. All returns above are in U.S. dollar terms.
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.

[1] Sources: WisdomTree, Bloomberg, 12/31/06–12/31/16.
[2] Size capitalization: A measure by which a company's size is classified. Large caps are usually classified as companies that have a market cap over $10 billion. Mid-caps range from $2 billion to $10 billion. Small caps are typically new or relatively young companies and have a market cap between $200 million to $2 billion.
[3] Sources: WisdomTree, 12/31/06–12/31/16. Refers to the performance of the WisdomTree International LargeCap Dividend Index vs. the WisdomTree International SmallCap Dividend Index.

REGIONALLY: JAPAN OUTPERFORMED DEVELOPED WORLD, SMALL CAPS OUTPERFORMED LARGE CAPS

On a regional basis, Japanese small-cap stocks outperformed a broad international small-cap benchmark, as well as European small-cap stocks. The outperformance of Japanese small-cap stocks over large caps was even larger than it was for a broad international set of stocks. In the prior 10 years ending December 31, the WisdomTree Japan SmallCap Dividend Index returned more than 400 basis points per year ahead of the MSCI Japan Index.[4]

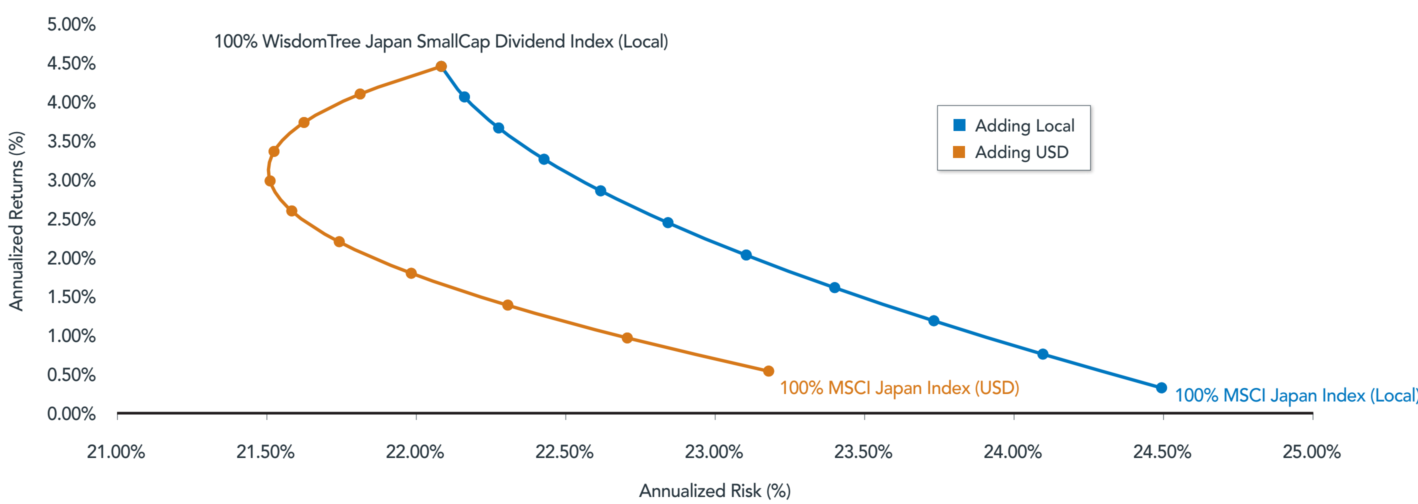
Although Japanese small caps displayed strong relative performance over the past decade, we think it remains important to stay invested in this region and potentially increase your allocation based on current valuations[5] and future growth prospects, as we will outline below.

When allocating to a market like Japan, it is important to consider whether or not you want to take the currency exposure. Below, we show blends of the WisdomTree Japan SmallCap Dividend Index (in local terms) with the MSCI Japan Index in both U.S. dollars and Japanese yen.

Over the past decade, Japanese small caps also outperformed their large-cap counterparts, and this was true on both a local and USD basis. Therefore, increasing allocations to Japanese smalls caps improved returns and in some cases even lowered the risk, depending on if they were blended with or without the currency. Looking at just large caps, it is apparent that over the period, taking the currency exposure (i.e., the MSCI Japan USD Index) outperformed the local returns and even did so with less risk.

Japan is one of the few markets where the currency and the stocks are negatively correlated[6], so that adding in yen exposure on top of the stocks can result in lower volatility[7] than just looking at the stocks by themselves. Typically, when WisdomTree discusses foreign currency risk[8] on broad baskets of International equities, we refer to currency as uncompensated risk that would typically increase the volatility of that basket. Japan is the outlier.

FIGURE 2: JAPAN EQUITY BLENDS



Sources: WisdomTree, MSCI, 12/31/06–12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

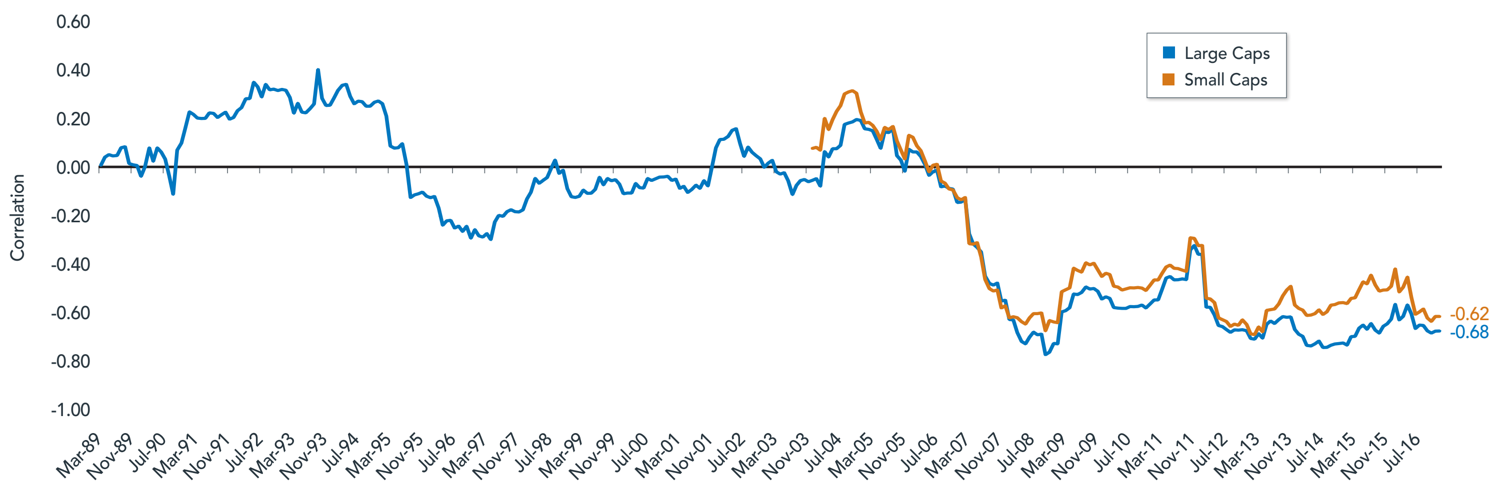
4 Sources: WisdomTree, 12/31/06–12/31/16. Refers to the performance of the WisdomTree Japan SmallCap Dividend Index vs. the WisdomTree International SmallCap Dividend Index and the WisdomTree Europe SmallCap Dividend Index.
5 Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.
6 Correlation: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly opposite directions.
7 Volatility: A measure of the dispersion of actual returns around a particular average level.
8 Risk: Also "standard deviation," which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

WHAT DO NEGATIVE CORRELATIONS IMPLY?

One could interpret the negative correlation between the currency and the stock market as requiring a view that the currency is going to weaken to be supportive for investing in the market. This is largely a critical part of the view we have for large caps and exporters, which are more sensitive to fluctuations in the exchange rate[9]. Interestingly, though, the Japanese small-cap market was also fairly strongly negatively correlated to the yen.

It is important to note that the fundamental relationship between the yen and the Japanese equity markets has and may change over time. In the early 1990s, the correlations between the yen and Japanese stocks were slightly positive, and this occurred again at times in the early 2000s. After the financial crisis, the correlations have been consistently negative, with average three-year correlations of -0.60 for large caps and -0.52 for small caps over the past decade.

FIGURE 3: ROLLING THREE-YEAR CORRELATIONS: JAPANESE EQUITIES VS. YEN



Sources: WisdomTree, MSCI, 3/31/1989–12/31/2016. Large caps are represented by the MSCI Japan Index, and small caps are represented by the MSCI Japan Small Cap Index. Start dates were chosen based on respective live inception of the Indexes displayed above. Past performance is not indicative of future results. You cannot invest directly in an index.

FUNDAMENTAL[10] CONSIDERATIONS

When deciding whether to add exposure to an asset class, correlations can help measure the degree to which an asset will move in relation to another, but it shouldn't be the only consideration. If there were a view the yen were going to weaken, this could be positive for Japanese stocks if past correlations persist.

But at WisdomTree, we believe fundamentals matters most. Both dividends[11] and share buybacks[12], whose components together are often referred to as "shareholder yield[13]," are important to consider when evaluating as asset class. And the trends in these variables for Japan are among the most promising when it comes to the outlook for Japanese stocks.

[9] Exchange rate: The exchange of one currency for another, or the conversion of one currency into another currency.
[10] Fundamentals: Attributes related to a company's actual operations and production as opposed to changes in share price.
[11] Dividend: A portion of corporate profits paid out to shareholders.
[12] Net share buyback: Takes both the issuance of any new shares and the buyback of any outstanding shares into account. A positive net share buyback means that more was spent on buying back existing shares than on issuing new shares.
[13] Shareholder yield: A data point that references the combination of dividend yield and buyback yield.

THE DIVIDEND DECOMPOSITION MODEL

One way to frame returns on the market is a mathematical decomposition of the total returns over any period into three sources:

1) Price returns:

  a. The growth rate in dividends over the period in question

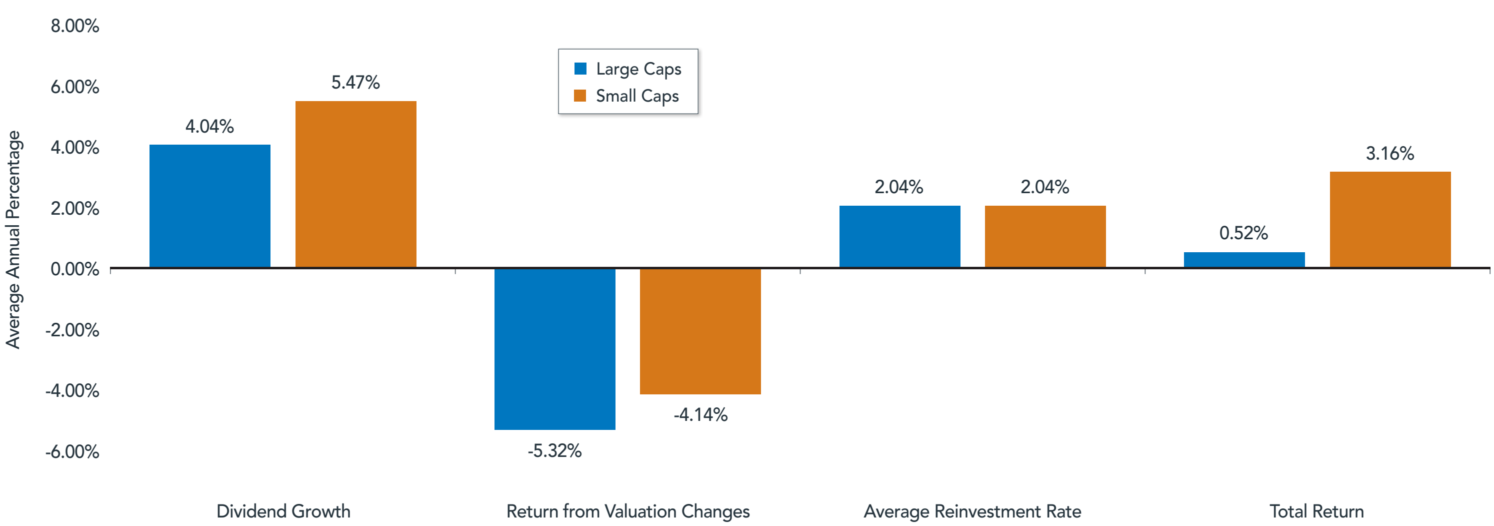
  b. The change in valuation (dividends/price) over the period

2) Impact of reinvested dividends over time (average dividend yields[14] over period)

Over the last 10 years ending December 31, 2016, for Japanese large caps, dividends grew 4.04%, the average dividend reinvestment rate was 2.04% and total returns were 0.52%. Since the dividend growth plus the reinvestment rate (6.08%) was higher than the total return of 0.52%, there was a valuation compression of 5.32% per year. This means that the dividend yield ended the period higher than it started, as dividend growth outstripped price changes. In other words, the price-to-dividend ratio[15] fell over the last 10 years from 87.1x dividends to 50.5x dividends (and the corresponding dividend yields rose from 1.15% to 1.98%), with the market getting less expensive on a price-to-dividend basis/dividend yield basis.

We saw similar results in Japanese small caps over the same period. Dividend growth was higher than price growth, so the small-cap market actually got less expensive on a price-to-dividend basis. Since the dividend reinvestment rates were similar, the small-cap performance advantage was driven by the combination of higher dividend growth and lower valuation compression.

FIGURE 4: JAPANESE 10-YEAR TOTAL RETURN DECONSTRUCTION



Sources: WisdomTree, MSCI, 12/31/06–12/31/16. Large caps are represented by the MSCI Japan Index, and small caps are represented by the MSCI Japan Small Cap Index, both in local terms. Past performance is not indicative of future results. You cannot invest directly in an index.

[14] Dividend yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.
[15] Price-to-dividend ratio: Refers to the index price divided by the trailing 12-month dividends.

INCREASED ATTENTION TO SHAREHOLDER RETURNS

Looking at the history of Japan Inc. over the last 10 years, firms have been increasing both their dividends and stock buybacks, leading to a higher shareholder yield. This was a key focus of the Abe plan to increase focus on return-on-equity (ROE)[16] improvement and the creation of the JPX-Nikkei Index 400, which was going to include return on equity as an inclusion criterion. This Index, which many refer to as the "shame index" if you were not included, gives companies incentives to focus on putting the cash on their balance sheets to more productive uses or to pay that cash out to shareholders. A higher cash level on the balance sheet means higher shareholder equity levels and therefore lower ROE figures. Continued focus on improving ROE levels remain a reason we believe dividend growth and buyback growth can be persistent for some time, as we will show later there are still elevated cash levels.

+ **Dividend Growth:** Over the 10-year period below, total cash dividends grew from ¥5.08 trillion to almost ¥9 trillion, a cumulative growth of more than 75%, or 5.85% per year.[17]
+ **Buyback Growth:** For the same 10-year period, total net stock buybacks grew from ¥1.97 trillion to ¥5 trillion, a cumulative growth of more than 150%, or 9.77% per year.
+ **Total Growth:** Dividends and net buybacks combined grew from ¥7.05 trillion to ¥13.97 trillion, a cumulative growth of almost 100%, or 7.08% per year.

Some companies buy back stock only to offset the dilution of shares that results from share issuance. What has an impact on future earnings and dividend growth are the buybacks that reduce total shares outstanding[18], as these buybacks impact per-share earnings and dividend distributions in the future, assuming a constant level of aggregate dividends being distributed or earnings generated.

FIGURE 5: JAPAN SHAREHOLDER DISTRIBUTIONS: NET BUYBACKS AND DIVIDENDS

Sources: WisdomTree, MSCI, 12/31/06–12/31/16. Japan is represented by the MSCI Japan Index. Past performance is not indicative of future results. You cannot invest directly in an index.

[16] Return on equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.
[17] Note: These levels are different from the index levels above due to these being aggregate dividend levels and not per-share numbers on an index basis.
[18] Shares outstanding: All the shares of a corporation or financial asset that have been authorized, issued and purchased by investors.

SHARE COUNT REDUCTION

The unmistakable conclusion from the last few years of Japan Inc.'s buyback data is that buybacks are having an impact on reducing shares outstanding. Impressively, since the calendar-year bottom in 2010, when Japan Inc. was a net share issuer, net buybacks have increased by ¥8.9 trillion. On a percentage basis, over the same period, the net buyback yield went from a -1.83% drag to a 1.04% tailwind.

In small caps, there tends to be larger share issuance compared to large caps because the small-cap market has more companies that need to raise capital. What we also noticed in small caps is that there tends to be a larger difference in the buyback yields of companies with high valuations (either companies losing money and needing to raise capital to fund their existence or companies selling at high price-to-earnings [P/E] ratios[19]) compared to lower-priced, higher-dividend-type companies.

From the perspective of a small company, it is much more attractive to raise capital by issuing shares when the company's price is selling at a premium compared to the market than when your price is selling at a discount to the market. The net issuance that happens in the small-cap, expensive-stock universe is one of the reasons we believe the small-cap growth category has a tough time outperforming the small-cap value category over time. Companies that are constantly issuing shares have to achieve a higher growth rate to overcome the dilution from raising shares outstanding.

THE FUNDAMENTAL DIFFERENCE: DIVIDEND WEIGHTED VS. CAP WEIGHTED[20]

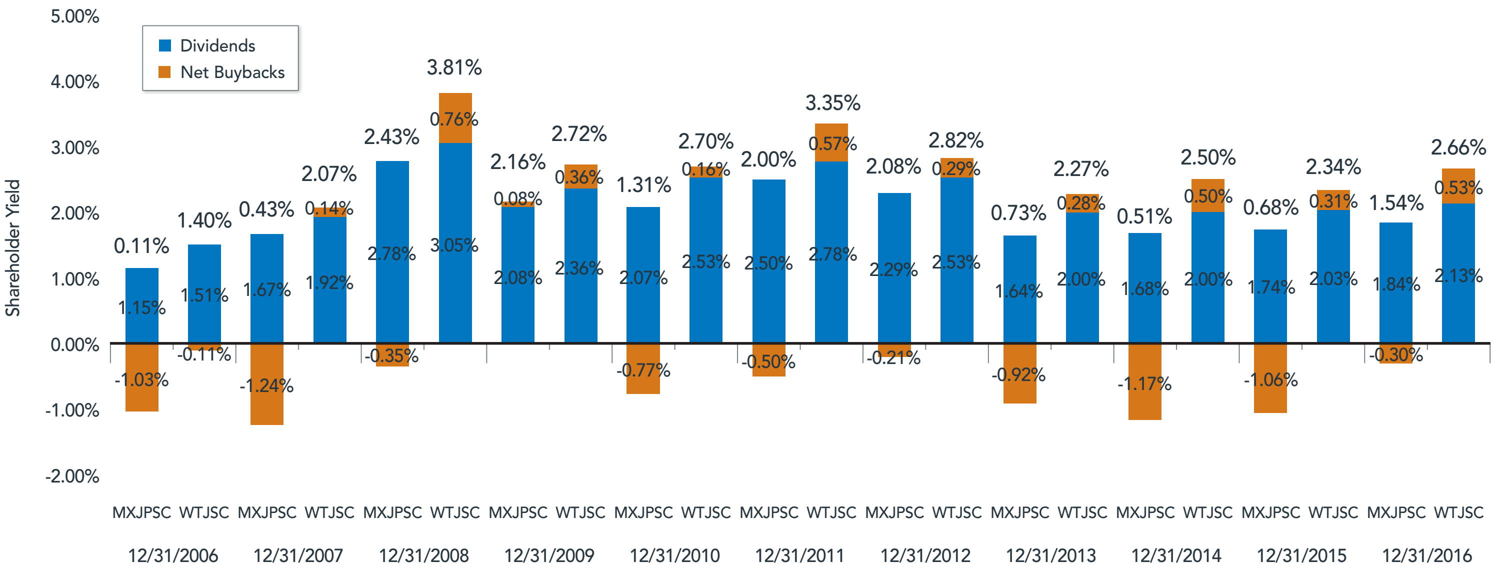
At WisdomTree, we believe that screening and weighting equity markets based on fundamentals such as dividends or earnings can help produce higher total and risk-adjusted returns[21] over a complete market cycle. One of the most important elements of a fundamental index is the annual rebalance process, where the index screens the eligible universe and then weights those securities based on their fundamentals. In essence, the process takes a detailed look at the relationship between the underlying fundamentals and price performance.

One way to illustrate the benefits of this approach for our fundamentally weighted process is to compare the total shareholder yield of the WisdomTree Japan SmallCap Dividend Index (WTJSC) to a market cap-weighted peer universe. Weighting by a fundamental such as dividends is essentially tilting weight from a market cap-weighted scheme to over-weight those companies with higher dividend yields (lower priced) and to under-weight those companies with low dividend yields (higher priced).

Below we look at how the net buyback yield[22] and dividend yield changes when the Japanese small-cap market is screened and weighted by a firm's cash dividend instead of its market cap.

[19] 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.
[20] Market capitalization weighting: Market cap = share price x number of shares outstanding. Firms with the highest values receive the highest weights.
[21] Risk-adjusted returns: Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.
[22] 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.

FIGURE 6: JAPAN SMALL-CAP SHAREHOLDER DISTRIBUTIONS: NET BUYBACK AND DIVIDEND YIELDS



Sources: WisdomTree, MSCI, 12/31/06–12/31/16. MXJPSC represents the MSCI Japan Small Cap Index. WTJSC represents the WisdomTree Japan SmallCap Dividend Index. Past performance is not indicative of future results. You cannot invest directly in an index.

THE DIVIDEND-WEIGHTED DIFFERENCE

The WisdomTree Japan SmallCap Dividend Index consistently had higher dividend and net buyback yields than a comparable market cap index like the MSCI Japan Small Cap Index. The WisdomTree Index averaged a dividend yield of 2.24% and net buyback yield of 0.39% over the period, compared to a dividend yield of 1.98% and net buyback yield of -0.61% for the MSCI Japan Small Cap Index. The average shareholder yield for the WisdomTree Index was 2.63% compared to just 1.37% for MSCI, an advantage of 1.26%.

We believe this differential helped drive the 1.48% performance advantage for the WisdomTree Japan SmallCap Dividend Index over the past 10 years.

FUNDAMENTAL GROWTH OUTPACING PRICE GROWTH

Obviously, past performance can't predict future results, but a question we get asked a lot is whether now is still a good time to be considering Japanese small caps after the relative outperformance against international benchmarks. In the above we explained why we believe the growth in dividends and buybacks is supportive for markets, and if you assume no growth and no change in valuations going forward, an investor could expect to earn (on a real, after-inflation[23] basis) the combined dividend and net buyback yield.

But this is not our base case. We expect that, with ample cash on their balance sheets and a focus on investor stewardship reforms, Japanese companies will continue to increase both dividends and buybacks over the next few years.

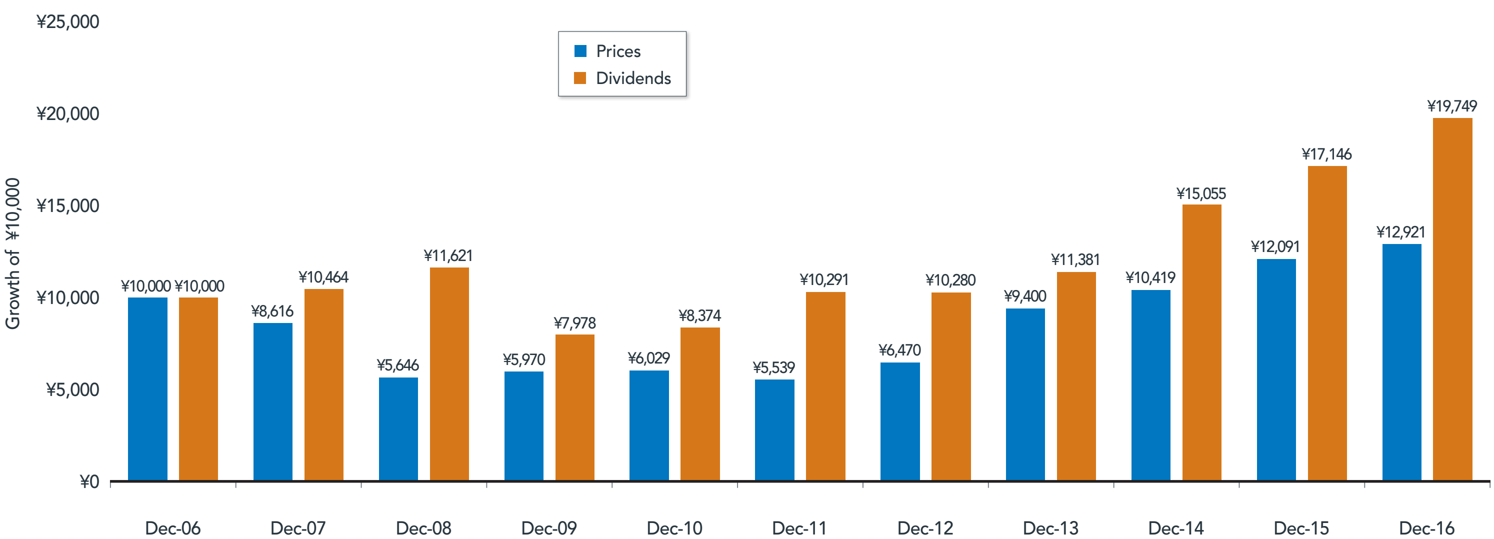
[23] Inflation: Characterized by rising price levels.

So is now a good entry point? Looking at just dividends and prices, one could argue the market actually got less expensive on a price-to-dividend basis, as dividends grew faster than prices. Over the last 10 years, dividends grew 97.5%, or 7.04% per year, which is higher than the aggregate price growth of just 29.2%, or 2.60% per year.

Looking at earnings growth, you can also illustrate a similar story of fundamentals outpacing prices. The cumulative earnings growth over the period was 83.2%, or 6.24% per annum, which was higher than the price appreciation, so the market actually became less expensive on a P/E basis as well.[24]

This is the underlying fundamental support we refer to in saying this was not just a price-driven market recently.

FIGURE 7: WISDOMTREE JAPAN SMALLCAP DIVIDEND INDEX: PRICE GROWTH VS. DIVIDEND GROWTH



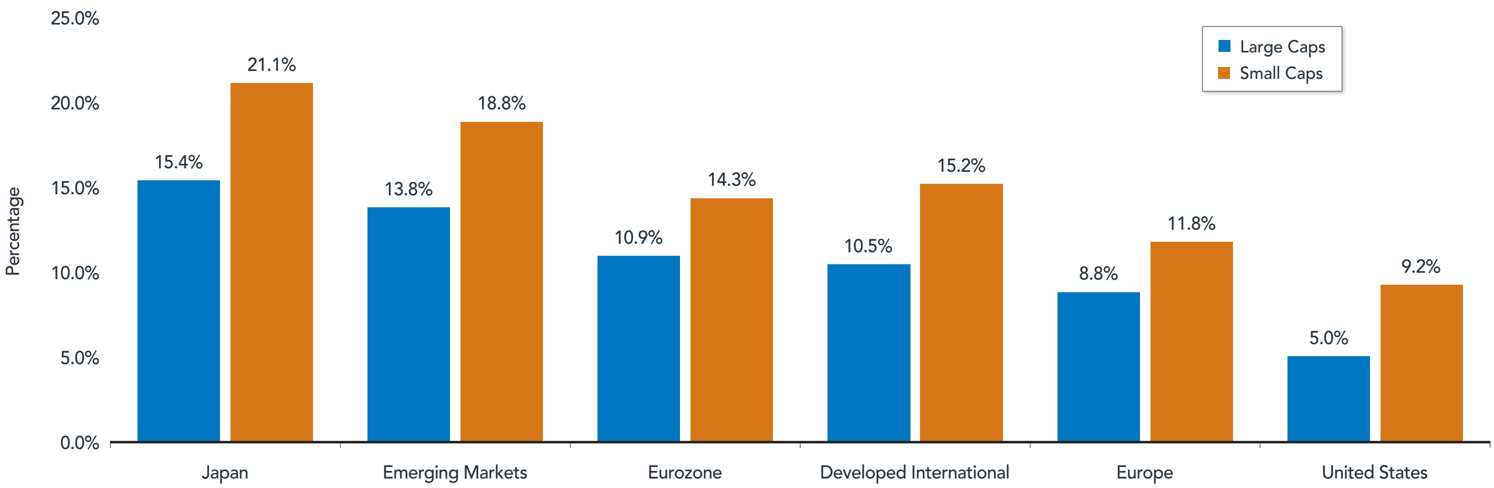
Sources: WisdomTree, 12/31/06–12/31/16. Analysis done on the WisdomTree Japan SmallCap Dividend Index in local currency. Past performance is not indicative of future results. You cannot invest directly in an index.

SOURCES OF FUTURE CASH DISTRIBUTIONS

Japanese companies have a wealth of cash on their balance sheets. There has been a lot of talk about all the cash on U.S. companies' balance sheets that will be paid as dividends and buybacks with different repatriation policies. What is interesting in terms of how these cash levels can impact valuations and also the potential for distribution growth: Japanese large-cap companies have 3x the relative cash compared to market cap than U.S. large-cap companies (15% cash to market cap versus 5%). Japanese small-cap companies have even more than large caps—at 21% cash to market cap. These are the highest levels compared to all other regions. This also means that, when we look at valuation levels that compare, say, total market cap to total earnings, Japanese companies have an even greater discount given that they have cash levels that make them 15% to 20% cheaper than their absolute levels.

[24] Sources: WisdomTree, Bloomberg, 12/31/06–12/31/16. Refers to the WisdomTree Japan SmallCap Dividend Index.

FIGURE 8: CASH AS A PERCENTAGE OF MARKET CAP (EX-FINANCIALS)



Sources: WisdomTree, MSCI, as of 12/31/16. Each region/country is represented by its respective MSCI market cap-weighted index.

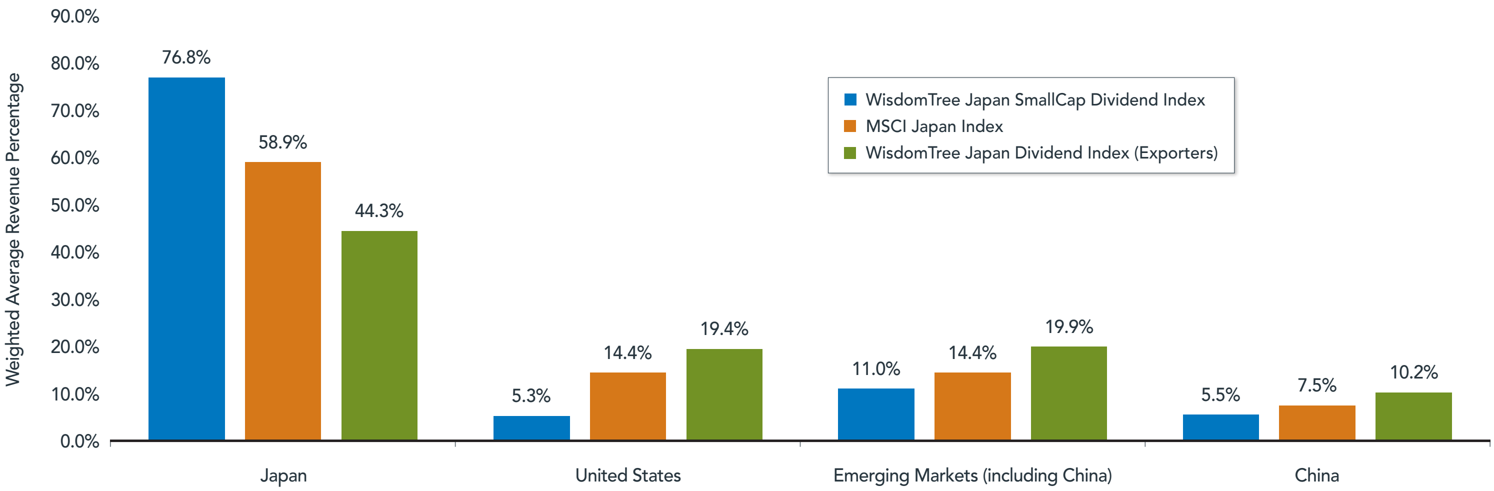
OTHER CONSIDERATIONS FOR JAPANESE SMALL CAPS: MORE LOCAL REVENUE BASE

One of the reasons we suggest to investors to consider blending Japanese small caps with Japanese large caps is the different revenue profiles. Japanese large caps have large growth drivers from the global economy and growth cycle, while Japanese small-cap companies are more sensitive to local economic growth drivers.

Whereas the WisdomTree Japan Dividend Index, which is focused on exporters, derives less than 45% revenue from within Japan, the WisdomTree Japan SmallCap Dividend Index generates more than 75% of its revenue from within Japan.

If an investor has a view that the Japanese economy is inflecting more positively with domestic demand drivers, as we will outline below, then a mix of Japanese small caps with the exporters can be a nice complementary type of exposure.

FIGURE 9: WEIGHTED AVERAGE REVENUE BREAKDOWN



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

THE MACROECONOMIC CASE FOR JAPANESE SMALL CAPS

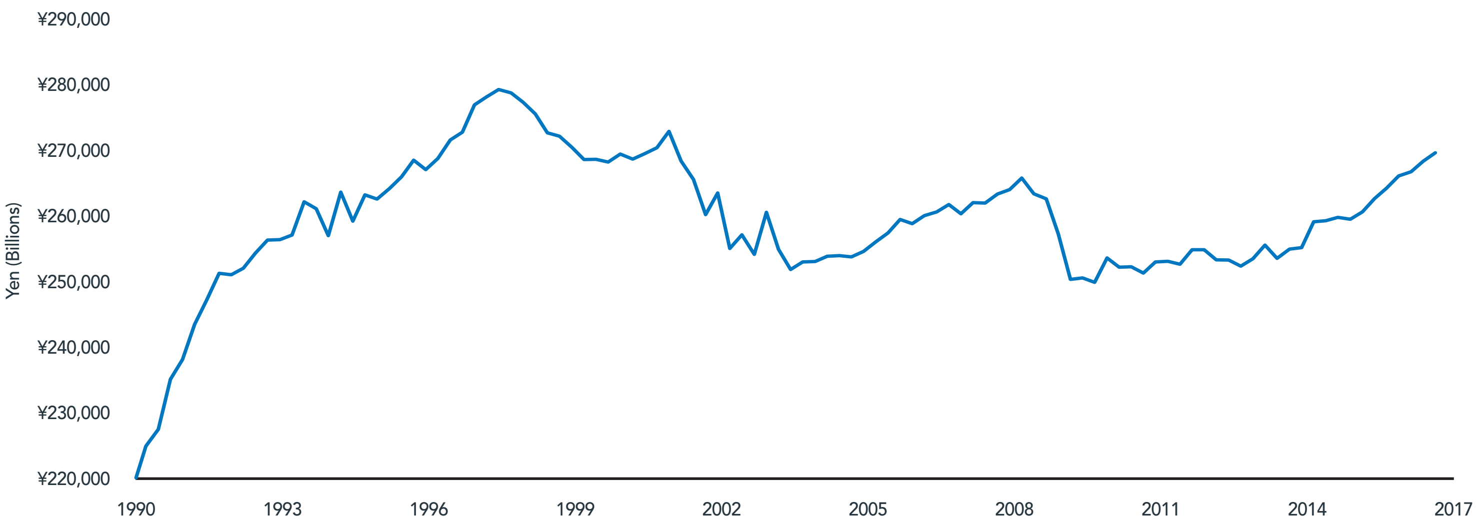
Finally, the investment case for Japanese small caps is based on our bullish view on the Japanese domestic economy: After decades of deflation[25], deleveraging and demand contraction, Japan's domestic demand has entered a structural up-cycle driven by two fundamental forces:

1) Demographic "sweet spot" and the rise of a new middle class

The structural shortage of labor is now forcing improvements in both the quality of employment and the incomes earned from employment. Specifically, after almost two decades of full-time job destruction, full-time job creation has inflected to positive growth since 2015, and nominal workers' compensation has pulled up from a 20-year trend decline—workers' nominal incomes were up ¥5.4 trillion (or 2%) in 2016 and up ¥14.5 trillion (or 5.7%) over the past two years (2014–2016). Again, it has to be stressed that this is the first time in two decades that nominal workers' compensation has been in an uptrend (see chart). Importantly, this uptrend is bound to be structural, given the structural decline in the supply of labor.

[25] Deflation: The opposite of inflation, characterized by falling price levels.

FIGURE 10: WORKERS' NOMINAL COMPENSATION INCREASING

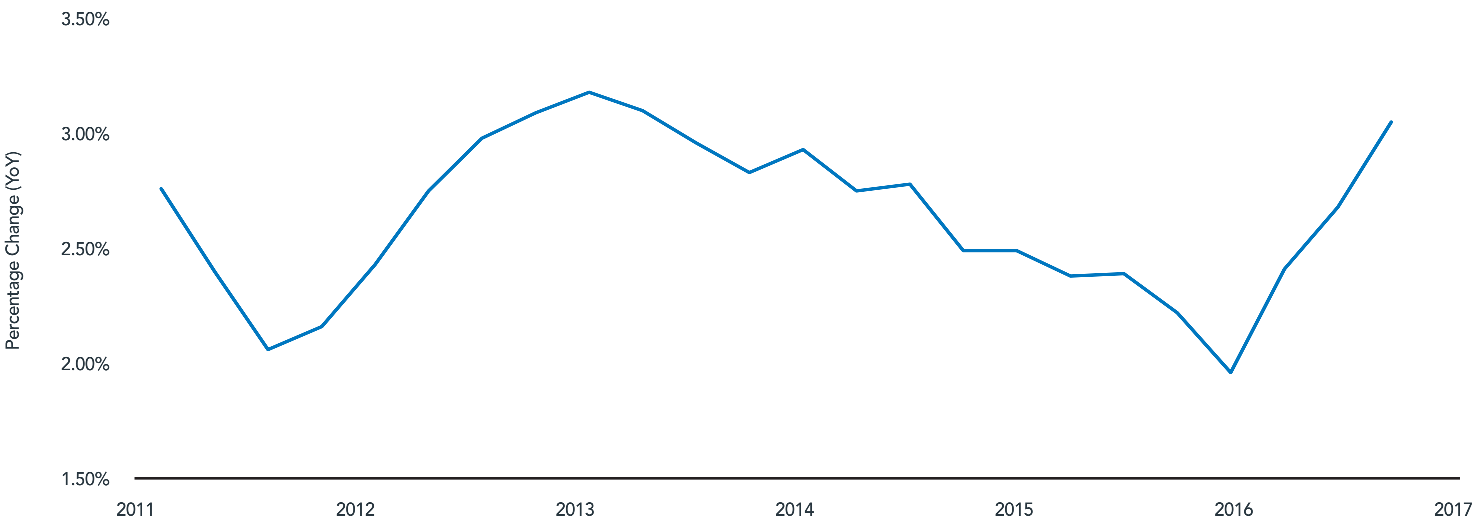


Sources: WisdomTree, Japan Cabinet Office, as of 12/31/16. Past performance is not indicative of future results.

We at WisdomTree are very focused on the potential for a virtuous cycle for domestic demand driven by Japan's structural upturn in incomes and employment. After two decades of declining incomes, it may take some time for the positive demand multipliers to unfold. However, incomes are now beginning to rise and this dynamic has the potential to drive an endogenous self-sustaining Japanese cycle, independent from and uncorrelated to the cyclical ups and downs of the global economic cycle. Such is the benefit of Japan's demographics.

As a leading indicator, we like to focus on the mortgage credit and housing market. If we are right and the demographics of Japan force the rise of a new middle class, household formation and real estate and housing should be in a structural uptrend. Here, the fact that mortgage credit growth has been accelerating smartly in the past 12 months points in the right direction, in our view.

FIGURE 11: MORTGAGE CREDIT GROWTH: YEAR-OVER-YEAR CHANGES



Sources: WisdomTree, Bank of Japan, as of 12/31/16. Past performance is not indicative of future results.

2) Policy switch to "fiscal dominance"

The other force that makes us confident in the structural bull case for domestic Japan is Prime Minister Shinzo Abe's decisive turn toward expansionary fiscal policy: In August 2016, the cabinet approved a multiyear supplementary spending program of ¥28 trillion, approximately 5.5% of GDP. This is to be spent over the four years running up to the Tokyo Olympics in 2020. While exact spending allocations are subject to tactical necessities from year to year, the basic thrust suggests fiscal policy should boost domestic demand by approximately 0.5% to 075% of gross domestic product (GDP)[26] for the coming years. The primary beneficiaries of this policy are bound to be small and medium-sized companies.

In our view, the combination of the inflationary upturn in domestic household incomes and the positive fiscal pull on demand suggest Japan's domestic economy is poised for positive growth surprises. In turn, earnings growth momentum and profit visibility for domestic small and medium-sized companies should benefit throughout 2017 and 2018, in our view.

[26] Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

CONCLUSION

In summary, the case for Japan, both large caps and small caps, has an important fundamental backdrop. High cash on balance sheets provides potential for future dividend and buyback acceleration, when combined with a positive outlook for earnings growth. We see a case for the Japanese small-cap companies that are tied to the positive trends in the local economy, tied to the demographic sweet spot and the fiscal policy push.

The primary question an investor might have about implementing Japanese small caps is whether to hedge currency exposure or not. Our efficient frontier charts in the beginning of the paper showed there could be risk-reduction properties of combining some exposure to Japan unhedged, while also having some exposure hedged based on a view of the yen. On the other hand, the negative correlations between the yen and equity markets suggest that a weak yen is still an important consideration and could be a further motivation for investing in Japan—if an investor thought the yen was going to weaken. We would suggest a minimum of a 50% yen-hedged approach, with an argument that a full hedge would help mitigate the risk of the yen being a structurally weak currency over time.

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Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

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WisdomTree International Equity Index: A fundamentally weighted index that measures the performance of dividend-paying companies in the industrialized world, excluding Canada and the United States, that pay regular cash dividends and that meet other liquidity and capitalization requirements. It comprises companies incorporated in 15 developed European countries, Japan, Australia, New Zealand, Hong Kong, Israel and Singapore. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree International LargeCap Dividend Index: A fundamentally weighted index that measures the performance of the large-capitalization segment of the dividend-paying market in the industrialized world outside the U.S. and Canada. The Index comprises the 300 largest companies ranked by market capitalization from the WisdomTree International Equity Index. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree International SmallCap Dividend Index: A fundamentally weighted index that measures the performance of the small-capitalization segment of the dividend-paying market in the industrialized world outside the U.S. and Canada. The Index comprises the companies that make up the bottom 25% of the market capitalization of the WisdomTree International Equity Index after the 300 largest companies have been removed. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree Europe SmallCap Dividend Index: A fundamentally weighted index meant to measure the performance of dividend-paying European small-cap equities; weighted by cash dividends. WisdomTree Japan SmallCap Dividend Index: Designed to provide exposure to dividend-paying small-capitalization companies in Japan. MSCI EAFE Index: A market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan. 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JPX-Nikkei Index 400: Comprised of common stocks whose main market is the TSE First Section, Second Section, Mothers or JASDAQ market (in principle). The components are reviewed annually to keep the representativeness of the market. The annual review shall be conducted at the end of August as follows: (1) 1,000 stocks are selected based on trading value in the past three years and the market value on the selection base date (the end of June) of the annual review. (2) Each stock is scored by three-year average ROE, three-year cumulative operating profit and market value on the selection base date, with the weights on each indicator 40%, 40% and 20%, respectively. (3) 400 stocks are selected by the final ranking with the scores calculated in (2) and qualitative factors from the perspectives of corporate governance and disclosure. In case of delisting of the components due to a merger or bankruptcy, etc., new stocks shall not be added in principle. When the annual review is conducted, the number of components is back to 400; therefore, the Index is calculated with fewer than 400 components until then. MSCI EMU Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of the markets in the European Monetary Union. MSCI EMU Small Cap Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of the small-cap markets in the European Monetary Union. MSCI Emerging Markets Index: A broad market cap-weighted index showing the performance of equities across emerging market countries defined as "emerging markets" by MSCI. MSCI Emerging Markets Small Cap Index: A broad market cap-weighted index showing the performance of small-cap equities across emerging market countries defined as "emerging markets" by MSCI. MSCI Europe Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe. MSCI USA Index: Designed to measure the performance of the large- and mid-cap segments 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. WisdomTree Japan Dividend Index: Designed to provide exposure to dividend-paying Japanese exporters. Constituents are dividend-paying companies incorporated in Japan that derive less than 80% of their revenue from sources in Japan. Weighting is by cash dividends paid.

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