# A MULTIFACTOR APPROACH TO DEVELOPED EQUITY MARKETS

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International equity markets have made headlines this year for all the wrong reasons.

Between an abundance of negative-yielding sovereign debt, the fear of a catastrophic "no-deal" Brexit, and central banks struggling to remedy their worsening economies, it has been difficult to find an investment that can outpace the region's dull prospects.

But just because lackluster performance and looming uncertainty have become the status quo in developed markets doesn't mean investors need to acquiesce and hold on for the ride.

One year ago, WisdomTree introduced a unique way of investing in developed international equity markets based on an analysis of technical and fundamental factors. Since inception, the WisdomTree International Multifactor Fund (DWMF) has amassed over 359 basis points (bps) of outperformance against the MSCI EAFE Index (on a net return basis), proving there is no need to settle for underwhelming returns just because the region has little to offer. *For standardized performance of DWMF, please click here.*

**Looking Under the Hood**

WisdomTree's approach blends both technical and fundamental analysis. It scores companies based on a combination of value, quality, momentum and correlation measurements. The result is a carefully selected basket of about 200 holdings with the highest composite scores, split between large- and mid-cap companies with diversity by both sector and country. The icing on the cake is a dynamic currency hedge that uses carry, value and momentum factors to mitigate the risks associated with weakening developed market currencies.

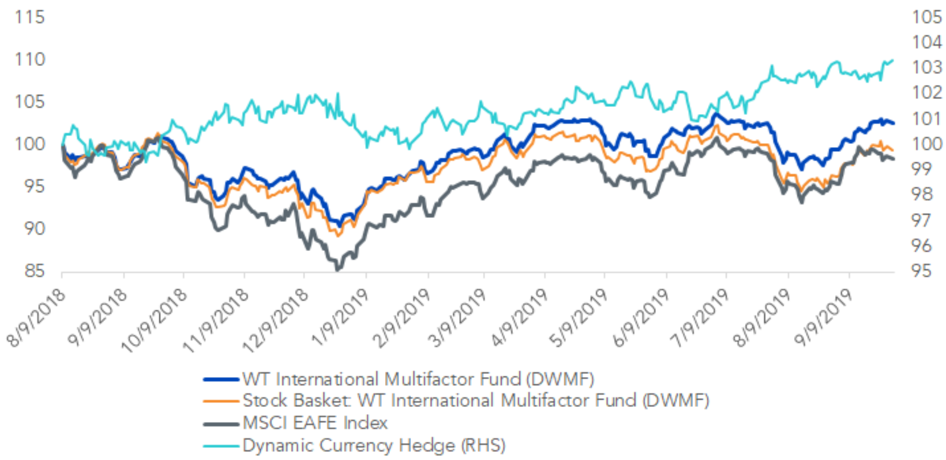
Emphasis on the four factors also provides significant diversification across the Fund's holdings and factor exposures. Whereas other market cap-weighted developed market indexes concentrate much of their weight in a smaller number of holdings, WisdomTree's strategy distributes its allocations more broadly thanks to its factor-weighting mechanism. For example, the top decile of companies in the MSCI EAFE Index amounts to 92 companies and holds close to 46% of the index's total weight. WisdomTree's weighting mechanism cuts this concentration almost in half, with its top decile holding less than 20% of the total weight. This increased diversification has provided the Fund with the ability to maintain a low beta while still leveraging its model-based multifactor stock selection process to help generate excess returns.

**Reading Between the Lines**

The Fund combines a composite-scoring multifactor stock selection model with a dynamic currency hedge in an attempt to generate excess return. The Fund's 359 bps of outperformance versus the MSCI EAFE Index, as of September 30, can be attributed to both stock selection and its dynamic currency hedge.

In figure 1, we break down DWMF's performance since inception across the two components alongside that of the MSCI EAFE Index. DWMF's stock selection, shown as the orange line, has consistently outperformed on its own. The dynamic currency hedge return, shown as the teal line plotted on the right-hand axis, also contributed to the overall performance of the Fund (shown as the dark blue line) and helped reduce drawdown during volatile market periods.

**Figure 1: Since Inception: Growth of $100**




Sources: WisdomTree, FactSet, 8/09/18–9/30/19.

**Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at wisdomtree.com.**

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. ET net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

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. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

Since DWMF's inception, both the stock selection and the dynamic currency hedge have worked together to achieve DWMF's outperformance. The interaction between these two has contributed to the strategy's lower beta, which has been especially valuable during periods of heightened volatility, such as December 2018, May 2019 and most recently in August 2019. Keep in mind, when markets are ripe with uncertainty and recession anxieties are top of mind, downside protection can be just as valuable as outperformance itself.

**The Multifactor Benefit**

WisdomTree's approach also offers distinct, fundamental advantages due to its emphasis on value and quality factors. As of its most recent rebalance on September 13, the multifactor strategy offers a 12.5% discount in its price-to-earnings ratio compared to the MSCI EAFE Index. Likewise, it provides a 282-bps improvement in return on equity and an 81-bps enhancement in return on assets, both attributable to the strategy's focus on well-capitalized companies with efficient and robust operations.

As a result, the Fund provides a selection of healthy companies at a discount to the broad developed market, which is especially important in a region with sluggish growth.

**Figure 2: The Factors Explain the Fundamentals**

| Fundamentals Comparison | | |
|---|---|---|
| | DWMF | MSCI EAFE Index |
| Dividend Yield | 3.36% | 3.32% |
| Price-to-Earnings | 13.24x | 15.15x |
| Return On Equity | 13.40% | 10.58% |
| Return On Assets | 2.34% | 1.53% |
| Leverage | 5.73x | 6.92x |

Sources: WisdomTree, FactSet, as of 9/30/19. You cannot invest directly in an index. Past performance is not indicative of future results.

*For definitions of terms in the chart, please visit our glossary.*

**It's Time to Get Creative in Developed Markets**

Although the Fund is still in its infancy, it has already proven that there's value in a multifactor stock selection strategy in developed equity markets.

Couple that with a currency risk mitigator, and suddenly the region has much more to offer than geopolitical uncertainty and sluggish economic activity.

While it's easy to be discouraged by prospects within the region, at WisdomTree, we believe there's opportunity in every market. You just need to know where to look for it.

***Unless otherwise stated, data sources are WisdomTree and FactSet, as of 9/30/19.***



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You cannot invest directly in an index.

## DEFINITIONS

**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.

**Brexit** : an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.

**Factor** : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

**MSCI EAFE Index** : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over tim.

**Momentum** : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**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 the opposite direction.

**Large-Capitalization (Large-Cap)** : A term used by the investment community to refer to companies with a market capitalization value of more than $10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**Mid-Cap** : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

**Currency hedging** : Strategies designed to mitigate the impact of currency performance on investment returns.

**Carry** : The amount of return that accrues from investing in fixed income or currency forward contracts.

**Diversification** : A risk management strategy that mixes a wide variety of investments within a portfolio.

**Market capitalization-weighting** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Beta** : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

**Volatility** : A measure of the dispersion of actual returns around a particular average level. 

**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.

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

**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.