

# WISDOMTREE'S INDIA EARNINGS INDEX: ANNUAL REBALANCE SCREENING

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Both the Indian equity market and the Indian rupee have experienced strong bouts of [volatility](#) in recent years. Amid the noise of central bank actions and macro-related policy debates, WisdomTree rebalanced its [India Earnings index](#) on September 20—the same day the new governor of the Reserve Bank of India (RBI) made his first policy announcement. The timing of this Index rebalance and central bank meeting was a coincidence—the Index rebalance occurs at the same time every September. Each year, WisdomTree calculates the [Earnings Stream](#) of India's equity market to identify firms that have generated positive cumulative profits. Qualifying companies are weighted by their proportionate contribution to the total Earnings Stream. • Firms whose price levels have declined but whose earnings have either remained constant or grown tend to see increases in their weights at the rebalance. This rules-based methodology applies a disciplined focus to firms' [fundamentals](#) and [relative valuations](#). **Sector Weight Changes and Measures of Potential Rupee Sensitivity** In the trailing 12 months prior to the rebalance date (September 20, 2013), India's equities as measured by the WisdomTree India Earnings Index ([WTIND](#)) delivered returns of -13.2%. Given that the rupee declined more than 14% over this period, the currency move explains the Index decline. But there were big divergences among sectors that led to shifts in sector weights at the rebalance. One factor that was important in explaining the sector performance was each sector's sensitivity to the currency, so in the below analysis we list those sector [correlations](#). **Analysis of Sector Changes**

in		Weight		and		Rupee		Sensitivity	
		Old Weight <sup>1</sup>	Sector Performance <sup>2</sup>	New Weight <sup>3</sup>	Change in Weight	Performance of Sector Relative to WTIND	3-Year Correlation of MSCI India Respective Sector Index to INR <sup>4</sup>		
Underperforming Sectors	Industrials	4.59%	-34.49%	5.40%	0.80%	-21.29%	0.76		
	Materials	9.90%	-28.27%	8.69%	-1.21%	-15.07%	0.62		
	Utilities	4.22%	-24.93%	6.42%	2.20%	-11.73%	0.67		
	Financials	22.05%	-24.34%	25.21%	3.16%	-11.14%	0.72		
	Energy	20.45%	-14.03%	20.65%	0.20%	-0.83%	0.66		
Outperforming Sectors	Consumer Discretionary	10.62%	-3.27%	8.78%	-1.85%	9.93%	0.39		
	Information Technology	16.03%	8.91%	14.47%	-1.56%	22.11%	0.17		
	Health Care	4.36%	10.99%	4.85%	0.49%	24.19%	0.40		
	Consumer Staples	5.13%	13.22%	4.36%	-0.77%	26.42%	0.58		
	Telecommunication Services	2.64%	25.14%	1.18%	-1.47%	38.34%	0.46		
		Old Weight <sup>1</sup>	Average Sector Performance <sup>2</sup>	New Weight <sup>3</sup>	Change in Weight	Average of Sector Performance Relative to WTIND	Average MSCI India Sector 3-Year Correlation to INR		
Sectors that Outperformed		38.79%	11.00%	33.63%	-5.16%	24.20%	0.40		
Sectors that Underperformed		61.21%	-25.21%	66.37%	5.16%	-12.01%	0.69		

Sources: WisdomTree, Standard & Poor's. Past performance is not indicative of future performance. Subject to change.

<sup>1</sup> As of 9/20/2013, before rebalance

weights went into effect. <sup>2</sup> Performance of specified sector from 9/21/2012 to 9/20/2013. <sup>3</sup> As of 9/20/2013, after rebalance weights went into effect. <sup>4</sup> From 8/31/2010 to 8/31/2013. For definitions of terms in the charts, please visit our [Glossary](#). There were five sectors in this Index that underperformed and five sectors that outperformed. Some notable points: • **The Underperformers:** This group consisted of Industrials, Utilities, Materials, Financials and Energy. Their average return over the period was worse than -25%, about 12% worse than the performance of WTIND (-13.2%). These underperforming sectors received about 5% additional weight at this year's annual rebalance screening. The greatest two weight increases were to Financials and Utilities, whereas Energy and Industrials were largely unchanged in weight. • **The Outperformers:** This group consisted of Consumer Discretionary, Health Care, Consumer Staples, Information Technology and Telecommunication Services.

Their average return over the period was approximately 11%, about 24% better than the performance of WTIND as a whole. The outperformers saw their weight reduced by 5%. The greatest reduction in weight came from Information Technology and Consumer Discretionary. • **Correlation to the Rupee—Results:** The sectors that underperformed were the ones most correlated to the rupee, in particular Financials, Energy, Industrials and Utilities. One factor causing this high correlation could be these companies' issuance of dollar-denominated debt. When the local currency declines, it causes their debt levels to rise because it costs more rupees to pay off their debt. • Companies that have revenue in U.S. dollars, for example the exporters, benefit from a weaker rupee; the Technology sector is one of most prominent sectors whose companies can be said to have benefited on a revenue basis from the weakening rupee and which also had little [dollar-denominated debt](#). • The actions taken by the new head of the central bank to provide discounted loans to financials represented a large change in sentiment and helped alleviate the pressures they faced from the declining rupee on their dollar-denominated debt—it may mark a turning point for these companies. • **Rebalance Results:** By shifting weight toward the Financials sector and away from the Technology sector, the correlation of the India Earnings Index to the currency change has the potential to become a bit more sensitive by adding more weight to a sector that is highly correlated to the rupee and taking weight away from the Tech sector, which is less correlated to the rupee.

**Conclusion** Volatility in the markets creates the potential for opportunity to take stock of fundamentals and identify when stock prices have moved more than is justified by changes in the relative value of companies or markets. This year's annual rebalance in India was such a time when there were large changes in many asset prices. We took this opportunity to add weight to Financials and Utilities, two sectors that underperformed, while taking weight away from sectors that performed relatively well: Technology. We believe this disciplined, rules-based rebalance is a key way to add value to our indexing approach.

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## **DEFINITIONS**

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

**WisdomTree India Earnings Index** : A fundamentally weighted Index that measures the performance of companies incorporated and traded in India that are profitable and that are eligible to be purchased by foreign investors. Companies are weighted in the Index based on their earnings in their fiscal year prior to the Index measurement date, adjusted for a factor that takes into account shares available to foreign investors.

**Earnings Stream®** : Earnings per share x the number of shares outstanding. For an index, these totals are added for all constituents.

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

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

**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.

**Dollar-denominated debt** : Debt that is issued in U.S. dollars and must be paid in U.S. dollars. If the issuer's local currency depreciates against the U.S. dollar, it becomes more expensive for the issuer to pay off the debt; if the issuer's local currency appreciates against the U.S. dollar, the debt obligation becomes less expensive.