MOMENTUM STOCKS FALTER IN 2014

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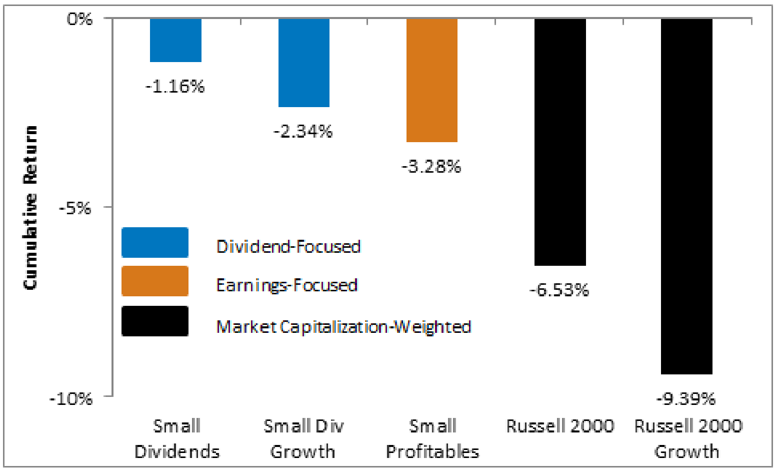
Within equities, few things capture the excitement and imagination of investors as well as a good growth story. Frequently, these are the stories of companies involved in cutting-edge technologies that could very well change how we live our lives—with the caveat, of course, that they are successful. In 2013, a year of equity performance driven by multiple expansion, we saw very strong performance from these types of stocks. **Sentiment Can Shift on a Dime** Usually, there comes a time when the "good story" is no longer enough, and a stock stops trading based on possibilities and potential and starts trading based on the actual business operations. It's possible that we saw such a shift around March 4, 2014, as discussion around U.S. equities began to note that high-growth-potential momentum stocks have gone from outperforming broad U.S. equities (represented here by the Russell 3000 Index) to underperforming them by a significant margin. **Studying the Case of Small Caps** If one were to ask where many of these "story stocks" reside, we'd point to the small-cap growth segment of the market, whose performance is well captured by the Russell 2000 Growth Index These can be new businesses, yet to generate profits but high on potential—and also high on risk. One of the biggest elements of risk involves the fact that, in many cases, the more exciting the story, the less attention potential investors pay to valuation. Ultimately, we believe that small-cap stocks in general represent an important part of an equity portfolio, and history shows their potential to greatly outperform large caps over long periods. However, we find it important to remind investors that, historically speaking, the small-value style has significantly outperformed the small-growth style, even though the most exciting stock stories typically would not be found within the "value" style. **WisdomTree Uses Fundamental Discipline to Mitigate Risk in Small-Cap Stocks** At WisdomTree, we have nothing against riding the wave of the next awesomely successful small-cap company, but we recognize that selecting it ahead of time without a crystal ball is extremely difficult. Instead, we focus on two key principles: *Fundamentals* and *Valuation*. We do this using the following three Indexes, as we attempt to more effectively manage the risks inherent in small-cap stocks: • **WisdomTree SmallCap Dividend Index** **(Small Dividends):** This Index includes only dividend payers, weighted by the cash dividends they pay, thereby avoiding more speculative non-dividend-paying companies. • **WisdomTree SmallCap Earnings Index** **(Small Profitables):** This Index includes only firms that have demonstrated their ability to make money, weighted by the earnings they generate, thereby avoiding more speculative firms that have yet to prove their profitability. • **WisdomTree U.S. SmallCap Dividend Growth Index** **(Small Div Growth):** This Index selects firms that pay dividends but also demonstrate relatively high long-term earnings growth expectations and measures of quality[1], weighted by the dividends they pay. The methodology is therefore sensitive to growth potential but able to steer around firms that tend to use high degrees of leverage to support growth. Each of these Indexes also has an annual rebalance that is sensitive to changes in relative valuation. Simply put, this process tends to shift weight from some of the top-performing stocks by share price and move it toward those better able to improve and grow their fundamentals. In a sense, it's almost a built-in discipline to be "anti-momentum," and we believe it plays a role in risk mitigation, since the very stocks that exhibit big upward movements can often exhibit downward volatility as they come back down to earth. **Navigating the Shifting Sentiment across Small Cap Stocks (3/4/2014 to 5/23/2014)**



Source: Bloomberg. Past performance is not indicative of future results.

• **Common Thread—Avoiding Speculative Names:** What we saw across the brief Index descriptions above was that each WisdomTree Index requires something of its small-cap constituents. In each case, the "story stocks" that may not have actually made any money would have been excluded. The Russell 2000 Index—the broadest shown—would tend to include all small caps. The Russell 2000 Growth Index, as we mentioned earlier, would focus on the growth segment of the small-cap market, a segment that can be prone to higher valuations as well as speculative companies. • **Small Dividends Leads the Way:** For those concerned about the prospects of small-cap stocks in the U.S., we believe that Small Dividends deserves particular focus. The focus solely on dividend payers and the broad diversification combine to form what we'd categorize as WisdomTree's most defensive way to maintain small-cap equity exposure. Small Div Growth and Small Profitables would both creep more toward the growth side of the style box compared to Small Dividends. **Conclusion: All Small Cap Indexes Are NOT Created Equal** After 2013, a year where many segments of the U.S. equity markets performed particularly well, we believe that attentiveness to risk mitigation has become more important, especially in small-cap stocks. While we wrote about potential [pockets of value within small caps] earlier this year, here we emphasize Index methodologies, and those that purposefully avoid the more speculative companies can be beneficial. One may never fully eliminate the risk of investing in small-cap stocks, but we believe that a few simple rules have the potential to make a noticeable difference—especially during periods where markets become a bit choppy. [1]Measures of quality refer to three-year average return on equity (ROE) and three-year average return on assets (ROA)

Important Risks Related to this Article

Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time. Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development.

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Multiple expansion : Term for a rising P/E ratio, meaning that share prices are rising faster than earnings are growing.

Russell 3000 Index : Measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

Russell 2000 Growth Index : Measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

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.

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.

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.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

WisdomTree SmallCap Dividend Index : A fundamentally weighted index measuring the performance of the small-capitalization segment of the U.S. dividend-paying market. The Index comprises the companies that constitute the bottom 25% of the market capitalization of the WisdomTree Dividend Index after the 300 largest companies have been removed. The Index is dividend weighted annually to reflect the proportionate share of the aggregate cash dividends each component company is projected to pay in the coming year, based on the most recently declared dividend per share.

WisdomTree SmallCap Earnings Index (WTSEI) : measures the performance of earnings-generating companies within the small-capitalization segment of the U.S. Stock Market. The index is comprised of the companies in the bottom 25% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed.

WisdomTree U.S. SmallCap Dividend Growth Index (WTSDG) : A fundamentally weighted index designed to track the performance of dividend-paying companies in the U.S. small-cap equity universe that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by indicated cash dividends.

Long-Term Earnings Growth Expectations : Compilation of analyst estimates of the growth in operating earnings expected to occur over the next full business cycle, typically 3 to 5 years, sourced from Bloomberg.

Leverage : Total 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.