

# TARGETING BENCHMARK SIZE EXPOSURES WITH SMART BETA INDEXES

Christopher Gannatti – Global Head of Research  
09/18/2014

Adding mid- or small-cap exposures to a portfolio, over long periods of time, has tended to change the overall risk and return picture. Benchmark-aware portfolio managers may be attracted to the enhanced return potential of mid and small caps, but they may also be leery of the added risk, or “size bet,” they assume by adding these exposures. But we’ve found that by using certain smart beta indexes, investors can employ mid- or small-cap strategies without taking a size bet relative to a benchmark. The table below illustrates this point: **Using Smart Beta Indexes without Making Size Bets**

Matching the MSCI EAFE Size Factor	Market Factor	Size Factor	Value Factor	Momentum Factor	Average Annual Returns
WT DEFA Index	0.988	-0.230	0.060	0.010	4.99%
WT International LargeCap	0.980	-0.364	0.020	0.030	4.53%
55% WT International LargeCap/ 45% WT International MidCap	0.993	-0.156	0.099	-0.004	5.51%
77% WT International LargeCap/ 23% WT International SmallCap	0.985	-0.156	0.070	0.010	5.09%
77% WT DEFA/ 23% WT International MidCap	0.993	-0.156	0.091	-0.003	5.20%
91% WT DEFA/ 9% WT International SmallCap	0.989	-0.156	0.077	0.004	5.17%
MSCI EAFE	0.986	-0.156	0.047	0.008	3.87%

  

Matching the MSCI EAFE IMI Size Factor	Market Factor	Size Factor	Value Factor	Momentum Factor	Average Annual Returns
57% WT International LargeCap/ 22% WT International MidCap/ 21% WT International SmallCap	0.991	-0.069	0.105	-0.005	5.34%
81% MSCI EAFE/ 14% MSCI EAFE Mid Cap/ 5% MSCI EAFE Small Cap	0.995	-0.069	0.055	0.000	3.95%
MSCI EAFE IMI	0.994	-0.069	0.055	0.001	4.05%

Sources: WisdomTree, Bloomberg, Zephyr StyleADVISOR, Kenneth French Data Library, Period 6/1/06–6/30/14 due to inception dates of the WisdomTree Indexes shown. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms and Indexes in the chart, visit our [glossary](#).

- **How Large is LARGE?** In this table, a greater negative number in the size factor column indicates greater exposure to large-cap stocks. The MSCI EAFE Index comes in at -0.156, thereby setting the bar. The WT DEFA Index comes in at -0.230, while the WT International Large Cap Dividends comes in at -0.364, or more than twice as exposed to large caps as the MSCI EAFE Index.
- **Adding 9%–45% weight to Mid or Small Caps to Match MSCI EAFE:** The fact that the WT DEFA and the WT International LargeCap Dividend are so large means that we can add anywhere from 9% to 45% exposure to mid- or small-cap stocks, defined by blends with the WT International MidCap Index or the WT International SmallCap Index. The important thing is that we can do this **without** taking any size bet relative to the MSCI EAFE Index, based on the returns exhibited over the period of time represented by the table, June 1, 2006, through June 30, 2014. We believe that it is beneficial to think in this manner because adding small or mid-caps can build a more complete exposure to a particular region, not to mention that all of the blends outperformed the MSCI EAFE Index over this period.
- **Blending with WT Int. LargeCap Dividend:** It’s clear that this Index is the largest, so when it is used as the foundation of a blend, it allows the use of 45% weight toward the [WT International MidCap Dividend Index](#) or 23% weight toward the [WT International SmallCap Dividend Index](#) while maintaining the same overall size exposure as the MSCI EAFE Index. The 45% weight toward [mid caps](#) certainly contributed to the 5.51% average annual return—the best of all blends shown in this table.
- **Blending with WT DEFA:** This Index isn’t quite as large as the WT International LargeCap Dividend and does include exposure to large-, mid- and small-cap

size segments. Still, we have the flexibility to add 23% exposure to the WT International MidCap Dividend Index or 9% to the WT International SmallCap Dividend Index without taking a size bet relative to the MSCI EAFE. • **What about the MSCI EAFE IMI?** Even MSCI has recognized that the MSCI EAFE Index is not necessarily a “total market” exposure, largely missing out on the small-cap size segment. That’s one of the main reasons that the MSCI EAFE IMI has been gaining attention; it does in fact include large-, mid- and small-cap stocks, and it is broader than the MSCI EAFE Index. - Even though the MSCI EAFE IMI has greater exposure to small caps than the MSCI EAFE Index, as seen by its -0.069 size factor loading, a wisdomTree blend of large cap, mid cap and small cap focused Indexes can match this size exposure while tilting significantly more weight toward mid- and small-cap stocks, specifically 43%. This is even true if we compare to the MSCI EAFE size-focused options, which stand at 19%. This is a big reason why we think the blend of 57% WT International LargeCap Dividend, 22% WT International MidCap Dividend and 21% WT International SmallCap Dividend Indexes delivered the second-best performance of the blends shown in this table, 5.34% average annual returns. Read full research on International Smart Beta [here](#).

**Important Risks Related to this Article**

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

**IMPORTANT INFORMATION**

**U.S. investors only:** Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.  
You cannot invest directly in an index.

## DEFINITIONS

**WisdomTree International MidCap Dividend Index**: A fundamentally weighted index that measures the performance of the mid-capitalization segment of the US dividend-paying market. The Index is comprised of the companies that compose the top 75% 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 International SmallCap Dividend Index**: A fundamentally weighted index measuring the performance of the small-capitalization segment of the US dividend-paying market. The Index is comprised of the companies that compose 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.

**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.