

THE SMART BETA RALLY THAT MANY INVESTORS MISSED IN 2015

Luciano Siracusano — Chief Investment Strategist
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One of the big trends in the exchange-traded fund (ETF) industry has been this year’s flow of new money into developed world equity ETFs, both [unhedged](#) and currency [hedged](#). WisdomTree estimates that nearly \$100 billion of this year’s \$171 billion in ETF industry inflows cascaded into these funds through the end of October. But the vast majority of assets in international equity ETFs—and the vast majority of net inflows this year—has been concentrated primarily in developed world [large-cap](#) strategies. While equity returns for the [MSCI Europe](#) and [MSCI Japan](#) indexes have, thus far in 2015, exceeded those generated by the [S&P 500 Index](#), the bigger [bull](#) market has actually occurred in the smaller-company segment of the developed world. If we look at year-to-date returns through October 30, we can see by how much [small-cap](#) indexes have outperformed compared to broad market indexes comprising primarily large-cap companies in Europe, Japan

Index	WisdomTree Index Inception Date	Average Annual Total Returns as of 9/30/2015					
		YTD through 10/30/2015	YTD through 9/30/2015	1 year	3 years	5 years	Since Inception of WT Index
WisdomTree International SmallCap Dividend Index	6/1/2006	6.65%	0.74%	-3.48%	9.57%	7.21%	4.59%
MSCI Eafe Index		2.13%	-5.28%	-8.66%	5.63%	3.98%	1.68%
MSCI EAFE Small Cap Index		8.76%	2.62%	0.29%	10.17%	7.30%	3.22%
WisdomTree Europe SmallCap Dividend Index	6/1/2006	11.11%	5.80%	4.95%	18.19%	11.27%	5.51%
MSCI Europe Index		1.58%	-5.20%	-9.33%	6.03%	4.28%	1.97%
MSCI Europe Small Cap Index		10.80%	5.29%	3.87%	14.03%	9.53%	5.10%
WisdomTree Japan SmallCap Dividend Index	6/1/2006	15.34%	7.92%	3.87%	9.91%	8.24%	2.19%
MSCI Japan Index		10.32%	0.21%	-2.22%	8.96%	4.91%	-0.31%
MSCI Japan Small Cap Index		12.93%	5.87%	2.94%	10.58%	8.18%	0.54%

Sources: WisdomTree, Bloomberg. 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.

and the developed world.

For definitions of indexes in the chart, visit our [glossary](#). What’s interesting is that the excess return produced by the small caps compared to their large-cap brethren is [not just a 2015 phenomenon](#). Excess returns have held up over the last year, three years, five years and the better part of the last decade going back to the inception of the WisdomTree Indexes back in May of 2006. **When One Compares Returns across Asset Classes, Additional Light Bulbs Light Up** The double-digit gains European and Japanese small caps have generated thus far in 2015 have not only surpassed the broad European and Japanese benchmarks (MSCI Europe and MSCI Japan), they have outperformed the major asset classes investors typically tap to construct a globally diversified portfolio: large caps and small caps in the U.S.¹; [MSCI EAFE Index](#) and [MSCI Emerging Markets Index REITs](#)², U.S. Treasuries, investment-grade and high-yield corporate bonds³; commodities⁴ and gold⁵. Moreover, year-to-date in 2015, small caps measured by the [WisdomTree Japan SmallCap Dividend Index](#) and the [WisdomTree Europe SmallCap Dividend Index](#) outperformed each of the major indexes designed to measure how each [smart beta](#) factor is performing: [MSCI Momentum](#) [MSCI Quality](#) [MSCI Value](#) [MSCI Low Volatility](#) or [MSCI Size](#). What accounts for the divergence in returns? Part of it can be explained by sector concentrations, country and currency exposure. Another reason: Small-cap stocks are less tied to the global economy and often more sensitive to inflections in local economies. This can be partly explained by the historic tendency of small-company stocks to outperform large caps. This is one of the reasons that back in 2006 WisdomTree became the first ETF manager to launch international small-cap ETFs. At that time, WisdomTree knew that international small caps not only added potential for higher returns compared to large caps but they could also provide diversification benefits to a globally diversified portfolio. Since its

inception in 2006, for example, the WisdomTree Japan SmallCap Dividend Index had [a correlation](#) of .49 to the S&P 500. Adding components with lower correlations to one's U.S. equity exposure has the potential to lower the overall [volatility](#) of a globally diversified portfolio. **Conclusion** Because most [passive](#) indexes and [active](#) international managers tend to concentrate primarily on large-cap stocks, international investors may miss the potential of small-cap companies unless they make a conscious effort to include them in their portfolios. We believe international small-cap exposure can help investors complete their international allocations. Returns this year in Europe, Japan and the developed world add additional real-time evidence to support our thesis. ***Unless otherwise stated, data sources are Bloomberg and WisdomTree.***

¹S&P 500 and [Russell 2000 Index](#) ²MSCI US REIT Gross Total Return and [S&P Global ex-U.S. REIT USD Index](#)
³Barclays US Agg Corporate Yield-To-Worst and Barclays U.S. High Yield 2% Issr Cap Yield To Worst.⁴Commodity Research Bureau BLS/US Spot all Commodities Index. ⁵Gold Spot Price Index.

Important Risks Related to this Article

Performance, especially for very short periods, should not be the sole factor in making your investment decision.

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. Investments in commodities may be affected by overall market movements, changes in interest rates, and other factors, such as weather, disease, embargoes and international economic and political developments.

Diversification does not eliminate the risk of experiencing investment losses.

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Unhedged : Strategy that includes the performance of both the underlying asset as well as the currency in which it is denominated. The performance of the currency can either help or hurt the total return experienced.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

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.

MSCI Europe Index : A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe.

MSCI Japan Index : A market cap-weighted subset of the MSCI EAFE Index that measures the performance of the Japanese equity market.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Bullish : a position that benefits when asset prices rise.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

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.

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

MSCI US REIT Index : a market capitalization index measuring the performance of equity Real Estate Investment Trusts (REITs) with the United States.

Smart Beta : A term for rules-based investment strategies that don't use conventional market-cap weightings.

MSCI Momentum Index : designed to embody the performance of an equity momentum strategy by to emphasizing stocks with high price momentum, while also maintaining reasonably high trading liquidity, investment capacity and moderate investment turnover.

MSCI USA Quality Index : refers to the MSCI USA Quality Index which is a large and mid cap US equity index aiming to capture the performance of quality growth stock. The Index screens its parent index, the MSCI USA Index for ROE, stable year-over-year earnings growth, and low financial leverage.

MSCI USA Value Index : is a large and mid cap US equity index aiming to capture securities exhibiting overall value style characteristics. The Index screens for book value to price, 12-month forward earnings to price, and dividend yield as value characteristics.

MSCI Low Volatility Index : designed to embody the performance of a minimum variance equity strategy or managed volatility strategy and is calculated by optimizing a traditional cap weighted "parent MSCI Index" to attain the minimum level of volatility for a set of constraints.

MSCI Size Index : designed to capture returns of smaller firms relative to their larger counterparts via market capitalization.

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.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

Active : Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

S&P Global ex-U.S. REIT USD Index : designed to reflect the equity performance of both international developed and emerging market real estate stocks.