

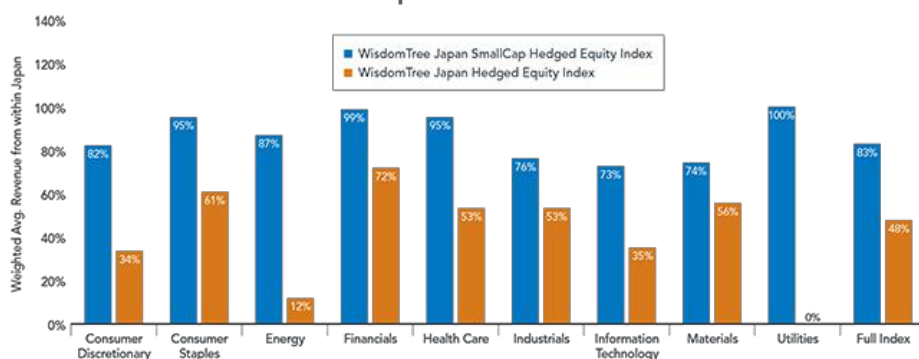
# A FOCUS ON JAPAN SMALL CAPS FOR DOMESTIC DEMAND

Jeremy Schwartz — Global Chief Investment Officer

06/24/2013

2013, in many ways, has been the year of Japan. Interest in Japanese stocks has soared with a rising equity market and weakening currency based on optimism about prime minister Shinzo Abe and his “Abenomics” policies to reinvigorate Japan. Abenomics focuses on a “three-arrow” policy of fiscal stimulus, monetary stimulus and structural reforms. All of Abenomics’ goals are aimed at one thing: promoting economic growth in Japan. The country has been mired in a slow-growth, [deflationary](#) slump for some time, and Mr. Abe is determined to reverse that painful cycle of deflation. **A Depreciating Yen Helps Japanese Exporters** Thus far, one side effect (if not a central goal of Abenomics) has been weakness in the yen. We created an Index (the [WisdomTree Japan Hedged Equity Index](#)) to focus on companies we believe stand to benefit from a weaker yen—those companies that are exporters and have a global revenue base.<sup>1</sup> We [hedge](#) the yen from that Index to prevent exchange rate movements from impacting the performance of the Index. **Domestic Consumption Is the Government’s Larger Focus** However, at its core, Abenomics is designed to stimulate economic growth in Japan—by encouraging Japanese consumers to come off the sidelines where they have sat with significant savings for a long time. Domestic consumption is an important element of Abenomics. To expand our coverage of Japanese stocks beyond just the exporters, we have created an additional Japan Hedged Equity Index focused on the small-cap part of the equity markets that we believe are more levered to local Japanese revenue and consumption. **Key attributes of the small-cap focus of the Japan SmallCap Hedged Equity Index:** 1. Small-cap stocks typically export less and are more sensitive to the domestic economy than large-cap stocks. 2. While the WisdomTree Japan Hedged Equity Index has a revenue filter excluding firms that generate more than 80% of their revenue from Japan, the [WisdomTree Japan SmallCap Hedged Equity Index](#) has no such revenue screen and is meant to be broadly inclusive of Japanese small-cap dividend payers. This new Index seeks to balance the export nature of large caps with the more domestic consumption element of many small caps.

## Local Consumption Levered: How Much Revenue Comes from Japan?



Sources: WisdomTree, Bloomberg, Standard & Poor's. Subject to Change. You cannot invest directly in an index.

### • Small Caps Are Locally

**Based:** The WisdomTree Japan SmallCap Hedged Equity Index derives nearly twice the amount of revenue from within Japan (83%) than the WisdomTree Japan Hedged Equity Index on a weighted average basis. • Over half the constituents of the Japan SmallCap Hedged Equity Index have 100% of their revenue coming from Japan. • **Sector Comparisons:** The WisdomTree Japan SmallCap Hedged Equity Index derives a greater weighted average revenue from within Japan than the WisdomTree Japan Hedged Equity Index in all 10 industry sectors. Consumer Staples, Financials, Health Care and Utilities stand out as being the most locally based, but even the Consumer Discretionary sector (which is the most globally based sector in the export basket) has 82% of its revenue coming from Japan. **Additional Valuation Advantage** The WisdomTree Japan SmallCap Hedged Equity Index also exhibits a [valuation](#) advantage compared to the

WisdomTree Japan Hedged Equity Index as of the May 31, 2013, Index Screening: • The WisdomTree Japan SmallCap Hedged Equity Index has a [price-to-earnings \(P/E\) ratio](#) of about 13x earnings and a [price-to-book value \(P/B\) ratio](#) of .8x. • The WisdomTree Japan Hedged Equity Index has a P/E ratio of about 14x earnings and a P/B ratio of 1.2x. We believe this relationship between the Japanese large and small cap equities to be impacted by a lot of international investor interest in Japan—the large global revenue generators in the WisdomTree Japan Hedged Equity Index are the firms that these investors would know, whereas the smaller firms in the WisdomTree Japan SmallCap Hedged Equity Index would be less familiar. **Conclusion** We believe that Abenomics will not fade quickly—on both the monetary and fiscal side, commitments have been made with a focus on long-term results and a willingness to stay the course. That points to a need for flexibility: Japan's global revenue generators might be in favor some of the time, while at other times the focus could shift more toward the more domestically sensitive firms. In conceptualizing how best to measure the performance of Japanese equities, it could make sense to consider each of what we believe are quite different ways of looking at a single country's equities. <sup>1</sup>Companies with a global revenue base are identified as companies that have less than 80% of their revenue coming from Japan.

#### Important Risks Related to this Article

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. This may result in greater share price volatility. Investments focusing in Japan, thereby increasing the impact of events and developments in Japan that can adversely affect performance. Investments in currency involve additional special risks, such as credit risk, interest rate fluctuations, derivative investments which can be volatile and may be less liquid than other securities, and more sensitive to the effect of varied economic conditions.

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**

**Deflation** : The opposite of inflation, characterized by falling price levels.

**WisdomTree Japan Hedged Equity Index** : Index designed to provide exposure to Japanese equity markets while at the same time neutralizing exposure to fluctuations of the Japanese yen movements against the U.S. dollar. Constituents are dividend-paying companies incorporated in Japan that derive less than 80% of their revenue from sources in Japan. Weighting is by cash dividends paid.

**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.

**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.