FACEBOOK PROVES INVESTING AND EMOTIONS DON'T MIX

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The recent Facebook initial public offering (IPO)—and its aftermath—reminds me how the fastest-growing companies with the most exciting technologies often become overpriced. Consider that the reason the Facebook IPO may have been so highly anticipated is because hundreds of millions of individuals use Facebook. Facebook has just begun to figure out how to monetize its users and turn its huge subscriber base into real earnings for its shareholders. Many of Facebook's users were excited about this IPO, because Facebook is a company they know, connect with and enjoy on a daily basis. This was largely thought to be an investment with such great prospects, it could not lose. Unfortunately, when investment decisions are made based on emotions and future potential, investors often pay too much for an uncertain growth prospect. Few decisions are best made with emotions—and investment decisions, in my opinion, never are. I believe in the power of a rigorous, rules-based approach that focuses on valuations and a long-term perspective. And one of the valuation indicators I believe is quite powerful is an earnings-based metric called the P/E ratio. The P/E ratio of a stock and a market can help you judge if you are getting in at a reasonable price. Investors may be surprised to learn that many investment approaches don't look at earnings but only at market cap. I believe the result is that, by design, they may pay too much for growth and sometimes end up investing in unprofitable companies. WisdomTree takes a fundamental approach to investing that provides investors with the market at a reasonable price: • We look at earnings. Is the company profitable? Does the company have at least a year of profitability? • We weight stocks based on earnings rather than market cap—which helps lower the P/E ratio of our portfolios. Facebook is currently a profitable company. It was just added to the Russell 1000 Index on June 22, 2012. If it continues to have positive earnings, it will be eligible for inclusion in the WisdomTree Earnings Indexes and ETFs after the next screening date in December of this year. But given its above-average valuations (its P/E ratio), I expect WisdomTree will put less weight in Facebook than the Russell 1000 Index does. This is because the Russell 1000 weights firms by market capitalization (price times shares outstanding), while WisdomTree weights firms by their earnings streams (earnings per share times shares outstanding). For two stocks with the same level of earnings, a market capitalization-weighted index will give more weight to the stock with the higher P/E ratio, while an earnings-weighted index tilts weight to stocks with relatively lower P/E ratios. This is the core discipline of our unique, rules-based approach to weighting by earnings, and it is designed to help our investors avoid weighting stocks with higher P/E ratios too heavily. *Read more about the power of earnings and taking a rules-based approach to investing here.*

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