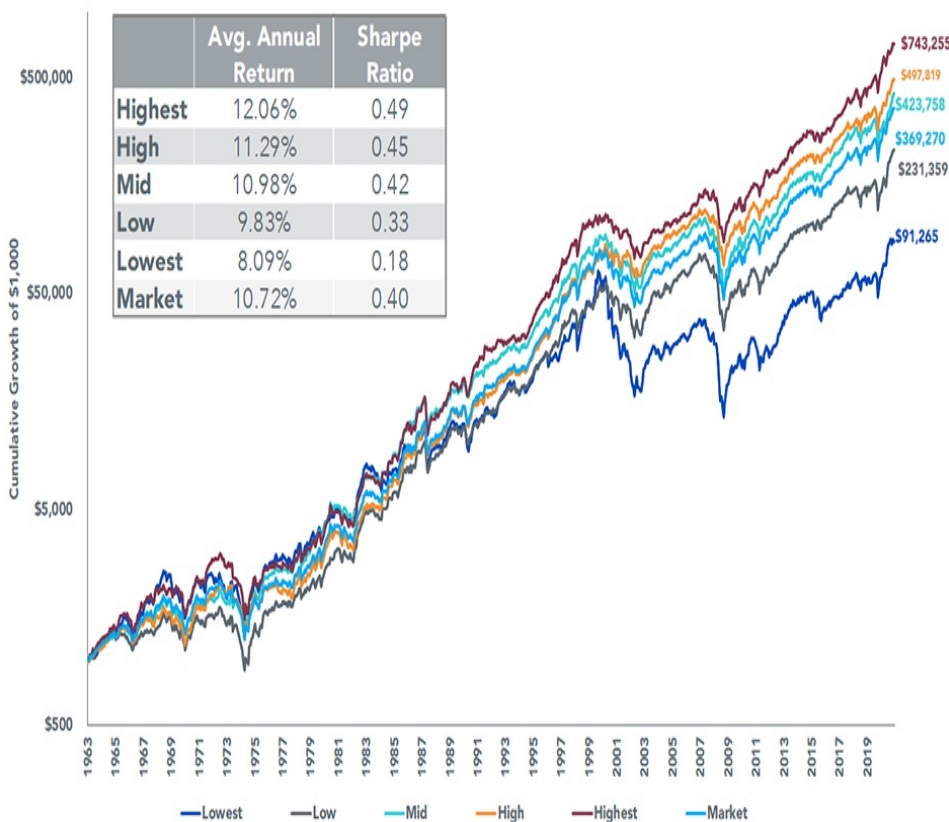


WHY QUALITY FOR THE LONG RUN

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High-quality companies—companies with strong profitability metrics, low debt and low variability in earnings—represent one of the better opportunities in the market today.

Academic research shows that a very simple sort of the market by a profitability metric known as [return on equity \(ROE\)](#) has delivered strong long-term returns. The return spread between the highest and lowest ROE companies has been approximately 4% a year going back almost 60 years.



Source: Kenneth French Data Library, with data as of 6/30/2021. Data as of specified dates using latest available quarterly data. Period based on availability of operating profitability returns sorted into quintiles, which begins 6/30/1963. Universe is U.S. listed equities grouped on the basis of operating profitability. Market refers to Fama-French's measure of return on the market, which is based on the value-weight return of all CRSP firms incorporated in the U.S. and listed on the NYSE, AMEX or NASDAQ. Past performance is not indicative of future results.

Looking over more recent history, we see over the last 15 years that high-ROE stocks have even expanded their lead over low and negative ROE stocks. But over the last year, there has been a large “junk rally” taking place, with the market propelled by firms with negative ROE or the lowest ROE.

WisdomTree believes fundamentals are going to start to matter again as we get later into the [bull](#) market cycle and have a return to the longer-term trends of profitability and ROE driving performance.

WisdomTree launched a family of quality Indexes in 2013 that shifts the weight to high-ROE stocks—as well as stocks with low [leverage](#) and positive expected earnings growth trends. It manages [valuations](#) of this basket by incorporating a rebalancing process back to dividends and the underlying cash flows once a year.

The following table shows the weight to the various ROE [quintiles](#) across the U.S., developed international and global ex-U.S. quality Indexes.

While the U.S. market sees more than 75% of its weight in the two highest ROE quintiles—a full 24 points higher than the [S&P 500](#)—the international versions of the strategy see 87% and 94% of their weight allocated to the top two quintiles, essentially doubling the weight of the international MSCI benchmarks.

Index	Weight Allocated to Each ROE Quintile							
	Highest ROE Quintile	Quintile 2	Quintile 3	Quintile 4	Lowest ROE Quintile	Negative ROE	Top 2 Quintiles	Bottom 2 Quintiles + Negative ROE
WisdomTree U.S. Quality Dividend Growth Index	48%	30%	10%	7%	4%	0%	78%	11%
S&P 500	30%	23%	14%	12%	13%	4%	54%	29%
WisdomTree International Quality Dividend Growth Index	69%	18%	9%	1%	2%	0%	87%	3%
MSCI EAFE	26%	18%	17%	13%	14%	10%	45%	37%
WisdomTree Global ex-U.S. Quality Dividend Growth Index	81%	13%	3%	2%	1%	0%	94%	3%
MSCI ACWI ex USA	25%	20%	18%	14%	14%	9%	45%	36%

Source: WisdomTree, as of 7/31/21. You cannot invest directly in an index. Subject to change.

International stocks have a reputation of being cheaper than U.S. markets for good reason. That is because they tend to have lower profitability and lower growth prospects. The [MSCI EAFE Index](#), for instance, has an ROE of just 8.8%, while the S&P 500 has 15.6% ROE. Yet when you employ a quality discipline in these foreign markets, you can get ROEs at significant premiums even to U.S. markets while retaining a valuation discount.

Characteristic	Fundamental Comparison as of 7/31/21					
	WisdomTree U.S. Quality Dividend Growth Fund (DGRW)	S&P 500 Index	WisdomTree International Quality Dividend Growth Fund (IQDG)	MSCI EAFE Index	WisdomTree Global ex-U.S. Quality Dividend Growth Fund (DNL)	MSCI ACWI ex USA Index
Dividend Yield	2.08%	1.32%	2.64%	2.29%	2.01%	2.21%
Net Buyback Yield	1.21%	0.90%	0.23%	-0.11%	0.33%	-0.38%
Shareholder Yield	3.29%	2.22%	2.87%	2.18%	2.34%	1.83%
Trailing Price-to-Earnings (P/E)	21.67	29.66	19.16	21.96	24.06	20.17
Trailing Price-to-Earnings (P/E) Excl. Negative Earners	21.54	26.57	19.14	18.63	24.06	17.55
Estimated Price-to-Earnings (P/E)	17.76	22.17	15.42	16.08	20.08	15.2
Return on Assets (ROA)	7.70%	3.29%	9.82%	1.21%	11.86%	1.40%
Return on Equity (ROE)	27.45%	15.63%	24.81%	8.76%	28.82%	10.14%
Return on Sales (ROS)	18.77%	15.20%	25.06%	10.22%	26.54%	12.01%
Leverage	3.56	4.75	2.53	7.25	2.43	7.24

Source: WisdomTree, as of 7/31/21. Subject to change. 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. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

Overall, we believe that there is an opportunity in the current quality market that should not be overlooked. Markets may have dislocated from longer-term quality trends over the past year, but we think they'll restore their preference for higher-quality companies soon.

Related Blogs

- + [Everyone Talks about “Quality” Funds, but What Does That Even Mean?](#)
- + [A Quality Opportunity for Quality](#)
- + [Quality 101: What it Is and Why it Works](#)

Related Funds

- + [WisdomTree U.S. Quality Dividend Growth Fund](#)
- + [WisdomTree U.S. LargeCap Dividend Fund](#)
- + [WisdomTree International Quality Dividend Growth Fund](#)

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

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

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You cannot invest directly in an index.

DEFINITIONS

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Bullish : a position that benefits when asset prices rise.

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.

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.

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.

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.