SOLVING THE CHALLENGE OF EM FX

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In 2018, emerging market (EM) equities ended the year down nearly 15%. Approximately one-third of that loss was attributable to broad-based dollar strength against most EM currencies. Heading into 2019, we question whether investors should remain agnostic to managing EM foreign exchange (FX) risk.

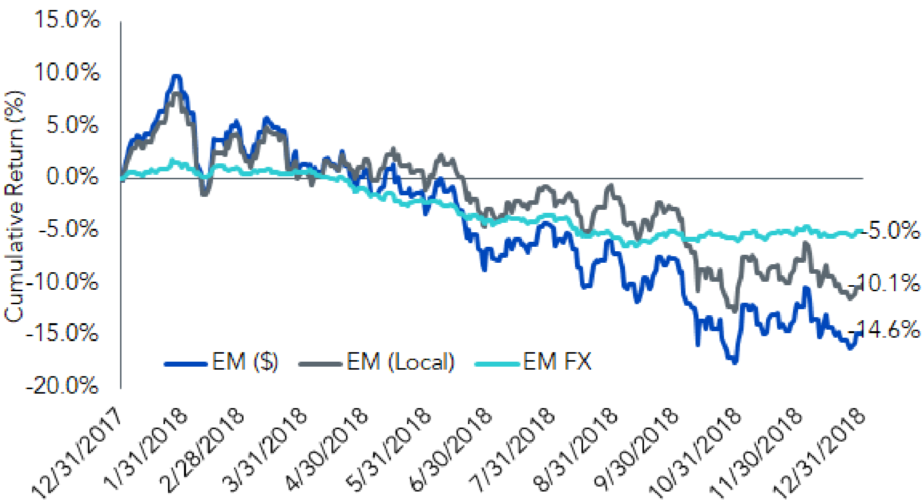
Thinking in Bets

Anytime investors consider allocating internationally, they're making two decisions: views on asset returns and views on currency returns. The more understood (and fretted-over) decision is whether or not the foreign asset will go up or down. However, the second decision has unfortunately been on autopilot for many U.S. investors. Due to benchmark decisions, a majority of investors default to the view that anytime they invest internationally, the value of the U.S. dollar will need to go down for them to capture local asset returns.

2018 EM Performance

After an amazing 2017, emerging markets faced headwinds over trade disputes, tighter central bank policies and concerns about the state of the global economy. In general, these risky assets underperformed. For investors that benchmark to the MSCI Emerging Markets Index, EM equities declined over 10%. Declines were 5% in the U.S., 7% in Europe and 15% in Japan. While no one was satisfied with last year's peformance, we believe we've identified a solution for managing currency risk in EM portfolios.

EM Equity Returns, 12/31/17–12/31/18



Source: Bloomberg, as of 12/31/18. EM ($), EM (Local), and EM FX proxied by the MSCI Emerging Markets Index in USD, Local, and the resulting FX, respectively. Past performance is not indicative of future results. You cannot invest directly in an index.

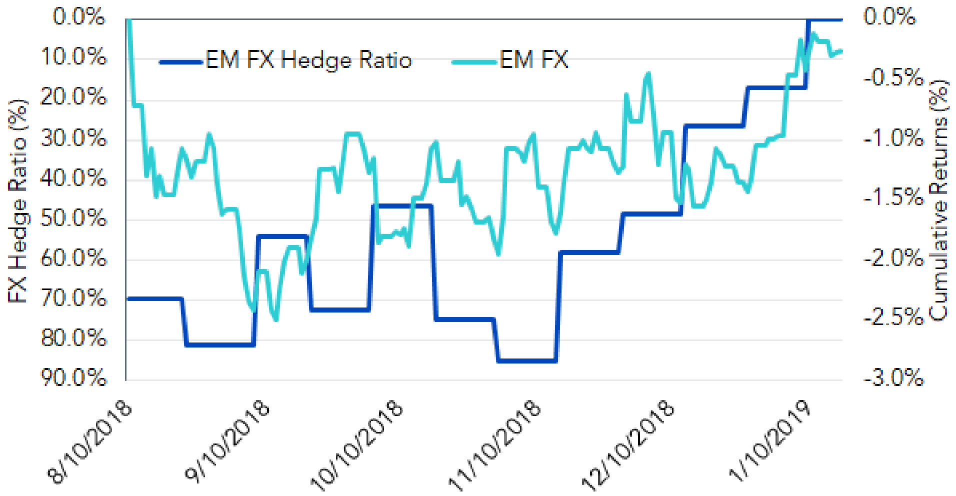
Currency as a Factor

While most active managers have sought to focus on the value they can add via local asset returns, our research has found that adding value via currency decisions is just as important. In the WisdomTree Emerging Markets Multifactor Fun d (EMMF), our active approach to factor investing is applied to both stock selection and currency selection. While equity selection focuses on value, quality, momentum and low correlation, the decision on currency hedging is determined by momentum. For example, if a specific EM currency is trending toward depreciation, an investor should hedge. While the trend in FX eventually will have an impact on the companies in that market, the investor feels these impacts much more immediately.

EMMF Currency Positioning

Markets are, by definition, dynamic. This is also the reason why we seek to adjust our FX hedges multiple times per month based on our model. In the chart below, we show EMMF's FX positioning over time. As downside EM FX momentum began to stall, our dynamic approach to FX risk gradually reduced our hedges. In the second week of January, EMMF was currently 100% long EM FX.

EMMF Currency Hedging, 8/10/18–1/17/19



Source: Bloomberg, as of 1/17/2019. EM FX proxied by the difference between the MSCI Emerging Markets Index in USD and Local. Past performance is not indicative of future results. You cannot invest directly in an index.

While active management has generally focused on security selection, we believe investors should continue to probe the decisions managers are making regarding FX risk. Through our dynamic approach, we believe we've identified a way to add value that helps solve the challenge that currency risk plays in emerging market portfolios.

Unless otherwise stated, all data is from Bloomberg as of December 31, 2018.

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You cannot invest directly in an index.

DEFINITIONS

MSCI Emerging Market Index : The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

Currency risk : the risk that an investment will decline in value due to a change in foreign exchange rates.

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

Active manager : Portfolio managers who run funds that attempt to outperform the market by selecting those securities they believe to be the best.

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 tim.

Momentum : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Low Correlation : Characterized by assets that have a relatively lower correlation vs the market over time. This term is also associated with the Low Correlation Factor which associates these stock characteristics with excess returns vs the market over time.

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.

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.

Downside : Currency depreciation.