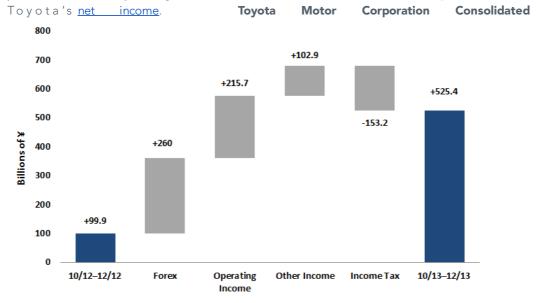
## YEN WEAKNESS CONTINUES TO SUPPORT EXPORTERS' EARNINGS, LATEST QUARTERLY RESULTS

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Japanese stocks soared last year as a result of "Abenomic" policies, which are all aimed at one thing: promoting economic growth in Japan. The unprecedented monetary easing by the Bank of Japan—which I believe has become the most aggressive central bank in the world as the Federal Reserve has started to taper its balance sheet expansion—has improved sentiment in Japan, caused the yen to weaken and strengthened the markets. **Weaker Yen Has Benefited Exporters' Earnings** Thus far, the monetary stimulus has coincided with a weaker yen. A weaker yen ultimately helps large multinational companies that sell products overseas. Products of these companies generally become more attractive to foreign buyers when the yen weakens. Also, overseas sales converted back to a weak yen translate to more yen revenue, ultimately adding to the bottom line. The chart below illustrates the positive effect a weaker yen has had on



Source: Toyota FY2014 3Q Financial Results (February 4, 2014): Earnings Release Presentation. Net income above is attributable to Toyota Motor Corporation. Periods being compared are 10/01/12–12/31/12 and 10/01/13–12/31/13. Past performance is not indicative of future results

• Yen Depreciation

Net

Income

**Dramatically Contributes to Earnings** – The depreciation of the yen accounted for ¥260 billion of the ¥425.5 billion growth in net income over the same reporting period compared to last year. It is important to realize that Toyota's gain from the yen depreciation represents over 60% of the total growth in net income for the period. • **Further Yen Depreciation Can Add to Future Profits** - If the yen continues to depreciate, it could potentially continue to add to Toyota's bottom line. Toyota has forecasted to sell 9.1 million vehicles over their 2014 fiscal year, and 6.8 million (approximately 75%) of those are expected to be sold outside Japan. This continued overseas sales converted back to a potentially weaker yen translate to even more yen revenue. • **Toyota's Stock Performance Also Strong** – <u>Market participants</u> have recognized the benefit a weaker yen has had on Toyota's bottom line. Toyota's total return was approximately 64.0%, while the broader <u>Tokyo Stock Price Index (TOPIX)</u> for Japan was up 54.4%, over the 2013 calendar year. The yen is down 17.6% over this same period. Other **Automakers Also Benefit from a Weaker Yen** 



Other large Japanese automakers have all benefited from a weakening yen due to their export-oriented business models. The list below shows the major automakers and the amount of reported income during their most recent earnings period compared to the same period of the preceding year. • Honda – Reported income of ¥216.5 billion, up ¥126.8 billion from the year before, with a gain of ¥83.1 billion from currency effects. From the year before, with a gain of ¥83.1 billion from currency effects. Nissan – Reported operating profit of ¥106.1 billion, up from ¥62.1 billion from the year before, with a gain of ¥78.5 billion from currency effects.4 • Mazda -Reported operating profit of ¥50.6 billion, up ¥42.5 billion from the year before, with a gain of ¥36.7 billion from currency effects. 5 Chinese Auto Sales Gear Up One factor that weighed on Honda and Nissan in 2013 was weak Chinese sales due to a flare-up in political tensions and talks of slower growth in China. It is very positive to see the turnaround in the Chinese growth for some of the autos in their latest reports. • Honda – Reported a record number of automobile sales to China for the 2013 calendar year, over a 26% increase from 2012.6 • Nissan – Reported Chinese sales were up 17.2% for 2013, year-over-year, enough for an all-time calendar-year record. <sup>7</sup> • Mazda – Recently reported Chinese retail volume had increased by 9.3% for the first nine months of the fiscal year ending March 31, 2014, and they expect full-year volume to be up 14.5% over the previous fiscal year.<sup>8</sup> Hedge Your Currency Exposure If the year continues to weaken, Japanese exporters should continue to benefit. On the other hand, a weakening yen is not good for U.S. investors in Japanese equities—unless they hedge the currency. Currency-hedged strategies allow investors to focus on Japanese equities without the worry over currency declines. Conclusion All the actions by the Japanese have the same goal: stimulate Japan's economic growth. The weaker yen has helped start the economic engine, but I feel we are still in the early innings of Japan's true transformation. If Japan's citizens are able to benefit, potentially in the form of wage increases, from this increased profitability described above, this could further help increase consumption and investments. A positive wage surprise—which is Prime Minister Abe's focus for this year—could benefit small-cap stocks, which are more sensitive to the domestic economy. I think the majority of the smaller-cap stocks have yet to fully benefit from the structural reforms of Abenomics, which are still a work in progress and will play out over the next two years. WisdomTree has two different small-cap Indexes that track dividend-paying stocks in Japan. • WisdomTree Japan SmallCap Dividend Index – includes exposure to the yen • WisdomTree Japan Hedged SmallCap Equity Index – seeks to hedge out the currency exposure Also, if yen weakness continues to provide tailwind, the result could be very positive for Japan's equity investors. I remain optimistic on the prospects for Japanese equities. Please see our Japan Strategist Roundtable for further insights on Japan here. For current holdings of the WisdomTree Japan SmallCap Dividend Index (including Toyota, Mazda, Nissan, and Honda), please click here. For current holdings of the WisdomTree Japan Hedged SmallCap Equity Index (including Toyota, Mazda, Nissan, and Honda), please click <u>here</u>. <sup>1</sup>Source: Toyota FY2014 3Q Financial Results (2/4/14). <sup>2</sup>Source: Bloomberg. <sup>3</sup>Source: Honda FY2014 3rd Quarter Financial Results (1/31/14). <sup>4</sup>Source: Nissan FY2013 Third-Quarter Financial Results (2/10/14). <sup>5</sup>Source: Mazda FY2014 Third-Quarter Financial Results (2/5/14). <sup>6</sup>Source: 2013 Honda Sales & Production Results (1/29/14). <sup>7</sup>Source: Nissan Production, Sales and Export Results (1/29/14). <sup>8</sup>Source: Mazda FY2014 Third-Quarter Financial Results (2/5/14).

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## **DEFINITIONS**

**Abenomics**: Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

**Monetary easing policies**: Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

**Net income**: A company's total earnings (or profit), which are calculated by taking revenues and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses.

**Market participant**: Anyone interacting with the ETFs in some capacity. It can be end investors, market makers, hedgers, authorized participants.

**Tokyo Stock Price Index (TOPIX)**: A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

**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.

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

**WisdomTree Japan SmallCap Dividend Index**: Designed to provide exposure to dividend-paying small-capitalization companies in Japan.

**WisdomTree Japan Hedged SmallCap Equity Index**: Designed to provide exposure to Japanese equity markets while at the same time neutralizing fluctuations of the Japanese yen movements against the U.S. dollar.

