THE EMERGING MARKETS 50/50: YIELDS & VOLATILITY

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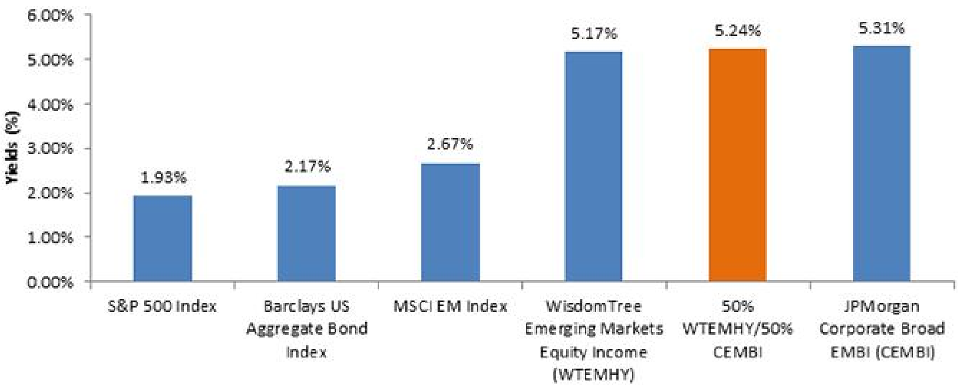
The emerging markets (EM) represent great valuation opportunities and some of the highest income levels, but they also represent significant volatility. One strategy that may help investors capture yields and mitigate volatility is to blend EM equities and EM corporate bonds. In this blog post, we will explore the strategy of blending the WisdomTree Emerging Markets Equity Income Index (WTEMHY) and the JP Morgan Corporate Broad EMBI Index (CEMBI), which zeroes in on the debt of EM corporate issuers, to help investors reduce volatility and potentially increase total returns. **The 50/50 WTEMHY and CEMBI Blend Has the Second-Highest Yields**



Sources: WisdomTree, Bloomberg, as of 5/31/14. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes in the chart, visit our Glossary. **The 50/50 blend offers the opportunity of: • Yield Pickup:** Compared with an all-equity position in WTEMHY that yields 5.17%, the blend offers approximately a 10-basis-point pickup in yields (5.24%). Compared with the S&P 500 Index and the Barclays U.S. Aggregate Bond Index, the WTEMHY/CEMBI blend offers a 3.31% and 2.57% pickup in yields, respectively. It is also noteworthy that WTEMHY has a 2.50% yield advantage compared with the broad MSCI EM Index. We believe that WisdomTree's yield advantage is largely a function of WTEMHY's smart beta methodology, which is focused on higher-dividend-yielding stocks. • **Lower Volatility:** WTEMHY, has an annualized volatility of 22.07% since its inception on June 1, 2007. We contrast this with CEMBI Index, which has an annualized volatility of 10.77% since inception. The 50/50 blend gives investors a midway total volatility number of 15.10% annually. To add further context, the S&P 500 Index and the MSCI EM Index have annual volatility numbers of 17.06% and 26.22%, respectively. The blend's ability to help lessen volatility is especially powerful against a backdrop of higher yields, as discussed in the above bullet point. • **Attractive Equity Valuations:** Since the inception of WTEMHY, the price-to-earnings ratio (as of May 31, 2014) is trading at a 20% discount to its average; the price-to-book ratio is trading at a 35% discount; the price-to-sales ratio[1] is trading at a 15% discount; and the price-to-cash-flow ratio is trading at a 5.8% discount. This offers a powerful rationale for considering emerging market equities in a portfolio. • **Attractive Fixed Income Valuations:** EM corporates presently trade at a yield premium to B-rated U.S. corporates. CEMBI is 69% investment grade as of 5/31/2014, while B-rated corporates represent the middle tier of speculative credits in the U.S. Prior to last year's sell-off, yields for EM corporates have historically traded more in line with Ba-rated credits. Yields for Ba corporates as of 5/31/2014 are 4.16%, a full 115 basis points lower than CEMBI. The wider spreads are representative of more attractive valuations in EM corporates. **Some of the notable characteristics of using this 50/50 blend of WTEMHY and CEMBI include: • First, the blend maintains exposure to leading EM corporations while**

reducing emerging markets foreign exchange (FX) exposure by half. Through WTEMHY's methodology, investors gain exposure to some of the highest-yielding segments of emerging market equities and exposure to the pursuant currencies. As we have argued in the past, EM currencies can be very expensive to hedge, given relatively higher local interest rates. CEMBI offers a solution for investors who want to take part in the EM story while dialing down exposure to EM FX. In particular, a 50% allocation to CEMBI can help reduce currency exposure by half without incurring the high cost of hedging local currencies; CEMBI invests in USD-denominated corporate bonds. • **Second, the blend scales the capital structure.** Going up in capital structure from equities to emerging market corporate bonds can translate into a reduction in asset volatility for the balanced portfolio. Further, a priority claim on assets is an important consideration in emerging markets. • **Third, it blends active and passive management:** WisdomTree's Emerging Markets Corporate Bond Fund is sub-advised by Western Asset Management, one of the premier active managers for emerging markets. Given that the role of fixed income in a portfolio is principally to deliver income and mitigate risk from equities alone, the active overlay, with history evaluating credits, may provide an extra level of comfort in accessing this asset class.

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You cannot invest directly in an index.

DEFINITIONS

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

WisdomTree Emerging Markets Equity Income Index : A subset of the WisdomTree Emerging Markets Dividend Index measuring the performance of the higher-yielding stocks as measured by trailing 12-month dividend yields, weighted by cash dividends.

Smart Beta : A term for rules-based investment strategies that don't use conventional market-cap weightings.

JP Morgan Corporate Emerging Markets Bond Index Broad (CEMBI Broad) : The JPMorgan Corporate Emerging Markets Bond Index Broad (CEMBI Broad) is a market capitalization weighted index consisting of US dollar-denominated Emerging Market corporate bonds. The index serves as a global corporate benchmark representing Asia, Latin America, Europe and Middle East / Africa. US dollar-denominated corporate issues from index-eligible countries are narrowed further by only including issues with more than $300m current face outstanding and at least five years to maturity (at the time of inclusion into the index).

S&P 500 Quality Index : Designed to track high quality stocks in the S&P 500 by quality score, which is calculated based on return on equity, accruals ratio and financial leverage ratio.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Basis point : 1/100th of 1 percent.

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.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.