

# ARE INVESTORS IGNORING IMPORTANT DIVIDEND PAYERS?

Jeremy Schwartz — Global Chief Investment Officer

02/26/2013

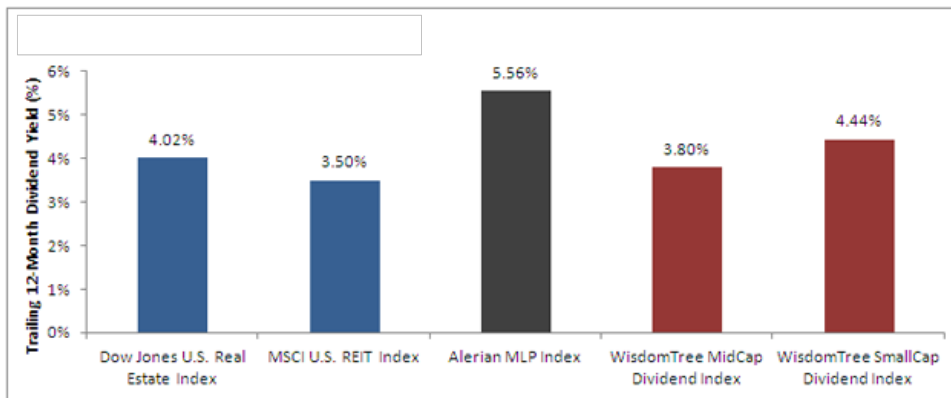
Income is the story of the day—notably the lack of any reasonable levels of income from such traditional sources as bonds and money market investments. This has caused many to search for income in a variety of asset classes; from large-cap, blue-chip dividend payers to [real estate investment trusts \(REITs\)](#) to preferred stocks to [master limited partnerships \(MLPs\)](#)—if it produces a good income stream, it has been in high demand in recent years. There is a big part of the U.S. equity market that I believe has—to a significant extent—been glossed over and ignored in this hunt for income, and that is mid- and small-cap dividend payers in the United States. **The Forgotten Dividend Payers** While there are a large number of dividend-based exchange-traded funds (ETFs) that concentrate on the large-cap segment of the market, I believe there are only two indexes (and ETFs designed to track them) in the United States focused exclusively on stocks outside this size segment: the WisdomTree MidCap Dividend Index (with the [WisdomTree MidCap Dividend Fund](#)—DON—designed to track it) and the WisdomTree SmallCap Dividend Index (with the [WisdomTree SmallCap Dividend Fund](#)—DES—designed to track it). Mid- and small-cap ETFs in general represent a very large category of traditional asset allocation models for U.S. equities and two of the biggest market segments within ETFs. There are almost \$60 billion invested in small-capitalization ETFs and close to another \$60 billion invested in mid-capitalization ETFs. Collectively, these two market segments represent over 20% of the approximately \$514 billion invested in U.S.-based equities focused on broad market indexes. Yet while U.S.-based dividend ETFs collectively represent almost \$49 billion in assets, or about 9% of U.S. equity assets under management, there are less than \$1 billion combined in the mid- and small-cap dividend category. Based on the investable opportunity sets, I believe these mid- and small-cap dividend funds should be much larger. Consider this: **Market Capitalization as a Measure of Potential**

As Of 1/31/2013

Index	Market Capitalization
Dow Jones U.S. Real Estate Index	\$578.35 Billion
MSCI U.S. REIT Index	\$497.59 Billion
Alerian MLP Index	\$294.23 Billion
WisdomTree MidCap Dividend Index	\$1.52 Trillion
WisdomTree SmallCap Dividend Index	\$511.37 Billion

**Opportunity**

(For Index definitions, go to [Glossary](#).) There are more than \$10.5 billion invested in either ETFs or [exchange-traded notes](#) tracking the performance of the Alerian MLP Index, and more than \$20 billion in ETFs designed to track the Dow Jones U.S. Real Estate Index and the MSCI U.S. REIT Index. Based on the aforementioned market capitalization statistics, I believe the biggest investment opportunity set by far exists in the ETFs that track the WisdomTree MidCap and SmallCap Dividend Indexes—and there is less than \$1 billion invested in these funds. Moreover, the dividend yields have recently been fairly competitive with these smaller market segments. **Indexes Indicate Similar Yield Levels:** [Trailing 12-Month Index Dividend Yields](#), As of 1/31/2013



Source: Bloomberg

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.

We recognize the inherent differences in methodology and market segments between these particular indexes, but we feel that the one common element—that many people consider these types of asset classes, be it real estate, REITs, MLPs and dividends—as income generators. Through the common theme of “income generation,” we believe there is merit to the comparison, but we acknowledge that people should consider the differences in potential risk profiles between these asset classes when conducting any analysis. **How Much to Allocate?** What would be an appropriate allocation to the mid- and small-cap dividend segments within an income-focused allocation? We believe that a good place to start could be an analysis of the exposure of mid- and small-cap stocks in broad market capitalization-weighted indexes. Of course, every investor will have different investment needs and should work with their investment advisor to determine the right balance for their needs. **Percentage of Market Cap Index:** If we look at the Russell 3000 Index—one of the most often-cited measures of large-, mid- and small-cap equities in the United States—17.5% of the index comprises mid-cap stocks (defined here as those with market caps between \$2 billion and \$10 billion), while 6.6% is in small-cap stocks (defined here as those with market caps below \$2 billion), for a combined mid- and small-cap weight of approximately 23%. This is a similar share as what we saw earlier in terms of the proportion of mid- and small-cap allocations across U.S.-focused ETFs. **Percentage of Dividend Index:** Within the universe of U.S. dividend payers, and using the same market capitalization breakpoints as the Russell 3000 Index, 13% of the WisdomTree Dividend Index comprises mid-cap stocks and 4% is small-cap stocks. We believe that these could be good starting baseline allocations. Many people often overweight mid- and small-cap segments when it comes to their breakdown vs large caps in asset allocation, and the same can be done compared to large-cap dividend ETFs. ***WisdomTree’s Jeremy Schwartz discusses the case for investing in Emerging Markets equities with Michael Johnston of ETF Database. Hear the [podcast](#).*** **Source for data in this article:** Bloomberg, as of 1/31/2013.

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Funds’ prospectus for specific details regarding the Funds’ risk profile.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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

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

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## **DEFINITIONS**

**Real estate investment trust (REIT)** : Investment structure containing a basket of different exposures to real estate, be it directly in properties or in mortgages. Returns predominantly relate to changes in property values and income from rental payments.

**Master limited partnership (MLP)** : Investment structure where holdings typically must derive most of their cash flows from real estate, natural resources or commodities, combining the tax benefits of a partnership—taxes occur when holders receive distributions—with the liquidity of a publicly traded company.

**Exchange-traded notes** : Different from exchange-traded funds in that they are a direct obligation of a financial entity—typically a bank—where the contract specifies that the bank will pay the holder of the note according to the returns of an underlying index minus applicable fees. Exchange-traded funds hold the underlying assets of the index and their returns represent the returns of the assets held.

**Trailing 12-month dividend yield** : Dividends over the prior 12-months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.