

# HOW U.S. ECONOMY CENTRIC IS YOUR U.S. EQUITY EXPOSURE?

Jeremy Schwartz — Global Chief Investment Officer  
08/17/2015

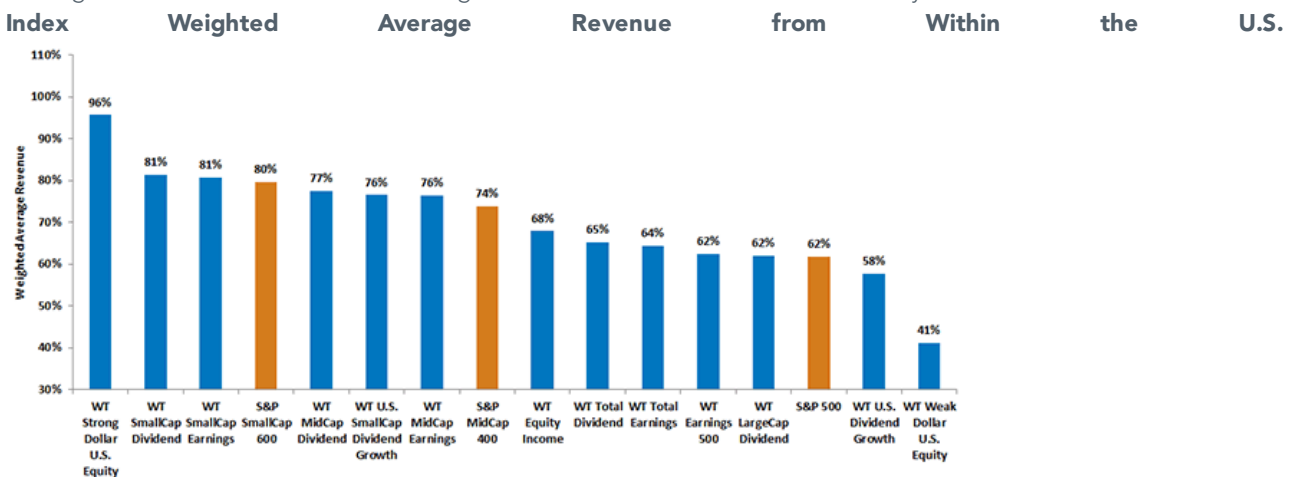
Given today's increased focus on the global economy, investors are likely aware of how foreign currency movements can impact their international investments. But the U.S. dollar can affect domestic equities as well. Many U.S. companies generate a large portion of their [revenue](#) outside the United States. A strong dollar can hurt these companies' competitiveness as their goods and services become more expensive to their international clients. As a result of the recent dollar strength, many of these U.S. exporters have reported large currency headwinds as part of their earnings statements this year, which has hurt their performance compared to European and Japanese exporters, who have benefited from the yen and euro, respectively, weakening against the U.S. dollar. Jon R. Moeller, Chief Financial Officer of Procter & Gamble, summarized the challenges facing many companies during P&G's most recent earnings call:

"Core earnings per share for the year were \$4.02, down 2% versus the prior year. This includes a 13-point headwind from [foreign exchange \(FX\)](#), over \$1.5 billion after tax.

"Foreign exchange will continue to be a significant sales and earnings headwind, particularly in the first two quarters. To offset the foreign exchange impacts and restore structural economics, we've taken significant price increases in some markets. We need to manage through the market contraction and [volatility](#) that naturally follow.

"We have disproportionately large positions in the markets most affected by FX. We're market leaders in Russia, the Ukraine, in Japan and in Venezuela. In contrast, many of our internationally domiciled competitors are benefiting from their weaker currencies, providing fuel for reinvestment."<sup>1</sup>

On the other hand, there are domestically oriented companies that may perform better when the dollar is strong, because their earnings are not driven by foreign sales. In the chart below we quantify the weighted average revenue coming from within the United States to get a sense of how sensitive an index may be to fluctuations in the dollar.



Sources: WisdomTree, FactSet, 6/30/15. You cannot invest directly in an index. Past performance is not indicative of future results.

- [WisdomTree Strong](#)

**Dollar U.S. Equity Index** – generated the highest percentage of revenue from within the U.S. This Index includes only firms that derive more than 80% of their revenues from within the United States. These companies tend to be less impacted by a strong-dollar environment—they aren't focused on selling their goods and services abroad, and their

import costs decrease with a rising purchasing power of the dollar. The Index also tilts weight more heavily toward stocks whose returns have a higher [correlation](#) to the returns of the U.S. dollar. • **Small- and Mid-Cap Indexes** – typically generate a higher percentage of their revenues from their domestic economies than do [large-cap](#) indexes. Another way to potentially steer around the negative earnings impact from a strong dollar would be to focus on small- and [mid-cap](#) companies, which tend to be less reliant on exports to drive revenue. • **WisdomTree Weak Dollar U.S. Equity Index** – generated the lowest percentage of revenue from within the U.S. This Index includes only firms that derive at least 40% of their revenues from exports. These firms tend to be more impacted by a strong-dollar environment, as they are focused on selling their goods and services abroad. Similarly, during a weak-dollar period, we'd expect these firms to become more competitive in selling their goods abroad. The Index also tilts weight to stocks whose returns that are more negatively correlated (or have a lower correlation) to the returns of the U.S. dollar. **What Are Your Thoughts on the Dollar?** Among the most important macroeconomic forces impacting the market have been currency changes motivated by diverging [monetary policies](#). If you believe the U.S. dollar will continue to strengthen over the coming years, as is WisdomTree's baseline view, this can provide continued headwind to U.S. exporters. In response, we think it makes sense to favor the WisdomTree Strong Dollar U.S. Equity Index or indexes focused on mid- and small-cap companies. Conversely, if you believe the U.S. dollar trend is set to reverse, such an environment would favor U.S. exporters and the WisdomTree Weak Dollar U.S. Equity Index. <sup>1</sup>Procter & Gamble Q4 2015 Earnings Call Transcript, 7/30/15.

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, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch 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

**Revenue** : Income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

**Foreign Exchange (FOREX, FX)** : The exchange of one currency for another, or the conversion of one currency into another currency.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;nbsp;.

**Correlation** : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

**Large-Capitalization (Large-Cap)** : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**Mid-Cap** : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

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