

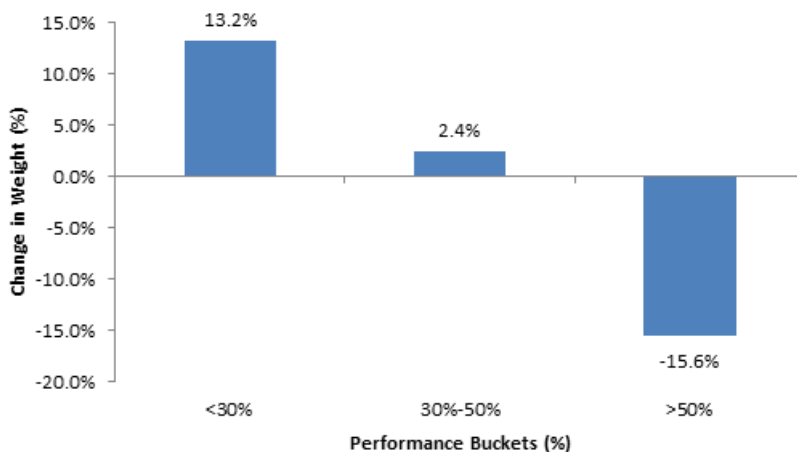
SMART BETA IN ACTION: TAKING CHIPS OFF THE SMALL CAP EUROPEAN TABLE

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The [last blog post](#) in our series on our European equity Index rebalance touched on changes to sector and country weights in one of our Indexes, but we now turn to a discussion of the rebalance methodology and how it impacted individual constituents. European equity markets performed strongly throughout much of 2013 and into the first five months of 2014. [WisdomTree's Europe SmallCap Dividend Index](#) (WT Europe Small) was up more than 44% over this same period—the strongest performer within WisdomTree’s developed international Index family. While it is difficult to time market tops and bottoms for individual stocks on a consistent basis, we believe there are benefits to undertaking a disciplined practice to rebalance weight based on changes in [relative valuation](#). **WT Europe Small as a Case Study** While the whole Index was up more than 44% between annual rebalance screenings, this is an average, and not every stock was up by this amount. If we think broadly in terms of sector performance, we find the following:

- **Seven Sectors Above 40%:** Telecommunication Services was the top-performing sector at more than 92% over the period. This was driven by one stock, Drillisch AG, which had an average weight of 2.38% over the period and a return of almost 140%¹. Industrials, the low performer of this group of seven, were up nearly 42% over the period.
- **All Sectors Above 35%:** It speaks to a particularly strong period when not one sector delivered performance below 35%.
- There were four countries above 10% in weight. Of these, Italy was the leader, delivering 68% over the period. The United Kingdom lagged but still returned greater than 36%.

How Chips Were Taken Off the Table Shifting to a constituent level, it’s important to remember that WT Europe Small is unique within the European small-cap equity space in that it weights constituent firms by dividends. **Greater Dividends = Road to Greater Weight:** The typical firm receiving increased weight in WT Europe Small will have grown or at least maintained its dividends but have had lackluster price performance. Conversely, the typical firm receiving lower weight will have had stronger price performance but dividend growth that did not keep pace. **Canceling Dividends Leads to Deletion:** Every constituent of WT Europe Small must be a dividend payer. Lack of dividends leads to a lack of representation. Fortunately, the dividend-paying culture of European firms is strong, leading to 290 qualifying constituents as of the 2014 screening date. **The Chips Coming Off the European Small-Cap Table**



Performance is measured from 5/31/13 to 5/31/14.
Sources: WisdomTree, Standard & Poor's, Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an Index.

• Almost 50% of Weight in Top

Performers: Approximately 47% of the weight in WT Europe Small was in firms that delivered a return greater than 50% from May 31, 2013, to May 31, 2014. We can see that 15.6% of WT Europe Small's weight in these securities was trimmed as a result of the 2014 Index screening. • **Subtracting from Winners and Adding to Losers:** Regardless of how strong a year it must be to have "losers" defined as those returning less than 30%, we clearly see that weight is taken from those firms with returns greater than 50% over the prior year and redistributed to firms with returns below 30%. **Effectively Taking the "Decision" Off the Table** WT Europe Small's relative value rebalance, the mechanics of which are seen above, is helpful in that it attacks the market in a disciplined way every year. This is especially important after the strong performance of European small caps this year, in that we believe investors might tend to want to hold on to the stronger performers. In sticking to the investment mantra "buy low, sell high," a relative value rebalance may aid in accomplishing this notably difficult action—a key feature of how we think investors can become smarter with their [beta](#) exposures. For the full research on the WisdomTree European Indexes rebalance, [click here](#).¹ Drillisch AG was a 1.76% in the WisdomTree Europe SmallCap Dividend Index as of 6/30/14.

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DEFINITIONS

WisdomTree Europe SmallCap Dividend Index : A fundamentally weighted index meant to measure the performance of small-cap European dividend-paying equities weighted by cash dividends paid.

Relative value : The relationship between a particular attribute, e.g., a dividend, and the firm's share price compared to that of another firm.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.