FOR THE NEXT RISK-ON RALLY, THINK MID-CAP VALUE

Brian Manby – Associate, Investment Strategy
12/27/2023

For the past two years, U.S. mid-caps have endured a struggle familiar to many asset classes.

Since the Federal Reserve began their rate hike cycle in earnest at the start of 2022, the Russell Midcap Index remained down 10% through the end of November. Neither the value nor growth investment style offered much relief, with the former down 8% and the latter down 14%.

Meanwhile, investors in beta products tracking market cap-weighted mid-cap indexes have had a disappointing experience, with virtually no silver linings like the success of the large-cap Magnificent 7 in 2023.

So where do mid-cap investors turn after two years nursing double-digit losses? We believe there's value to uncover in mid-cap strategies based on fundamentals rather than exclusive broad market ownership.

For those curious about fundamentals, we recently conducted an annual rebalance for our U.S. MidCap Dividend Index (WTMDI), which is tracked by the WisdomTree U.S. MidCap Dividend Fund (DON). Let's assess how its composition and fundamentals changed during the screening and reconstitution processes.

WisdomTree U.S. MidCap Dividend Index (WTMDI)

The WisdomTree U.S. MidCap Dividend Index (WTMDI) is comprised of dividend-paying U.S. mid-cap companies. It contains the top 75% of remaining market capitalization from the WisdomTree U.S. Dividend Index (WTDI) after the 300 largest companies have been removed to form the WisdomTree U.S. LargeCap Dividend Index (WTLDI). WTMDI is dividend-weighted so that each company is positioned based on its pro rata cash dividend contribution to the aggregate U.S. mid-cap *Dividend Stream™*.

The sector composition of the dividend-paying mid-cap market exhibited marginal changes after the rebalance, as WTMDI tilted slightly more toward Consumer Staples and Real Estate, primarily at the expense of Industrials and Information Technology.

Sector Composition – Post Rebalance Comparison

WTMDI	vs. Pre-Rebalance	vs. Russell 2000 Value
Communication Services	-0.17%	-1.06%
Consumer Discretionary	-0.23%	2.07%
Consumer Staples	3.17%	2.05%
Energy	-0.60%	1.71%
Financials	-0.07%	6.78%
Health Care	-0.37%	-4.64%
Industrials	-1.17%	-2.55%
Information Technology	-1.35%	-5.89%
Materials	0.05%	1.52%
Real Estate	1.40%	-0.34%
Utilities	-0.66%	0.35%

Sources: WisdomTree, FactSet, as of 11/30/23. You cannot invest directly in an index. Bolded sector labels indicate new over-weight allocation described in the text.

Relative to the Russell Midcap Value Index, however, the sector changes were more pronounced. The addition to Consumer Staples resulted in a new relative over-weight allocation, while reductions in Health Care, Industrials and Information Technology increased existing under-weight allocation. Another existing under-weight, in Real Estate, was trimmed by adding weight, while modest reductions pared a prior over-weight in Energy.

Though Financials remained virtually unchanged after the rebalance, WTMDI remains roughly 7% over-weight in the sector relative to the Russell Midcap Index, illustrating the sector's tendency to pay cash dividends out to shareholders. Financials are traditionally considered part of the value investing style due to lower valuation ratios and a propensity for dividend payments.

Its over-weight allocation comes at the expense of two growth-biased sectors, Information Technology and Health Care. Technology and Health Care companies (especially smaller biotechnology firms in the latter) generally prefer to retain cash for operations, reinvestment, and research and development (R&D) expenditures rather than pay dividends, which explains the routine under-weights to the sectors relative to the market.

The annual rebalance also enhanced the fundamentals of the Index, as WisdomTree's screening parameters and weighting technique directly improved exposures, valuations and yields. WTMDI is closer to a pure-play mid-cap Index, as it essentially cut the mid-cap market in half with about 335 constituents and 63% of true mid-cap ($2 billion-$10 billion in market capitalization) exposure. The Russell Midcap Value index skews larger in both constituency and size, with roughly 700 names and only 25% in true mid-cap weight.

These differences added almost 1% in trailing dividend yield relative to the market while improving upon return on equity by 4.5% and keeping return on assets steady at 2.5%. Normally, investors would expect to pay a larger valuation premium for improved metrics, but the opposite is true with WTMDI. After rebalancing, it shaved a point off its trailing price-to-earnings (P/E) multiple, leaving it seven points below that of the Russell Midcap Value Index.

Fundamental Comparison after Rebalance

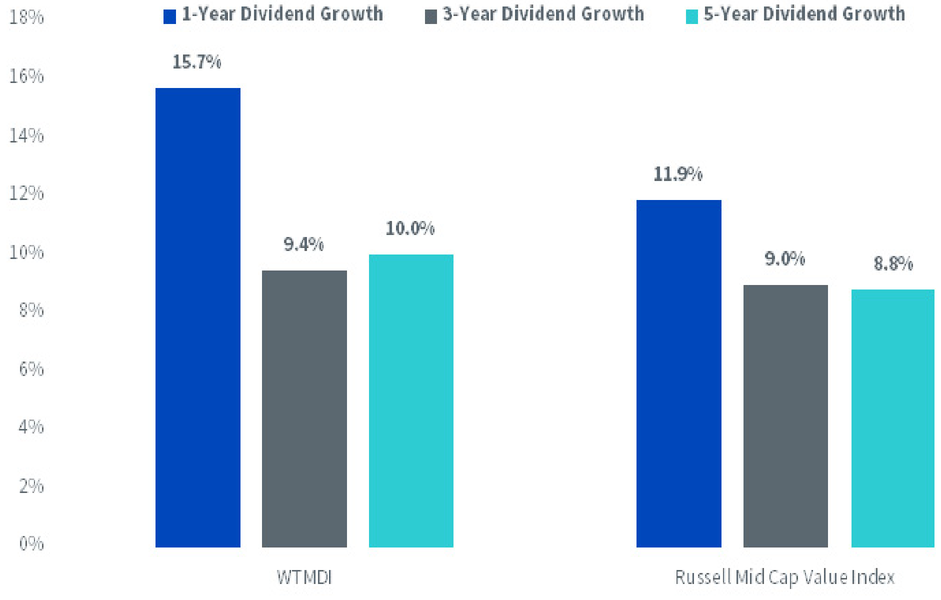
WTMDI	Pre-Rebalance	Post-Rebalance	Rebalance Improvement	Russell Midcap Value	Relative to Russell Midcap Value
Constituents	342	335	--	701	--
% Large Cap	37.1%	37.1%	0.0%	75.1%	-38.0%
% Mid-Cap	62.8%	62.7%	-0.1%	24.7%	-38.1%
% Small Cap	0.1%	0.2%	0.1%	0.3%	-0.01%
Dividend Yield	3.0%	3.0%	0.1%	2.1%	0.9%
Price-to-Earnings	12.8x	11.9x	-0.9x	19.1x	-7.3x
Return on Equity	14.5%	15.4%	0.9%	10.9%	4.5%
Return on Assets	3.0%	2.5%	-0.5%	2.5%	-0.1%
Leverage	4.8x	6.2x	1.4x	4.3x	1.9x

Sources: WisdomTree, FactSet, as of 11/30/23. You cannot invest directly in an index. Past performance is not indicative of future results.

For definitions of terms in the table above, please visit the glossary.

The dividend emphasis also improved dividend growth over the market for the past one-, three- and five-year periods.

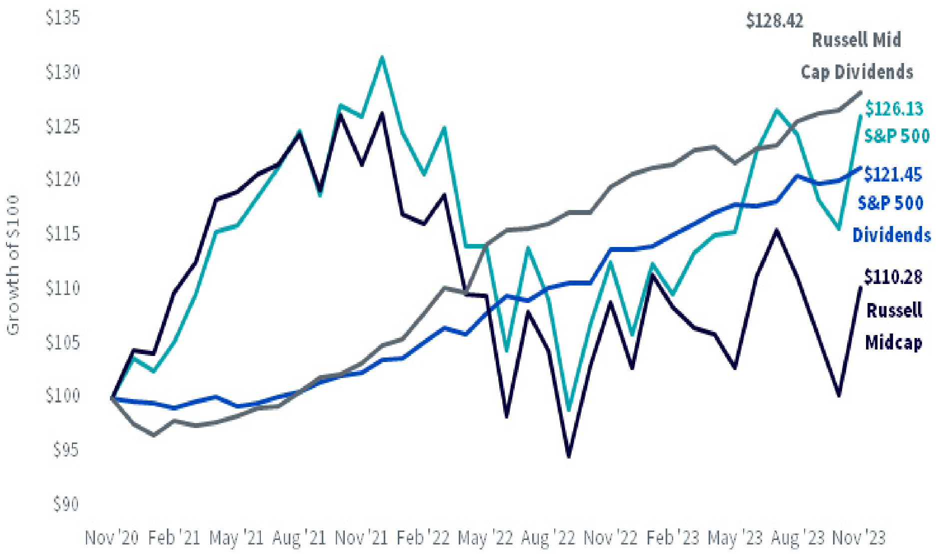
Dividend Growth Rates Lead the Broader Mid-Cap Value Market



Sources: WisdomTree, FactSet, as of 11/30/23. You cannot invest directly in an index.

This may be a good sign if prevailing trends in large-cap equities filter down to the mid-cap market. For the past three years, S&P 500 price returns have kept pace with the growth in dividend levels, a phenomenon absent in the mid-cap market.

The Fundamental Disconnect: Mid-Cap Prices Down while Dividends Up >25% over the Last 3 Years



Sources: WisdomTree, FactSet, as of 11/30/23. Dividends=Trailing 12-Month. Growth of $100 in index levels using price returns, rather than total returns. Past performance is not indicative of future results. You cannot invest directly in an index.

Onto 2024…

Heading into next year, we believe dividend-weighted mid-caps can provide compelling opportunities for whatever equity market environment lies ahead, especially once sentiment reverses in favor of risk assets.

Between sectoral shifts, fundamental improvements and positive trends among dividend-paying companies, we are encouraged that dividend-weighting the U.S. mid-cap equity markets may continue to be additive.

Important Risks Related to this Article

There are risks associated with investing, including the 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. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund’s prospectus for specific details regarding the Fund’s risk profile.

For the top 10 holdings of DON please visit the Fund's fund detail page at https://www.wisdomtree.com/investments/etfs/equity/don

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.

Related Funds

+ WisdomTree U.S. MidCap Dividend Fund

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)

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

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.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Russell Midcap Index : The Russell Midcap Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

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.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Magnificent 7 : Refers to a group of high-performing U.S. stocks including Microsoft (MSFT), Amazon (AMZN), Meta (META), Apple (AAPL), Google parent Alphabet (GOOGL), Nvidia (NVDA), and Tesla (TSLA)

Dividend Stream : Refers to the regular dividends per share multiplied by the number of shares outstanding.

Russell MidCap Value Index : measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA) : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

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.