

# YELLEN HIGHLIGHTS CASE FOR LOCAL ECONOMY STOCKS

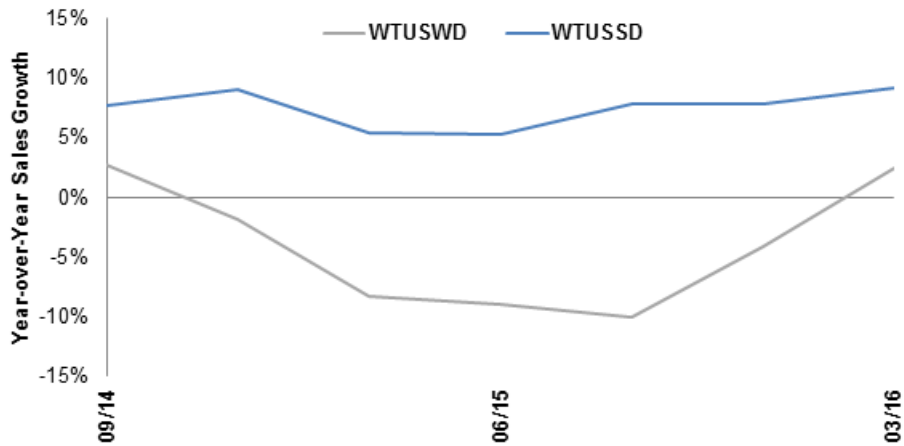
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In a press conference on September 17th, U.S. Federal Reserve (Fed) chairman Janet Yellen justified the decision to delay hiking interest rates by pointing to global growth concerns. She highlighted how the improvement in the U.S. on a standalone basis likely warranted a hike in interest rates by the Fed<sup>1</sup>. Regardless of whether the Fed should focus on [volatility](#) in global financial markets as an indicator in its policies, Yellen highlighted an important divergence: U.S. --centric businesses are seeing better trends than businesses operating in many global markets<sup>2</sup>. We see this playing out in both the [revenue](#) and [profit](#) sides of companies. WisdomTree recently established new indexes that focus on U.S. local economy companies and contrasts them with U.S. exporter companies operating on the global stage. We believe the moves in the U.S. dollar ultimately help determine the relative competitiveness of these baskets. Said differently, sensitivity to the U.S. dollar factor is a proxy of domestically-focused businesses versus multinationals. **The New Dollar Factor** In a rising U.S. dollar scenario, multinational companies that have more global sales exposure would not only lose on [translating](#) sales and profits earned overseas back into dollars, but secularly they'd become less competitive in the global markets, as their goods and services become more expensive to international consumers. What's worse, the U.S. dollar has been playing a more prominent role in both the revenues and profits of U.S. corporations in the absence of a robust growth— what Yellen said was the Fed's concern in delaying the hike. Some details on these new WisdomTree Indexes (the [Strong Dollar U.S. Equity Index \(WTUSSD\)](#) and [Weak Dollar U.S. Equity Index \(WTUSWD\)](#)):

- **Local Economy Focus:** In a nut shell, **WTUSSD** selects eligible U.S. companies that derive more than 80% of revenue from within the U.S. With respect to Index Screening, constituents within the energy and materials sectors are excluded<sup>3</sup>.
- **Exporter focus: WTUSWD** selects eligible U.S. companies that derive more than 40% of revenue abroad.
- In both cases, the weighting takes into account constituent [market capitalization](#) and the sensitivity of stock prices' returns to the dollar.

**Sales Trends in Strong and Weak Dollar Indexes** We collected the fundamental data of constituents of WTUSSD and WTUSWD and analyzed their sales growth during the recent quarters when the U.S. dollar had risen sharply. Domestic companies (as shown by WTUSSD) fared better than multinational companies (as shown by WTUSWD). It turns out that the constituents in WTUSSD were able to maintain more stable and better year-over-year sales growth from 3Q 2014 to 2Q 2015 while those in WTUSWD clearly struggled. Going forward, analysts seem to continue favoring the growth prospect of WTUSSD versus WTUSWD, although the gap is expected to close up gradually<sup>4</sup>. It is hard for analysts to determine moves in businesses caused by multinational currencies, and they often are surprised by currency impacts. **WisdomTree Strong Dollar (WTUSSD) & Weak Dollar (WTUSWD) U.S. Equity Index Year-over-Year Sales**



Source: FactSet and WisdomTree. Quarterly frequency of earnings and sales data releases are from 3Q 2014 to 1Q 2016. For periods prior to 2Q 2015, reported sales growth of current Index constituents is used. For periods after 2Q 2015, consensus analyst expectations of sales are used.

**Growth**

**Focus: Strong Dollar U.S. Equity Index**

The trend in [factor-based](#) or so-called “[smart beta](#)” investment strategies has focused on common factors such as [value](#), [quality](#), [momentum](#), and [low volatility](#). WisdomTree believes currency can also be a critical factor explaining various market returns, even within the U.S. markets. While the real time results are relatively new—as just about four months of performance exist with these indexes being live—we are witnessing a wide divergence in the returns between the strong and weak dollar strategies. Given the chart illustrating how long it takes for the dollar to feed into the competitiveness of the exports, we still may be early in this cycle of performance for U.S. local economy companies.

<sup>1</sup>Source: Board of Governors of the Federal Reserve System press release, 9/17/15. <sup>2</sup>Source: Jon Hilsenrath. “Fed’s Rate Decisions Hang on Dollar, Growth Concerns.” The Wall Street Journal. April 22, 2015.

<sup>3</sup>Subsequent to Index screening it is possible that a current constituent may spin off a subsidiary company that may be classified as an Energy or Materials firm. Spin off firms that remain within the Index do not get removed between Index rebalances due to their sector classification. <sup>4</sup>Source: Factset consensus analyst expectations for current constituents of WTUSSD and WTUSWD Indexes as of 6/30/15 quarterly reporting.

**For Local Economy**

**Important Risks Related to this Article**

Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations.

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.

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You cannot invest directly in an index.

## DEFINITIONS

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

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

**Profits** : Income that a company receives from revenue after costs and expenses are deducted.

**Translating** : The accounting procedure which occurs when a multinational company recognizes revenue outside of its home market and then must bring those revenues back into its home currency, with the process being strongly influenced by any exchange rate moves occurring over those periods, typically quarterly.

**Market Capitalization** : 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.

**Factor-based** : Strategies that focus on groups of firms thought to share common attributes, be it in terms of their fundamentals or their share price behavior.

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

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**Momentum Factor** : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.