

HOW TO MANAGE VALUATION RISK IN INDIA'S EQUITIES

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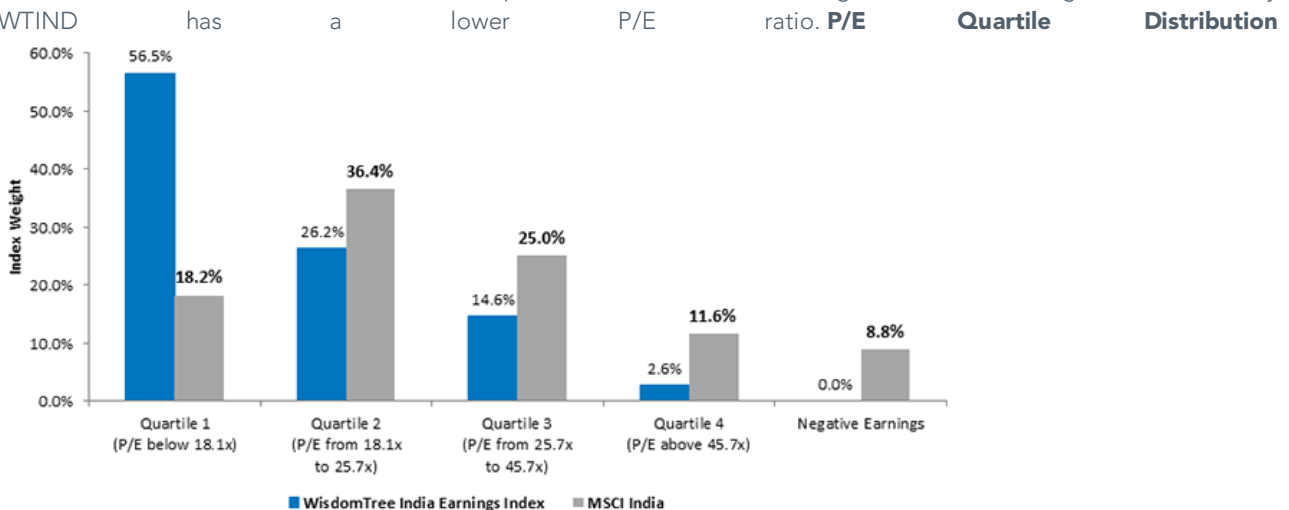
WisdomTree believes that weighting by [market capitalization](#), which does not weight, consider or [rebalance](#) back to any measure of economic importance of the underlying constituents, may not be the best approach to indexing. Instead, we believe a disciplined strategy of anchoring allocations back to a measure of [relative value](#), based on [fundamentals](#) such as [dividends](#) or earnings, can add value over time. We also believe that this fundamental process may prove to be most important in less efficient markets, such as [small caps](#) or emerging markets. In India we focus on earnings, and the [WisdomTree India Earnings Index \(WTIND\)](#) seeks to provide broad exposure to the profitable core market of India's equities while maintaining sensitivity to [valuation](#). To help achieve this, WisdomTree weights companies in the Index by the [profits](#) they generate, rather than their market cap, and rebalances back to profitability on an annual basis.

WisdomTree's India Earnings Index rebalance process typically is driven by the following:

- **Earnings Growth:** Companies that grow their profits see their weight increased.
- **Relative Performance:**

- Underperformers typically see their weight increased.
- Outperformers often see their weight decreased.

This process tends to shift weight to firms with lower [price-to-earnings \(P/E\) ratios](#), as illustrated in the chart below. It compares the distribution of stocks by their P/E ratios in WTIND to that of the [MSCI India Index](#), a widely followed market cap-weighted index that also measures the performance of India's equities. **P/E Ratio and Weight Distribution** WTIND's P/E ratio is approximately 12.5x—reflecting the 2015 Index screening—i.e., over 38% lower than the 20.3x P/E ratio of the MSCI India Index. The chart below provides a look at how the weight is distributed, to give a sense for why WTIND



Sources: Bloomberg, Standard & Poor's, with data as of 8/31/15, based on WTIND Index screening. You cannot invest directly in an index. Subject to change.

• More Weight to Lower-Priced Stocks: WTIND had more than 50% of its weight in the lowest-priced quartile, which is significantly more than the MSCI India Index. There is a natural tendency of earnings-weighted approaches to reduce weight to stocks whose prices have appreciated at a faster rate than their earnings, and concurrently to increase weight to stocks that have fallen in price despite exhibiting positive earnings growth. **• Less Weight to Higher-Priced Stocks:** On the other hand, WisdomTree's approach has less than 3% of its weight going to the highest-priced quartile. The MSCI India Index had

more than 20% of its weight in the most expensive quartile and stocks with negative earnings. • **Negative Earnings and Speculative Stocks:** Although profitability may fluctuate throughout the year, at each annual rebalance WisdomTree requires companies to be profitable before inclusion. This requirement keeps the weight to firms that we believe tend to be more speculative and of lower quality at zero. The MSCI India Index does not share this requirement.

Important Risks Related to this Article

Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments.

Investments focused in India increase the impact of events and developments associated with the region, which can adversely affect performance.

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

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You cannot invest directly in an index.

DEFINITIONS

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.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

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

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.

Qualified dividends : Dividend paid by corporations meeting certain criteria defined by the Internal Revenue Service and therefore eligible in certain instances to be taxed at rates below a tax filer's tax bracket on ordinary income.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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

MSCI India Index : A market capitalization-weighted index designed to measure the performance of the Indian equity market.