

WISDOMTREE JAPAN HEDGED EQUITY INDEX: 2022 INDEX RECONSTITUTION

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Last month, the Cabinet of Japan approved an economic package including 29.1 trillion yen (\$199 billion) to combat accelerating inflation after core consumer prices (measured by [CPI](#)) in Tokyo increased by 3.5% from October last year. It was the largest year-over-year gain since 1989.

Tokyo Metropolitan Area CPI, Year-over-Year



Sources: Statistics Bureau (Japan), 1/1/85–10/31/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

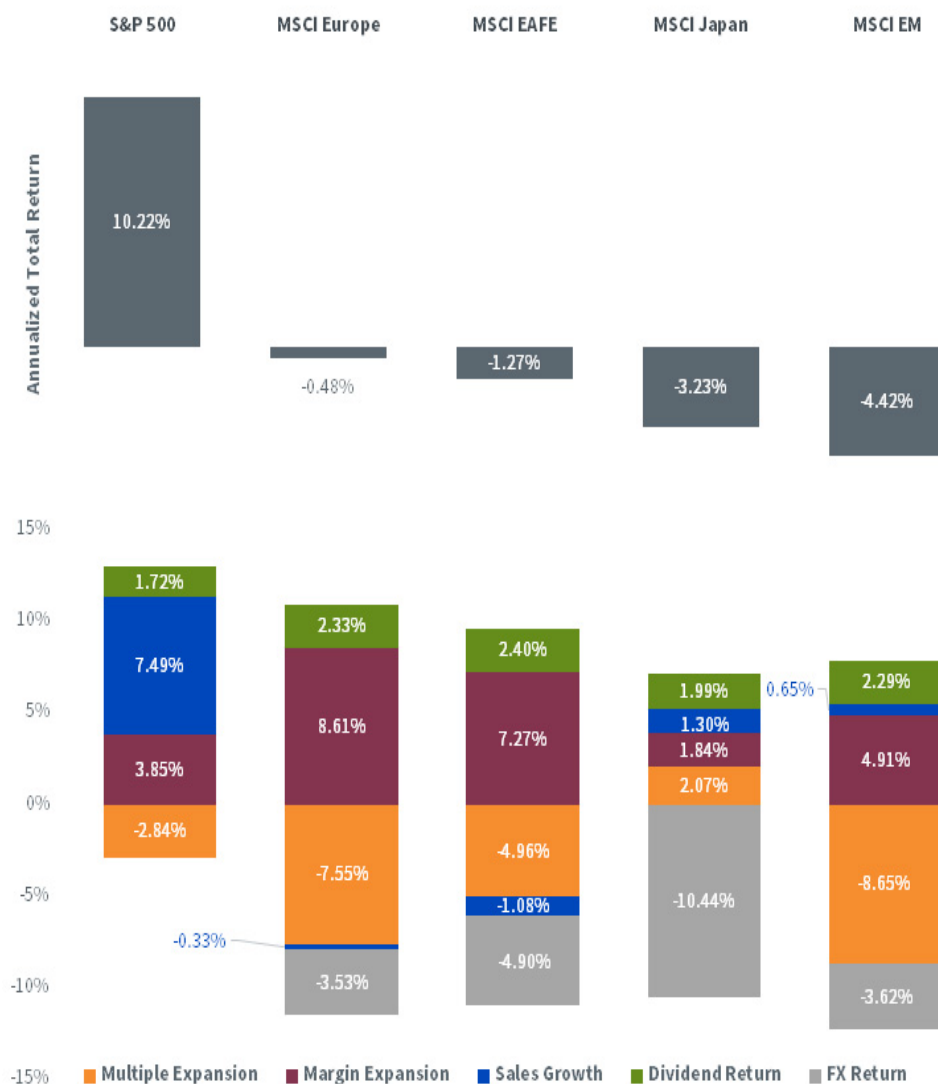
The package seeks to ease economic and geopolitical troubles in the island nation, which is the world's fourth-largest exporter and the fifth-largest importer of foreign goods like mineral fuels, machinery and food.

Import costs have skyrocketed as the yen has fallen to historic lows versus the dollar and the yuan. The United States and China are Japan's two largest exporters, and Japanese households are bearing the brunt of the impact.

Looking at the performance of equities around the world in the past three years, measured by the [S&P 500](#) and various [MSCI indexes](#) in U.S. dollars, the United States was the only region to have a non-negative return. Japan fared the worst among developed markets, with a trailing three-year return of -3.23%. But, unlike the other regions, all of its negative return was driven by the depreciation of the yen.

If you measure the same return values in local currencies, Japanese equities returned 7.6% annualized over the same period. Though materially lagging U.S. equities, the local currency return was far closer than the return including the depreciation of the yen.

Trailing Three-Year Returns, Regional Indexes



Sources: WisdomTree, S&P, MSCI, 10/31/19–10/31/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

For definitions of indices and terms in the chart above, please visit the [glossary](#).

By subsidizing household electricity and gas bills, among other efforts, the government estimates that the injection will help reduce overall inflation by over 1.2 percentage points and increase real [GDP](#) by approximately 4.6 points.

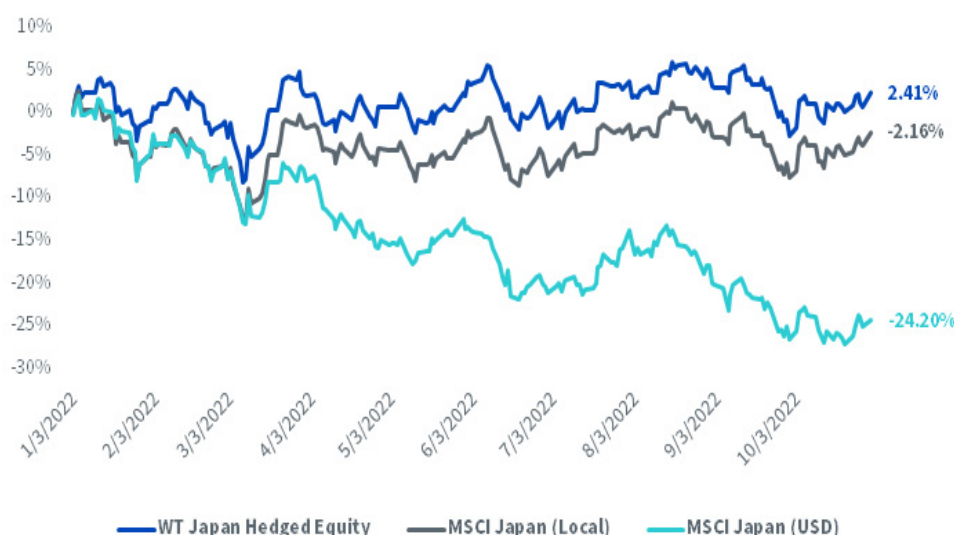
While Japanese consumers are plagued by sharp increases in costs of living and stagnating wages, Japanese multinational corporations tell a slightly different story.

Japan Inc. has increasingly been moving its production and manufacturing facilities overseas since the 1980s, looking to take advantage of cheaper labor costs and to cater more effectively to foreign demand. Today, such companies are seeing significant gains when converting overseas profits to yen, despite floundering local sales.

WisdomTree Japan Hedged Equity Index Rebalance

The [WisdomTree Japan Hedged Equity Index \(WTIDJH\)](#) seeks to provide exposure to Japanese equity markets while mitigating exposure to fluctuations of the yen versus the U.S. dollar. The Index consists of dividend-paying companies incorporated in Japan and traded on the Tokyo Stock Exchange, and excludes companies that derive 80% or more of their revenue from Japan. By excluding such companies, the Index has over-weight exposures to Japan's most export-centered companies and sectors.

Year-to-Date Performance, WisdomTree Japan Hedged Equity vs. [MSCI Japan Index](#)



Sources: WisdomTree, MSCI, 12/31/21–10/31/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The annual rebalance of the WTIDJH saw the number of constituents increase from 474 names to 528, as well as overall improvements in profitability and trading multiples. The Index shed some of its allocations to large caps, increasing its weight to mid and small caps, and its dividend yield increased slightly from 3.72% to 3.83%.

Rebalance Changes, Index Characteristics

	Company Count	Dividend Yield	P/E	ROA	ROE	Large Cap	Mid Cap	Small Cap
WTIDJH After Rebalance	528	3.8%	7.81	2.1%	13.1%	67.4%	22.1%	10.4%
WTIDJH Before Rebalance	474	3.7%	8.51	1.7%	11.7%	72.0%	19.5%	8.5%

Sources: WisdomTree, FactSet, as of 10/21/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The Index's [price-to-earnings ratio](#) decreased from 8.51 times to 7.81 times, to almost half of that of the MSCI Japan index (which trades at around 15 times), and is at a discount to almost all developed MSCI country indexes.

WisdomTree Japan Hedged Equity Index vs. MSCI EAFE, Top 10 Constituent P/E Ratios

MSCI EAFE Index Top 10 Holdings				
Security	Country	Sector	Weight	P/E
Nestle SA	Switzerland	Cons. Staples	2.38%	15.1x
Roche Holding AG	Switzerland	Health Care	1.81%	17.6x
Shell PLC	United Kingdom	Energy	1.60%	7.3x
ASML Holding NV	Amsterdam	Info. Tech.	1.49%	35.4x
AstraZeneca PLC	United Kingdom	Health Care	1.42%	31.2x
Novo Nordisk A/S Class B	Denmark	Health Care	1.40%	36.2x
LVMH Moet Hennessy Louis Vuitton SE	France	Cons. Disc.	1.36%	23.9x
Novartis AG	Switzerland	Health Care	1.36%	14.7x
Toyota Motor Corp	Japan	Cons. Disc.	1.14%	10.5x
TotalEnergies SE	France	Energy	1.05%	7.1x
WT Japan Hedged Equity Index Top 10 Holdings, Post-Rebalance				
Security	Sector		Weight	P/E
Toyota Motor Corp.	Cons. Disc.		5.13%	10.5x
Mitsubishi UFJ Financial Group, Inc.	Financials		3.48%	9.4x
Mitsubishi Corporation	Industrials		2.70%	4.9x
Sumitomo Mitsui Financial Group, Inc.	Financials		2.53%	6.9x
Japan Tobacco Inc.	Cons. Staples		2.53%	10.5x
Tokio Marine Holdings, Inc.	Financials		2.46%	13.7x
Takeda Pharmaceutical Co. Ltd.	Health Care		2.38%	22.9x
Mitsui & Co., Ltd.	Industrials		2.29%	5.4x
Nintendo Co., Ltd.	Comm. Svcs.		2.16%	14.1x
Tokyo Electron Ltd.	Info. Tech.		2.06%	14.5x

Sources: WisdomTree, MSCI, as of 10/31/2022. You cannot invest directly in an index. Past performance is not indicative of future returns.

The Index's increase in [ROE](#) from 11.7% to 13.7%—currently the highest it has been since inception—is particularly significant.

Until around a decade ago, many large Japanese companies were notorious for their low profitability, bloated [balance sheets](#) and poor management. In 2012, then-Prime Minister Shinzo Abe enacted a series of reforms, dubbed "[Abenomics](#)," to revitalize tired Japanese equities and make them more attractive to investors.

WisdomTree Japan Hedged Equity Index ROE



Sources: WisdomTree, FactSet, as of 9/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The [JPX-Nikkei 400 Index](#) was launched in 2014 as a part of these initiatives and included names based on metrics like ROE and cumulative operating profit. Nicknamed “the shame index,” the JPX-Nikkei 400 highlighted the nation’s best-run companies as well as its worst-run (along with its managers). From 2012 to 2018, ROE for Japanese stocks jumped from around 5% to 10%.

The WisdomTree Japan Hedged Equity Index’s post-rebalance ROE of 13.1% is testament to Japanese companies’ efforts to improve capital efficiency and return more cash to shareholders through dividends and buybacks.

After years of reform, Japanese companies now have much stronger balance sheets and cash reserves than they did a decade ago. In a cheap global market like today’s, those cash reserves leave plenty of room for further improvements in shareholder-friendly distributions.

As [central banks](#) around the world step in to hold the rising dollar at bay, many eyes are on the Japanese government to address the yen’s decline. The historically [dovish](#) Bank of Japan has reiterated its stance to leave interest rates unchanged. Currency-hedged investors stand to benefit from increasing profits for Japanese exporters from a weakening yen while neutralizing the impact of the weakening yen on returns.

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.

View the online version of this article [here](#).

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You cannot invest directly in an index.

DEFINITIONS

Consumer Price Index (CPI) : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

MSCI Inc. : An American finance company headquartered in New York City. MSCI is a global provider of equity, fixed income, real estate indexes, multi-asset portfolio analysis tools, ESG and climate products. It operates the MSCI World, MSCI All Country World Index, MSCI Emerging Markets Indexes.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

MSCI Japan Index : A market cap-weighted subset of the MSCI EAFE Index that measures the performance of the Japanese equity market.

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.

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

Balance sheet : refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

JPX-Nikkei 400 : is composed common stocks whose main market is the TSE 1st section, 2nd section, Mothers or JASDAQ market (in principle). The components are reviewed annually to keep the representativeness of the market. The Annual Review shall be conducted at the end of August as follows. (1) 1000 stocks are selected based on trading value in the past 3 years and the market value on the selection base date (the end of June) of the Annual Review, (2) Each stock is scored by 3-year average ROE, 3-year cumulative operating profit and market value on the selection base date with the weights on the each indicator 40%, 40%, 20% respectively, (3) 400 stocks are selected by the final ranking with the scores calculated in (2) and qualitative factors from the perspectives of corporate governance and disclosure. In case of delisting of the components due to a merger or bankruptcy etc, new stocks shall not be added in principle. When the Annual Review is conducted, the number of components is back to 400, therefore the index is calculated with less than 400 components until then.

Central bank : Refers to the the monetary authority of any country.

Dovish : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.