HOW TO LOOK AT EMERGING MARKET EQUITIES IF THE FED RAISES RATES

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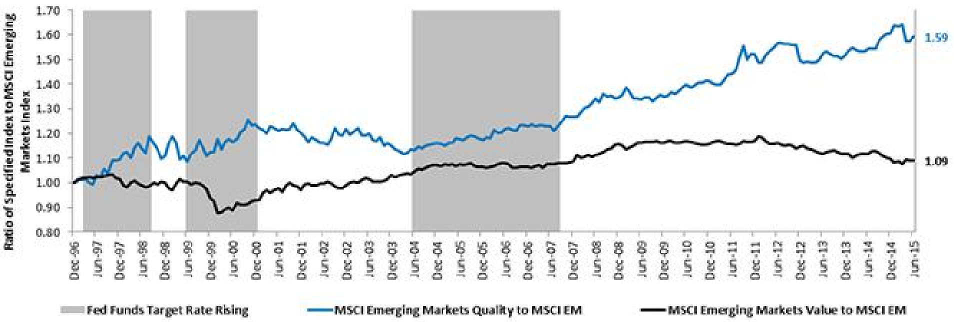
It's difficult to think about global equity markets today without considering the "liftoff" from zero for the U.S. Federal Funds Target Rate that may happen before the end of 2015. *If the Federal Reserve (Fed) is going to raise short-term interest rates, what does this mean for an investment in emerging market equities?* **Quality versus Value Emerging Market Equities** One consideration we often hear about is how companies within emerging markets that issue debt may face a headwind as short-term interest rates rise in the United States. The rationale is that many emerging market companies issue debt in U.S. dollars, and as the dollar strengthens against emerging market currencies, it may be difficult for them to pay this debt back. While it is important to recognize that many emerging market debt issuers do in fact have U.S. dollar revenue streams (many commodities that they tend to be selling are priced in dollars), let us assume that, all other things being equal, lower-leverage emerging market equities are more desirable if the perception is that U.S. short-term interest rates will rise, leading to a potentially strong U.S. dollar against emerging market currencies. • **Quality:** The MSCI Emerging Markets Quality Index (Quality) focuses on, as part of its methodology, firms with relatively lower debt-to-equity ratios. • **Value:** The MSCI Emerging Markets Value Index (Value) does not have a direct focus on debt as part of its methodology, but it does have more significant exposure to certain sectors, such as Financials, that tend to have a higher degree of leverage than other sectors. Ultimately, we looked to examine whether the MSCI Emerging Markets Quality Index or the MSCI Emerging Markets Value Index has outperformed the MSCI Emerging Markets Index (Broad EM) in past periods when the U.S. Federal Reserve was raising interest rates. **Quality Outperformed Value during Past Periods of the Fed Raising Short-Term Interest Rates (12/31/1996–6/30/2015)**



Sources: Bloomberg, MSCI. Period selected due to the available data of the MSCI Emerging Markets Value Index, history for which begins 12/31/96. You cannot invest directly in an index. Past performance is not indicative of future results.

• **Period 1 from March 31, 1997, to August 31, 1998:** The Fed Funds Target Rate went from 5.25% to 5.50%. The upward-sloping blue line indicates that Quality was outperforming the Broad EM. Specifically, Quality returned -32.94% over this period, while Value returned -41.38%. While neither of these returns looks good, it's important to note that the Asian currency crisis was impacting emerging markets over this period. • **Period 2 from June 30, 1999, to December 31, 2000:** The Fed Funds Target Rate went from 4.75% to 6.50%. Again, the upward slope of the blue line indicates that Quality was outperforming Broad EM. Quality returned -3.96%, Value returned -16.27% and Broad EM returned -11.94%. Again, none of these returns looks very favorable, but it's important to remember that the U.S. Technology sector was experiencing a bubble (and bursting thereof) over this period. • **Period 3 from June 30, 1994, to August 31, 2007:** The Fed Funds Target Rate went from 1.00% to 5.25%—the largest increase that we saw over any of these periods. Quality returned 41.20%, Value returned 39.00% and Broad EM returned 37.59%. Generally, this was a global "risk-on" period prior to what we now remember as the global financial crisis of 2008–09. **WisdomTree's Emerging Market Equity Toolkit** Our longest-standing emerging market equity exchange-traded fund (ETF), the WisdomTree Emerging Markets Equity

Income Fund, began trading on July 13, 2007, so we were unable to review live performance during past periods of Fed tightening. However, we can answer the question of which, if any, of WisdomTree's broad-based emerging market equity ETFs have lower leverage, which is one common measure of quality. • **WisdomTree Emerging Markets Dividend Growth Fund (DGRE):** DGRE tracks the performance of the WisdomTree Emerging Markets Dividend Growth Index, before fees and expenses, and this Index focuses on three-year average return on equity and return on assets in order to achieve an exposure to firms with lower leverage. • **WisdomTree Emerging Markets SmallCap Dividend Fund (DGS):** DGS tracks the performance of the WisdomTree Emerging Markets SmallCap Dividend Index, before fees and expenses. While this Index does not directly focus on firms with lower leverage, it has tended toward lower leverage due to its focus on small-cap companies. Based on what we've seen, small caps tend to have lower capacity to take on debt within emerging markets than large caps.

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You cannot invest directly in an index.

DEFINITIONS

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

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

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 tim.

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 tim.

Emerging market : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

Leverage : Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

MSCI Emerging Markets Quality Index : Measure of the performance of companies from within the MSCI Emerging Markets Index that have exhibited profitability, earnings stability and low debt to equity.

Debt-to-Equity Ratio : Measure of a firm's total outstanding debt to the book value, or value of its equity listed on its balance sheet. Higher values indicate greater debt issuance, and potentially greater risk if events occur that can negatively impact debt.

MSCI Emerging Markets Value Index : A market capitalization-weighted subset of stocks in the MSCI Emerging Markets Index that have lower share prices relative to their earnings per share, dividends per share, or lower prices relative to other financial metrics.

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

Bubble : when market participants drive stock prices above their "fair value" in relation to some system of stock valuation.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

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.