

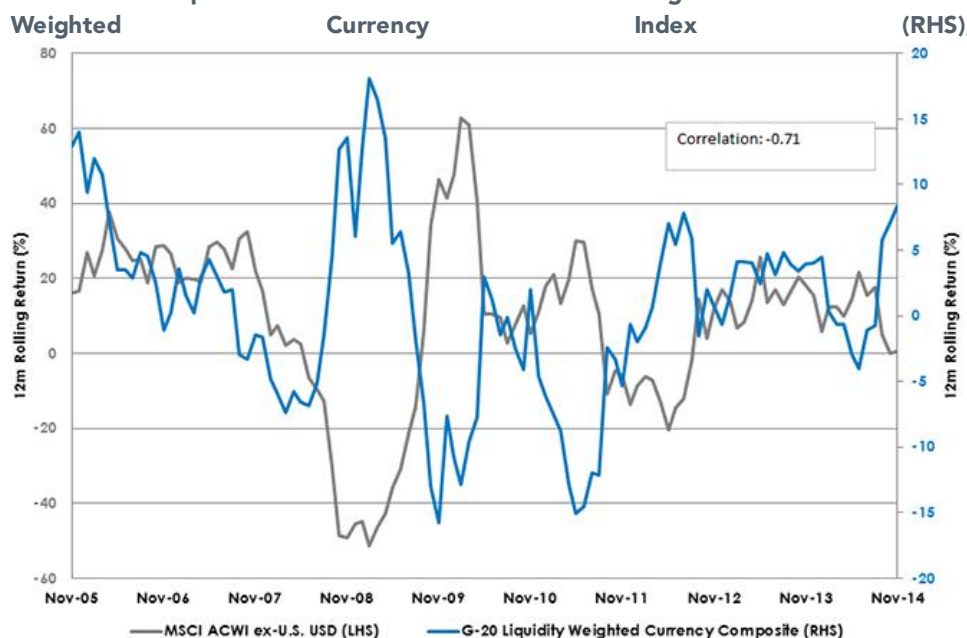
TACTICAL HEDGING OF FOREIGN CURRENCY RISK VIA U.S. DOLLAR ETFS

Bradley Krom — U.S. Head of Research

01/14/2015

For many investors, currency investing and [risk](#) have not historically been key determinants of their asset allocation decisions. However, with the proliferation of globally allocated portfolios, many investors are seeking to identify not only which asset classes appear attractively priced, but which currencies may offer opportunities as well. The rapid adoption of [currency-hedged equity products](#) can be seen as a logical byproduct of this trend. For many investors, motivations for investing abroad are to capture attractive [valuations](#) in underlying asset prices and enhance diversification. Unfortunately, currency fluctuations often represent an unwanted source of [volatility](#) or drag on performance. Should our theory of [continued dollar strength](#) persist in 2015, investors should consider [bullish](#) dollar positions as one way to help reduce risk. By incorporating a bullish dollar strategy into a portfolio, investors can selectively [hedge](#) currency risk or use it as a tactical way to benefit from a rise in the U.S. dollar. A distinct benefit we see compared to currency-hedged equity strategies is that investors are able to maintain legacy exposures while reducing currency risk. As we show in the chart below, over the last 10 years, the value of the dollar has exhibited a strong [negative correlation](#) (-0.71) with the value of [unhedged](#) international equity positions.¹ During periods of market stress, risky assets underperformed, and the value of the dollar has tended to strengthen. For investors interested in reducing the volatility of their portfolios, blending dedicated currency strategies to international equity positions could make sense.

Rolling Performance of International Equities & the U.S. Dollar 12-month Rolling Returns: MSCI ACWI ex-U.S. vs. Citi G-20 Liquidity Weighted Currency



Source: Bloomberg, as of 11/30/14. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms and

Indexes in the chart, visit our [glossary](#). **Mechanics of Dollar Bull Currency Strategies** While many investors understand the impact of currencies on their portfolios, they may not fully understand how to allocate to dedicated currency strategies as part of the asset allocation process. In WisdomTree's approach to the asset class, our [currency strategy Funds](#) are structurally no different from our equity or fixed income Funds. A dollar bullish strategy is created through the

combination of [short-term Treasury bills](#) or [repurchase agreements](#) and [forward currency contracts](#) that sell foreign currencies against the U.S. dollar. With the short-term fixed income positions serving as collateral, investors gain exposure to currency markets on a one-to-one [notional](#) basis. For investors concerned about currency risk, strategies such as the [WisdomTree Bloomberg U.S. Dollar Bullish Fund \(USDU\)](#) could prove beneficial. ¹Sources: Bloomberg, Citigroup, WisdomTree, as of 11/30/14.

Important Risks Related to this Article

Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. The Fund's investment in repurchase agreements may be subject to market and credit risk with respect to the collateral securing the repurchase agreements and may decline prior to the expiration of the repurchase agreement term. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Although the Fund invests in very short-term, investment-grade instruments, the Fund is not a "money market" fund, and it is not the objective of the Fund to maintain a constant share price. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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.

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

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.

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.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Bullish : a position that benefits when asset prices rise.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Negative correlation : Indicated by a tendency of two series of data to move in opposite directions. Shown in the chart (in the red box), the USD-to-GBP exchange rate is trending downward while the FTSE 100 Index is trending upward.

Unhedged : Strategy that includes the performance of both the underlying asset as well as the currency in which it is denominated. The performance of the currency can either help or hurt the total return experienced.

Short-term treasury bills : a debt obligation of the U.S. government with an original maturity of less than one year.

Repurchase agreement : a short-term investment similar to a money market security.

Forward currency contracts : A forward contract in the forex market that locks in the price at which an entity can buy or sell a currency on a future date.

Notional : The dollar value of the derivative contract.