HOW TO BLEND IN A CURRENCY HEDGE

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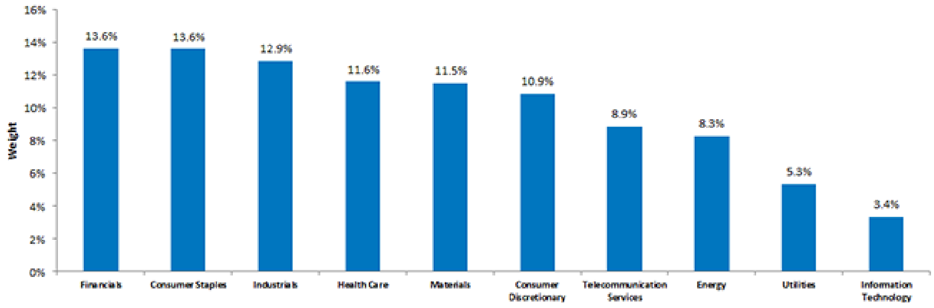
Looking across developed markets today, a common thread is that central bank policies have pushed interest rates to very low levels to support their economies. Looking at the major central banks—the U.S., the European Central Bank (ECB) and the Bank of Japan (BOJ)—it appears that Europe and Japan are still expanding their accommodative policies, while the U.S. is reducing[1] and is anticipated to be the first among these banks to raise interest rates[2]. This change has important implications for currencies that play a role in international equity returns. We believe it is important to maintain a globally diversified international equity portfolio, but we question the rationale of being fully exposed to foreign currencies. **Importance of Currency Considerations:** The euro, Yen and British pound comprise 70%–75% of the MSCI EAFE Index [3], a benchmark many use for their international allocations. Our position: if investors have no view on which direction currencies are going to move, they should consider a 50/50 blend of currency-hedged equities. • An investor who believes that the *dollar is going to fall* can shift weight to add more currency exposure; this would imply foreign currency appreciation, which can add to international equity returns. • An investor who believes that *foreign currencies are going to fall*—or that the dollar is going to rise—can shift that allocation to more currency-hedged strategies, as unhedged exposure in this case can detract from international equity returns. In this piece, we discuss a unique blend from WisdomTree for the developed international space. Our core developed international currency-hedged strategy focuses on Dividend Growers[4]. We think that marrying this approach with a focus on High Dividend Yielders[5] provides a nice complement in the stock selection strategies and the resulting currency exposures. **High Dividend Yielders:** These stocks are characterized by their relatively higher yields at each annual rebalance, and they fit in our "equity income" category. Simply put, these are the firms that presently have higher dividend payouts relative to their share prices. In this piece, these stocks are represented by the WisdomTree DEFA Equity Income Index • **Dividend Growers:** We tend to think about the potential for future dividend growth from both the earnings growth and quality perspectives, with our criteria for inclusion split evenly between these two factors. These firms may not have the highest dividend yields presently, but we believe that they have the potential to increase their dividends in the future. In this piece, these firms are represented by the WisdomTree International Hedged Dividend Growth Index. Viewed in combination, High Dividend Yielders are interesting as interest rates in developed markets remain low, and Dividend Growers provide diversification potential for the future, when both interest rates and inflation in developed markets may rise. We believe that the marriage of these two themes may connect where we are today from a macroeconomic perspective to where we may be heading in the future. **Sector Exposures: 50–50 Blend of High Dividend Yielders and Dividend Growers** One nice feature of this methodology is sector diversification. When we see a portfolio where the largest sector exposures are below 14%, we believe that it indicates a very balanced picture. **Marrying Dividend Growth and Dividend Yield for Balanced Sector Exposures**



Sources: Bloomberg, Standard & Poor's, as of 7/15/14. Subject to change.

Some of the more notable details underlying the characteristics of this blend: • **Financials:** High Dividend Yielders had nearly 25% exposure to Financials, but Dividend Growers had less than 2.5% exposure. It's also worth mentioning that the resulting 13.6% weight to Financials in the blend represented an 11.8% under-weight compared to the MSCI EAFE Index, the most widely followed performance measure of broad, developed international equities.[6] • **Balancing the Consumer Sectors with the High-Yielding Sectors:** It's interesting that the Dividend Growers had much greater exposure to the Consumer Discretionary and Consumer Staples sectors—10.1% and 12.8% higher, respectively, than the High Dividend Yielders. If economic fundamentals in developed markets improve and rates begin to rise, these are important sectors to be attentive to. On the other hand, the High Dividend Yielders had much greater exposure to Telecommunication Services and Utilities—10.8% and 8.6% higher, respectively, than the Dividend Growers. In the present, lower-yielding environment, exposure to these sectors can be important for potential income generation. **Bringing Valuation into the Discussion** To conclude, we present a simple table showing the valuation characteristics of this blend, its component indexes and how this relates to the MSCI EAFE Index. **Valuation Attributes**

	Dividend Yield	50/50 Blend	Dividend Growth	MSCI EAFE Index
Price to Earnings (P/E) Ratio[1]	13.6x	14.8x	15.9x	14.9x
Dividend Yield[2]	5.2%	4.2%	3.1%	3.4%
Return on Equity (ROE)[3]	15.9%	21.8%	27.8%	13.2%
Return on Assets (ROA)[4]	6.0%	8.8%	11.6%	5.0%
Leverage[5]	2.7x	2.5x	2.4x	2.6x

Sources: WisdomTree, Bloomberg, as of 7/15/14. Past performance is not indicative of future results.

For definitions of terms in the chart, please visit our glossary. In our opinion, the story that stands out is that, as of July 15, the 50–50 blend had a similar P/E ratio, a dividend yield approximately 80 basis points higher and a three-year average return on equity that was approximately 860 basis points higher than the MSCI EAFE Index. While it's true that the MSCI EAFE Index is the most widely utilized market capitalization-weighted measure of the performance of developed international equities, we believe that this blend combines sector and currency diversification while maintaining a focus on high-quality stocks. This is an attractive combination, in our view, for the current market environment. [1]Refers to the U.S. Federal Reserve tapering the amount of its monthly asset purchases. [2]Refers to the U.S. 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. [3]Source: Bloomberg, as of 7/15/14. [4]Refers to the universe of the WisdomTree International Hedged Dividend Growth Index. [5]Refers to the universe of the WisdomTree DEFA Equity Income Index. [6]Sources: Bloomberg, Standard & Poor's, as of 7/15/14.

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DEFINITIONS

MSCI EAFE Index : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

Rate-Hedged : A bond portfolio that has offsetting positions in Treasury securities to reduce interest rate risk.

Dividend yields : Refers to the trailing 12-month dividend yield. Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

Earnings growth estimates : Bloomberg analysts' long-term earnings growth expectations, which encompass the estimated growth in operating earnings per share over the company's next full business cycle, typically three to five years.

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.

WisdomTree International Hedged Dividend Growth Index : Designed to provide exposure to the developed market companies while neutralizing exposure to fluctuations between the value of foreign currencies and the U.S. dollar. Comprises companies from the WisdomTree DEFA Index with the best combined rank of growth and quality factors.

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.