

HOW TO BUILD A STRONG DOLLAR EMERGING MARKETS EQUITY INDEX

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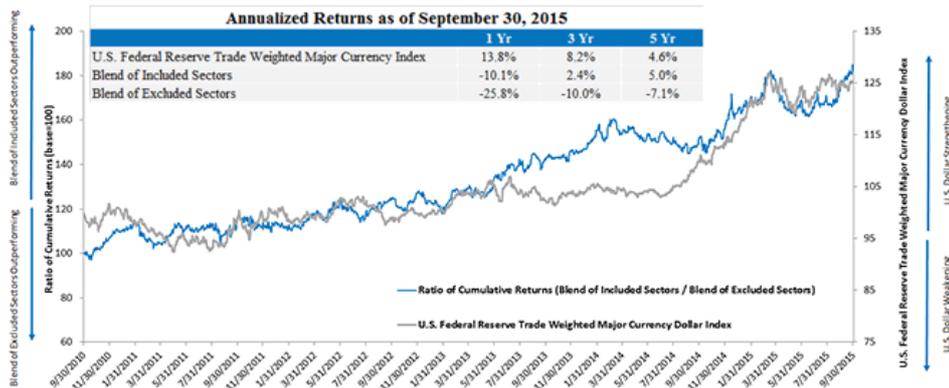
At WisdomTree, we have written extensively regarding how the movement of currencies can have the potential to impact equity investments. Within emerging markets, the approach of [currency hedging](#), which has become quite popular within developed markets, is currently expensive.¹ That's why we created a new approach, the [WisdomTree Strong Dollar Emerging Markets Equity Index](#), which seeks to [mitigate the potentially adverse impact of a strengthening U.S. dollar against emerging market currencies](#). **Does a Stronger U.S. Dollar Impact All Emerging Market Equities Equally?** Our answer is no—a strengthening U.S. dollar (and weakening emerging market currencies) does not create an equivalently negative impact across all emerging market stocks. Some important considerations could include:

- **Geographic Revenue Distribution:** Companies that derive more of their revenues from the United States actually see their goods and services become less expensive to U.S. consumers as the dollar strengthens.
- **Commodity Sensitivity:** Since many commodities are priced in USD, a strengthening U.S. dollar is usually accompanied by declining commodity prices. Certain emerging market companies are commodity sellers, thereby having the potential to see revenues increase as commodity prices rise. Of course, others are commodity buyers, so they have the potential to see their costs decrease as commodity prices fall.
- **Debt Levels:** For the most part, emerging market [corporate debt](#) issuance is in U.S. dollars. If the dollar is strengthening compared to a company's home currency, and the majority of that company's revenues are in that home currency, a scenario in which it is tougher for that company to continue to pay for its debt obligations can develop. These represent just some of the considerations to think about when looking at how companies within emerging markets may respond to a stronger U.S. dollar.

Zeroing In on Strong Dollar Emerging Market Constituents The WisdomTree Strong Dollar Emerging Markets Equity Index steers around companies that may be the most at risk to respond negatively to a strengthening U.S. dollar by virtue of its [annual screening](#) process:

- **Sectors Excluded at the Annual Screening²:** Energy, Financials, Materials, Telecommunication Services and Utilities. We believe that the companies within these sectors, in aggregate, could be at greater risk of responding negatively to a strengthening U.S. dollar.
- **Sectors Included at the Annual Screening:** Consumer Discretionary, Consumer Staples, Health Care, Industrials and Information Technology. We believe that companies within these sectors—given that they also must derive a minimum of 15% of their revenue from the United States—could be at a lower risk to respond negatively to a strengthening U.S. dollar. In the chart below, we look to explore these premises, utilizing blends of MSCI Indexes to represent included sectors³ and excluded sectors⁴. Within this chart, the U.S. dollar is measured by the [U.S. Federal Reserve Trade-weighted Major Currency Index](#)

Last Five Years: As U.S. Dollar Strengthened, Blend of Included Sectors Outperformed Blend of Excluded



Source: Bloomberg, with data for five years ending 9/30/15. Past performance is not indicative of future results. You cannot invest directly in an index.

Sectors

• Overall Upward

Trend of the U.S. Dollar: Over the five years ended September 30, 2015, the U.S. dollar strengthened 4.6% per year, creating a potential headwind for any [unhedged](#) exposure to emerging market equities. But we see that the ratio of the performance of the blend of the included sectors compared to the performance of the blend of the excluded sectors tended to increase. That means that the blend of included sectors outperformed that of the excluded sectors—showcasing our initial point that emerging market equities do not all respond equally to a stronger U.S. dollar. **• Positive Returns Even While Not Hedging:** What we also find interesting is that over the three-year and five-year periods, the blend of included sectors exhibited positive returns. This occurred as the dollar was getting strong, AND it is important to note that this blend is NOT currency-hedged. The performance of the underlying equities was enough to more than offset the currency headwind during these periods. While there is no way to know if this performance will continue, if an investor believes that the U.S. dollar has the potential to continue to strengthen and that U.S. [short-term interest rates](#) will remain lower than the short-term interest rates seen within many emerging markets for a considerable time, WisdomTree’s Strong Dollar Emerging Markets Equity Index could be interesting to consider.

¹Source: Bloomberg, as of 9/30/15. ²Subsequent to Index screening it is possible that a current constituent may spin off a subsidiary company that may be classified as a Consumer Staples, Health Care, Telecommunication Services or Utilities sector firm. Spin off firms that remain within the Index do not get removed between Index rebalances due to their sector classification. ³Blend of included sectors: Represents the eligible sectors of the WisdomTree Strong Dollar Emerging Markets Equity Index, while maintaining sensitivity to the country exposures of this Index as of 9/30/15. Includes the [MSCI Taiwan Information Technology Index](#) 24.7%; [MSCI Taiwan Consumer Discretionary Index](#) 12.0%; [MSCI Taiwan Industrials Index](#) 9.5%; [MSCI South Korea Information Technology Index](#) 15.2%; [MSCI South Korea Consumer Discretionary Index](#) 13.9%; [MSCI South Korea Industrials Index](#) 7.6%; [MSCI South Korea Health Care Index](#) 6.3%; [MSCI India Information Technology Index](#) 5.7%; and [MSCI India Health Care Index](#) 5.1%. ⁴Blend of excluded sectors: Represents an equally weighted blend of the sectors excluded from eligibility for the WisdomTree Strong Dollar Emerging Markets Equity Index and includes the [MSCI Emerging Markets Energy Index](#) the [MSCI Emerging Markets Materials Index](#) the [MSCI Emerging Markets Financials Index](#) the [MSCI Telecommunications Services Index](#) and the [MSCI Emerging Markets Utilities Index](#).

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.

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

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.

Corporate debt : Bonds a company issues in order to raise money.

Annual screening date : The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.

U.S. Federal Reserve Trade-weighted Major Currency Index : Is a Federal Reserve generated effective exchange rate between the US Dollar and its main trading partners.

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.

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.

Short-term rates : the rate of interest on a debt instrument maturing in two years or less.

MSCI Taiwan Information Technology Index : designed to measure the equity market performance of the Information Technology sector of Taiwan.

MSCI Taiwan Consumer Discretionary Index : designed to measure the equity market performance of the Consumer Discretionary sector of Taiwan.

MSCI Taiwan Industrials Index : designed to measure the equity market performance of the Industrials sector of Taiwan.

MSCI South Korea Information Technology Index : designed to measure the equity market performance of the Information Technology sector of South Korea.

MSCI South Korea Index : A free float-adjusted market capitalization-weighted equity index designed to measure the performance of the South Korean equity market.

MSCI South Korea Industrials Index : designed to measure the equity market performance of the Industrials sector of South Korea.

MSCI South Korea Health Care Index : designed to measure the equity market performance of the Health Care sector of South Korea.

MSCI India Information Technology Index : designed to measure the equity market performance of the Information Technology sector of India.

MSCI India Health Care Index : designed to measure the equity market performance of the Health Care sector of India.

MSCI Emerging Markets Energy Index : Designed to measure the combined equity market performance of the Energy sector of emerging market countries.

MSCI Emerging Markets Materials Index : Designed to measure the combined equity market performance of the Materials sector of emerging market countries.

MSCI Emerging Markets Financials Index : Designed to measure the combined equity market performance of the Financials sector of emerging market countries.

MSCI Emerging Markets Telecommunication Services Index : Designed to measure the combined equity market performance of the Telecommunication Services sector of emerging market countries.

MSCI Emerging Markets Utilities Index : Designed to measure the combined equity market performance of the Utilities sector of emerging market countries.