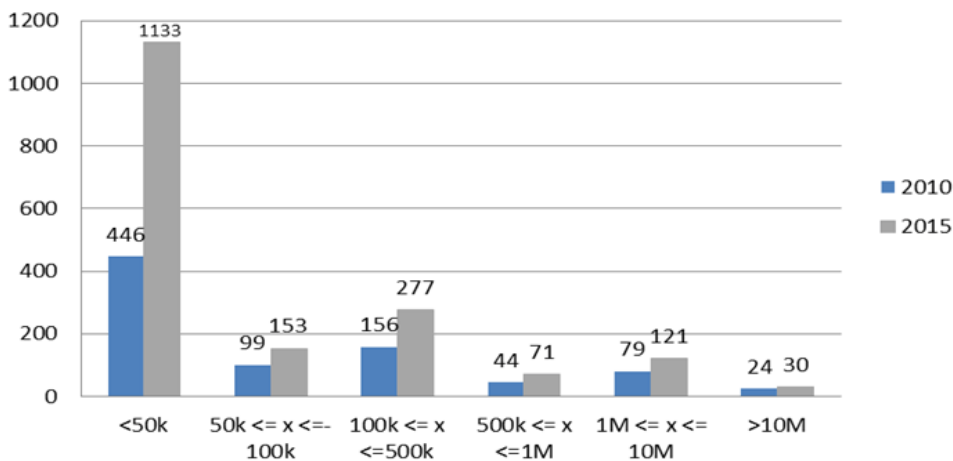


UNDERSTANDING ETF IMPLIED LIQUIDITY

Paige Corbin — Capital Markets Associate
02/04/2016

This blog post is relevant to institutional investors interested in trading exchange-traded funds (ETFs) in significant volume. Individual investors do not always have access to liquidity providers to trade ETFs as referenced below. The saying “Don’t judge a book by its cover” can be applied to ETFs when discussing [trading volume](#) and [liquidity](#). Oftentimes investors will rule out ETFs because they don’t meet a certain [average daily volume \(ADV\)](#) threshold. This could eliminate from consideration hundreds of ETFs that could potentially be effective and impactful investment vehicles. Let’s take a look at the ADV of all the U.S.-listed ETFs. As you can see in figure 1, more than half of the U.S.-listed ETFs in 2015 traded fewer than 50,000 shares a day, and only 151 funds traded more than 1 million shares. Many investors use 1 million shares as a volume threshold when surveying investment opportunities. By doing so, they are missing out on more than 90% of ETFs available. **Figure 1: Number of Funds By Trading Volume Bucket**

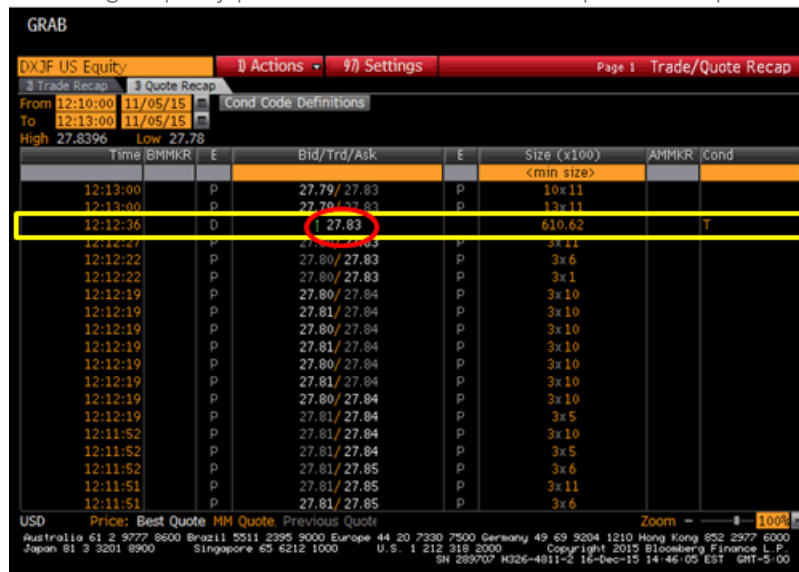


Source: Bloomberg, as of 12/17/15.

Introducing **ETF Implied**

Liquidity ETFs are at least as liquid as their [underlying basket](#), and there is a more accurate way for them to be measured than by the average daily volume of the ETF wrapper itself. ETF Implied Liquidity first looks at how many shares of each underlying component are in a [creation unit](#). The final output assumes that if transacting in the underlying securities, how many ETF shares would that translate into while being no more than 25% of the 30-day average volume of any security in the basket. ETF Implied Liquidity is a conservative measure of what can potentially be traded in ETF terms based on the ETF’s components, whereas average daily volume is historical. In order to effectively demonstrate the importance of implied liquidity, we can take a look at the [WisdomTree Japan Hedged Financials Fund, DXJF](#). The 30-day average volume was 18,400 shares (as of December 16, 2015, per Bloomberg). If we judge this ETF solely by the average daily volume, it may get overlooked despite the fact that as of December 16, 2015, it had returned 11.64% since the beginning of 2015, and 27.37% since inception. But its implied liquidity for the same day was 1.6 million shares. That’s a stark difference—18,400 shares versus 1,600,000 shares—especially in regards to evaluating the liquidity of an ETF. If investors can understand that the liquidity of an ETF lies in the components of the underlying basket, they can expand the realm of investment choices. **Trading Large Blocks of Low-Volume ETFs** In addition to liquidity misperception, many investors are worried about price impact on the ETF for a large trade size. Let’s continue looking at DXJF as an example to see how large trade size can be executed without impacting the Fund. In figure 2 we see that on November 5, 2015, a 61,062-share block traded on the [offer](#). That is more than three times the average daily volume!

The client who initiated this trade was able to work with an ETF [liquidity provider](#) who had the ability to access other sources of liquidity to facilitate the block trade of 61,062 shares. ETFs with lower ADV typically execute in large size with minimal market impact through liquidity provider facilitation. This is the power of implied liquidity. **Figure 2: DXJF**



Trades on 11/5/15 Source: Bloomberg as of 11/05/15.

Due to the importance of implied liquidity with regards to ETF selection and tradability, WisdomTree will begin making ETF Implied Liquidity information available daily on our website for all of our equity Funds. For an example of this powerful metric, see the [WisdomTree Japan Hedged Financials Fund, DXJF](#). We do not want investors missing out on an investment opportunity because information was not widely disseminated outside of Bloomberg terminals previously. We want ETF investors to understand that the liquidity is available, and the 30-day average volume is not necessarily a true representation of the liquidity profile of an ETF. We hope that by providing this information, we are empowering investors and giving them the tools to make the best investment decisions.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing their investments on certain sectors increase their vulnerability to any single economic, regulatory or sector-specific development. This may result in greater share price volatility. The Fund focuses its investments in Japan, thereby increasing the impact of events and developments in Japan that can adversely affect performance. The Fund uses various strategies to attempt to minimize the impact of changes in the Japanese yen against the U.S. dollar, which may not be successful. 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. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. 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, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch 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

Average Daily Trading Volumes : The average amount of individual securities traded in a day or over a specified amount of time. Trading activity relates to the liquidity of a security; therefore, when average daily trading volume is high, the stock can be easily traded and has high liquidity. As a result, average daily trading volume can have an effect on the price of the security. If trading volume isn't very high, the security will tend to be less expensive because people are not as willing to buy it.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Average daily volume : Average dollar amount traded over the course of a single trading day.

Underlying basket : Securities held by a fund to replicate an investment strategy or index.

Creation Unit (CU) : A specified number of shares issued by an exchange-traded fund (ETF) in large blocks, generally between 25,000 and 200,000 shares. The authorized participants that buy creation units either keep the ETF shares that make up the creation unit or sell all or part of them on a stock exchange.

Liquidity providers : Traders that facilitate the trading of ETF shares by conducting the transference of liquidity between the underlying basket shares and the ETF.