TRIMMING WINNING STOCK POSITIONS IN U.S. MID CAPS

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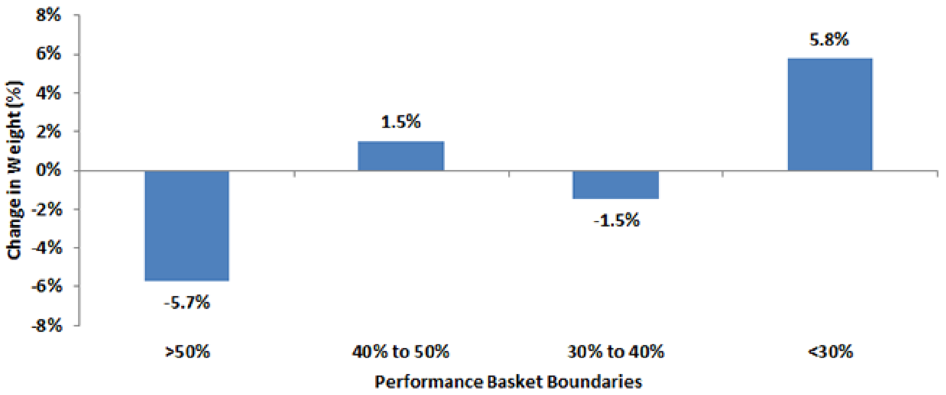
We've written multiple blog posts about U.S. equity market performance in 2013, so we won't belabor the point that it happened to be quite strong. Instead, we'd like to take the opportunity to discuss one of the less-mentioned areas of the equity market capitalization spectrum—mid-caps. **Mid-Caps Deserve Consideration** Investors know that small caps may respond more quickly to positive changes in economic growth expectations or that long-established large-cap blue chips are a good choice to potentially mitigate portfolio volatility. But what about mid-caps—do they deserve special consideration in portfolio allocations? The fact of the matter is that mid-cap equity[1] performance[2] has been impressive, outpacing that of U.S. large caps[3]. Similar to small caps, some of these firms might be potential acquisition targets and others might be poised to grow into the large-cap segment in the coming years. **WisdomTree MidCap Earnings Index (WTMEI) as a Case Study Mapping the Performance Picture** While the whole Index was up about 40% between annual rebalances[4], we know that this is an average and not every stock was up by this amount. If we think broadly in terms of sector performance: • **Three Sectors Greater Than 50%:** Consumer Staples (62.1%), Health Care (52.7%) & Telecommunication Services (65.0%) • **Three Sectors Less Than 30%:** Energy (26.2%), Materials (25.0%) & Utilities (19.6%) We believe that performance dispersion such as this leads to potential opportunities for a relative value rebalance to go to work—just as we wrote for the WisdomTree SmallCap Earnings Index (WTSEI). **How Chips Were Taken Off the Table** Shifting to a constituent level, it's important to remember that WTMEI is unique within the U.S. mid-cap equity space in that it weights constituent firms by earnings. • **Greater Earnings = Road to Greater Weight:** The typical firm receiving increased weight in WTMEI will have grown or at least maintained its earnings but have had lackluster price performance. Conversely, the typical firm receiving lower weight will have had stronger price performance but earnings growth that did not keep pace. • **Losses Lead to Deletion:** Every constituent of WTMEI must prove its cumulative profitability over the four quarters prior to the November 30 screening. Lack of profits leads to lack of representation. **Trimming Weight from Top Performers**



Performance basket boundaries refer to returns between the 11/30/2012 and 11/30/2013 Index screening dates.
Sources: WisdomTree, Bloomberg, Standard & Poor's. Past performance is not indicative of future results. You cannot invest directly in an index.

• **Nearly 40% of Weight Returned Over 50%:** It was a great year in U.S. mid-caps, and WTMEI's constituents were no exception. The overall Index returned approximately 40% between annual rebalance screening dates. Prior to the November 30, 2013, screening, almost 40% of its weight was in constituents that had returned better than 50%. • **Subtracting from Winners and Adding to Losers:** Regardless of how strong a year it must be to have "losers" defined as those returning less than 30%, we clearly see that weight is taken from those firms with returns greater than 50% over the prior year and redistributed to firms with returns below 30%. • **Accounting for the "Drop-Down" and "Move Up" Effects:** Some might correctly point out the possibility for underperforming firms in the WisdomTree Earnings 500 Index (WTEPS) to decrease in their market capitalizations such that they can become constituents of WTMEI. On the other hand, there is also the possibility for strongly performing constituents of the WisdomTree SmallCap Earnings Index (WTSEI) to increase in market capitalization and ultimately qualify for membership in WTMEI. Looking at these impacts: o **Drop-Downs:** Drop-downs from WTEPS accounted for approximately 7% of the weight in WTMEI as of the November 30 screening. Their average performance was 5%—definitely below that of the broader U.S. large-cap equity market. o **Move-Ups:** Move-Ups from WTSEI accounted for approximately 4% of the weight in WTMEI as of the November 30 screening. Their average performance was greater than 100%—definitely above that of the broader U.S. small-cap equity market. **Effectively Taking the "Decision" Off the Table** WTMEI's relative value rebalance, the mechanics of which are seen above, is helpful in that it attacks the market in a disciplined way each and every year. This is especially important after the phenomenal performance of U.S. mid-caps this year, in that we believe investors might tend to want to hold on to the stronger performers. In sticking to the investment mantra "buy low, sell high," a relative value rebalance may aid in accomplishing this notably difficult action as well as allowing for the potential to become smarter with mid-cap beta.[5]

[1]Mid-cap equity: Refers to the S&P MidCap 400 Index. [2]Refers to the period from 12/31/2012 to 11/30/2013; source: Bloomberg. [3]U.S. large caps: Refers to the S&P 500 Index. [4]Refers to the period between the 11/30/2012 and 11/30/2013 Index screenings. [5]A play on the term "smart beta," which means rules-based investment strategies that don't use conventional market-cap weightings.

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Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

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

WisdomTree MidCap Earnings Index : Fundamentally-weighted index that measures the performance of the top 75% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

Relative value : The relationship between a particular attribute, e.g., a dividend, and the firm's share price compared to that of another firm.

WisdomTree SmallCap Earnings Index (WTSEI) : measures the performance of earnings-generating companies within the small-capitalization segment of the U.S. Stock Market. The index is comprised of the companies in the bottom 25% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed.

Winners : Stocks that have delivered positive performance since the investor made their initial investment.

Losers : Stocks that have delivered negative performance since the investor made their initial investment.

WisdomTree Earnings 500 Index : A fundamentally weighted index that measures the performance of earnings-generating companies within the large-capitalization segment of the U.S. Stock Market. Companies in the index are incorporated and listed in the U.S and have generated positive cumulative earnings over their most recent four fiscal quarters prior to the index measurement date. The index is comprised of the 500 largest companies ranked by market capitalization in the WisdomTree Earnings Index.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.