WHY CURRENCY HEDGE FOREIGN DEVELOPED EQUITIES

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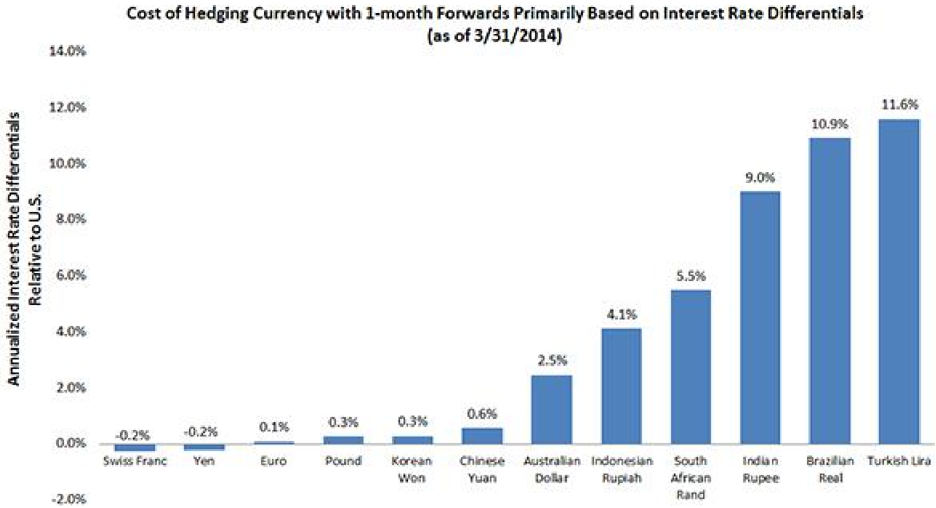
When investors allocate to foreign stocks, they typically assume a secondary currency exposure on top of their local equity market returns. This secondary currency exposure—or "currency bet"—can increase returns during periods when the euro, yen, British pound and other foreign currencies are rising versus the dollar. But it can also decrease returns when those foreign currencies are falling in value. If investors do not have strong conviction in the potential direction of the euro, yen or British pound, WisdomTree argues they should hedge at least a portion of their exposure to these currencies. Moreover, WisdomTree believes we may be entering a period when the U.S. dollar increases in value in a secular trend. This view is based on changes unfolding in central bank policies, as well as likely changes in interest rate policies developing between Europe, Japan and the United States. This does not mean one should allocate less to foreign stocks if the dollar is rising—in fact this could have the potential to be the best time to own foreign stocks, as illustrated in Japan in 2013. WisdomTree pioneered developing currency-hedged Indexes for use within the exchange-traded fund (ETF) structure as the first ETF firm to launch a currency-hedged ETF.[1] WisdomTree continues to innovate along this theme with the introduction of the WisdomTree International Hedged Dividend Growth Fund (IHDG), which tracks the performance of the WisdomTree International Hedged Dividend Growth Index after costs, fees and expenses. Before describing the characteristics of this new Index that IHDG is designed to track, it is important to establish why WisdomTree thinks currency hedging is increasingly critical to obtaining international investments exposure, particularly in the developed world. **Central Banks and Interest Rates Impact Currencies** If the U.S. Federal Reserve increases interest rates[2] before the European Central Bank (ECB) or the Bank of Japan (BOJ), there could potentially be a time in the next two years when U.S. investors are paid the relative interest rate differentials *to hedge* foreign currencies. Currency hedging contracts are priced based on relative interest rates. If the U.S. has higher interest rates than foreign markets, then U.S. investors would likely be paid to hedge the currency risk of those respective markets. For instance, if the Federal Funds Rate increases to 2% and the ECB and the BOJ both keep rates pegged near 0%, the U.S. investor could receive approximately 2% income to hedge the euro and yen risk. If this scenario materializes, it could have the potential to be a game-shifting catalyst for investors to transition to currency-hedged ETFs for their developed world exposures. In this scenario, one can argue it would be expensive to have euro and yen exposures like traditional foreign equity ETFs that do not hedge the currency risk—missing out on a potential 2% income or differential in interest rates from hedging the currency as well as the removal of a potential source of additional risk. **Myth Busting: Currency-Hedged Edition** WisdomTree believes there are common myths about hedging foreign currencies and I plan to address the three main misconceptions in a series of three blog posts. The first myth is that it is expensive to hedge foreign currencies, followed by the myth that the euro and yen can be beneficial for the purchasing power of the U.S. dollar, and finally the myth that currencies are a wash in the long run, so one should default to taking the currency risk. **Myth #1: It Is Expensive to Hedge Foreign Currencies** Typically, it is only expensive for U.S. investors to hedge certain foreign currencies—those that have much higher short-term interest rates than the United States. Two current examples are Brazil and India. Both countries' central banks have increased interest rates to help fend off declines in their currencies. By hiking interest rates, these central banks make it more costly for speculators to short the currencies and for hedgers to hedge the currencies. The interest rate hikes can also make it more attractive for foreign investors to hold assets in reais and rupees to collect higher short-term interest rates compared to the rates in, for example, the United States. The Brazilian Central Bank hiked rates to 11%,[3] while India hiked its repurchase rate three times since its new central bank governor, Raghuram Rajan, took office on September 4, 2013. The repurchase rate in India is at 8% as of March 31, 2014.[4] These are high hurdle rates for the currencies to depreciate against the U.S. dollar before a hedging investor has the potential to break even from the cost of the hedge. However, the euro, yen and British pound—which combine to represent almost three-quarters of the weight of the MSCI EAFE Index (a widely followed developed country international equity market benchmark)—each have a cost to hedge that is very low.[5] Specifically, this cost is approximately zero in the case of the euro and yen, and approximately 30 basis points for the British pound.[6] This is one reason why WisdomTree believes one may want to have a high conviction in the euro, yen and British pound's direction to fully take on this currency risk in a traditional ETF that does not hedge the currency. **Illustrating the Difference Between High- and Low-Cost Currency Hedging**



Sources: WisdomTree, Bloomberg, with data as of 3/31/2014. Subject to change.

Conclusion The bottom line is that WisdomTree ultimately believes currency hedging is gaining prominence and importance—as was particularly evident with Japan in 2013. But Japan is not a unique application. WisdomTree believes that currency-hedged strategies should have broad appeal, in Europe today based on monetary policy directions of the ECB, but also more strategically from a long-term standpoint in broader-based developed world exposures. [1]WisdomTree launched the WisdomTree Europe Hedged Equity Fund on 12/31/09, the first U.S.-listed currency-hedged equity ETF. [2]Refers to the Federal Funds Rate. [3]Source: Bloomberg, as of 3/31/14. Refers specifically to the SELIC rate, which was the rate used to implement this policy action. [4]Source: Bloomberg, as of 3/31/14. [5]Source: Bloomberg, as of 3/31/14. For both currency weights within the MSCI EAFE Index and the cost to hedge the respective currencies. [6]Source: Bloomberg, as of 3/31/14.

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DEFINITIONS

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.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

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.

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.

Speculators : Individuals—typically taking a shorter-term view—looking to trade quickly in and out of a position in an attempt to access a financial gain that is based purely on the currency’s shifting exchange rate.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Hedgers : Individuals—typically taking a longer-term view—looking to conduct business or make an investment in a particular country where they want to minimize the exchange rate impact as part of their strategic focus.

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.

Basis point : 1/100th of 1 percent.