

WHY VALUE INVESTORS DON'T HAVE TO WAIT FOR MEAN REVERSION

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When will [value](#) turn around and outperform [growth](#)? Over the past several years, this arguably has been one of the most hotly debated questions in index investing. Investors are now undoubtedly familiar with some sort of graph that shows the outperformance that growth has experienced over the past 10 years, punctuating the question around value [mean reversion](#).

With live performance available for many of WisdomTree's Funds for the past 10 years, some investors may be surprised to see outperformance, particularly in the [small-](#) and [mid-cap](#) segment, from some of our most value-tilted strategies. In this blog post, we utilize our Index Performance [Attribution tool](#) to explain the key drivers of outperformance of our mid-cap earnings Index over the past 10 years.

Quantifying Value: Earnings Yield Attribution

The tendency for inexpensive companies, using a ratio such as [price-to-earnings \(P/E\)](#), to outperform expensive companies over longer periods of time is one of the more generally accepted principles in [factor investing](#). Research such as this contributed to the creation of WisdomTree's earnings-weighted family that [rebalances](#) back to core earnings on an annual basis to reduce [valuation risks](#). By segmenting the [WisdomTree U.S. MidCap Earnings Index](#) and the [Russell Midcap Index](#) into [earnings yield quintiles](#), we can review how the least expensive stocks have performed relative to the more expensive stocks in real time, and how this helped contribute to 266 [basis points \(bps\)](#) of outperformance for the WisdomTree Index as of June 30, 2018:

- **First Quintile (Lowest P/E):** The WisdomTree Index had an [active weight](#) of 10.75% in this quintile, which was also the best performing in the benchmark quintile. This quintile was the biggest contributor to outperformance, adding 112 of the total 266 bps of outperformance.
- **Fifth Quintile (Highest P/E):** The WisdomTree Index was under-weight in the most expensive quintile by 12.85%, the largest absolute active weight of all the categories. This quintile was the worst performing in the benchmark, underperforming the Russell index's total return by nearly 200 bps. By tilting away from these expensive stocks, the category contributed 42 bps of outperformance.

WTMEI - WisdomTree U.S. MidCap Earnings Index

Earnings Yield Attribution

As of:

6/30/2018

VS.

RUMIDCAP - Russell Midcap® Index

MTD

QTD

YTD

1Y

3Y

5Y

10Y

Since Inception

Category	Attribution Component				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
1st Quintile (Lowest P/E)	0.32%	0.51%	0.28%	1.12%	25.84%	15.09%	10.75%	14.91%	11.63%
2nd Quintile	0.06%	0.36%	0.07%	0.49%	24.43%	17.00%	7.43%	13.16%	11.26%
3rd Quintile	0.01%	0.30%	0.08%	0.39%	21.60%	18.63%	2.97%	12.26%	10.42%
4th Quintile	0.05%	-0.08%	0.04%	0.00%	16.66%	20.15%	-3.49%	9.73%	10.17%
5th Quintile (Highest P/E)	0.28%	0.34%	-0.19%	0.42%	8.25%	21.10%	-12.85%	9.65%	8.31%
Negative Earners	-0.02%	0.58%	-0.33%	0.23%	2.94%	7.73%	-4.79%	12.78%	9.36%
N/A	0.00%	0.02%	-0.00%	0.02%	0.29%	0.32%	-0.02%	3.90%	6.02%
Total	0.70%	2.02%	-0.06%	2.66%	-	-	-	12.89%	10.23%

Sources: WisdomTree, FactSet, for the period 6/30/08–6/30/18. Past performance is not indicative of future results. You cannot invest directly in an index.

Quantifying Quality: ROE Attribution

[Return on equity \(ROE\)](#) is a key metric of profitability for equity investors, and one that is helpful to utilize in deconstructing the impact of our earnings-weighted methodology on returns. Similar to what was done for earnings yield quintiles, the two indexes are segmented into ROE quintiles, as well as a category for negative return.

- Top Two ROE Quintiles:** Over short periods of time, we can see any of the commonly accepted factors go out of favor. One surprise of 2018 thus far has been how well negative earners have performed in the mid-cap segment. Negative earners have outpaced all other ROE quintiles in a junk-led rally, resulting in a headwind for the WisdomTree Index's year-to-date returns. Over the 10-year period, the outperformance of the highest ROE quintiles has been definitive. The WisdomTree Index had a combined 14% over-weight in the top two quintiles, contributing 113 bps to outperformance.
- Negative Return Category:** What we have consistently seen when dipping down in market cap size is this negative return weight becomes more prevalent for [market cap-weighted](#) indexes, creating a greater exposure to companies more at risk of bankruptcy due to a lack of profitability. The WisdomTree Index had roughly 2.8% weight in this bucket, with over twice this exposure for the Russell index, which had 7.3% allocated there. This was the second-worst-performing category for the benchmark, which contributed 32 bps to outperformance.

WTMEI - WisdomTree U.S. MidCap Earnings Index

VS.

RUMIDCAP - Russell Midcap® Index

Return on Equity Attribution

As of: 6/30/2018

MTD

QTD

YTD

1Y

3Y

5Y

10Y

Since Inception

	Attribution Component				Average Category Weight			Category Performance	
Category	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
1st Quintile (Highest ROE)	0.09%	0.57%	0.16%	0.82%	26.99%	18.80%	8.19%	13.65%	10.80%
2nd Quintile	0.08%	0.19%	0.05%	0.31%	23.41%	17.89%	5.52%	12.56%	11.80%
3rd Quintile	0.03%	0.29%	-0.00%	0.32%	19.99%	17.95%	2.04%	12.11%	10.34%
4th Quintile	0.04%	0.89%	-0.08%	0.85%	15.65%	17.16%	-1.50%	13.19%	8.04%
5th Quintile (Lowest ROE)	0.12%	0.16%	-0.08%	0.19%	8.57%	17.44%	-8.87%	9.54%	9.05%
Negative Return	0.02%	0.56%	-0.26%	0.32%	2.79%	7.32%	-4.53%	12.68%	8.61%
N/A	-0.05%	-0.09%	-0.01%	-0.15%	2.60%	3.44%	-0.84%	12.63%	16.17%
Total	0.33%	2.56%	-0.23%	2.66%	-	-	-	12.89%	10.23%

Sources: WisdomTree, FactSet, for the period 6/30/08–6/30/18. Past performance is not indicative of future results. You cannot invest directly in an index.

Don't Sleep on Value

While one would expect an index that has outperformed its benchmark by 266 bps over 10 years should have stretched valuations, the design of WisdomTree's Index instills a selling discipline to mitigate any such valuation risk—an important consideration for investors in this aging [bull market](#). As of June 30, 2018, the valuation discount for the WisdomTree Index is about 30% on a trailing P/E basis, a discount that could portend even greater opportunity for outperformance going forward should value finally come back into favor.

Index	Trailing P/E	Fwd. P/E	ROE
WT U.S. MidCap Earnings	15.9x	15.2x	14.0%
Russell Midcap Index	22.7x	17.9x	12.1%

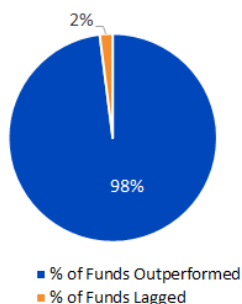
Sources: WisdomTree, FactSet. Data as of 6/30/18. Past performance is not indicative of future results.

You cannot invest directly in an index.

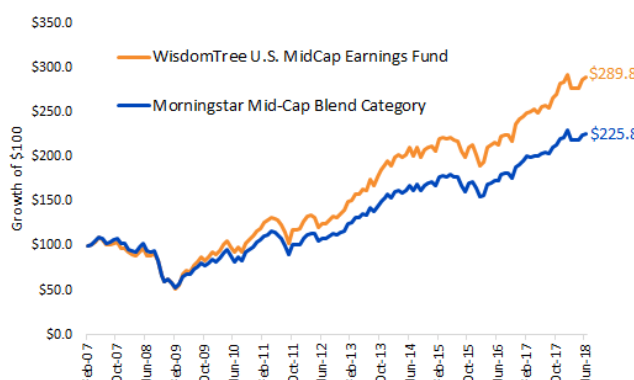
WisdomTree U.S. MidCap Earnings Fund (EZM): Beating 98% of Its Peers since Inception

The Fund tracking the WisdomTree U.S. MidCap Earnings Index, EZM, has proven its competitiveness up against both [passive](#) and [active managers](#), beating 98% of Morningstar Category peers based on total return since inception. The combination of value and quality exposures, which we have highlighted through the earnings yield and ROE attributions, has helped this Fund rise toward the top of its peer group despite the headwind of value over this period.

EZM Percentage of Peers Outperformed
(3/1/07–6/30/18)



WisdomTree and Median Peer Performance
(3/1/07–6/30/18)



				Average Annual Total Returns as of 6/30/18									
	Fund Information			NAV Returns (%)					Market Price Returns (%)				
Fund/Index/Category	Ticker	Exp. Ratio	Inception Date	1-Year	3-Year	5-Year	10-Year	Common Period	1-Year	3-Year	5-Year	10-Year	Common Period
WisdomTree U.S. MidCap Earnings Fund	EZM	0.38%	2/23/2007	13.2%	9.8%	12.3%	12.6%	9.8%	13.0%	9.8%	12.4%	12.6%	9.8%
S&P MidCap 400 Index				13.5%	10.9%	12.7%	10.8%	9.4%	13.5%	10.9%	12.7%	10.8%	9.4%
Morningstar Mid-Cap Blend Category				10.9%	8.4%	10.9%	9.1%	7.5%	10.9%	8.4%	10.9%	9.1%	7.5%

Sources: Morningstar, WisdomTree, for the period 3/1/07–6/30/18. "Common period" refers to 3/1/07–6/30/18 due to data availability inception of fund. 2/23/07 represents the EZM inception date.

197 investments included in peer group for Morningstar Mid-Cap Blend Category. For the 1, 5 and 10 year period the fund outperformed 75%, 82%, 100% respectively, out of 458, 331, 233, Funds.

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Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein. Additional Index information is available at www.wisdomtree.com.

All data as of June 30, 2018 and sourced from WisdomTree, FactSet.

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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](#).

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You cannot invest directly in an index.

DEFINITIONS

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Mean reversion : The concept that a series of returns has a tendency to return to its average level over longer periods, even if shorter periods can exhibit wide swings.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Mid-Cap : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

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.

Valuation risk : The risk of buying or over-weighting a particular stock that has appreciated significantly in price relative to its dividends, earnings or any other fundamental metric.

Russell Midcap Index : The Russell Midcap Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Earnings yield : The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.

Quintile : One of the class of values of a variate which divides the members of and batch or sample into equal-sized subgroups of adjacent values or a probability distribution into distributions of equal probability.

Basis point : 1/100th of 1 percent.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Market capitalization-weighting : 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.

Bullish : a position that benefits when asset prices rise.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

Active manager : Portfolio managers who run funds that attempt to outperform the market by selecting those securities they believe to be the best.