MANAGING VALUATION RISK IN INDIA'S EQUITIES

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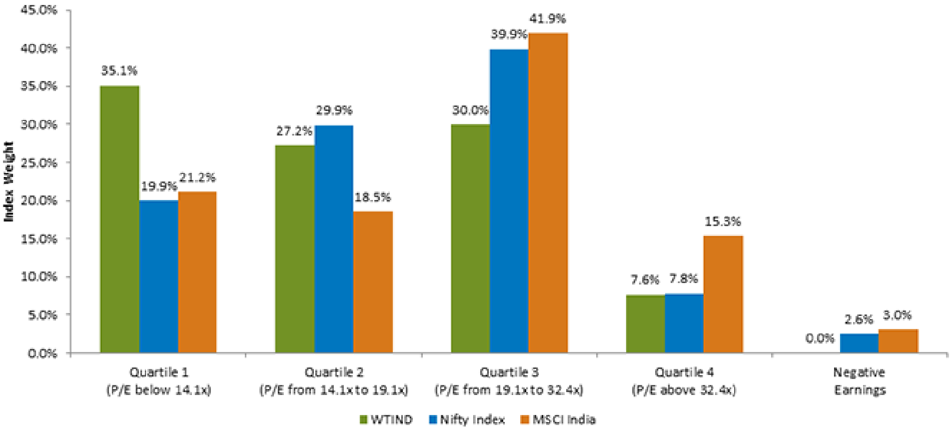
At WisdomTree, we believe in the potential of India's equity markets, especially since prime minister Narendra Modi's Bharatiya Janata Party (BJP) victory in May of 2014. Thus far, there have certainly been strong gains—a fact we discussed in a prior blog. We were able to realize some strong gains by redistributing the sector weights of the WisdomTree India Earnings Index (WTIND) toward sectors that hadn't performed as strongly, detailed further here. All this is a function of WTIND's unique, rules-based methodology, that redistributes weight toward stocks indicating strong profit growth relative to their share price performance. WisdomTree feels that weighting by market capitalization, which does not weight, consider or rebalance back to any measure of economic importance of the underlying constituents, may not be the best approach for this particular strategy. Instead, we believe a disciplined strategy of anchoring allocations back to a measure of relative value, based on fundamentals such as dividends or earnings, can add value over time. In India we focus on earnings, because the current landscape of India's equity markets is characterized by very low dividend yields and minimal dividend payouts. **The Fundamental Difference** The WisdomTree India Earnings Index seeks to provide exposure to the profitable core market of India's equities but to do so while maintaining sensitivity to valuation. To help achieve this, WisdomTree weights companies in the Index by the profits they generate, rather than their market cap, and rebalances back to profitability on an annual basis. WisdomTree's India Earnings Index rebalance process typically is driven by: • Earnings Growth: Companies that grow their profits see their weight increased • Relative Performance: - Underperformers typically see their weight increased - Outperformers often see their weight decreased This process tends to shift weight to firms with lower price-to-earnings (P/E) ratios, as illustrated in the chart below: it compares the distribution of stocks by their P/E ratios in WTIND to that of widely followed market cap-weighted indexes that also measure the performance of India's equities. **P/E Ratio and Weight Distribution** WTIND's P/E ratio is approximately 14.0x—reflecting the 2014 Index screening—i.e., almost 25% lower than the 18.4x P/E ratio of the S&P CNX Nifty Index (Nifty Index) or the 18.6x P/E ratio of the MSCI India Index.[1] The chart below provides a look at how the weight is distributed, to give a sense for why this lower P/E ratio is seen for the aggregate Index. **Zooming in on P/E Ratio Exposures by Quartile & Noting Exposure to Companies with Negative Profits**



Sources: Bloomberg, Standard & Poor's, with data as of the 8/31/14 WTIND Index screening. You cannot invest directly in an index. Subject to change.

• More Weight to Lower-Priced Stocks – The WisdomTree India Earnings Index has over 60% of its weight in the two lowest-priced quartiles, which is significantly more than the Nifty or MSCI India indexes. There is a natural tendency of earnings-weighted approaches to reduce weight to stocks whose prices have appreciated at a faster rate than their earnings, and concurrently to increase weight to stocks that have fallen in price despite exhibiting positive earnings growth. • **Less Weight to Higher-Priced Stocks –** On the other hand, WisdomTree's approach has less than 40% of its weight going to the two higher-priced P/E quartiles. The MSCI India Index has over 40% of its weight in the second most expensive quartile alone. • **Negative Earnings and Speculative Stocks –** Although profitability may fluctuate throughout the year, at each annual rebalance WisdomTree requires companies to be profitable before inclusion. This requirement keeps the weight to firms that we feel tend to be more speculative and of lower quality at zero. Neither of the market cap-weighted indexes above shares this requirement, but it is worth noting that they focus on large-cap stocks, which have a higher tendency to deliver positive cumulative profits. [1]Source: Bloomberg, as of 8/31/2014. [2]References the WisdomTree Equity Income Index. [3]References the WisdomTree LargeCap Dividend Index. [4]References the WisdomTree U.S. Dividend Growth 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. Investments focused in India are increasing the impact of events and developments associated with the region, which can adversely affect performance.

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You cannot invest directly in an index.

DEFINITIONS

WisdomTree India Earnings Index : A fundamentally weighted Index that measures the performance of companies incorporated and traded in India that are profitable and that are eligible to be purchased by foreign investors. Companies are weighted in the Index based on their earnings in their fiscal year prior to the Index measurement date, adjusted for a factor that takes into account shares available to foreign investors.

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.

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

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.

Dividend : A portion of corporate profits paid out to shareholders.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

NSE S&P CNX Nifty Index : A market capitalization-weighted index designed to measure the performance of 50 large companies listed on the National Stock Exchange of India.

MSCI India Index : A market capitalization-weighted index designed to measure the performance of the Indian equity market.

Quartile : Statistical measure that groups a series of values into four groups after ranking them from lowest to highest. The first quartile will have the lowest values, whereas the fourth quartile will have the highest.