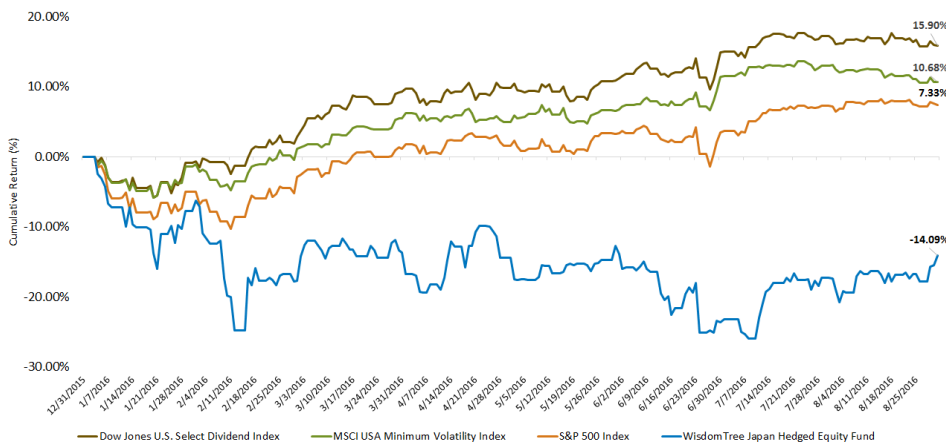


THE OTHER SIDE OF THE LOW VOLATILITY TRADE

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In the last year, there has been a tremendous amount of investor flow into, appetite for and discussion of the low-[volatility](#) factor of investing, along with high-[dividend](#) stocks such as utilities. The [Dow Jones U.S. Select Dividend Index](#), for instance, has more than one-third of its exposure in utilities and has seen a return that was double the [S&P 500](#) return through August 31. Low-volatility and minimum-volatility strategies have also been outperforming and have been the leading recipient of investor flows. Japan has been on the opposite end of the spectrum. While the S&P 500 was up more than 7% through August, DXJ, the [WisdomTree Japan Hedged Equity Fund](#), had a return of -14.09%. Investors have viewed Japan as a more cyclical exposure to the global economy, and global investors have been reducing exposure to Japan on the back of a strengthening yen. [Click here for standardized performance of DXJ.](#) **Year-to-Date Outperformance of Low-Volatility and High-Dividend Strategies**



Sources: WisdomTree, FactSet and Bloomberg, 12/31/15–8/31/16. Past performance is not indicative of future results. 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.

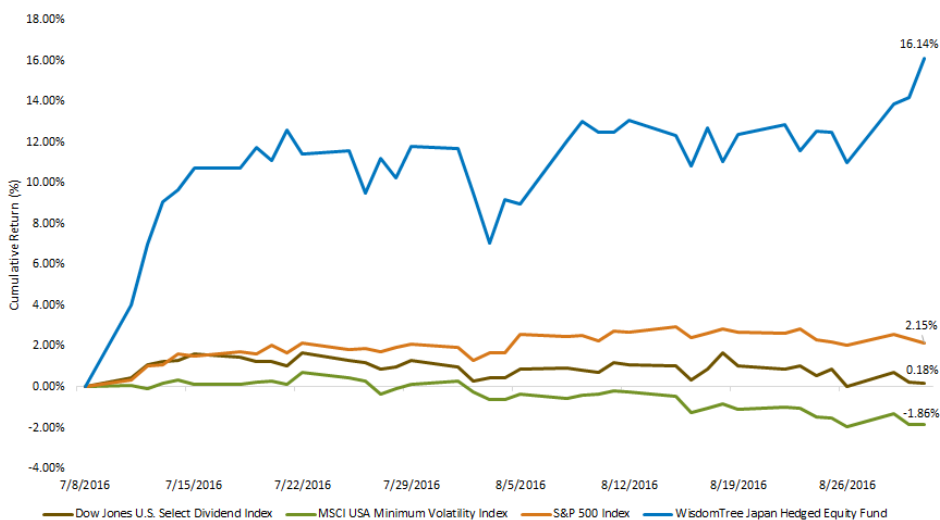
For definitions of indexes in the chart, visit our [glossary](#). In my opinion, the outperformance of low-volatility and high-dividend strategies and underperformance of Japan are two sides of the same coin and are driven by the same fundamental force: a declining U.S. [interest rate](#) environment that saw the U.S. 10-year [yield](#) decline from more than 2.2% at the start of the year to a low of 1.36% on July 8. **The Turning Point: July 8** However, since July 8, two things have happened: 1) Interest rates bottomed and started to rise from their lows following stronger jobs reports in the U.S. 2) Japanese Prime Minister Abe recorded a major political victory that saw his party and coalition win the upper house elections, and he received a bigger mandate for governing Japan. He has since passed a [fiscal stimulus plan](#) to support the economy. **U.S. 10-Year Government Bond**



Source: Bloomberg, 12/31/15–9/14/16. Past performance is not indicative of future results.

Yields

Since that bottom of interest rates and the upper house victory on July 8, low-volatility and high-dividend stocks have reversed their year-to-date strong performance and started to underperform the S&P 500, and [Japan has outperformed significantly](#), by more than 10 percentage points from July 8 to August 31. **Reversal of Low-Volatility and High-Dividend Stocks Paired with Strong Outperformance of Japan**



Sources: WisdomTree, FactSet and Bloomberg, 7/8/16–8/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

How Much Interest

Rate Risk Do You Have in Your Equity Portfolio? Investors who have been embracing the low-volatility/high-dividend/utilities sector trade should be aware of how much “bond [duration](#)” or [interest rate risk](#) they may have added to their portfolios. If interest rates continue to rise, these three areas of the market could face a tough period of performance and compound poor returns from bond-like allocations, in our view. One of the best [hedges](#) for rising interest rates in the U.S. is Japanese equity exposure. Japanese companies are very exposed to the U.S. economy—it is one of their biggest profit centers. A strengthening U.S. economy that supports rising U.S. interest rates is one of most supportive fundamental drivers of Japan. [A strengthening U.S. economy also hurts these lower-volatility and utilities-oriented equity exposures in U.S. markets](#), which are fairly interest-rate-sensitive and more expensive than normal today. For those investors like me who think the low-volatility trade of 2016 ended on July 8, I would add positions to Japanese equities, particularly on a [currency-hedged](#) basis, as that also may have marked the bottoming of Japanese equities’ underperformance. Again, I view these as two sides of the same interest rate coin. If rates bottomed, so too did Japan. *Unless otherwise noted, data source is Bloomberg, as of 8/31/16.*

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DEFINITIONS

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

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

Dow Jones U.S. Select Dividend Index: The index is a modified market capitalization approach and weights by dividend yield. Stocks are selected for fundamental strength relative to their peers, subject to various screens such as dividend quality and liquidity.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

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

Yield: The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Duration: A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Interest rate risk: The risk that an investment's value will decline due to an increase in interest rates.

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.

Currency hedging: Strategies designed to mitigate the impact of currency performance on investment returns.