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# INTERNATIONAL QUALITY DIVIDEND GROWTH REBALANCE: FILTERING OUT THE NOISE

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Focusing on the short run, it can feel like stock prices are overwhelmingly—if not solely—driven by [macroeconomic](#) forces like interest rates and [business cycle](#) fluctuations.

It's tempting to distill investment decisions down to forecasts for these factors.

But if the [Federal Reserve's](#) complete about-face this year on [inflation](#) can teach us anything, it's that even the world's foremost economic experts, working with the best data, can make catastrophic errors in macro forecasting.

If we can filter out the short-term noise that is today's market [volatility](#), in the long run what matters to investors is [cash flows](#).

This is why we have a family of Quality Dividend Growth Indexes that rebalance annually back to a fundamental measure of [value—dividends](#)—that ties investment decisions to cash flows in a systematic, rules-based fashion.

Let's look at the impact of the latest rebalance of the [WisdomTree International Quality Dividend Growth Index \(WITDG\)](#).

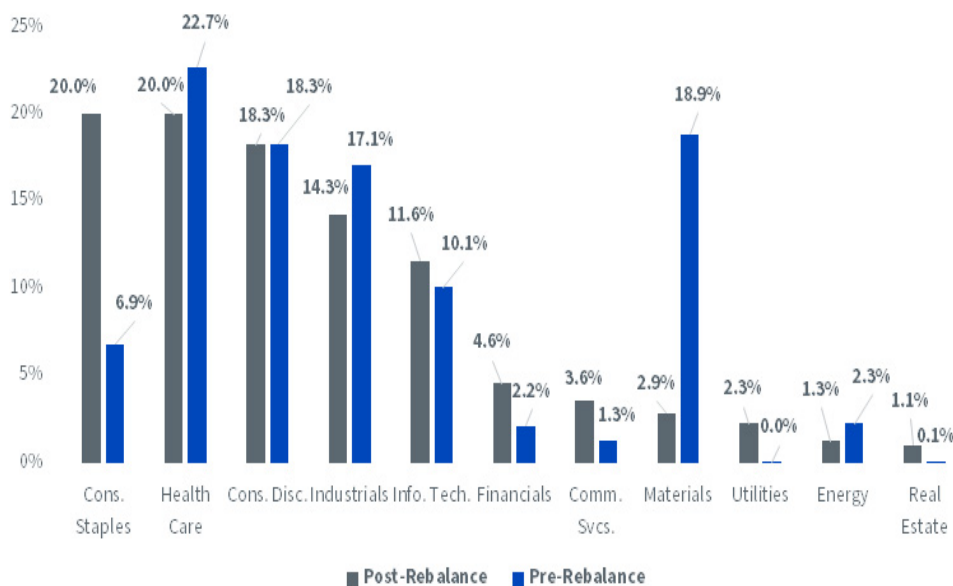
## **Sector and Country Changes**

WITDG selects dividend paying stocks in the developed world, excluding Canada and the U.S., with high profitability and [growth](#) characteristics. The top 300 ranked companies selected are weighted based on their contribution to the [Dividend Stream®](#).

The largest sector weight allocations at the rebalance were Consumer Staples and Health Care, at 20% each. To mitigate sector concentration, the Index caps any sector weight at 20%.<sup>1</sup>

The biggest increase in the Index was to Consumer Staples (+13%) and the biggest reduction was to Materials (-16%).

## **Index Sector Weights**



Source: WisdomTree. Index screening date was 9/30/22. Index pre-rebalance weights as of 11/2/22. Index post-rebalance weights as of 11/3/22. You cannot invest directly in an index.

The reason for the rotation out of Materials and into Consumer Staples primarily comes from the growth estimates variable for selection and the *Dividend Stream* weighting for selected constituents.

With the increasing likelihood of a global economic slowdown and the rollover in raw materials prices like copper, nickel, aluminum and zinc, profit expectations for many of the major Materials companies have been reduced significantly.

Since many of these companies tie dividend payouts to realized profits and/or cash flows, it is expected that many Materials companies will be forced to cut dividends from their record-high payouts in 2021 and 2022.

The negative growth expectations for Materials companies and the positive growth expectations for the more recession-resilient Consumer Staples names explains the sector shifts. As the Index weights by dividends paid, when big dividend payers make it into—or drop out off—the top-300 score, the shifts in weight can be pronounced.

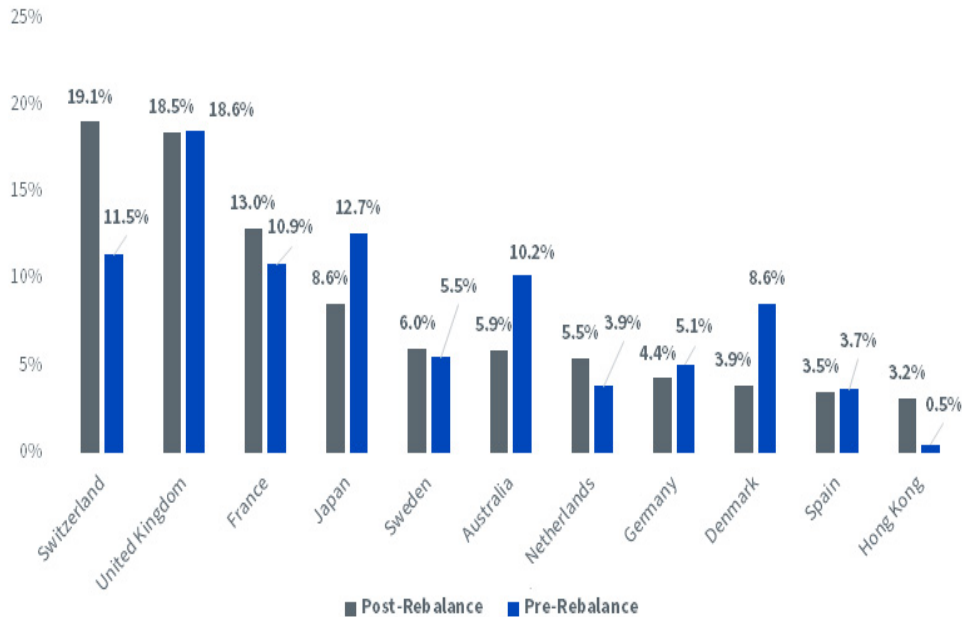
#### **S&P GSCI Industrial Metals Index Cumulative Trailing 3-Year Return**



Sources: WisdomTree, S&P, 9/30/19–9/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns. 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, brokerage commissions on transactions. Such fees, expense and commissions would reduce returns.

From a country perspective, the Index added notable weight to Switzerland (+7.7%) and reduced weight to Denmark (-4.7%), Australia (-4.3%) and Japan (-4.1%).

### Index Country Weights



Source: WisdomTree. Index screening date was 9/30/22. Index pre-rebalance weights as of 11/2/22. Index post-rebalance weights as of 11/3/22. You cannot invest directly in an index.

The top Index drops include three Materials companies BHP Group, Rio Tinto and Anglo American.

The top Index adds include the Consumer Staples companies Unilever and Nestle.

### Top 5 Index Drops/Adds

#### Top 5 Drops

Name	Sector	Country	Weight
BHP Group Ltd	Materials	Australia	5.23%
Rio Tinto plc	Materials	United Kingdom	4.84%
Anglo American plc	Materials	United Kingdom	4.52%
Deutsche Post AG	Industrials	Germany	2.14%
Tokyo Electron Ltd.	Information Technology	Japan	1.96%
<b>Total</b>			<b>18.69%</b>

#### Top 5 Adds

Name	Sector	Country	Weight
Unilever PLC	Consumer Staples	United Kingdom	4.71%
Nestle S.A.	Consumer Staples	Switzerland	4.34%
GSK plc	Health Care	United Kingdom	4.17%
Novartis AG	Health Care	Switzerland	4.16%
SAP SE	Information Technology	Germany	2.70%
<b>Total</b>			<b>20.08%</b>

Source: WisdomTree. Index screening date was 9/30/22. Top 5 drop weights as of 11/2/22. Top 5 add weights as of 11/3/22. You cannot invest directly in an index.

Analyst estimates for the next three fiscal years are for these three Materials companies to reduce dividends by as much

as 60% from their most recent fiscal year payouts.

Nestle and Unilever, on the other hand, are expected to grow dividends by 17% and 10%, respectively.

#### Forward Dividends per Share Estimates

Sector	Company	Currency	FY 0	FY 1	FY 2	FY 3	FY 3 vs. FY 0
Materials	BHP Group Ltd	USD	3.25	2.08	1.79	1.66	-49%
	Anglo American plc	USD	4.19	2.12	1.85	1.76	-58%
	Rio Tinto plc	USD	10.40	5.13	4.56	4.16	-60%
Consumer Staples	Nestle S.A.	CHF	2.80	2.94	3.15	3.27	17%
	Unilever PLC	EUR	1.71	1.72	1.79	1.87	10%

Sources: WisdomTree, FactSet, 10/25/22. FY is fiscal year. Estimates subject to change.

The cyclical sensitivity of Materials companies causes them to have structurally low [price-to-earnings](#) multiples and high [dividend yields](#).

Reducing exposure to the high-yield Materials companies and increasing exposure to lower-yielding Consumer Staples results in a reduction in the Dividend Yield at rebalance from 4.48% to 3.07%, and an increase in the price-to-earnings ratio from 11.85 times to 15.24 times.

[Return on equity](#) and [return on assets](#) are both reduced in the post-rebalance Index, but are still at significantly higher levels than for both the [MSCI EAFE](#) and [MSCI EAFE Growth indexes](#).

As a trade-off for a lower dividend yield and a lower [payout ratio](#), the fundamental growth rate improved from 13.87% to 15.17%.

#### Index Characteristic

	Pre-Rebalance	Post-Rebalance	MSCI EAFE	MSCI EAFE Growth
Constituents	297	300	799	458
Dividend Yield	4.48%	3.07%	3.50%	2.00%
Price to Earnings	11.85x	15.24x	12.77x	20.84x
Payout Ratio	53.06%	46.80%	44.64%	41.58%
<b>Fundamental Growth Rate</b>	<b>13.87%</b>	<b>15.17%</b>	<b>6.80%</b>	<b>8.10%</b>
Return on Assets	12.29%	8.81%	1.72%	2.93%
Return on Equity	29.54%	28.51%	12.28%	13.86%

Source: WisdomTree. Index screening date was 9/30/22. Index pre-rebalance weights as of 11/2/22. Index post-rebalance weights as of 11/3/22. MSCI EAFE and MSCI EAFE Growth Index weights as of 9/30/22. You cannot invest directly in an index.

<sup>1</sup> Real Estate has a separate sector cap of 15%.

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.

View the online version of this article [here](#).

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You cannot invest directly in an index.

## DEFINITIONS

**Macro** : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

**Business cycle** : The continuous lifecycle of the economy, which consists of periods of economic expansion, peaks, contractions, and troughs before.

**Federal Reserve** : The Federal Reserve System is the central banking system of the United States.

**Inflation** : Characterized by rising price levels.

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

**Cash flows** : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

**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.

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

**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.

**Dividend Stream** : Refers to the regular dividends per share multiplied by the number of shares outstanding.

**S&P GSCI Industrial Metals Index** : Seeks to provide investors with a reliable and publicly available benchmark for investment performance in the industrial metals market.

**Trailing** : Trailing refers to the property of a measurement, indicator, or data series that reflects a past event or observation. It is usually attached to a specified time interval by which the data trail or over which that data are aggregated, summed, or averaged.

**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.

**Dividend yields** : Refers to the trailing 12-month dividend yield. Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

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

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**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.

**MSCI EAFE Growth Index** : Market capitalization-weighted subset of stocks within the MSCI EAFE Index that have higher share prices relative to their earnings or dividends per share.

**Payout ratio** : The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.