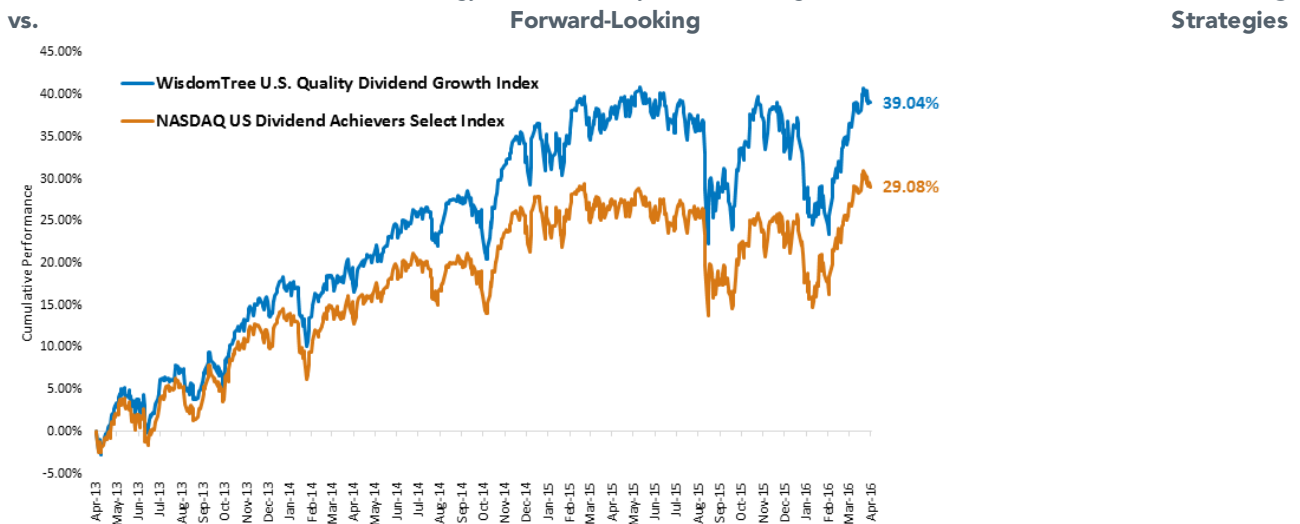


QUALITY DIVIDEND GROWTH: THE COST OF LOOKING BACKWARD

Tripp Zimmerman — Director, Research
05/06/2016

More than three years ago, WisdomTree realized that indexes focused on historical [dividend growth](#) and exchange-traded funds designed to track these backward-looking dividend indexes were extremely popular. While this seems like a smart idea, it keeps many investors from capitalizing on shifting trends in the dividend landscape and positioning for the future, specifically when it comes to newer payers and firms recovering from recent dividend contractions. Take Apple, for example.¹ Apple is currently the largest dividend payer in the United States but only started paying [dividends](#) again in 2012². So if an index is using backward-looking screens that go back 10 to 20 years, as some do, it won't include Apple for some time to come. Always looking to innovate, WisdomTree created a forward-looking dividend growth Index that seeks to capture dividend growth trends that often are not captured by backward-looking indexes. The [WisdomTree U.S. Quality Dividend Growth Index \(WTDGI\)](#) looks at [fundamental](#) metrics that could indicate future dividend growth potential. Two variables govern stock selection: • **Quality:** Defined as companies with high [return on equity \(ROE\)](#) and high [return on assets \(ROA\)](#)—both key profitability metrics tied to dividend growth potential • **Growth:** Defined as companies with high expected [earnings growth](#), as future dividends must be funded from the cash flow a company generates. It is important to note that WisdomTree's Dividend Indexes do not require historical dividend growth to be eligible for inclusion. We believe companies with a long history of dividend growth may not be the key drivers of tomorrow's dividend growth and that it's necessary to be more dynamic in the selection criteria to capture the current shifting trend in the U.S. dividend market. To quantify the cost of looking backward for dividend growth over the past three years, the chart below shows the performance of WTDGI against its benchmark, the [NASDAQ US Dividend Achievers Select Index](#), whose methodology includes a 10-year dividend growth look-back screen. **Backward-Looking**



Sources: WisdomTree, Bloomberg, 4/11/13–4/11/16. Date was chosen to reflect the three years since WTDGI's inception. 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.

• **Information Technology**

Added to Outperformance: WTDGI's forward-looking methodology and quality bias have resulted in the Index being

over-weight the Information Technology sector compared to indexes reliant on backward-looking dividend growth trends. This over-weight has added to its relative performance since inception, which makes sense to us, because the sector is also a dividend growth leader. To look at Apple again: after reinstating dividend payments back in 2012, the company has grown its dividend by 50% on a cumulative basis, or over 11% on an average annual basis.³ Yet a 10-year backward-looking dividend growth methodology would exclude Apple until at least 2022. **Preparing for the Future** We believe that backward-looking strategies can keep the companies growing their dividends the fastest out of a portfolio. While no approach can predict which firms will increase future dividends, we believe that being broad, flexible and forward-looking will enable WTDGI to more quickly respond to—and better capitalize on—the changing U.S. dividend landscape. In turn, we believe this methodology will track the performance of the companies growing their dividends the fastest today—and tomorrow. Another important metric we feel can be [an indication for longer-run real returns](#) is considering dividends and share [buybacks](#) together, and WTDGI is one of our most attractive Indexes on that measure. ¹As of 4/11/16, Apple was a 3.3% weight in the [WisdomTree U.S. Quality Dividend Growth Index](#). ²Source: WisdomTree, Bloomberg, As of 5/2/16. ³Sources: WisdomTree, Bloomberg; refers to dividend growth from dividend ex-date over the period of 8/9/12 to 05/05/16.

Important Risks Related to this Article

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

For more investing insights, check out our [Economic & Market Outlook](#)

Dividend growth : The growth in trailing 12-month dividends for the specified universe.

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

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

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

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.

Earnings growth estimates : Bloomberg analysts' long-term earnings growth expectations, which encompass the estimated growth in operating earnings per share over the company's next full business cycle, typically three to five years.

NASDAQ US Dividend Achievers Select Index : Designed to track the performance of dividend-paying companies in the U.S. that have increased their annual dividend payments for the last 10 or more consecutive years.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.