POSITIONING FOR ECONOMIC GROWTH WITH MID CAP STOCKS

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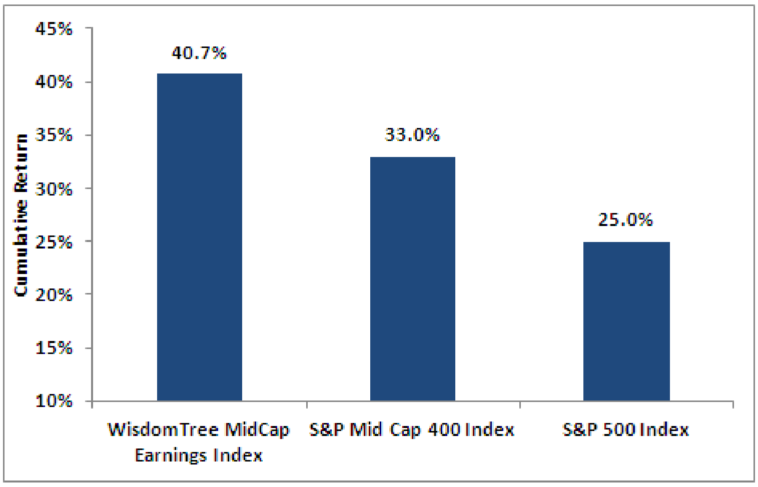
I recently reviewed the WisdomTree SmallCap Earnings Index as a way to potentially benefit from an economic recovery in the United States. Below I discuss similar reasons to also consider the mid-cap segment of the market—along with valuation considerations, given the major moves we have seen in that market. **WisdomTree MidCap Earnings Index (MidCap Earnings): Outperformance (7/31/2012–7/31/2013)**



Source: Bloomberg. Past performance is not indicative of future results.
You cannot invest directly in an index.

Average Annual Returns (as of 6/30/2013)

Index	WT Index Inception Date	1-Year	3-Year	5-Year	Since WT Index Inception	10-Year
WisdomTree MidCap Earnings Index	2/1/2007	30.98%	20.91%	13.21%	8.07%	N/A
S&P Mid Cap 400 Index		25.18%	19.45%	8.91%	6.91%	10.74%
S&P 500 Index		20.60%	18.45%	7.01%	3.98%	7.30%

Sources: WisdomTree, Bloomberg. Past performance is not indicative of future results.
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For definitions of indexes in the charts, please visit the Glossary. • **MidCap Earnings Performed Strongly**: Whether one looks at one-year, three-year, five-year or even since-inception returns, MidCap Earnings has done well compared to the S&P MidCap 400 Index (S&P 400) and the S&P 500 Index, possibly the most widely followed measure of U.S. equity market performance. • **Consumer Discretionary & Industrials**: The changing tone coming out of the Federal Reserve could signal an improving economic picture for the U.S. If this is indeed the case, U.S. consumers may ultimately pick up their consumption. As of July 31, 2013, compared to the S&P 400, MidCap Earnings had an approximate 3.1% over-weight (16.6% vs. 13.5%) in the Consumer Discretionary sector and an approximate 2.3% over-weight (18.7% vs. 16.4%) in the Industrials sector. This coincides with a broader measure of exposure to the more defensive sectors[1] —sectors that generally underperform as economic growth rises and the economy improves. As of July 31, 2013, defensive sector exposure was at approximately 16.6% for MidCap Earnings and 19.4% for the S&P 400. As a point of reference, the S&P 500 Index's exposure to defensive sectors was nearly 30% at the same point in time, and it helps to explain the relative performance differences over the one-year period described above. **Characterizing the Strong One-Year Performance**

For the one-year period ending July 31, 2013, MidCap Earnings outperformed the S&P 400 by nearly 8% and the S&P 500 Index by almost 16%. We believe the two crucial questions are: • What drove this outperformance? • After such outperformance, are valuations becoming expensive? **Mid-Cap Stocks Deliver on a One-Year Basis** For the S&P 400, 9 out of 10 sectors delivered positive cumulative performance for the one-year period ending July 31, 2013. For MidCap Earnings, this figure is 10 out of 10. What this tells us is that, generally speaking, mid-cap stocks performed well over the past year. The main drivers of the MidCap Earnings outperformance were: • **Stock Selection**: MidCap Earnings has a rebalancing process that, each year, refocuses solely on companies that were able to deliver positive profits for the year preceding the screening date, occurring annually on November 30[2] . This stock selection process contributed to the lion's share of the nearly 8% outperformance compared to the S&P 400; being over- or under-weight in different sectors proved much less influential. • **Financials, Consumer Discretionary and Information Technology**: It was in these three sectors that the MidCap Earnings stock selection added the most value compared to the S&P 400's performance over the one-year period ending July 31, 2013. The differences in performance by sector (MidCap Earnings vs. S&P 400) were: Financials: 39.8% vs. 24.6%; Consumer Discretionary: 50.1% vs. 33.6%; Information Technology: 33.6% vs. 23.2%. **Valuation and the Importance of the Annual Rebalance** We all recognize that, at times, stocks or sectors can have a run of strong performance and then become more expensive relative to their fundamentals. Market capitalization-weighted indexes reward firms with higher market caps with greater weights—which means they tend to have greater weights in stocks that have recently performed strongly. Rebalancing back toward a fundamental factor—such as earnings—actually unlinks the share price from constituent weights in an index, in essence rewarding greater profit generators—rather than greater stock price performance—with higher weights. A potential result could be a lower valuation compared to a market capitalization-weighted approach. Utilizing the three sectors discussed earlier—Financials, Consumer Discretionary and Information Technology—as well as the indexes as a whole, let's compare a few different valuation metrics: **MidCap Earnings vs. S&P 400 Valuation Metrics (as of 7/31/2013)**

	Index	Price-to-Earnings (P/E) Ratio	Price-to-Book Ratio	Price-to-Cash Flow Ratio
Financials	MidCap Earnings	14.7x	1.3x	10.7x
	S&P 400	19.7x	1.8x	11.3x
Consumer Discretionary	MidCap Earnings	14.4x	3.4x	10.6x
	S&P 400	17.4x	3.3x	14.7x
Information Technology	MidCap Earnings	14.3x	2.2x	11.6x
	S&P 400	17.5x	2.9x	15.2x
Full Index	MidCap Earnings	14.6x	2.0x	9.3x
	S&P 400	17.5x	2.3x	11.3x

Past performance is not indicative of future results.

For definitions of terms in the chart, please visit our Glossary. In every metric except for one (Consumer Discretionary on a price-to-book ratio) MidCap Earnings exhibits a lower valuation than the S&P 400. Even though these sectors are the three most responsible for MidCap Earnings' nearly 8% outperformance of the S&P 400 over the past year, it is difficult, based on these figures, to make the case that they are becoming "expensive." Moreover, we are more than halfway through the year. This Index will undergo a rules-based rebalancing process in December (based on a November 30 Index screening) to make adjustments to securities and their weights based on changes in relative value of the component securities. With the Index up 40% over the prior one-year period it will be a good year to make adjustments and reduce weight to those companies that have appreciated more than their underlying fundamentals (their *Earnings Streams*) at the rebalance. WisdomTree believes a disciplined process of rules-based rebalancing back to fundamentals is important, but it could be especially important in the mid-cap sector, given the large moves we have seen over the prior one-year period. [1]Defensive sectors: Consumer Staples, Health Care, Telecommunication Services, Utilities. [2]Specifically, positive cumulative core earnings for the four quarters preceding the Index screening date. Core earnings are a means to focus more on earnings from operations and less on earnings derived from one-time events, such as the sale of a subsidiary.

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You cannot invest directly in an index.

DEFINITIONS

WisdomTree SmallCap Earnings Index (WTSEI) : measures the performance of earnings-generating companies within the small-capitalization segment of the U.S. Stock Market. The index is comprised of the companies in the bottom 25% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

S&P MidCap 400 Index : provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market, and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an on-going basis.

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.

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.

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

Earnings Stream® : Earnings per share x the number of shares outstanding. For an index, these totals are added for all constituents.