BASIS POINTS MATTER, ESPECIALLY OVER THE LONG TERM

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At WisdomTree, we are fortunate to have a rich tapestry of investment strategies with 10 years or more of live performance history. When looking at our U.S. Earnings Indexes, we find the following:[1]

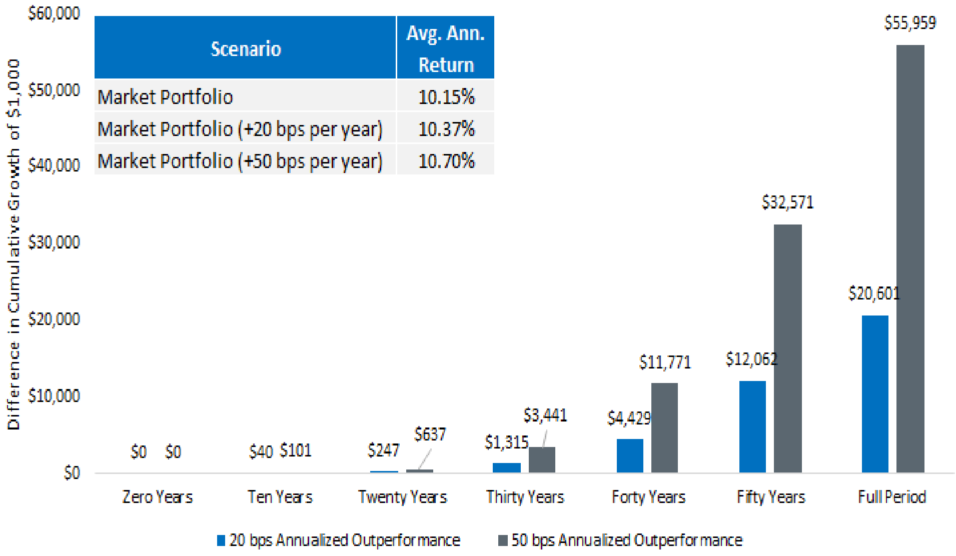
- **Broad Based:** The WisdomTree Earnings Index outperformed the Russell 3000 Index, 7.77% to 7.40%, 33 basis points (bps) per year since inception.
- **Large Cap:** The WisdomTree Earnings 500 Index outperformed the S&P 500 Index, 7.50% to 7.34%, 16 bps per year since inception.
- **Mid-Cap:** The WisdomTree MidCap Earnings Index outperformed the S&P MidCap 400 Index, 9.74% to 9.05%, 69 bps per year since inception.
- **Small Cap:** The WisdomTree SmallCap Earnings Index outperformed the Russell 2000 Index, 8.56% to 7.09%, 147 bps per year since inception.

The issue: *Particularly in the broad market and large-cap areas, clients tend to tell us that the margin of outperformance over this long period isn't large enough to be "exciting" or at least enough of a catalyst to think about diverging from looking at market capitalization-weighted "beta" indexes.*

How Important Is 20 Basis Points?

To put a round number to it, we took a step back and did the math to determine how much of a real difference 20 basis points of incremental, annualized outperformance actually is. We also looked at a 50-bps annualized outperformance.

Incremental Difference in Growth of Hypothetical $1,000 over Specified Periods (June 30, 1963, to March 31, 2017)



Sources: WisdomTree, Kenneth French Data Library. Period is from 6/30/1963 to 3/31/17. Performance is hypothetical.

- The analysis starts with the market portfolio, which includes all U.S.-listed equities, market capitalization weighted. We then took the monthly returns and increased them in the appropriate fashion in order to equate to approximately 0.20%, or 0.50% per year. Due to compounding over a period greater than 50 years, the actual percentages weren't EXACTLY 0.20% and 0.50% (rather, about 0.22% and 0.55%).
- If we recognize that with the assumption of only a hypothetical $1,000 going in and nothing further being contributed, at the 10-year mark, yes, there is a difference compared to the market, but one cannot say it's a huge difference. The way compounding works—and what makes investing so hard in our society of instant gratification—is that the picture doesn't start to get exciting until 30 to 50 years. But the point here is that it gets REALLY exciting. Over a 50-year period, an approximate outperformance over the market return of 20 bps led to more than $12,000, hypothetically. This figure was more than $32,500 at the 50-bps level.

While many people aren't necessarily buying their investments with a 50-year holding period in mind, we do know that a popular term these days is "goals-based investing." With increased life expectancies, even if people aren't thinking 50 years ahead in their portfolios, there are certainly people out there with goals referring to 50 years into the future. Although 20 bps may not seem like much this year, next year or even next decade, over a goals-based horizon of multiple decades, it's possible that it will add up.

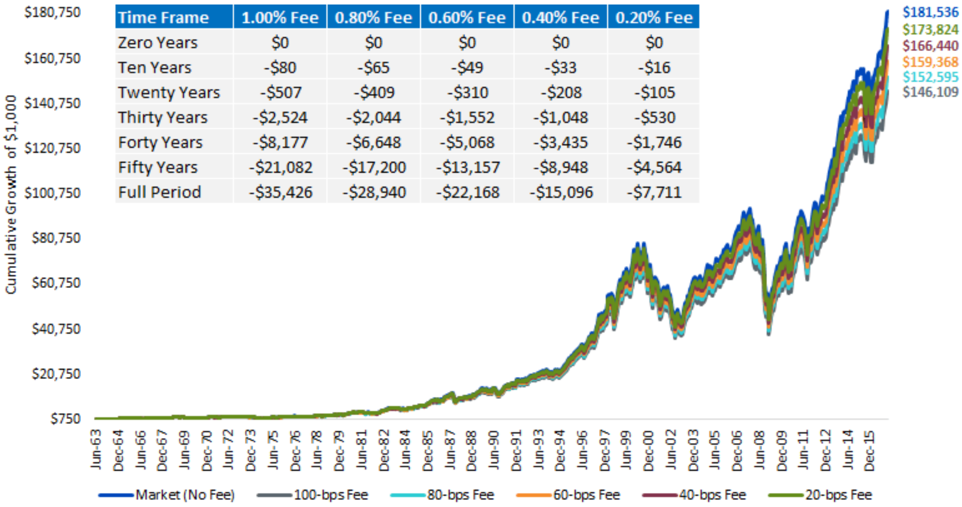
The Market Immensely Values EVERY Basis Point

While it is absolutely true that we speak each day to investors who may not even raise their eyebrows at 10, 20 or 30 bps of annualized outperformance, we know that the collective U.S. market of investors absolutely cares—A LOT—about every single basis point. Otherwise, why would we be talking about "fee wars" or replacing human-led investment teams with algorithmic approaches? It's a classic illustration of "framing."

- **Scenario 1:** There is a portfolio with the potential to generate 10–30 bps of incremental outperformance over time with a rules-based investment process and a decade-plus track record.
- **Scenario 2:** There is a portfolio that just saw 10–30 bps of incremental fee reduction.

The current environment seems much more apt to respond to Scenario 2 than Scenario 1.

Cumulative Growth of Hypothetical $1,000 under Different Fee Scenarios (June 30, 1963, to March 31 2017)



Time Frame	1.00% Fee	0.80% Fee	0.60% Fee	0.40% Fee	0.20% Fee
Zero Years	$0	$0	$0	$0	$0
Ten Years	-$80	-$65	-$49	-$33	-$16
Twenty Years	-$507	-$409	-$310	-$208	-$105
Thirty Years	-$2,524	-$2,044	-$1,552	-$1,048	-$530
Forty Years	-$8,177	-$6,648	-$5,068	-$3,435	-$1,746
Fifty Years	-$21,082	-$17,200	-$13,157	-$8,948	-$4,564
Full Period	-$35,426	-$28,940	-$22,168	-$15,096	-$7,711

Sources: WisdomTree, Kenneth French Data Library

- We start out by assuming again that there is a market portfolio holding all publicly listed U.S. equities. A hypothetical $1,000 in this portfolio from June 30, 1963, to March 31, 2017, would have grown to more than $181,500.
- If an investor were paying an annual fee of 1.00%, instead of getting to the $181,536 level, that investor would have gotten to a level of only approximately $146,109 (a $35,427 difference). If the annual fee were instead 0.20%, this difference would have been only $7,712, and the hypothetical growth would have gotten all the way to $173,824. So the difference between the 1.00% fee and the 0.20% fee is about $27,700 over this period.
- Similar to what we saw earlier, the benefit of lowering fees is not over the short term but rather over the long term. The difference over the first 10 years, for instance, was not all that great.

Passive vs. Active vs. Rules Based

So a big debate in today's market regards whether it makes sense to be "active" or "passive." In our opinion, any basis points that an investor can get from either outperformance or lower costs absolutely matter over the long run. This is why WisdomTree developed a suite of low-cost[2] index-based investing options that we believe have potential to add to performance while mitigating costs.

[1]Source: Bloomberg, for period from 2/1/07 to 3/31/17.

[2]Ordinary brokerage commissions apply.

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.

For more investing insights, check out our Economic & Market Outlook

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DEFINITIONS

Russell 3000 Index : Measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

Basis point : 1/100th of 1 percent.

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.

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.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

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.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Framing : a behavioral finance concept for how investors view the same or similar outcomes differently depending on how the information is presented. .

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

Active : Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.