RISING RATES IMPACT

Jeremy Schwartz — Global Head of Research
09/16/2013

Since May, indexes focused on higher-yielding stocks have underperformed the broad market, largely as a result of the steady increase in interest rates. In a previous blog post, I looked at the overall performance impact the rising interest rates had on different dividend indexes. Below, I will take a closer look at the performance attribution and underlying exposures that caused the performance divergences. **Federal Reserve (Fed) Taper Talk Caused Interest Rates to Rise** Starting in May this year, longer-term interest rates in the U.S. rose considerably on just a hint the Fed could begin tapering its bond purchases later in the year. Between May 1 and August 20, 2013, the 10-Year Treasury yield increased 118 basis points to 2.81%.[1] **A Detailed Look at Attribution** In the chart below, I take a detailed look at the sector composition and underlying performance of a few indexes that I recently highlighted here. The indexes below include the best-performing of the analyzed indexes (WT SmallCap Earnings), the one with the lowest return (Morningstar Dividend Yield Focus) and one from the middle ground (WT U.S. Dividend Growth) focused on dividend growth that held up better than the high-dividend-yield indexes. **Index Sector Performance**

	Average Weight			Performance		
Sectors	WT SmallCap Earnings Index	WT U.S. Dividend Growth Index	Morningstar Dividend Yield Focus Index	WT SmallCap Earnings Index	WT U.S. Dividend Growth Index	Morningstar Dividend Yield Focus Index
Telecom Serv.	1.4%	0.0%	15.2%	14.9%	0.0%	-9.1%
Utilities	1.3%	0.1%	13.6%	-0.1%	-4.2%	-7.8%
Cons. Staples	4.3%	19.1%	15.5%	11.9%	-2.5%	-5.6%
Cons. Discret.	19.9%	19.9%	4.3%	13.9%	3.7%	-5.2%
Energy	4.9%	3.0%	7.9%	7.7%	5.5%	-0.3%
Info. Tech.	14.6%	20.4%	13.8%	16.5%	4.9%	-0.2%
Health Care	6.2%	8.0%	22.3%	12.1%	8.0%	2.8%
Materials	6.2%	4.1%	2.7%	10.3%	1.4%	7.9%
Financials	24.0%	5.7%	1.5%	13.2%	10.5%	14.9%
Industrials	17.2%	19.7%	3.1%	11.6%	8.6%	18.9%
	WT SmallCap Earnings Index	WT U.S. Dividend Growth Index	Morningstar Dividend Yield Focus Index	WT SmallCap Earnings Index	WT U.S. Dividend Growth Index	Morningstar Dividend Yield Focus Index
Total	100.0%	100.0%	100.0%	12.79%	4.30%	-2.05%

Sources: Bloomberg, WisdomTree (04/30/13–08/20/13). Past performance is not indicative of future results. You cannot invest directly in an index. Subject to change.

For definitions of indexes in the chart, please visit our Glossary. • **High-Yield Stocks Underperformed** – A look at the Morningstar Dividend Yield Focus Index reveals that the typically higher-yielding sectors (Consumer Staples, Utilities and Telecommunications) had the worst performance since April 30. Each of these sectors represented at least 13% of the index and 44.3% in aggregate. • **Performance Divergences Even among Sectors** – Looking at specific sectors across the indexes, we see vastly different constituent performance, which is largely a result of selection methodology. A closer look at the Consumer Discretionary sector reveals how the WT SmallCap Earnings and WT U.S. Dividend Growth Indexes outperformed the Morningstar Dividend Yield Focus Index by 19.1% and 8.9%, respectively, from a stock selection basis. It is also important to note that all the underlying constituents in both the WT U.S. Dividend Growth and Morningstar Dividend Yield Focus indexes are dividend payers, but the WisdomTree Index focuses on potential dividend growers while the Morningstar index focuses on high-dividend yielders. • **Cyclical Sectors Outperformed** – Some of the best-performing sectors during the period for all indexes above were the cyclical sectors. These sectors are usually tied more closely to economic growth and tend to perform well when the economy is growing or expectations are improving. Cyclical sectors are characteristically some of the lower-yielding sectors, and indexes that select based on dividend yield are typically under-weight in these sectors compared to the broad market. **Diversifying for the Future** The recent rising rate environment has signaled an improving U.S. economic picture for some. If this is indeed the case and rates continue to increase, it could be beneficial to diversify dividend-paying equity exposure away from sectors that are most sensitive to rising interest rates and into sectors that could benefit from economic growth. This coincides with a broader exposure to more cyclical sectors (lower yield and higher dividend growth) and potentially less exposure to the more defensive (higher-yielding) sectors. To read more on this topic, please see the market insight we published here. [1]Source: Bloomberg

Important Risks Related to this Article

Diversification does not eliminate the risk of experiencing investment loss. Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.

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

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Tapering : A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Treasury yield : The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

Basis point : 1/100th of 1 percent.

Cyclical sectors : Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.

Defensive sectors : Consumer Staples, Health Care, Telecommunication Services and Utilities.