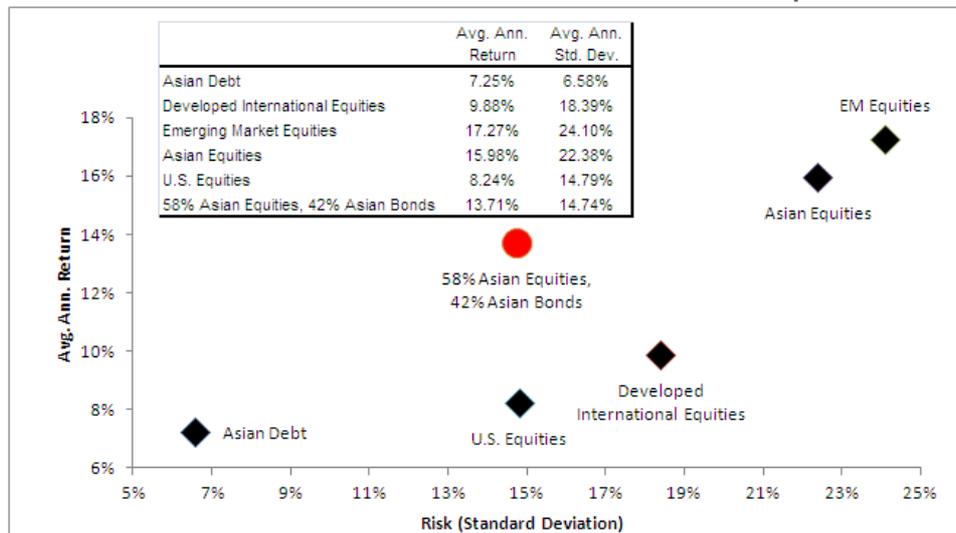


# RETHINKING STRATEGY TO INCREASE ALLOCATIONS TO ASIA

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My [last blog](#) on Asian equities (represented here by the [MSCI AC Asia Pacific ex Japan Index](#)) discussed my bullish view on this region for 2013 because of relatively attractive valuations and an analysis of forward returns from similarly attractive price points. Of course, one must recognize that Asian equities typically display higher risk levels than U.S. equities (represented by the [S&P 500 Index](#)) or developed international equities (represented by the [MSCI EAFE Index](#)), and almost as much risk as Emerging Markets (EM) Equities (represented by the [MSCI Emerging Markets Index](#)) over the past decade. One traditional approach used to manage risk in asset allocation is combining higher-risk assets such as equities with lower-risk assets such as bonds in a multi-asset framework. In this piece, we look at such a portfolio combination of Asian equities with Asian bonds (represented by the [HSBC Asian Local Bond Index \(ALBI\)](#)) to evaluate potential mixes with various risk profiles. **Targeting the Blend** While we recognize that every situation is different, it is useful to start any asset allocation discussion with a goal in mind. In this case, we asked whether there was a particular combination of Asian equities and Asian bonds that, over the past 10 years, delivered approximately the same level of risk as U.S. equities. We start here because U.S. investors tend to overweight their portfolios toward domestic assets.

## The 60/40 Framework—Similar Risk to U.S. Equities over the Past Decade



Period: 2/28/2003 to 2/28/2013. Sources: Zephyr Style ADVISOR, Bloomberg  
Past performance is not indicative of future results.

(For definitions of terms in this chart, please see our [Glossary](#).)

- **Asian Debt:** Delivered an average annual [standard deviation](#) that was approximately one-quarter that of Asian equities and less than half that of U.S. equities over the period. Asia’s debt—specifically its [sovereign debt](#)—registered a [yield to maturity](#) of 3.59% and a [duration](#) of 5.63 years—all while being 94% investment grade as of February 28, 2013.
- **58% Asian Equities/42% Asian Bonds:** The combination (very close to a 60%/40% equity/bond model) delivered approximately the same level of average annual standard deviation as did U.S. equities over the past 10 years. However, the 58/42 equity/bond combination exceeded the average annual return of U.S. equities by nearly 5.5%. Of course, there is no way to know whether this combination will produce a level of risk comparable to U.S. equities over the next 10 years, but we believe it is a worthwhile illustration of how a multi-asset class approach could have the potential to lower the volatility experienced by Asian equities alone. **Another Tool in the Search for Income Generation** When considering the aforementioned blend of Asian equities and Asian bonds, we

believe that another useful attribute could relate to the current low interest rate environment. The truth of the matter is that traditional income-producing assets—such as 10-Year U.S. Treasury Notes or high-quality fixed income ([Barclays U.S. Aggregate Bond Index](#))—remain at very low levels. As of February 28, 2013, Asian equities exhibited a higher [trailing 12-month dividend yield](#) than U.S. equities, and Asian bonds exhibited a higher yield to maturity than both high-quality fixed income and 10-Year U.S. Treasury Notes. **Further Potential Benefits with a Fundamental Focus** WisdomTree focuses on Asia with strategies for both equities and debt markets. The main difference regards a separation of market capitalization from weighting, instead focusing on fundamentals. In the coming years, Asian countries have the potential to be engines of global growth. We believe that multi-asset-class exposure as well as a fundamental focus could have strong potential. *For more information on the subject, read our research [here](#).*

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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You cannot invest directly in an index.

## DEFINITIONS

**MSCI AC Asia Pacific ex Japan Index** : The MSCI AC Asia Pacific ex Japan Index captures large and mid cap representation across 4 of 5 Developed Markets countries (excluding Japan) and 8 Emerging Markets countries in the Asia Pacific region. With 683 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Developed Markets countries in the index include: Australia, Hong Kong, New Zealand and Singapore. Emerging Markets countries include: China, India, Indonesia, Korea, Malaysia, the Philippines, Taiwan and Thailand.

**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.

**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 Emerging Markets Index** : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

**HSBC Asian Local Bond Index (ALBI)** : The HSBC Asian Local Bond Index tracks the total return performance of liquid bonds denominated in the local currencies in China, Hong Kong, India, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand. Country weightings are driven by market capitalization, liquidity, accessibility, and market development, while security weightings within the countries are based on market capitalization.

**Standard deviation** : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

**Sovereign Debt** : Bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth.

**Yield To Maturity** : Portfolio Yield to Maturity represents the weighted average yield to maturity of a Fund's investments in money market securities and fixed income securities as a specified date. Yield to maturity is the rate of return generated on these securities, assuming interest payments and capital gains or losses as if the instrument is held to maturity. The weighted average yield is calculated based on the market value of each security. The calculation does not incorporate yield from any derivative instruments that are part of the Fund's investments.

**Duration** : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

**Barclays U.S. Aggregate Bond Index, 1-3 Year** : This index is the 1-3 Yr component of the U.S. Aggregate index.

**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.