

# HOW SMALL IS YOUR SMALL-CAP INDEX?

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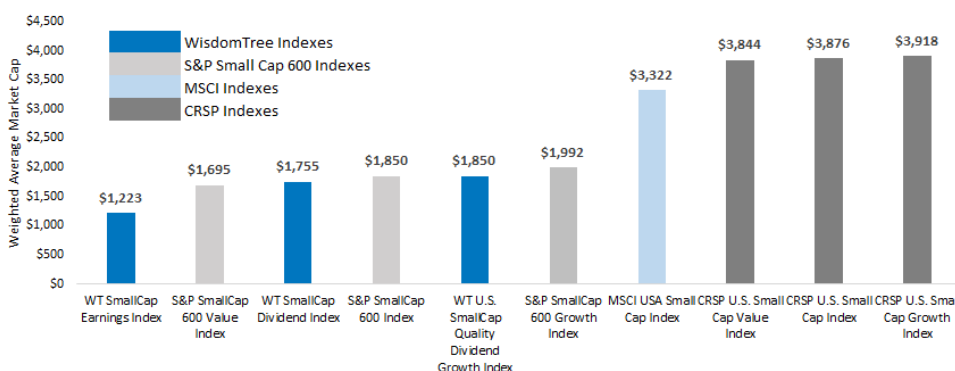
After Donald Trump’s presidential election victory on November 8, 2016, U.S. small-cap stocks enjoyed a significant upward move. We believe further interest is justified in the following scenarios:

- If there is corporate tax reform, we’ve found that [small-cap stocks do in fact tend to pay higher effective tax rates](#) than large-cap stocks. If the statutory rate for U.S. corporations is lowered from the current 35% to 25% (or lower), [the biggest incremental impact could hit profitable, small-cap companies.](#)
- If U.S. Federal Reserve (Fed) policy does lead to a stronger U.S. dollar, small-cap stocks, which garner most of their revenues from within the U.S., as opposed to exports, could see less of a headwind to their competitiveness than large caps, which tend to be much more globally oriented.

## But What Is a Small Cap?

Interestingly, there are no universally accepted definitions for large caps, mid-caps or small caps. WisdomTree often defines its small-cap Indexes using a concept that determines the percentage of total [market cap](#) of its respective universes. For reporting purposes, we also broadly categorize size according to the following classifications: Stocks with market capitalizations below \$2 billion constitute small caps, while stocks between \$2 billion and \$10 billion constitute mid-caps and stocks above \$10 billion constitute large caps.

## How Different Are Commonly Followed U.S. Small-Cap Indexes? (data in millions)



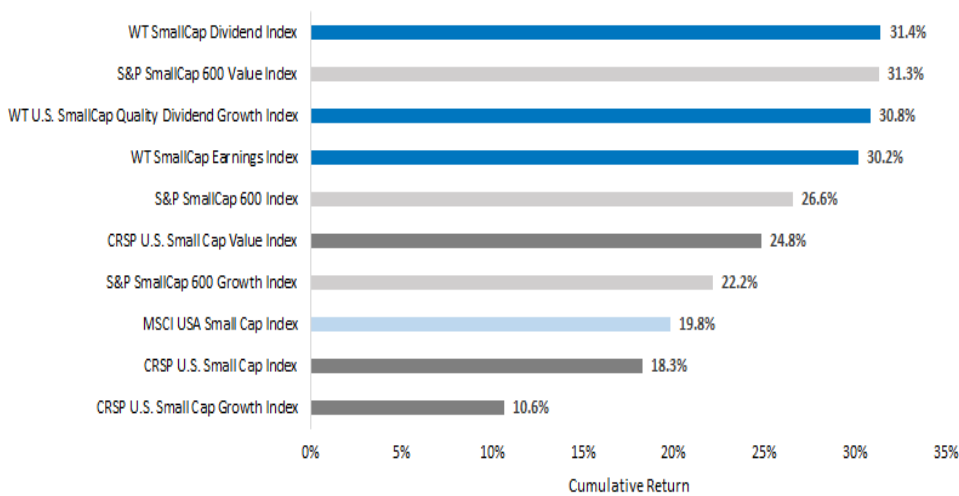
Sources: WisdomTree, Bloomberg, with data as of 12/31/16. Due to data access, Russell Indexes are not shown. You cannot invest directly in an index.

*For definitions of indexes in the chart, visit our [glossary](#).*

## A Key Size Metric

- **Weighted Average Market Capitalization:** This is an important metric to consider in that it combines the actual market capitalization size of the firms with the weighting mechanism of the Indexes. The [WisdomTree SmallCap Earnings Index](#) is weighted by earnings, whereas the [WisdomTree SmallCap Dividend](#) and [U.S. SmallCap Quality Dividend Growth Indexes](#) are weighted by [dividends](#). Stocks that are 1) included and then 2) weighted more highly would have the greatest influence.
- **WisdomTree SmallCap Earnings Was the Smallest:** In terms of weighted average market capitalization, it was the smallest index at approximately \$1.2 billion.
- **WisdomTree & S&P SmallCap 600 Indexes** shown in this chart all generally find themselves in that “below \$2 billion” category. This is distinctly different from the MSCI and CRSP Indexes—notable in that the CRSP Indexes have weighted average market capitalizations approaching \$4.0 billion, three times larger than the WisdomTree SmallCap Earnings Index. This raises the question, is the CRSP U.S. Small Cap Index really weighted more toward the mid-cap spectrum?

**Does Size Exposure Matter in Small Caps?**



Sources: WisdomTree, Bloomberg, with data for 2016 from 12/31/15 to 12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

- **Smaller Weighted Average Market Cap=Better Performance in 2016:** While we certainly couldn’t say that this would always be the case, the more important point is that—even though these are all Indexes focused on U.S. small-cap stocks—there was a spread of greater than a cumulative 20% between the top and bottom performers. It clearly matters how the exposure is garnered. 2016 is an example of a year when the small-cap theme worked well, and it’s interesting that the small-cap Indexes from CRSP and MSCI that had higher weighted average market capitalizations did not perform as strongly.
- **Value Led Growth in 2016:** WisdomTree’s Dividend Indexes reached their 10-year anniversary of live performance on June 1, 2016, while WisdomTree’s Earnings Indexes hit this same milestone on February 1, 2017. During both of these distinct 10-year periods, the growth style generally outperformed the value style across the market capitalization size spectrum. However, 2016 showed an important shift in the small-cap Indexes we discuss here, with the value style outperforming the growth style. Whether or not value continues to perform well, it’s important to note that WisdomTree’s focus on a relative value [rebalance](#) is important in helping mitigate the risk of exposure to stocks that might have outperformed their [fundamentals](#), thereby refreshing [valuation](#) characteristics on an annual basis.

**WisdomTree’s Earnings Indexes Hit 10 Years of Live History**

If people asked us—assuming that the corporate tax reform proposed by President Trump passed in some version—what our strongest small-cap offering would be, we would cite the WisdomTree SmallCap Earnings Index. This Index has 10 years of live calculation and includes only profitable companies—in other words, the ones that would benefit from a reduction in taxes, as opposed to those with negative earnings. It additionally has a strong historical track record of generating returns when interest rates have risen—a consequence we believe to have high potential if President Trump’s stimulus plans are passed.

**Important Risks Related to this Article**

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

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development.

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](#)

View the online version of this article [here](#).

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You cannot invest directly in an index.

## DEFINITIONS

**Market Capitalization** : 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.

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

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Growth** : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

**Rebalance** : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

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

**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.