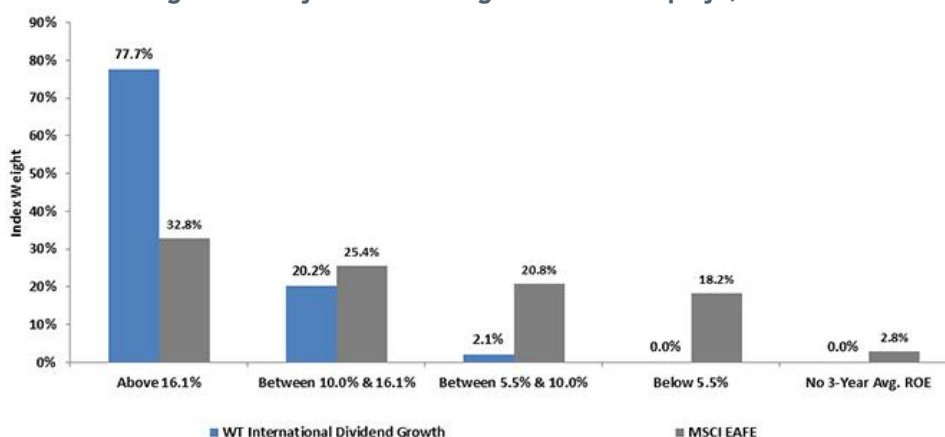


# BUFFETT'S ACQUISITION RULES APPLIED INTERNATIONALLY

Christopher Gannatti — Global Head of Research  
06/25/2015

One of our most popular blog posts in 2015 focused on characterizing the types of companies that [Warren Buffett and Berkshire Hathaway might see as interesting acquisitions targets](#). There was one criterion in particular that we found interesting: “Businesses earning good [returns on equity \(ROE\)](#) while employing little or no debt.”<sup>1</sup> In essence, this single line encapsulates the core focus of WisdomTree’s [dividend growth strategies](#), which apply a focus on quality companies around the world. **Exemplifying a “Quality Tilt”** When we say “quality” at WisdomTree, what we mean is a focus on the combination of: • Three-year average return on equity (ROE) *and* • Three-year average [return on asset \(ROA\)](#) Focusing on both penalizes firms that may have high return on equity through the use of [leverage](#) or, in other words, debt. **Impact of Focusing on Quality: 3-Year Average Return on Equity (as of 5/31/2015 WisdomTree Index**



Sources: Bloomberg, WisdomTree. Past performance is not indicative of future results. You cannot invest directly in an

Screening) index.  
indexes in the chart, visit our [glossary](#).

For definitions of

- **77.7% Weight in Stocks with Three-Year Average ROE above 16.1%:** We arrived at this 16.1% three-year average return on equity figure as the boundary denoting the top 25% of three-year average return on equity values for the [MSCI EAFE Index](#) universe. WisdomTree’s methodology finds and then weights its securities such that nearly 80% of the Index’s weight is in these highly profitable firms.

- **80.5% Weight in stocks with Three-Year Average Return on Assets above 6.8%:** While we don’t show it in the chart, this 6.8% figure is the three-year average return on assets figure that is the boundary for the top 25% in the MSCI EAFE Index universe. The idea of low leverage must connect these two figures.

- **Comparing to the MSCI EAFE:** The EAFE has approximately 30%–33% of its weight in the highest three-year average ROA and ROE quartiles, respectively, which sets the baseline for comparison. This means that WisdomTree’s International Dividend Growth Index is pushing more than twice the weight of the [market capitalization](#) benchmark into these respective top [quartiles](#), a significant focus on quality.

**Sector Manifestation of This Tilt** As a result of the global financial crisis of 2008–09, the word “leverage” found its way from the discussion of balance sheet statistics into more mainstream dialogue. As a result, the term became closely connected with Financials. Logically, an approach that focused on low leverage would necessarily have to under-weight

Financials. As of the May 31, 2015 Index Screening, the [WisdomTree International Hedged Dividend Growth Index](#) had an approximately 20% under-weight to Financials as measured against the MSCI EAFE Index. As bets against a benchmark go, we think the strength of this contrast duly emphasizes the commitment of WisdomTree's dividend growth Index methodology to focus on quality companies. **Quality Stocks with a [Currency Hedge](#) to Reduce Risk** The WisdomTree Index that includes this quality tilt also employs a currency hedge on top of the equities to just target the local market return of these foreign equities. WisdomTree believes that [currency hedging](#) is becoming increasingly important as a strategic baseline for global allocations due to its [risk](#) reduction properties, as we discussed in this [blog post](#). At a time when many investors are looking overseas for their additional portfolio allocations, the [WisdomTree International Hedged Dividend Growth Index](#) represents a marriage of two core ideas: a focus on quality companies positioned for growth, and the risk reduction properties of currency-hedged foreign allocations. <sup>1</sup>Warren Buffett, "Letter to Shareholders 2015," Berkshire Hathaway.

#### Important Risks Related to this Article

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 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](#).

## **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](http://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, 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**

**Return on Equity (ROE)** : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Quality** : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Leverage** : Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

**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.

**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.

**Quartile** : Statistical measure that groups a series of values into four groups after ranking them from lowest to highest. The first quartile will have the lowest values, whereas the fourth quartile will have the highest.

**Currency hedging** : Strategies designed to mitigate the impact of currency performance on investment returns.

**Risk** : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.