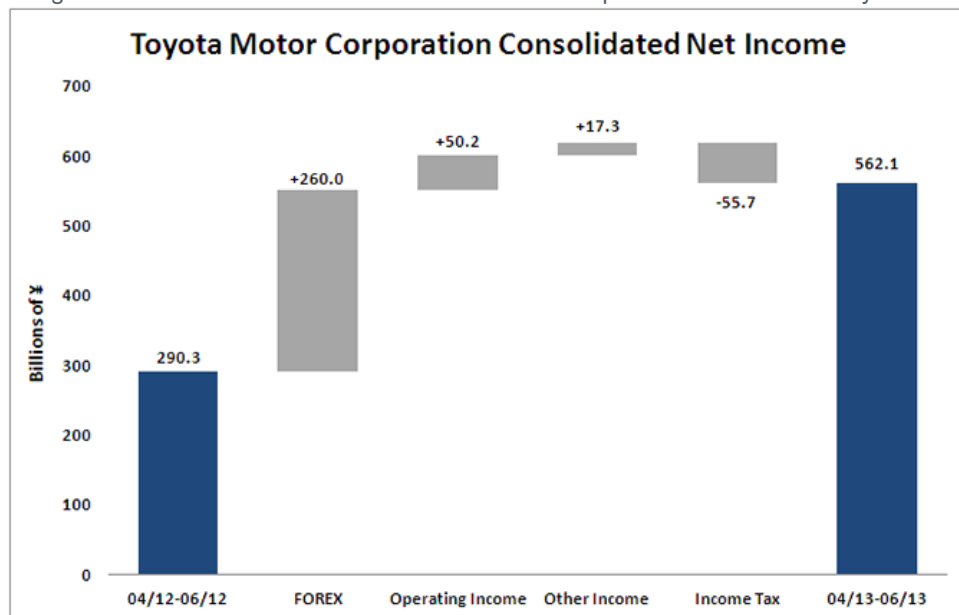


JAPANESE YEN WEAKNESS FLOWING THROUGH TO EXPORTERS' BOTTOM LINE

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Japanese stocks have soared since Shinzo Abe was elected prime minister based on the belief that his “Abenomics” policies will reinvigorate Japan. Abenomics focuses on a three-arrow policy of fiscal stimulus, monetary stimulus and structural reforms. All of Abenomics’ goals are aimed at one thing: promoting economic growth in Japan. **Weaker Yen Has Benefited Exporters’ Earnings** Thus far, the monetary stimulus has coincided with a weaker yen. A weaker yen ultimately helps large multinational companies that sell products overseas. Products of these companies generally become more attractive to foreign buyers when the yen weakens. Also, overseas sales converted back to a weak yen translate to more yen revenue, ultimately adding to the bottom line. The chart below illustrates the positive effect a weaker yen has had on



Source: Toyota FY2014 1Q Financial Results (August 2, 2013): Earnings Release Presentation.
Net Income above is attributable to Toyota Motor Corporation.
Time periods being compared are 04/01/12-06/30/12 and 04/01/13-06/30/13.

Toyota’s [net income](#).

For definition of FOREX, [click here](#).

For

• Yen Depreciation Dramatically Contributes to Earnings – The depreciation of the yen accounted for ¥260 billion of the ¥270.1 billion growth in net income over the same period last year. It is important to realize that Toyota’s gain from the yen depreciation is absolutely remarkable and represents over 95% of the total growth in net income for the period. **• Further Yen Depreciation Can Add to Future Profits** – If the yen continues to depreciate, it could potentially continue to add to Toyota’s bottom line. Toyota is forecasting to sell 9.1 million vehicles over their 2014 fiscal year, and 6.8 million (approximately 75%) of those are expected to be sold outside Japan.¹ These future overseas sales converted back to a potentially weaker yen translate to even more yen revenue. **• Toyota’s Stock Performance Also Strong** – Market participants have recognized the benefit a weaker yen has had on Toyota’s bottom line. As of this writing (August 23), Toyota’s total return has been 94%, while the broader [Tokyo Stock Price Index \(TOPIX\)](#) for Japan is up 53%, over the past year. The yen is down 21% over this same period.² **Other Automakers Also Benefit from a Weaker Yen**

Other large Japanese automakers have all benefited from a weakening yen due to their export-oriented business models. The list below shows the major automakers and the amount of reported income during their most recent earnings period compared to the same period of the preceding year. • **Honda** – Reported income of ¥172.0 billion, down ¥22.7 billion from the year before, even with a gain of ¥82.9 billion from currency effects.³ • **Nissan** – Reported income of ¥117.8 billion, down ¥2.9 billion from the year before, even with a gain of ¥69.8 billion from currency effects.⁴ • **Mazda** – Reported income of ¥36.5 billion, up ¥34.7 billion from the year before, with a gain of ¥29.2 billion from currency effects.⁵

Hedge Your Currency Exposure If the yen continues to weaken, Japanese exporters should continue to benefit. On the other hand, a weakening yen is not good for U.S. investors in Japanese equities—unless they hedge the currency. Currency-hedged strategies allow investors to focus on Japanese equities without the worry over currency declines. **Don't Forget about Small Caps** Japan's global revenue generators might be in favor due to recent yen weakness, while in the future the focus could shift more toward the domestically sensitive firms. Small-cap stocks typically export less and are more sensitive to the domestic economy than large-cap stocks. I think the majority of the smaller-cap stocks have yet to fully benefit from the structural reforms of Abenomics, which are still a work in progress and will play out over the next two years. WisdomTree has two different small-cap Indexes that track dividend-paying stocks in Japan. • **WisdomTree Japan SmallCap Dividend Index** – includes exposure to the yen • **WisdomTree Japan Hedged SmallCap Equity Index** – hedges out the currency risk

Conclusion All the actions by the Japanese government have the same goal: stimulate Japan's economic growth. The weaker yen has helped start the economic engine, but I feel we are still in the early innings of Japan's true transformation. If Japan's citizens are able to benefit from structural reforms and thus increase consumption and investments, and yen weakness continues to provide tailwind, the result could be very positive for Japan's equity investors. I remain optimistic on the prospects for Japanese equities. For current holdings of the WisdomTree Japan SmallCap Dividend Index, please click [here](#). For current holdings of the WisdomTree Japan Hedged SmallCap Equity Index, please [click here](#).¹Source: Toyota FY2014 1Q Financial Results (August 2, 2013).²Source: Bloomberg (08/23/13).³Source: Honda FY2014 1st Quarter Financial Results (July 31, 2013).⁴Source: Nissan FY2013 First-Quarter Financial Results (July 25, 2013).⁵Source: Mazda Consolidated Financial Results for the First Quarter of the Fiscal Year Ending March 31, 2014 (July 31, 2013).

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DEFINITIONS

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

Net income : A company's total earnings (or profit), which are calculated by taking revenues and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses.

Foreign Exchange (FOREX, FX) : The exchange of one currency for another, or the conversion of one currency into another currency.

Tokyo Stock Price Index (TOPIX) : A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

WisdomTree Japan SmallCap Dividend Index : Designed to provide exposure to dividend-paying small-capitalization companies in Japan.

WisdomTree Japan Hedged SmallCap Equity Index : Designed to provide exposure to Japanese equity markets while at the same time neutralizing fluctuations of the Japanese yen movements against the U.S. dollar.