YOUR TOOLKIT FOR RISING RATES

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2015 could be the year we finally see rising interest rates in the U.S. This creates an opportunity to reassess portfolios and asset classes and evaluate how they performed during historical periods of rising interest rates. While the past can never guarantee the future, historical context is important for understanding a phenomenon that we really haven't seen in a longer-term trend for approximately 30 years. **Bonds vs. Stocks** The critical question here—as in many environments—is stocks versus bonds. By design, the fixed nature of bond interest payments creates a bit of a headwind as rates rise. On the other hand, rising interest rates usually occur in tandem with rising inflation, and stocks have historically grown their dividends at a level above that of inflation over long periods.[1] **Big Picture:** To the extent that rising interest rates reflect rising growth expectations and rising inflation expectations, we believe that equities can see a tailwind and perform quite well over the medium to long term, even if U.S. Federal Reserve (Fed) activity (or inactivity) can cause some short-term volatility. **Further Distinctions to Be Made** Also here—as in many environments—it's not just stocks versus bonds, but types of stocks versus types of bonds. Within equities, we wanted to look at three categories: large caps (the S&P 500 Index), small caps (the Russell 2000 Index) and high-yielding dividend payers (the Dow Jones U.S. Select Dividend Index). While this certainly doesn't exhaust all equity possibilities, it does provide an interesting cross-section of a few major categories—indicating how they reacted in different periods of rising interest rates. Within fixed income, we examined the difference between a pure government bond exposure (interest rate risk, but not credit risk), a high-quality bond index and a high-yield bond index (less interest rate risk, more credit risk). Within equities, we looked at dividend-paying stocks. We'd expect higher-yielding dividend payers to face a headwind, while more growth-oriented companies could be better positioned to grow their dividends with rising interest rates and rising inflation. **We looked at times when the U.S. 10-Year Treasury note rose 100 basis points (bps) or more and saw the following: • High-Quality and U.S. Government Fixed Income Faced a Headwind:** Both the U.S. 10-Year Treasury note and the Barclays U.S. Aggregate Index experienced negative average returns during our rising rate periods. **• High-Yield Fixed Income Performed Better:** While the BofA Merrill Lynch High Yield Index delivered differentiated performance with respect to the other two fixed income options, it was still able to generate a positive average return during the rising rate periods. It actually outperformed an index of high-yielding dividend payers on an average annual basis over these periods. **• Equities Strong to Quite Strong:** Both the S&P 500 Index and the Russell 2000 Index tended to perform better during the rising rate periods than over the entire period. This fits with what we mentioned earlier—that equities can perform well when rising rates are signaling improvements in growth and generally rising inflation. **• Small Caps Were Especially Strong in Rising Rates:** With the exception of the first rising rate period, from October 15, 1993, to November 7, 1994, the Russell 2000 Index delivered a double-digit return in every period. Its average annual return during the rising rate periods was 15.1%, versus its average annual return during the full period at 8.6%.

		10/15/1993 - 11/7/1994	1/18/1996 - 6/12/1996	10/5/1998 - 1/20/2000	11/7/2001 - 4/1/2002	6/13/2003 - 6/14/2006	6/1/2005 - 6/28/2006	12/30/2008 - 6/10/2009	10/7/2010 - 12/15/2010	5/2/2013 - 9/5/2013	Average Return Rising Rates	Full Period Avg. Ann. Return
Fixed Income Returns	U.S. 10-Year Treasury Return	-12.1%	-7.6%	-9.2%	-6.6%	-0.6%	-4.8%	-13.9%	-8.4%	-9.5%	-8.1%	5.5%
	Barclays U.S. Aggregate Index	-4.8%	-3.4%	-1.4%	-2.1%	1.8%	-0.8%	-0.3%	-3.0%	-4.9%	-2.1%	5.6%
	BofA Merrill Lynch High Yield Index	0.5%	0.7%	3.0%	4.1%	8.6%	5.4%	33.0%	1.2%	-2.3%	6.0%	7.7%
Large Caps	S&P 500 Index	2.1%	11.4%	34.3%	3.1%	9.1%	6.2%	9.4%	6.9%	5.4%	9.8%	8.7%
High-Yielding Dividend Payers	Dow Jones U.S. Select Dividend Index	1.5%	9.0%	2.7%	16.6%	13.5%	6.1%	-6.0%	4.5%	1.2%	5.5%	10.9%
Small Caps	Russell 2000 Index	-1.3%	19.4%	38.9%	14.6%	15.3%	12.0%	13.2%	12.4%	11.8%	15.1%	8.6%

*Average Return Rising Rates: Average cumulative total return during periods of rising rates shown in the chart.
**Full Period Average Annual Return: Average annual total return for each Index from 10/15/1993 to 9/5/2013.
Source: Bloomberg. Data measured from 10/15/1993 to 6/30/2015. Periods of rising rates determined by an increase of at least 100 basis points in the 10-Year Treasury note interest rate. Past performance is not indicative of future results. You cannot invest directly in an index.

Rising Rate Solutions for Your Toolkit: • The WisdomTree U.S. Dividend Growth Fund (DGRW): DGRW tracks the performance of the

WisdomTree U.S. Dividend Growth Index before fees and expenses. This Index includes dividend-paying companies with relatively high growth and quality characteristics, historically placing very low weight in the Utilities and Telecommunication Services sectors. • **The WisdomTree U.S. SmallCap Dividend Growth Fund (DGRS):** DGRS tracks the performance of the WisdomTree U.S. SmallCap Dividend Growth Index before fees and expenses. This Index includes small-cap, dividend-paying companies with relatively high growth and quality characteristics, historically placing very low weight within the Utilities and Telecommunication Services sectors. • **The WisdomTree BofA Merrill Lynch High Yield Bond Negative Duration Fund (HYND):** HYND tracks the performance of the BofA Merrill Lynch 0-5 Year US High Yield Constrained, Negative Seven Duration Index before fees and expenses. This Index takes short positions in longer-maturity U.S. Treasury futures contracts to have the potential to profit if interest rates at the longer-maturity part of the yield curve rise. In the meantime, the underlying high-yield bonds may mitigate the cost of applying the Treasury futures positions while waiting for rates to rise. [1]Source: Professor Robert Shiller, with data measured from 12/31/1957 to 6/30/2015 for the S&P 500 Index universe.

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DEFINITIONS

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Inflation : Characterized by rising price levels.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

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.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

Dow Jones U.S. Select Dividend Index : The index is a modified market capitalization approach and weights by dividend yield. Stocks are selected for fundamental strength relative to their peers, subject to various screens such as dividend quality and liquidity.

Interest rate risk : The risk that an investment's value will decline due to an increase in interest rates.

Credit risk : The risk that a borrower will not meet their contractual obligations in conjunction with an investment.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securitie.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

U.S. 10 Year Treasury Note : A debt obligation issued by the United States government that matures in 10 years.

Basis point : 1/100th of 1 percent.

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

BofA Merrill Lynch 0-5 Year US High Yield Constrained, Zero Duration Index : Tracks the performance of the combination of a long position in short maturity US high yield bonds and a short position in on the run US Treasuries where the net interest rate exposure of the index is adjusted to a zero year duration. Market values of long and short positions are rebalanced at month-end.

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.

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 tim.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

U.S. Treasury futures contract : A standardized contract to buy or sell a Treasury security on a specified date at a predetermined price.