

The Smart Beta Rally That Many Investors Missed in 2015

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One of the big trends in the exchange-traded fund (ETF) industry has been this year's flow of new money into developed world equity ETFs, both unhedged and currency-hedged. WisdomTree estimates that nearly \$100 billion of this year's \$271 billion[1] in ETF industry inflows cascaded into these funds through the end of October.

Whilst the vast majority of assets in developed world equity ETFs—and the vast majority of net inflows this year—have been concentrated primarily in *large-cap* strategies, the bigger bull market has actually occurred in the smaller-company segment of the developed world.

If we look at year-to-date returns through October 30, we can see by how much small-caps have outperformed compared to broad market indices comprising primarily large-caps.

What's interesting is that the excess return produced by small caps compared to their large-cap peers is not just a 2015 phenomenon. Excess returns have held up over the last year, three years, five years and the better part of the last decade going back to the inception of the WisdomTree Indexes back in May of 2006.

When One Compares Returns across Asset Classes, Additional Light Bulbs Light Up

The gains that developed world small caps have generated thus far in 2015 have not only surpassed the broader regional benchmarks, they have outperformed the major asset classes investors typically tap to construct a globally diversified portfolio: large caps and small caps in the U.S.[2]; MSCI EAFE Index and MSCI Emerging Markets Index; REITs[3], U.S. Treasuries, investment-grade and high-yield corporate bonds[4]; commodities[5] and gold[6]. Moreover, year-to-date in 2015, small caps outperformed each of the major indexes designed to measure how each smart beta factor is performing: MSCI Momentum, MSCI Quality, MSCI Value or MSCI Size. What accounts for the divergence in returns? Part of it can be somewhat explained by sector concentrations, country and currency exposure. Another reason: Small-cap stocks are less tied to the global economy and often more sensitive to inflections in local economies. The potential for higher returns compared to large caps and the diversification benefits within a globally diversified portfolio are key reasons why WisdomTree became the first ETF manager to launch small-cap ETF strategies.

Conclusion

Because most passive indices and active international managers tend to concentrate primarily on large-cap stocks, international investors may miss the potential of small-cap companies unless they make

a conscious effort to include them in their portfolios. We believe small-cap exposure can help investors complete their international allocations. Returns this year in Europe and the developed world add additional real-time evidence to support our thesis. Investors sharing this sentiment may consider the following UCITS ETF:

- [WisdomTree Europe SmallCap Dividend UCITS ETF \(DFE\)](#)
- [WisdomTree Emerging Markets SmallCap Dividend UCITS ETF \(DGSE\)](#)

All data is sourced from WisdomTree Europe and Bloomberg, unless otherwise stated.

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