

WISDOMTREE U.S. Quality Dividend Growth ETF

DGRW: This Quality Dividend Growth ETF Deserves More Recognition

Forget about SCHD, DGR0, and VIG – DGRW is worthy of a look.

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A glaring concern is that most dividend ETFs, even with their high yields reinvested, often just match or lag behind the performance of S&P 500 index ETFs, which come as a disappointment to investors who are looking for both income and growth.

The phenomena can be attributed to the natural efficiency of market-cap weighted ETFs, which provide broad exposure to the market with minimal drag from fees and portfolio turnover. These two factors—low fees and lower portfolio turnover—are considerable advantages that

make it challenging for most dividend-oriented ETFs to outperform the S&P 500.

That said, when I took a closer look at the **WisdomTree U.S. Quality Dividend Growth ETF (DGRW)**, I was pleasantly surprised to discover that this under-the-radar fund has historically outperformed the S&P 500. It's an exception that makes you sit up and take notice.

So, what gives DGRW its edge over the better-known dividend ETFs, and even the venerable S&P 500? Today's topic is a deep dive into DGRW to understand what

makes it tick and what sets it apart from its more popular counterparts.

DGRW: Methodology

DGRW is a bit of a strange ETF – it's not exactly actively managed, given that it tracks the WisdomTree U.S. Quality Dividend Growth Index, but I wouldn't consider it equivalent to the average market-cap weighted index ETF either.

Its index uses a very different indexing methodology that can be best described as "fundamentals-based". Traditional

Portfolio	Initial Balance	Final Balance	CAGR	Stdev	Best Year	Worst Year	Max. Drawdown	Sharpe Ratio	Sortino Ratio	Market Correlation
WisdomTree US Quality Dividend Gr ETF	\$10,000	\$27,970	11.13%	14.27%	29.55%	-6.34%	-19.29%	0.73	1.16	0.96
SPDR S&P 500 ETF Trust	\$10,000	\$27,644	10.99%	15.05%	31.22%	-18.17%	-23.93%	0.69	1.06	1.00

Portfolio Growth



Source: Portfolio Visualizer. Data as of 1/1/2014 – 8/31/2023. **Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data and the 30-Day SEC Yield for the most recent month-end is available at wisdomtree.com/investments/etfs/equity/dgrw. You cannot invest directly in an index.**

market-cap weighted indices give weight to companies based on their market capitalization, meaning that larger companies take up a bigger portion of the index.

In contrast, a fundamentals-based index like the one used by DGRW utilizes specific financial metrics and data points to weigh the stocks. This rules-based approach seeks to identify companies with strong financial health and growth prospects rather than merely relying on market capitalization.

The specific criteria DGRW's index currently employs are as follows:

- **Primary Screening Universe:** Constituents of the WisdomTree U.S. Dividend Index with a market capitalization of at least \$2 billion.
- **Top 300 Companies:** Selected based on a combined ranking of growth and quality factors.
- **Growth Factor:** Long-term earnings growth expectations.
- **Quality Factor:** Three-year historical averages for return on equity (ROE) and return on assets (ROA).
- **Dividend Weighting:** Annually updated to reflect the projected share of aggregate cash dividends each company will pay in the coming year, based on the most recent dividend per share.

Why DGRW's Methodology Works

The unique methodology employed by DGRW places a significant emphasis on growth and quality metrics, which are crucial for long-term financial health and sustainability of the companies in the index.

In a world where dividend-paying companies are often considered "old economy" stalwarts, long-term earnings growth expectations serve as a vital indicator of a company's future prospects. Companies with strong growth prospects are more likely to sustain and even increase their dividends over time.

This focus on growth potential helps DGRW avoid the trap of "yield chasing," where investors sometimes get lured by high-dividend-yielding companies that have poor growth prospects and may even have to cut dividends in the future.

ROE and ROA are also important quality metrics that gauge the effectiveness with which a company uses its resources. High ROE and ROA figures usually indicate strong management and efficient utilization of assets and equity, which can be a reliable sign of a company's resilience and profitability.

Companies scoring well on these quality factors are often better positioned to weather economic downturns and continue paying dividends, making them valuable additions to any dividend-focused ETF.

What really sets DGRW apart is its dividend-weighting scheme. Traditional market-cap weighted indices give more weight to larger companies, irrespective of their dividend-paying capabilities or financial health. In other words, you're not really getting pure play exposure to the best dividends.

Instead DGRW's approach to dividend weighting annually adjusts the portfolio to reflect the proportionate share of the aggregate cash dividends each component company is projected to pay in the coming year.

This means that companies contributing more to the dividend pool will have a greater weight in the index. This strategy aligns the fund more closely with investors' income goals, while still focusing on the quality and growth metrics that back up those dividend payments.

The Effects of DGRW's Methodology

The efficacy of DGRW's unique methodology becomes especially apparent when examining its factor exposures through a regression analysis. Here, DGRW demonstrates statistically significant exposures to Fama-French factors

of profitability (RMW) and investment (CMA), which are vital from an investment perspective.

The profitability factor highlights how efficiently a company is turning its revenues into actual profits. High profitability usually suggests better management and strong business models, characteristics commonly associated with quality stocks. These businesses often show resilience in market downturns and have more resources to grow dividends or reinvest for growth, which can be particularly important for long-term investors.

The investment factor focuses on a company's investment behavior in its business. Companies with conservative investment policies are often considered more quality-focused because they are less likely to take on high-risk projects. In the long run, this cautious strategy can contribute to more stable and sustainable business operations, thereby translating to a consistent dividend-paying record.

When we look at the numbers, DGRW's exposure to these factors clearly outpaces that of the S&P 500:

- **DGRW:** RMW at 0.28, CMA at 0.25
- **S&P 500 (SPY):** RMW at 0.07, CMA at 0.02

Source: Portfolio Visualizer. Data as of 8/31/2023.

The higher exposure to both profitability and investment factors means that DGRW could offer investors a better blend of quality and growth-oriented dividend-paying stocks.

This combination could potentially lead to better risk-adjusted returns over the long term, making DGRW a compelling choice for those looking to diversify their income sources while maintaining a focus on stock quality and growth potential, despite its higher 0.28% expense ratio and fairly low 1.81% 30-day SEC yield. (Source: Portfolio Visualizer. Data as of 8/31/2023.)

Glossary

Compound Annual Growth Rate (CAGR): The mean annual growth rate of an investment over a specified period of time longer than one year.

Correlation: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

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.

Max drawdown: The maximum observed loss from a peak to a trough of a portfolio, before a new peak is attained.

Return on Assets (ROA): A firm's 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.

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

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.

SEC Yield: The yield figure reflects the dividends and interest earned during the period, after the deduction of the Fund's expenses. This is also referred to as the "standardized yield."

Sharpe ratio: Measure of risk-adjusted return. Higher values indicate greater return per unit of risk, specifically standard deviation, which is viewed as being desirable.

Sortino Ratio: Measures the risk-adjusted return of an investment asset, portfolio, or strategy.

Standard deviation: A measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

WisdomTree U.S. Quality Dividend Growth Index: A fundamentally weighted index that consists of dividend-paying stocks with growth characteristics. The primary starting screening universe for this index is the constituents of the WisdomTree U.S. Dividend Index with market capitalization of at least \$2 billion. The Index is comprised of the 300 companies in the WisdomTree U.S. Dividend Index with the best combined rank of growth and quality factors. The growth factor ranking is based on long-term earnings growth expectations, while the quality factor ranking is based on three-year historical averages for return on equity and return on assets.

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.

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iShares MSCI USA Quality Factor ETF (QUAL): The iShares MSCI USA Quality Factor ETF seeks to track the investment results of an index composed of U.S. large- and mid-capitalization stocks with quality characteristics as identified through certain fundamental metrics. 30-Day SEC Yield as of 8/31/2023: 1.29%. Expense Ratio: 0.15%. Performance data for QUAL for the most recent month-end is available at www.ishares.com/us/products/256101/QUAL. iShares are distributed by BlackRock Investments, LLC.

Schwab U.S. Dividend Equity ETF (SCHD): The Schwab U.S. Dividend Equity ETF fund's goal is to track as closely as possible, before fees and expenses, the total return of the Dow Jones U.S. Dividend 100™ Index. 30-Day SEC Yield as of 9/28/2023: 3.78%. Expense Ratio: 0.06%. Performance data for SCHD for the most recent month-end is available at www.schwabassetmanagement.com/products/schd. Schwab Funds are distributed by Charles Schwab & Co., Inc.

iShares Core Dividend Growth ETF (DGRO): The iShares Core Dividend Growth ETF seeks to track the investment results of an index composed of U.S. equities with a history of consistently growing dividends. 30-Day SEC Yield as of 8/31/2023: 2.51%. Expense Ratio: 0.08%. Performance data for DGRO for the most recent month-end is available at www.ishares.com/us/products/264623/DGRO. iShares are distributed by BlackRock Investments, LLC.

Vanguard Dividend Appreciation Index Fund ETF (VIG): The Vanguard Dividend Appreciation Index Fund ETF seeks to track the performance of the S&P U.S. Dividend Growers Index. 30-Day SEC Yield as of 8/31/2023: 1.83%. Expense Ratio: 0.06%. Performance data for VIG for the most recent month-end is available at investor.vanguard.com/investment-products/etfs/profile/vig#overview. Vanguard Funds are distributed by Vanguard Marketing Corporation.

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