

# The Potential Benefits of International Diversification with Mid- and Small-Cap Dividends

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In our last market insight, we discussed one segment of the market that often gets overlooked in the hunt for income-producing asset classes—mid- and small-cap dividend payers in the United States. Most investors focus solely on the large-cap, blue-chip dividend payers, despite the fact that mid and small caps often have higher dividend yields<sup>1</sup>, based on an analysis of the WisdomTree Dividend Indexes.

In this piece, we extend the analysis of dividend-paying stocks by market capitalization<sup>2</sup> segment beyond the United States to developed international markets. We believe the benefits of looking beyond large caps and into mid and small caps are, in many ways, even stronger in the international markets.

## WHY INTERNATIONAL DIVIDENDS?

For starters, international markets generally pay more dividends than U.S. markets—which means they represent a bigger investment opportunity set. According to the WisdomTree Global Dividend Index, the dividend stream<sup>3</sup> as of the most recent screening date (May 31, 2012) was over \$1 trillion. While the U.S. market made up 29.2% of the total dividend stream, the developed world ex-U.S. accounted for 53.8% of it. The international developed world also tends to have higher trailing 12-month dividend yields than the United States.

In today's slow-growth and low-yielding environment, many investors are looking for sources of potential income, and we believe that dividends may warrant attention for this purpose. Additionally, WisdomTree feels that dividends are an important fundamental measure in determining equity valuations. Furthermore, weighting by dividends in international markets may be even more important because there are many accounting differences across various regions of the world. Dividends paid in cash represent a metric that is independent of accounting differences, making it easier to determine how one firm should be weighted against another in accordance with its fundamentals.

Weighting eligible companies in our international Dividend Indexes by cash dividends enables us to potentially magnify the effect on yield and performance relative to market capitalization-weighted indexes representing similar equity markets. Market capitalization-weighted indexes provide the benefit of as broad an exposure as possible to a given universe of stocks, but they do not directly focus on dividends or weight by fundamental factors. WisdomTree's dividend-weighted Indexes, on the other hand, focus solely on dividend payers, and additionally, their dividend-weighted approach may serve to boost trailing 12-month dividend yields compared to market capitalization-weighted approaches. These differences in methodology should be kept in mind when considering the analysis that follows.

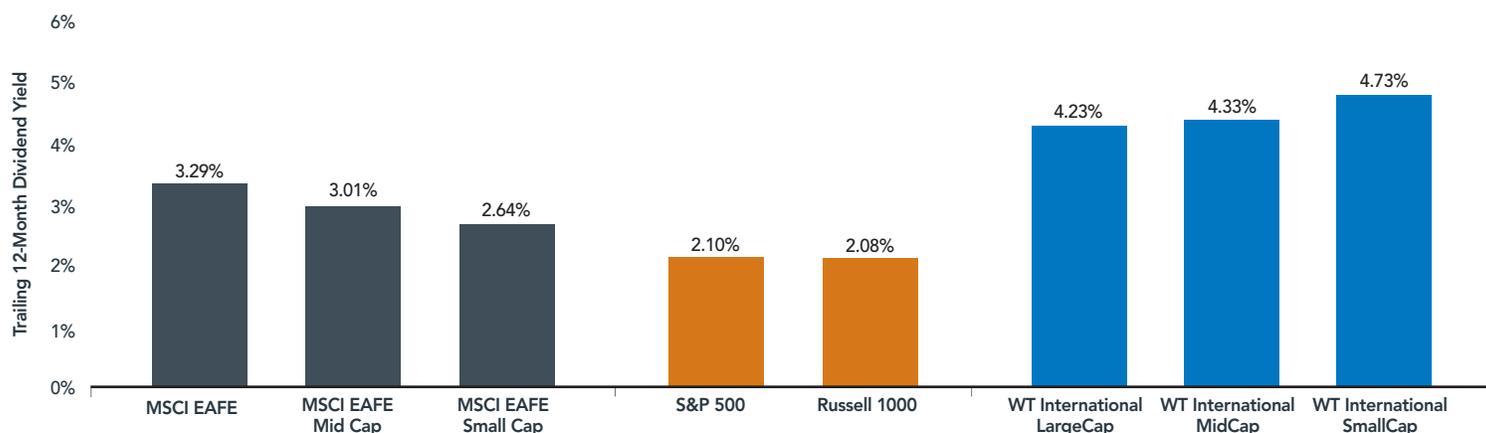
<sup>1</sup> Dividend yield: Trailing 12-month dividend yield, which adds up the prior 12 months of dividends paid and divides the amount by the current share price. Higher values indicate more dividends are being generated per unit of share price.

<sup>2</sup> Market capitalization: Share price times number of shares outstanding.

<sup>3</sup> Dividend stream: Regular dividends per share over the 12 months prior to the screening date multiplied by the number of shares outstanding on the screening date for each constituent. Values for each constituent are then added together.

Throughout this piece we will use the MSCI EAFE indexes<sup>4</sup> to illustrate certain characteristics of the international developed ex-U.S. markets (international equities), and we will use the S&P 500 Index and the Russell 1000 Index to represent the U.S. markets. These indexes are weighted by market capitalization, which provides the broadest exposure to the equities we are trying to represent for comparison purposes, and they contain both dividend-paying and non-dividend-paying stocks.

**FIGURE 1: MARKET CAP WEIGHTING VS. DIVIDEND WEIGHTING**



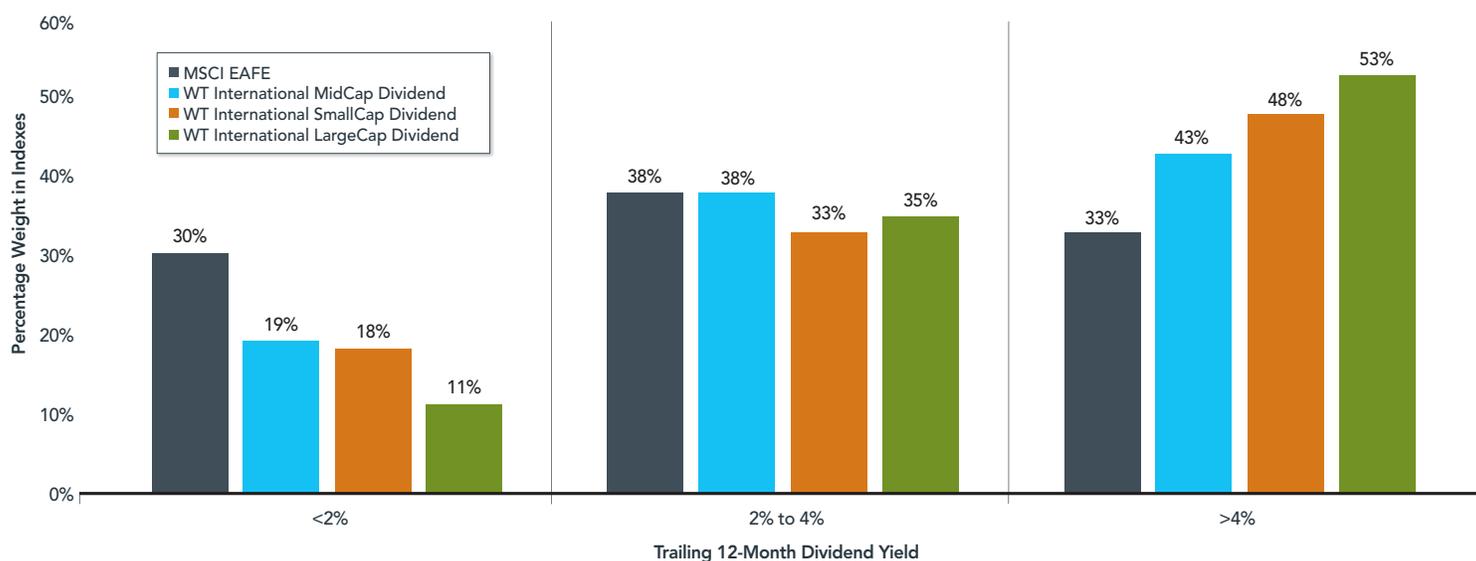
Sources: WisdomTree, Bloomberg (03/31/13)  
 Past performance is not indicative of future results. You cannot invest directly in an index.

- + International Equities Have Higher Yields — All the MSCI EAFE indexes and WisdomTree International Dividend Indexes displayed above have higher trailing 12-month yields than both the S&P 500 Index and the Russell 1000 Index.**
- + WisdomTree International Dividend Indexes Have Highest Yields — WisdomTree weights companies in its International Dividend Indexes by cash dividends, which tends to increase the yield compared to traditional market cap-weighted benchmarks that do not weight by dividends. Each of these WisdomTree International Indexes has at least twice the trailing 12-month dividend yield of the S&P 500 Index. Now, the mandate of the S&P 500 Index is not to provide a high dividend yield, but we believe this comparison is nevertheless worth mentioning within the present-day environment of extremely low interest rates.**
- + WisdomTree International SmallCap Leads — As you move down the size spectrum in the WisdomTree International Dividend family, you see a higher trailing 12-month yield that is not present in the MSCI EAFE indexes, where the largest-market-capitalization firms (represented as those in the MSCI EAFE Index) have the highest trailing 12-month dividend yields.**

<sup>4</sup> Specifically, the MSCI EAFE, MSCI EAFE Mid Cap and MSCI EAFE Small Cap indexes.

In figure 2 below, we illustrate how weighting by dividends shifts weights in the index to companies with higher dividend yields. We recognize that dividend income is not the objective of the MSCI EAFE Index, but we chose the index for comparison purposes, based on the broadness of its exposure to developed international equities.

**FIGURE 2: PERCENTAGE WEIGHT IN DIVIDEND PAYERS — INDEX COMPARISON**



Sources: WisdomTree, Bloomberg (03/31/13)  
 Past performance is not indicative of future results. You cannot invest directly in an index.

- + More Weight in High Payers — The WisdomTree International Dividend Indexes tend to have higher weights in higher-yielding companies than the MSCI EAFE Index, allowing these Indexes to have potentially higher yields.**
- + Less Weight in Low Payers — By weighting our Indexes on dividend income instead of market capitalization, we are able to potentially have lower weights in relatively lower-yielding companies and avoid companies that do not pay dividends.**

**POSSIBLE DIVERSIFICATION BENEFITS: INTERNATIONAL MID AND SMALL CAPS**

We feel that when investors decide to invest internationally, they usually do so through large-cap companies. We believe the mid- and small-cap international dividend payers offer a further set of exposures beyond this more traditional option.

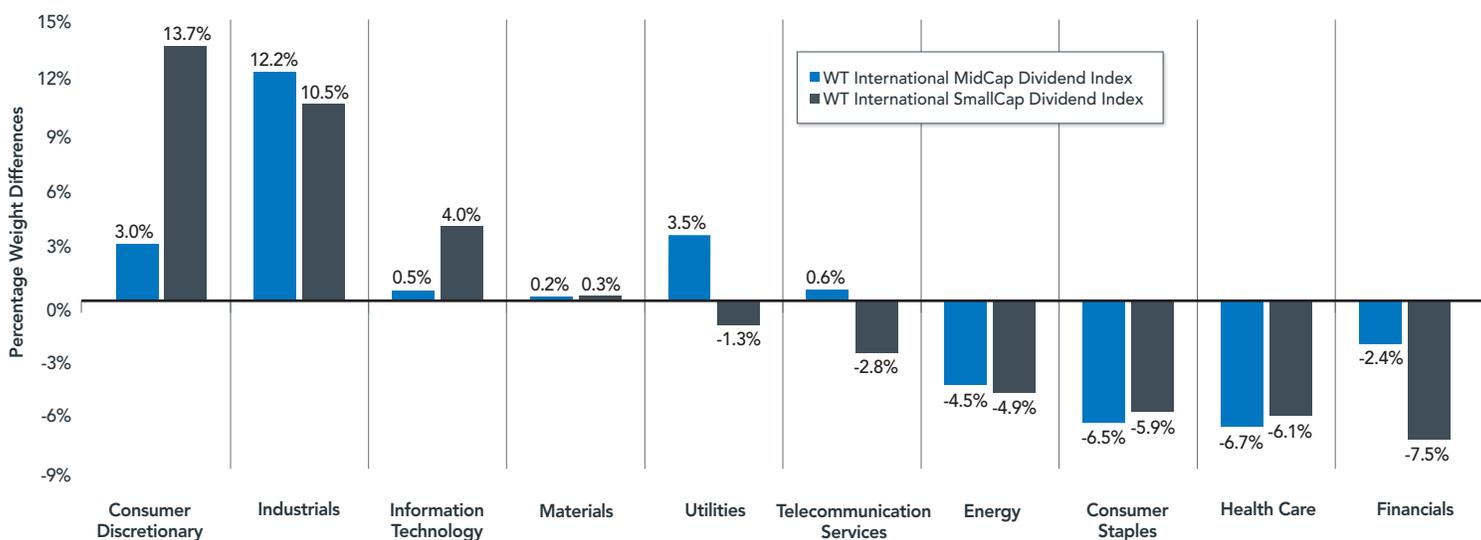
For instance, international mid- and small-cap dividend-paying stocks represent just a small percentage of a traditional index such as the MSCI EAFE Index.

**WEIGHT OF STOCKS WITHIN THE MSCI EAFE INDEX<sup>5</sup>:**

- + **WisdomTree International MidCap Dividend Index — 15.3%**
- + **WisdomTree International SmallCap Dividend Index — 0.09%**

Moreover, the stocks themselves tend to display different characteristics than large-cap stocks, as can be illustrated by their sector differentials. In figure 3, we will look at the sector differences between the WisdomTree International MidCap and SmallCap Dividend Indexes compared to the MSCI EAFE Index.

**FIGURE 3: ANALYSIS OF SECTOR DIFFERENTIALS ACROSS SIZE SEGMENTS**



Sources: WisdomTree, Bloomberg (03/31/13)

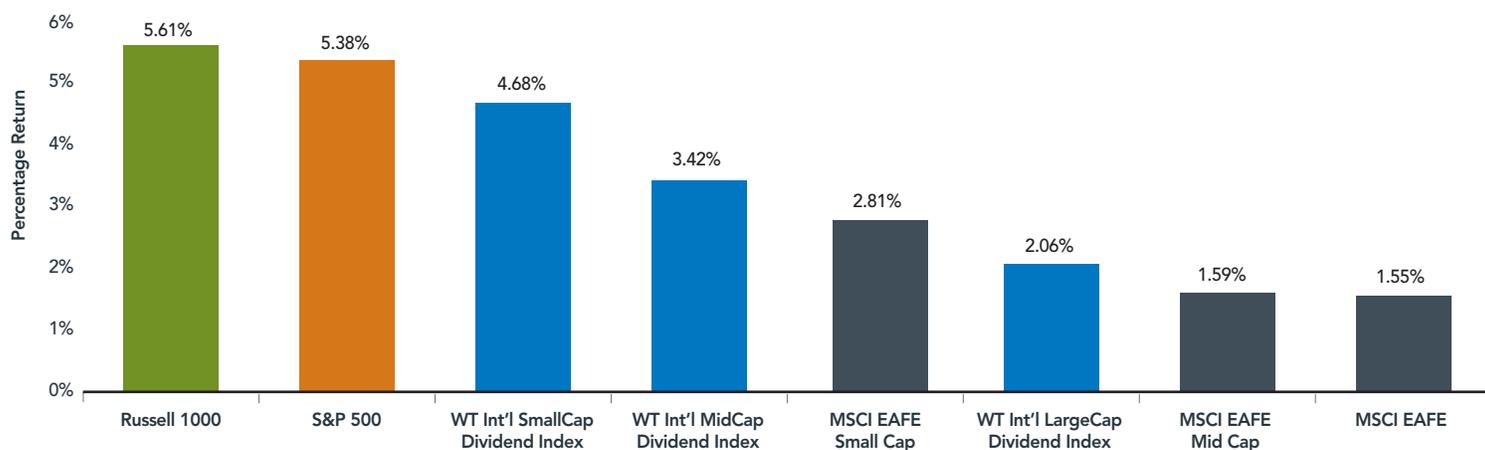
- + **Cyclical Sector Over-weights** — The WisdomTree International MidCap and SmallCap Dividend Indexes tend to have more exposure to two of the more cyclical sectors of the markets—Consumer Discretionary and Industrials.
- + **Defensive Sector Under-weights** — Unlike traditional dividend-paying stocks, the WisdomTree International MidCap and SmallCap Dividend Indexes tend to be under-weight in a number of the traditional dividend-paying sectors (Consumer Staples, Health Care and Telecommunication Services).

<sup>5</sup> Sources: WisdomTree, Bloomberg (03/31/13).

## PERFORMANCE: THE BOTTOM LINE

Perhaps most importantly, there can be notable differences in performance across the size segments of international equity dividend payers (large, mid and small caps).

**FIGURE 4: AVERAGE ANNUAL PERFORMANCE SINCE WISDOMTREE INTERNATIONAL DIVIDEND INDEXES INCEPTION**



Sources: WisdomTree, Bloomberg. Performance numbers are average annual returns since inception of the WisdomTree International Dividend Indexes (06/01/06–03/31/13). Past performance is not indicative of future results. You cannot invest directly in an index.

- + Small Caps Were Best Size Segment — The WisdomTree International SmallCap Dividend Index had the best return among the international indexes displayed here (4.68% per year), while the MSCI EAFE Index had the worst (1.55% per year).**
- + WisdomTree International SmallCap and MidCap Lead International Indexes — The WisdomTree International SmallCap and MidCap Dividend Indexes outperformed their market capitalization benchmarks by 1.87% and 1.83%, respectively, on an average annual basis.**
- + WisdomTree International LargeCap Dividend Index — The WisdomTree International LargeCap Dividend Index outperformed its benchmark, the MSCI EAFE Index by over 0.50% on an average annual basis since inception.**
- + U.S. Indexes Lead International — Both the Russell 1000 and the S&P 500 indexes outperformed all the international indexes listed above; they outperformed the MSCI EAFE Index by over 3.8% on an average annual basis since the WisdomTree International Dividend Indexes' inception.**

**FIGURE 5: RISK AND RETURN DETAIL**

Indexes	Annual Average Return				Standard Deviation <sup>6</sup>			
	1-Year	3-Year	5-Year	Since Inception <sup>7</sup>	1-Year	3-Year	5-Year	Since Inception <sup>7</sup>
WisdomTree International LargeCap Dividend	11.06%	4.63%	-1.46%	2.06%	16.45%	19.69%	23.11%	20.72%
MSCI EAFE	11.25%	5.00%	-0.89%	1.55%	16.06%	19.35%	23.21%	20.61%
MSCI EAFE Value	11.02%	3.45%	-1.70%	0.43%	17.89%	20.38%	24.70%	21.89%
WisdomTree International MidCap Dividend	11.55%	5.76%	0.06%	3.42%	16.24%	19.65%	24.17%	21.64%
MSCI EAFE Mid Cap	10.99%	6.14%	-0.53%	1.59%	15.68%	19.30%	24.10%	21.43%
MSCI EAFE Mid Cap Value	12.41%	4.84%	-0.12%	1.35%	17.23%	19.50%	24.16%	21.31%
WisdomTree International SmallCap Dividend	17.17%	9.98%	2.77%	4.68%	14.87%	18.05%	23.76%	21.43%
MSCI EAFE Small Cap	13.28%	8.41%	2.03%	2.81%	15.47%	19.87%	24.78%	22.18%
MSCI EAFE Small Cap Value	14.21%	7.52%	2.06%	2.90%	17.13%	20.48%	25.64%	22.71%
Russell 1000	14.43%	12.93%	6.15%	5.61%	10.49%	15.34%	19.35%	17.23%
S&P 500	13.96%	12.67%	5.81%	5.38%	10.39%	15.01%	18.92%	16.87%

Sources: Bloomberg, Zephyr StyleADVISOR

Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

- + WisdomTree International SmallCap Dividend Index — The WisdomTree International SmallCap Dividend Index has been able to outperform both the MSCI EAFE Small Cap and the MSCI EAFE Small Cap Value indexes over all periods shown above. This was also accomplished with less total risk, as measured by standard deviation.**
- + WisdomTree International MidCap Dividend Index — The WisdomTree International MidCap Dividend Index has been able to outperform both the MSCI EAFE Mid Cap and the MSCI EAFE Mid Cap Value indexes over the most recent 5-year and since-common-inception periods.**
- + WisdomTree International LargeCap Dividend Index — The WisdomTree International LargeCap Dividend Index has been able to outperform both the MSCI EAFE and the MSCI EAFE Value indexes since inception.**

<sup>6</sup> Standard deviation: Also risk, which measures the dispersion of actual returns around an average value over a specific period. Higher values indicate a higher probability for returns to be farther from this average value.

<sup>7</sup> The earliest most common date is 06/01/06, since the inception date of the WisdomTree International LargeCap, MidCap and SmallCap Dividend Indexes was 06/01/06.

## CONCLUSION

In our opinion, exposure to international equities is important for providing diversification benefits and increased potential return. Specifically, we think that exposure to international dividend-paying companies provides a current higher-trailing 12-month dividend yield and offers a historical return advantage since the WisdomTree International Dividend Indexes' inception. Also, increased exposure to mid- and small-cap dividend-paying companies can help increase diversification and trailing dividend income.

Unless otherwise stated, data source is WisdomTree.

Diversification does not eliminate the risk of experiencing investment losses. Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company paying dividends may cease paying dividends at any time.

**Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, call 866.909.WISE (9473) or visit [wisdomtree.com](http://wisdomtree.com). Read the prospectus carefully before you invest.**

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 or 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. Due to the investment strategy of certain Funds, they may make higher capital gain distributions than other ETFs. Please see prospectus for discussion of risks.

WisdomTree Global Dividend Index: WisdomTree's broadest measure of dividend-paying stocks, including firms incorporated in emerging markets, developed international markets and the United States, weighted by cash dividends. WisdomTree Dividend Index of Europe, Far East Asia and Australasia (WisdomTree DEFA): A fundamentally weighted index that measures the performance of dividend-paying companies in the industrialized world, excluding Canada and the United States, that pay regular cash dividends and that meet other liquidity and capitalization requirements. It comprises companies incorporated in 16 developed European countries, Japan, Australia, New Zealand, Hong Kong and Singapore. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree International LargeCap Dividend Index: A fundamentally weighted index that measures the performance of the large-capitalization segment of the dividend-paying market in the industrialized world outside the U.S. and Canada. The Index comprises the 300 largest companies ranked by market capitalization from the WisdomTree DEFA Index. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree International MidCap Dividend Index: A fundamentally weighted index that measures the performance of the mid-capitalization segment of the dividend-paying market in the industrialized world outside the U.S. and Canada. The Index comprises the companies that compose the top 75% of the market capitalization of the WisdomTree DEFA Index after the 300 largest companies have been removed. Companies are weighted in the Index based on annual cash dividends paid. WisdomTree International SmallCap Dividend Index: A fundamentally weighted index that measures the performance of the small-capitalization segment of the dividend-paying market in the industrialized world outside the U.S. and Canada. The Index comprises the companies that compose the bottom 25% of the market capitalization of the WisdomTree DEFA Index after the 300 largest companies have been removed. Companies are weighted in the Index based on annual cash dividends paid. MSCI EAFE Index (Europe, Australasia, Far East): A free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. MSCI EAFE Value Index: Market capitalization-weighted subset of stocks within the MSCI EAFE Index that have lower share prices relative to their earnings or dividends per share. MSCI EAFE Mid Cap Index: A free float-adjusted market capitalization equity index that captures small-cap representation across developed markets countries around the world, excluding the U.S. and Canada. MSCI EAFE Mid Cap Value Index: A free float-adjusted market capitalization equity index that captures mid-cap securities exhibiting overall value style characteristics across developed market countries around the world, excluding the U.S. and Canada. MSCI EAFE Small Cap Index: A free float-adjusted market capitalization equity index that captures small-cap representation across developed markets countries around the world, excluding the U.S. and Canada. MSCI EAFE Small Cap Value Index: A free float-adjusted market capitalization equity index that captures small-cap securities exhibiting overall value style characteristics across developed market countries around the world, excluding the U.S. and Canada. S&P 500 Index: A capitalization-weighted index of 500 stocks selected by the Standard & Poor's Index Committee, designed to represent the performance of the leading industries in the United States economy. Russell 1000 Index: Measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership.

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