

GLOBAL SMALL CAPS LEADING THE WAY: COMPARING REGIONAL OPPORTUNITIES

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Small companies may have big potential. In fact, today they're leading the way across the globe. As the worldwide economy has emerged from the great recession and leading indicators are pointing to a rebound in many of the major developed markets, including the United States, Europe and Japan, optimism is evident in the recent performance of equity markets. For the 2013 year, for example, U.S. equity markets, as measured by the S&P 500, have performed strongly, leading broad developed and emerging indexes with a return of over 30%. Impressive? Yes. But there have been even better returns in global small caps during this cyclical upturn.

In this market insight, we highlight the recent performance of the small-capitalization market around the globe and discuss important considerations for allocations beyond today's levels. Small caps in general can offer increased diversification and return potential, but all small cap investment strategies are not created equal—and investors should be aware of the critical differences between them.

In our opinion, a rules-based approach that focuses on—and rebalances based on—underlying fundamentals¹ may enable investors to better capitalize on the small-cap segment, especially given the large performance run small caps have experienced recently.

Throughout this piece we will use the S&P 500, MSCI EAFE and MSCI Emerging Markets indexes to represent domestic, developed international and emerging market large-cap equities, respectively. Also, we will use the Russell 2000 Index to represent a broad measure of U.S. small-cap equities.

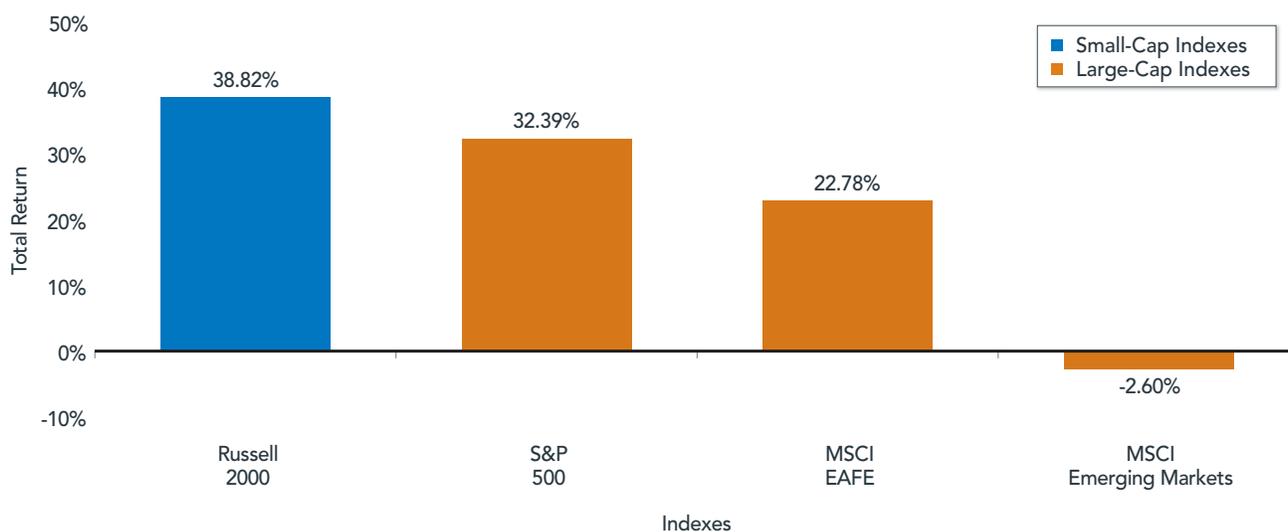
These indexes were chosen because of their scope in their respective asset classes and their general popularity for tracking and measuring these segments.

SMALL CAPS PERFORM

Many small-cap indexes across the U.S., international and emerging markets outperformed their large cap peers last year, illustrating the importance of looking beyond the large-cap market. Specifically, the Russell 2000 Index outperformed the S&P 500, MSCI EAFE and MSCI EM indexes by 6.43%, 16.04% and 41.42%, respectively.

¹ Fundamentals: Attributes related to a company's actual operations and production as opposed to changes in share price.

FIGURE 1: 2013 INDEX PERFORMANCE



Sources: Bloomberg, WisdomTree (12/31/12–12/31/13).
Past performance is not indicative of future results. You cannot invest directly in an index. Subject to change.

SMALL CAPS HAVE GROWING DIVIDENDS

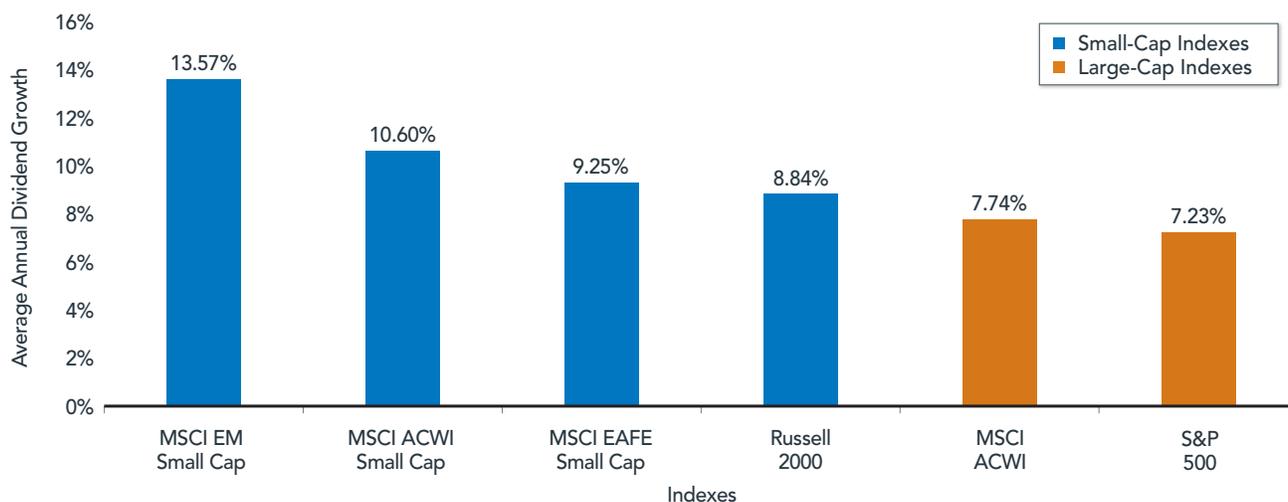
In today’s low-interest-rate environment, dividend²-paying equities have become an attractive alternative source of income—not only because of the current income they provide, but also because of their potential for growth. Of course, when investors think of dividends, they tend to think of mature large-cap companies as the primary source. As a result, we feel that many investors mistakenly overlook small-cap equities as attractive income options. Additionally, it is important to remember that, historically, U.S. dividends have grown more than 1% faster than the Consumer Price Index, a common measure of inflation.³

We believe there is not only an important fundamental link between dividend growth and income, but also between dividend growth and total return. Would it surprise you to learn that over the last 10 years, small-cap indexes have delivered higher dividend growth than their large-cap peers both in the United States and globally? Consider that:

- + **Domestically, the Russell 2000 grew its dividends more than 1.6% faster than the S&P 500.**
- + **In global and emerging markets, the MSCI ACWI Small Cap Index grew dividends more than 2.8% faster than the MSCI ACWI Index, and the MSCI EM Small Cap Index grew dividends far faster than any other small- or large-cap index.**

² Dividend: A portion of corporate profits paid out to shareholders.
³ Source: Bob Shiller, <http://www.econ.yale.edu/~shiller/data.htm> (1957–2013).

FIGURE 2: 10-YEAR DIVIDEND GROWTH



Sources: Bloomberg, WisdomTree, MSCI (12/31/03–12/31/13).

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SMALL CAPS OFFER SECTOR DIVERSIFICATION

One of the important reasons to consider small-cap strategies is their diversification potential from traditional large-cap index strategies. One practical measure of this diversification is the difference in sector composition of small-cap and large-cap indexes. The small-cap indexes have higher weights in more cyclical sectors⁴ (which are tied more closely to economic growth) than do the large-cap indexes. Global small caps provide even more diversification potential than U.S.-centric small caps, as these tend to have a bias toward health care and technology (which, together, make up approximately one-third of the Russell 2000), while most other regions are less exposed to these sectors. Of course, it's worth noting that diversification does not eliminate the risk of experiencing investment losses, as these are still equity exposures, but we believe that small caps could offer a tool to more finely tune exposure considerations in broader equity portfolios.

THE IMPORTANCE OF TAKING A FUNDAMENTAL APPROACH

At WisdomTree, we believe it is important to focus on fundamentals when selecting and weighting securities and rebalancing Indexes. Consider that the majority of indexes in existence are market capitalization weighted—meaning they give more weight to companies selling at higher prices than those offering stronger fundamentals. We believe fundamentals—such as dividends or earnings—offer a more objective measure of a company's health, value and profitability than stock price alone. We use proprietary weighting methodologies designed to magnify the effect fundamentals have on risk and return characteristics.

⁴ Cyclical sectors: Include Consumer Discretionary, Energy, Industrials, Materials, Information Technology and Financials sectors; defensive sectors: Consumer Staples, Health Care, Telecommunication Services and Utilities.

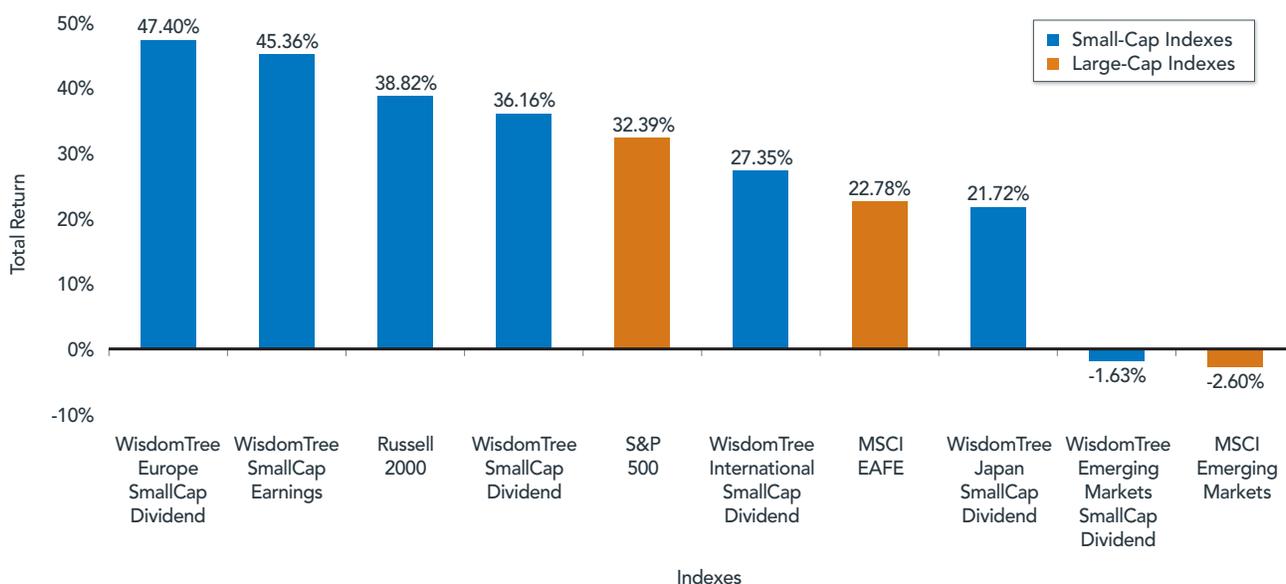
WisdomTree employs a rules-based rebalancing mechanism that adjusts relative Index weights based on underlying fundamentals. During the rebalancing process, which occurs once per year for each Index, the relationship between share price performance and either dividend growth or earnings growth is measured, helping to manage the valuation risk inherent in strong short-term performance. In our opinion, the rebalancing process is critical for long-term performance and risk management.

WISDOMTREE SMALLCAP INDEXES PERFORM

As previously discussed, small caps in general have been outperforming their large-cap peers. And WisdomTree Indexes have been leading the pack. During the period:

- + **The WisdomTree Europe SmallCap Dividend Index was the best performer, delivering an almost 50% return in 2013.**
- + **The WisdomTree International SmallCap Dividend Index led the MSCI EAFE by more than 4.5%.**
- + **The WisdomTree Emerging Markets SmallCap Dividend Index led the MSCI Emerging Markets Index by nearly 1%.**
- + **The WisdomTree SmallCap Earnings Index outperformed the Russell 2000 Index by more than 6.5%.**

FIGURE 3: 2013 INDEX PERFORMANCE



Source: Bloomberg. Period from 12/31/2012 to 12/31/2013.
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WISDOMTREE SMALLCAP INDEXES DELIVER INCOME

WisdomTree’s dividend-weighted approach can not only magnify the effects of dividends on performance but also significantly impact the amount of income Indexes can generate—enabling small-cap Indexes to deliver big income potential. In fact, our weighting and rebalancing process tends to produce higher trailing 12-month dividend yields:

- + **The WisdomTree SmallCap Earnings Index (WTSEI) had the lowest dividend yield of the indexes examined. It is important to remember that the WTSEI Index focuses on earnings and not dividends.**
- + **The WisdomTree Emerging Markets SmallCap Dividend Index had the highest dividend yield—a full 3% higher than U.S. small caps.**
- + **Interestingly, across the cap spectrum, some of the the highest dividend yields today are outside the United States.**

FIGURE 4: TRAILING 12-MONTH DIVIDEND YIELD⁵ [As of 12/31/13]



Sources: Bloomberg, WisdomTree.

Past performance is not indicative of future results. You cannot invest directly in an index. Subject to change.

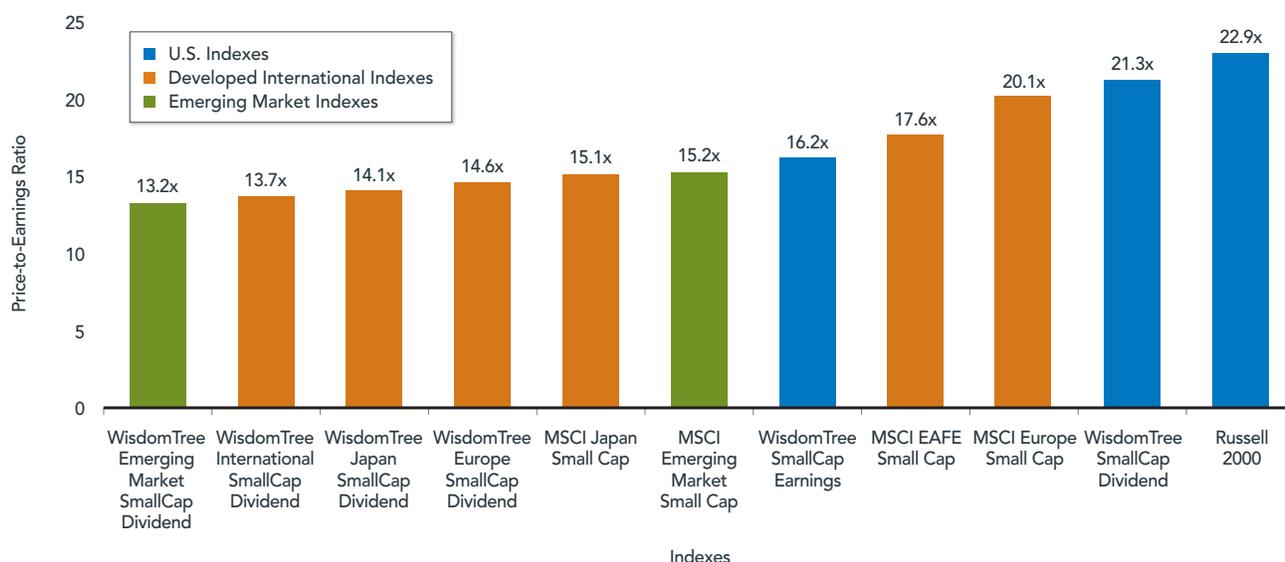
WISDOMTREE INDEXES EXHIBIT LOWER VALUATIONS

Investors have a tendency to get overly enthusiastic about growth prospects, and when this happens there is a tendency to overpay for potential growth, especially with small caps—a challenge that can be compounded as strong performance can drive up price and index weightings, adding valuation risk if the fundamentals do not justify the increased price. That is why a fundamental rebalance is so important to WisdomTree Indexes.

⁵ Dividend yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Through rebalancing, WisdomTree looks to mitigate the risk of being exposed to firms that may have enjoyed strong momentum and price increases but whose valuations have not improved commensurately. As a result, each of the WisdomTree SmallCap Indexes shown below has lower valuations, as seen through their price-to-earnings (P/E) ratios⁶ as of December 31, 2013, than their cap-weighted counterparts, effectively lowering the prices of their respective markets (it's worth noting that emerging markets are currently displaying the lowest valuations of all the listed small-cap indexes).

FIGURE 5: INDEX PRICE-TO-EARNINGS RATIOS [As of 12/31/13]



Sources: Bloomberg, WisdomTree (12/31/13).

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ALLOCATING TO GLOBAL SMALL CAPS

Many investors incorporate U.S. small-cap strategies as part of their portfolios. But most have yet to expand these allocations internationally. In our opinion, with the Russell 2000 price-to-earnings ratio currently at 22.9x, now may be the right time to consider adding allocations to international and emerging market small caps to a diversified portfolio. We believe investors could benefit over the long term as these strategies:

- + **Have demonstrated strong historical performance**
- + **Are growing dividends faster than domestic asset classes**
- + **Provide additional diversification potential**
- + **May have better valuations**

After such strong recent short-term performance, however, we believe a focus on a fundamental rebalancing process is critical to managing the potential valuation risk in these markets.

⁶ Price-to-earnings (P/E) Ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

CONCLUSION

While market capitalization-weighted indexes by their definition and investment process allocate the greatest weights to the firms with the largest market caps and thereby focusing weights in many of the stocks that may have appreciated the most, WisdomTree Indexes focus on fundamentals—either dividends or earnings—to determine their constituent weights. We believe this gives WisdomTree Indexes the potential to sell stocks that have become more expensive relative to their underlying fundamentals and buy stocks that have become less expensive relative to their underlying fundamentals. In the global small-cap space, where performance has been particularly strong recently, we believe it is important to take a fresh look at index strategies that focus on relative value.

Unless otherwise stated, data source is WisdomTree.

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

From 12/31/2012 to 12/31/2013, the period for which performance is analyzed within this piece, small cap stocks in the United States delivered very strong performance. The statistics analyzed within this piece cannot predict or imply that future performance will be similarly strong with any degree of certainty.

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. Read the prospectus carefully before you invest.

RISKS: There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments focusing on a single sector generally experience greater price volatility. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Investments focused in Japan are increasing the impact of events and developments associated with the region, which can adversely affect performance. Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. You cannot invest directly in an index.

WisdomTree SmallCap Earnings Index: A fundamentally weighted index that measures the performance of the earnings-generating small-cap segment of the U.S. equity market. The Index comprises the companies in the bottom 25% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed. WisdomTree SmallCap Dividend Index: A fundamentally weighted index that measures the performance of the small-capitalization segment of the U.S. dividend-paying market. The Index comprises the companies that constitute the bottom 25% of the market capitalization of the WisdomTree Dividend Index after the 300 largest companies have been removed. The Index is dividend weighted annually to reflect the proportionate share of the aggregate cash dividends each component company is projected to pay in the coming year, based on the most recently declared dividend per share. 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. WisdomTree Emerging Markets SmallCap Dividend Index: A subset of the WisdomTree Emerging Markets Dividend Index measuring the performance of the smallest firms by market capitalization comprising 10% of the total market capitalization, weighted by cash dividends. WisdomTree Europe SmallCap Dividend Index: A fundamentally weighted index meant to measure the performance of small-cap European dividend-paying equities, weighted by cash dividends paid. WisdomTree Japan SmallCap Dividend Index: Designed to provide exposure to dividend-paying small-capitalization companies in Japan. 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 2,000 of the smallest securities based on a combination of their market cap and current index membership. S&P 500 Index: A 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. MSCI EAFE Index: A market cap-weighted index composed of companies representative of the developed market structure of 22 developed countries in Europe, Australasia and Japan. MSCI Emerging Markets Index: A broad market cap-weighted index showing the performance of equities across 21 emerging market countries defined as "emerging markets" by MSCI. MSCI EAFE Small Cap Index: A free float-adjusted market capitalization equity index that captures small-cap representation across developed market countries around the world, excluding the U.S. and Canada. MSCI Emerging Markets Small Cap Index: A broad market cap-weighted index showing the performance of equities across 21 emerging market countries defined as "emerging markets" by MSCI, specifically focusing on the small-cap segment of these equity markets. MSCI Europe Small Cap Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe, specifically focusing on the small-cap segment of these equity markets. MSCI Japan Small Cap Index: A free float-adjusted market capitalization-weighted index designed to measure the equity market performance of Japanese small-cap securities. MSCI ACWI ex-US Index: A free float-adjusted market capitalization-weighted index designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States. MSCI ACWI ex-US Small Cap Index: A free float-adjusted market capitalization-weighted index designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States, specifically focusing on the small-cap segment of these equity markets.

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WIS006309 1/2015