WisdomTree Research

WISDOMTREE®

WHY DIVIDENDS FOR THE EMERGING MARKETS, AND WHY NOW?

The Fundamental Difference

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Why Emerging Markets?

Emerging markets (EM) represent one of the world's best long-term economic growth stories. Consider that nearly two-thirds of the world's investment opportunities are outside the United States. And approximately 85% of the global population resides in the emerging markets.[1]

Additionally, in recent years, the economies of major emerging market nations have been expanding faster than many industrialized economies. Consider that from 2001 to 2013 the global economy nearly doubled in size, growing from approximately $45 trillion in total production to more than $87 trillion on a purchasing power parity[2] (PPP) basis. And emerging markets accounted for approximately 65% of this nearly $42 trillion increase.[3]

Yet faster economic growth does not always translate to higher investment returns, as the recent underperformance of emerging markets can attest to. A number of investors are reevaluating the case for investing in emerging markets. We believe it is especially important now to consider the valuation opportunities present there, and having a disciplined focus on cash flows and dividends is timely. As these economies and markets are expected to play a greater role in the global economy and equity markets, investors may want greater exposure to emerging markets in order to remain appropriately diversified. Of course, diversification does not eliminate the risk of experiencing investment losses.

THERE ARE MANY WAYS TO INVEST

As emerging markets have become more accessible, there are an increasing number of ways to invest in them. One of the most common methods is to invest in active mutual funds or passive exchange-traded funds (ETFs)[4] benchmarked against the MSCI Emerging Markets Index ("MSCI EM"). Developed by MSCI Inc., the index is designed to measure equity market performance in emerging markets. It is, in fact, considered the global standard in emerging market performance.

MSCI EMERGING MARKETS INDEX DEFINED

The MSCI EM is a free float-adjusted market capitalization[5] index that is designed to measure the equity market performance of emerging markets. The index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Malaysia, Mexico, Greece, Peru, Philippines, Poland, Qatar, Russia, South Africa, South Korea, Taiwan, Thailand, Turkey and U.A.E., as of December 2014.

1 Source: Bloomberg.
2 Purchasing power parity: Academic concept for the movement of exchange rates based on the idea that the same products should cost the same amounts in different countries after adjusting for exchange rates for the different currencies. Meant as an approximation rather than an exact rule to show what currencies might be over- or undervalued on this basis, here shown relative to the U.S. dollar.
3 Source: IMF Data, 2014.
4 Passive exchange-traded funds (ETFs): Exchange-traded funds that track the performance of an index.
5 Free float-adjusted market capitalization: Market capitalization = share price x shares outstanding. The free-float adjustment subtracts from the number of shares outstanding those shares that are, for example, held by company insiders and may not be actively traded. Meant to make the market capitalization measure more indicative of the actual tradable market cap value and not reflect the value of shares that may not trade.

At WisdomTree, we have developed a different way to access emerging markets, which provides the potential for better returns with lower risk.

The WisdomTree Emerging Markets Dividend Index ("WTEMI") is built differently—and it performs differently as well. WTEMI has not only outperformed the MSCI EM since its inception in 2007, but it has done so with less risk.

Since its inception, WTEMI has outperformed the MSCI EM by 125 basis points (bps)[7] per year, with a standard deviation[8] that is 215 bps lower on an average annual basis.

FIGURE 1: PERFORMANCE DIFFERENTIAL BETWEEN MSCI EM AND WTEMI

[Since WTEMI Inception, 6/1/2007–12/31/2014]

Index	Avg. Ann. Return	Cumulative Return	Standard Deviation	Beta[1]
WisdomTree Emerging Markets Dividend Index	2.87%	23.96%	23.11%	0.91
MSCI Emerging Markets Index	1.62%	12.95%	25.26%	1.00

Sources: WisdomTree, S&P, Zephyr StyleADVISOR. Past performance is not indicative of future results. You cannot invest directly in an index.

[1] Beta: Measure of the volatility of an index or investment relative to a benchmark. A reading of 1.00 indicates that the investment has moved in lockstep with the benchmark; a reading of -1.00 indicates that the investment has moved in the exact opposite direction of the benchmark. For emerging markets, the MSCI EM Index is considered the benchmark and has a beta of 1.

THE FUNDAMENTAL DIFFERENCE

What's behind this striking performance differential? The answer, in a word, is dividends. WisdomTree weights the constituents in its Indexes based on fundamentals[9]—in this case dividends— instead of market capitalization.

At WisdomTree, we use fundamentals because we believe that stock markets are not always efficient.[10] Stock prices may deviate from the underlying fundamental value for a number of reasons. Weighting by market capitalization, the way the MSCI EM and many other indexes are constructed, can magnify these deviations. For example, given two stocks with the same level of earnings per share[11] and the same number of shares outstanding, a market cap-weighted index typically will give the greatest weight to the stock with the highest price-to-earnings (P/E) ratio[12] without regard to any measure of fundamental value. As a result, the market capitalization-weighted index may tend to over-weight more expensive equities, sectors and countries, and under-weight those that may be relatively less expensive.

[6] "MSCI Market Classification as of 9/30/14.

[7] Basis point: 1/100th of 1 percent.

[8] Standard deviation: A measure of how widely an investment or investment strategy's returns move compared 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. Standard deviations are compared to the MSCI EM in this instance.

[9] Fundamentals: Refers to financial and accounting characteristics meant to measure the potential value of equities, in contrast to approaches focused on market capitalization.

[10] Efficient Market Hypothesis: Current share prices correctly reflect all available information about publicly traded firms and continually incorporate the emergence of new information on a nearly instantaneous basis; there are no bubbles, and firms are neither expensive nor inexpensive.

[11] Earnings per share: Total earnings divided by the number of shares outstanding.

[12] 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.

WisdomTree uses a rules-based methodology to weight companies in our Indexes by *Dividend* or *Earnings Streams*[13] rather than by market cap. Furthermore, WisdomTree rebalances its Indexes annually to adjust for relative value. MSCI implements a semi-annual index review in May and November and makes adjustments for new float shares outstanding but does not implement rebalances based on changes in relative valuation.

HOW WISDOMTREE WEIGHTS INDEXES BY DIVIDENDS

In its dividend family of Indexes, WisdomTree weights each stock eligible for inclusion in an Index by its share of the *Dividend Stream*—or the sum of regular cash dividends paid by all the companies in the Index:

+ **In addition to many other potential benefits, WisdomTree believes that weighting by dividends can potentially raise a portfolio's trailing 12-month dividend yield[14] and provide increased income to investors.**
+ **WisdomTree's dividend-weighted Indexes allocate weights to stocks, sectors and countries by treating all dividends equally.**
+ **Additionally, we use a rules-based rebalancing mechanism that adjusts relative weights based on the concept of relative value—shifting the weight away from stocks exhibiting lower rates of dividend growth (relative to their price performance) in order to focus on those companies that have achieved higher rates of dividend growth. This weighting and rebalancing process is one way in which WisdomTree manages the valuation risk of its Indexes and consistently shifts weight toward firms exhibiting greater rates of dividend growth.**

WHY DIVIDENDS?

WisdomTree believes there are many compelling economic and theoretical reasons for assigning Index weights based on the aggregate value of cash dividends paid by component companies. Consider:

+ **Regardless of country, in the past, cash dividends have provided an objective measure of a company's health, value and profitability—one that cannot be manipulated.[15]**
+ **Historically, dividend-paying equities have provided better downside protection[16] during bear markets.[17]**
+ **Historically, dividends are responsible for the majority of the stock market's real return.[18]**

[13] Dividend or earnings streams: Every firm within a WT dividend Index has paid a dividend in the past 12 months; every firm within a WT earnings Index has had positive earnings in the past 12 months; dividends or earnings for every constituent firm within a WT Index can be added up to create a dividend stream or an earnings stream.
[14] Trailing 12-month dividend yield: Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.
[15] Accounting earnings are subject to assumptions, which may or may not reflect reality. Dividends consist of direct cash given to shareholders and are not based on any estimates or assumptions. There is no certainty or assurance that the payment of dividends always indicates a company's financial health or viability.
[16] Downside protection: A broad investment concept referring in this case to the potential for the mitigation of risk due to the payment of dividends.
[17] Source: "Dividend Dynamics: Assessing the Benefits of Dividend-Paying Stocks," RidgeWorth Investments, January 2011.
[18] Source: Online Data Robert Shiller (www.econ.yale.edu/~shiller/data.htm), 2014.

DIVIDENDS IN EMERGING MARKETS

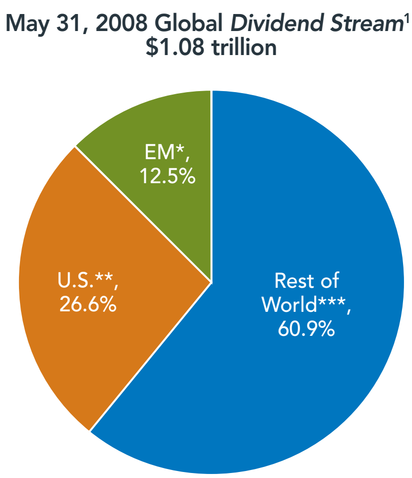
Within emerging markets, WisdomTree believes that investing in dividend-paying securities enables us to provide exposure to more established companies while mitigating some of the downside risk seen in many market cap-weighted indexes. In fact, relative to the MSCI EM, WTEMI has experienced lower volatility as measured by both its since-inception beta and standard deviation.

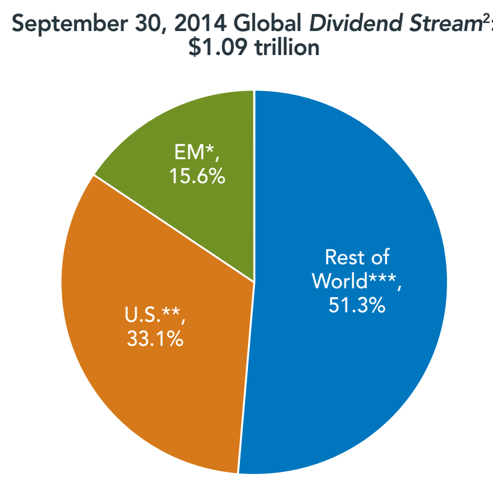
Since inception, WTEMI's standard deviation has been 215 bps lower than the MSCI EM's, with a beta of 0.91.

In our opinion, the case for dividends is especially compelling in emerging markets because these markets can at times have the potential to be less efficient than developed ones.[19]

FIGURE 2: EMERGING MARKETS AND U.S. GAINING SHARE AT THE EXPENSE OF THE GLOBAL PIE

[5/31/2008 – 9/30/2014]





Sources: WisdomTree, Standard & Poor's. Past performance is not indicative of future results.

[1] May 31, 2008, Global *Dividend Stream* refers to the sum of the cash dividends paid by constituents of the WisdomTree Global Dividend Index as of the May 31, 2008, Index screening date.

[2] September 30, 2014, Global *Dividend Stream* refers to the sum of the cash dividends paid by constituents of the WisdomTree Global Dividend Index as of the September 30, 2014, Index screening date.

*EM: Refers to the *Dividend Stream* of constituents of the WisdomTree Global Dividend Index incorporated in any of the following 17 countries: Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, South Korea, Taiwan, Thailand and Turkey.

**U.S.: Refers to the *Dividend Stream* of constituents of the WisdomTree Global Dividend Index incorporated in the United States.

***Rest of World: Refers to the *Dividend Stream* of constituents of the WisdomTree Global Dividend Index incorporated outside the United States and outside any of the 17 emerging market countries.

[19] Refers to the fact that developed markets typically feature equities that tend to trade among a wider array of investors. The breadth of the investor base, combined with the volume of trading, is meant to imply the potential for greater market efficiency. This is not a hard and fast rule and may not be true at all times or in all markets.

What we can see is that since our first international rebalance in May 2008, which included emerging market equities, the total *Dividend Stream* of our Global Dividend Index has remained more or less the same. However, both the U.S. and the EM equity constituents of the Index have increased their proportionate contributions. While the pie may not have gotten that much larger, the relative size of the slices has changed.

As this piece is focused specifically on the EM slice of the pie, we'll now turn to how we emphasize certain characteristics by cutting this EM slice in different ways.

INTRODUCING THE WISDOMTREE EMERGING MARKETS DIVIDEND INDEXES

WisdomTree created sub-segments within its EM-focused family to emphasize different attributes and serve as precision tools for benchmarking these exposures. Each selects constituents from the broader WisdomTree Emerging Markets Dividend Index:

+ **WisdomTree Emerging Markets Equity Income Index (WTEMHY):** Built to focus on the relatively higher-yielding segment of the market.
+ **WisdomTree Emerging Markets Dividend Growth Index (WTEMDG):** Built to focus on stocks that WisdomTree believes have the potential to increase their future dividend payments.
+ **WisdomTree Emerging Markets SmallCap Dividend Index (WTEMSC):** Built to focus on the small-cap segment of emerging market dividend payers.

The interesting point to keep in mind is that, although each of these Indexes selects its constituents very differently, the weighting is exactly the same. In other words, each firm in each of these Indexes is weighted by its contribution to the *Dividend Stream*, and it is in this way that WisdomTree's dividend-focused emerging market Indexes are attentive to relative valuation.

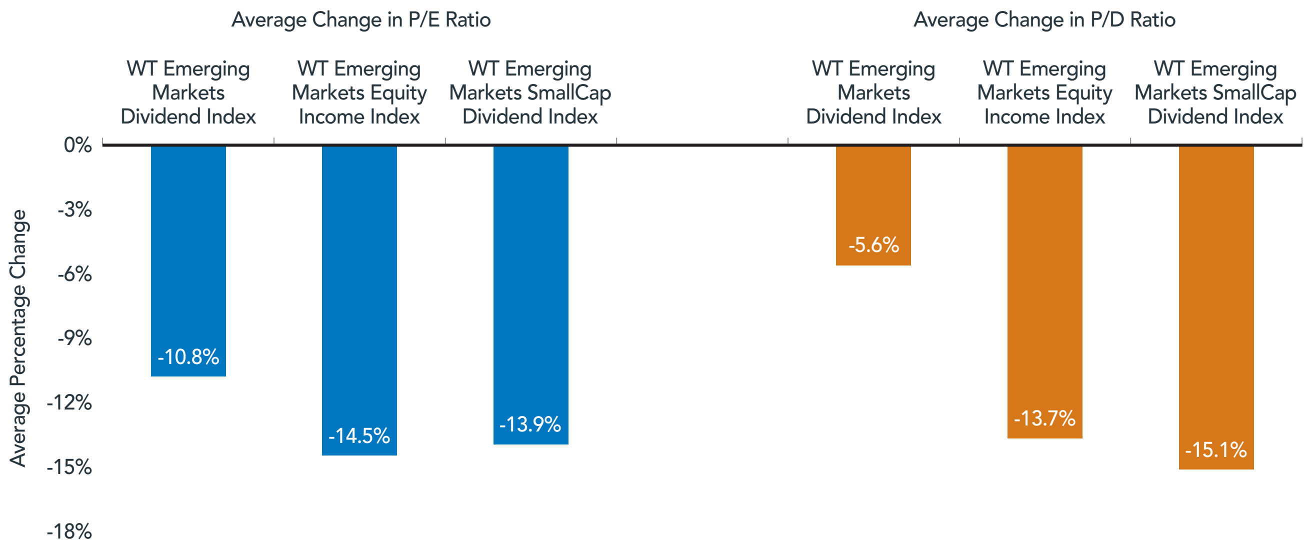
ILLUSTRATING THE RELATIVE VALUE REBALANCES AT WORK: VALUATION CHANGES

With market capitalization-weighted indexes, when constituents increase in price compared to other stocks, they are gaining a greater weight and therefore greater potential impact on the subsequent performance of the index. WisdomTree Emerging Markets Indexes employ a rules-based rebalancing mechanism that adjusts relative weights based on underlying fundamentals.

As a result of the rebalance process, WisdomTree Indexes typically see improvement in valuation through lower price-to-earnings (P/E) ratios and lower price-to-dividend (P/D) ratios[20]. We analyze how the rebalance impacted the relative valuation multiples at each of the real-time rebalances on the following page.

[20] Price-to-dividend ratio: Refers to the index price divided by the trailing 12-month dividends.

FIGURE 3: AVERAGE CHANGE IN RELATIVE VALUATION AT INDEX REBALANCES [5/31/2008–9/30/2014]



Sources: WisdomTree, Standard & Poor's. Past performance is not indicative of future results. You cannot invest directly in an Index.

Selection Methodologies for WT EM Dividend-Focused Indexes

WISDOMTREE EMERGING MARKETS DIVIDEND INDEX (WTEMI)

This Index creates the selection universe from which the constituents for the three Indexes that follow are pulled. It is meant to be as broad as possible, because the broader it is, the richer the selection universe from which these other Indexes can pull. The main criteria for inclusion are:

- **Incorporation in one of WisdomTree's Emerging Market Countries:** Currently, this includes the following 17 countries: Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, South Korea, Taiwan, Thailand and Turkey. WisdomTree sets its own list of eligible countries and does not follow the list of any other index provider.
- **Dividend Payers:** Payment of at least $5 million in cash dividends on shares of common stock in the annual cycle prior to the annual reconstitution in October.
- **Market Capitalization:** Firms must have a market capitalization of at least $200 million as of the annual EM screening date.

It is from this list of companies, numbering 1,163 as of the September 30, 2014, screening, that the three WisdomTree Indexes below are constituted.

WISDOMTREE EMERGING MARKETS EQUITY INCOME INDEX (WTEMHY)

For some, valuation sensitivity is the primary interest, and WTEMHY keeps that element at the forefront of its selection methodology. There are many ways to gauge whether a stock is expensive or inexpensive, but in this particular case, dividend yield is used:

- **Main Selection Criteria:** For initial inclusion to the Index, WTEMI constituents are ranked by dividend yield. The top 30% become eligible for inclusion in WTEMHY.
- **Deletion Criteria:** To be deleted from the Index, constituents must fall outside the top 35% of WTEMI when ranked by dividend yield.

ILLUSTRATING THE RELATIVE VALUE REBALANCE

The annual rebalance of constituents is driven both by the selection of high-dividend-yield securities, which introduces a relative value discipline, but also by the aggregate *Dividend Stream*, increasing weight to companies growing their dividends. The following analysis illustrates the typical characteristics of firms that see their weight raised against those that see it lowered at each rebalance.[21]

FIGURE 4: WTEMHY'S REBALANCE DRIVERS: DIVIDEND GROWTH AND RELATIVE PERFORMANCE

	Dividend Growth							
	Weight Change at Rebalance	2009	2010	2011	2012	2013	2014	Median of All Rebalances
Median *Dividend Stream* Growth	Raised	21.59%	21.02%	96.17%	35.54%	26.10%	18.46%	23.85%
	Lowered	-5.69%	-37.92%	11.35%	-11.11%	-16.54%	-20.89%	-13.82%
	ALL	0.89%	-1.06%	25.87%	-0.48%	-0.24%	-1.47%	-0.36%

	Performance							
	Weight Change at Rebalance	2009	2010	2011	2012	2013	2014	Median of All Rebalances
Median Total Return	Raised	-32.47%	27.74%	27.30%	-24.19%	7.65%	-3.02%	2.32%
	Lowered	-19.23%	27.20%	38.87%	-12.04%	21.95%	2.45%	12.20%
	ALL	-25.50%	27.26%	33.24%	-16.12%	17.69%	-0.56%	8.56%

Sources: Bloomberg, Standard & Poor's, WisdomTree. You cannot invest directly in an Index. Past performance is not indicative of future results.

- **Main Selection Criteria:** The essence of WTEMHY's methodology lies in allocating greater weight to constituents who have raised their dividends. As shown above, companies that saw their weight raised across each rebalance had a median dividend growth of 23.85%, whereas companies that saw reduction in weight had a median dividend reduction of approximately 13.82%.
- **"Buy Low, Sell High" Discipline:** The median performance characteristics of companies that saw their weight increased at each rebalance was only about 2.32%, significantly below that of the companies that had their weights lowered. This shows the relative-value discipline to buy stocks that have generally lower prices and selling stocks that have relatively higher prices.

[21] Additions (firms that previously were not in the Index) are included in the "weight raised" category; deletions (firms that lost Index representation) are included in the "weight lowered" category.

WISDOMTREE EMERGING MARKETS SMALLCAP DIVIDEND INDEX (WTEMSC)

We believe that small-cap stocks offer a different risk profile and return potential that at times can be complementary to large-cap securities. Some of the long-term research on equity markets suggests that small-cap value is one of the best-performing segments across long periods, and we think this strategy is very well represented in the emerging markets with a focus on small-cap dividend payers:

+ **Main Selection Criteria:** WTEMI constituents are ranked by market capitalization. The firms comprising the bottom 10% of WTEMI's total market cap become eligible for inclusion in WTEMSC.
+ **Deletion Criteria:** To be deleted from the Index, constituents must fall outside the bottom 13% of WTEMI's total market cap.

ILLUSTRATING THE RELATIVE VALUE REBALANCE

Just as illustrated for WTEMHY in figure 4, the principal drivers of the annual rebalance are both dividend growth and relative stock performance.

FIGURE 5: WTEMSC'S REBALANCE DRIVERS: DIVIDEND GROWTH AND RELATIVE PERFORMANCE

	Dividend Growth							
	Weight Change at Rebalance	2009	2010	2011	2012	2013	2014	Median of All Rebalances
Median *Dividend Stream* Growth	Raised	4.43%	18.16%	80.89%	19.31%	19.71%	16.24%	18.74%
	Lowered	-8.17%	-31.03%	13.99%	-4.76%	-10.48%	-7.99%	-8.08%
	ALL	-5.71%	0.11%	30.94%	2.47%	4.47%	0.00%	1.29%

	Performance							
	Weight Change at Rebalance	2009	2010	2011	2012	2013	2014	Median of All Rebalances
Median Total Return	Raised	-32.01%	33.05%	30.20%	-22.82%	17.51%	-2.20%	7.66%
	Lowered	-19.21%	35.02%	38.79%	-13.59%	28.45%	2.33%	15.39%
	ALL	-26.38%	33.81%	34.20%	-18.41%	22.44%	0.33%	11.39%

Sources: Bloomberg, Standard & Poor's, WisdomTree. You cannot invest directly in an Index. Past performance is not indicative of future results.

+ **Dividend Growth among Small Caps:** Similar to what we saw with WTEMHY, the WTEMSC constituents that had their weight raised exhibited much stronger median dividend growth over the years than those that had their weight lowered.
+ **"Buy Low, Sell High" Discipline:** Median price performance also looked similar to the WTEMHY pattern—lower median performance for the "weight raised," higher median performance for the "weight lowered" companies.

We find this of special interest because it really speaks to the potential benefit of focusing constituent weights on a fundamental metric—dividends—which delinks the share price from the ultimate weight. There is a similar "buy low, sell high" discipline to what we saw with WTEMHY.

WISDOMTREE EMERGING MARKETS DIVIDEND GROWTH INDEX (WTEMDG)

For some, emerging market equities are primarily about growth potential. WTEMDG is a tool designed to select equities that can potentially emphasize that attribute, specifically regarding dividend growth. The primary elements of its constituent selection are as follows:

+ **Dividend Coverage Ratio:** WTEMI constituents must have dividend coverage ratios[22] greater than 1.0x to be eligible for inclusion in WTEMDG.
+ **Growth & Quality Ranking:** Among the stocks qualifying for screening, the top 50% of firms with the best combined rank of growth and quality factors will be selected for WTEMDG.
    - **Growth Ranking 50%:** Long-term earnings growth expectations.[23]
    - **Quality Ranking 50%:** Evenly split between three-year average return on assets (ROA)[24] and three-year average return on equity (ROE) [25].

Some of the resulting attributes are indicated in the following table.

FIGURE 6: EVALUATING THE GROWTH POTENTIAL OF EMERGING MARKET INDEXES

WisdomTree Emerging Markets Dividend Growth Index Characteristics (12/31/2014)							
Primary Selection Criteria	Index	Long-Term Earnings Growth Expectations	Return on Equity (ROE)	Return on Assets (ROA)	Leverage	Earnings Retention	ROE x Earnings Retention
Growth-Focused Selection	WisdomTree Emerging Markets Dividend Growth Index	14.2%	23.9%	11.1%	2.2x	41.8%	10.0%
Yield-Focused Selection	WisdomTree Emerging Markets Equity Income Index	9.2%	12.1%	2.6%	4.7x	47.9%	5.8%
Broad-Based	MSCI Emerging Markets Index	9.8%	11.6%	2.4%	4.9x	65.9%	7.7%
Broad-Based with Valuation Sensitivity	MSCI Emerging Markets Value Index	8.0%	10.5%	2.0%	5.2x	63.6%	6.7%
	MSCI Emerging Markets Growth Index	14.9%	14.0%	3.2%	4.3x	71.3%	10.0%

Sources: WisdomTree, Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index.
Leverage: Total assets divided by equity.

[22] Dividend coverage ratio: Earnings per share divided by dividends per share. Higher numbers indicate a firm has a greater amount of earnings per share relative to its dividend payments.
[23] Long-term earnings growth expectations: Compilation of analyst estimates of the growth in operating earnings expected to occur over the next full business cycle, typically three to five years.
[24] Return on assets (ROA): Firm 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.
[25] Return on equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

A statistic that we find worth noting in this chart is referenced as "ROE x Earnings Retention." In essence, this denotes the percentage of a firm's profits that is retained for future use, and the ROE is a measure of how efficiently they are deployed to generate more profits. Academically speaking, this figure could denote the potential rate of dividend growth that could be achieved, given the firm's current policies. Currently, we feel the earnings retention rate for the different emerging market indexes could be influenced by the large disparities in valuations accross the market.

Is the Dividend Focus Making a Difference?

OUTPERFORMING THE CAP-WEIGHTED BENCHMARKS— AND MOST ACTIVE MANAGERS[26] AS WELL

For WTEMHY and WTEMSC, both of which were launched during the summer of 2007, we're starting to have significant history from which to glean the specific drivers of performance.[27]

Dividend weighting and stock selection helped WTEMHY and WTEMSC not only with dividend yields and dividend growth but with overall performance and volatility reduction as well (data as of 12/31/2014):

+ **WTEMHY outperformed the MSCI EM, by 49 bps over the five-year period and by 252 bps since index inception. These performance numbers would have outperformed approximately 60% and 96%, respectively, of active managers and ETFs over the five-year and since-inception periods.**
+ **WTEMSC outperformed the MSCI EM Small Cap by 182 bps over the five-year period and by 293 bps since Index inception. Still, these performance numbers would have outperformed approximately 87% and 96%, respectively, of active managers and ETFs over the five-year and since-inception periods.**

FIGURE 7A: OUTPERFORMANCE VS. OTHER EMERGING MARKET STRATEGIES [6/1/2007–12/31/2014]

Percentage of Active Managers Beaten by the Specified Index, as of December 31, 2014						
	YTD	1-Year	3-Year	5-Year	8/1/2007-12/31/2014	6/1/2007-12/31/2014
WisdomTree Emerging Markets Equity Income Index	5%	5%	5%	60%	95%	96%
MSCI Emerging Markets Index	59%	59%	44%	50%	61%	68%
WisdomTree Emerging Markets SmallCap Dividend Index	73%	73%	79%	87%	96%	96%
MSCI Emerging Markets Small Cap Index	86%	86%	85%	72%	65%	79%
Number of Managers	793	793	546	358	234	231

Sources: WisdomTree, Zephyr StyleADVISOR. You cannot invest directly in an index. Past performance is not indicative of future results.

[26] Active managers: Portfolio managers who run funds that attempt to outperform the market by selecting those securities they believe to be the best. For this study, it specifically refers to active managers within the Morningstar diversified emerging market category.
[27] WTEMDG, launched in the summer of 2013, doesn't have a history to display in this fashion.

FIGURE 7B: AVERAGE ANNUAL INDEX RETURNS [6/1/2007–12/31/2014]

Index Performance: Average Annual Returns, as of December 31, 2014						
	YTD	1-Year	3-Year	5-Year	8/1/2007-12/31/2014	6/1/2007-12/31/2014
WisdomTree Emerging Markets Equity Income Index	-10.63%	-10.63%	-0.40%	2.27%	3.34%	4.14%
MSCI Emerging Markets Index	-2.19%	-2.19%	4.04%	1.78%	0.33%	1.62%
WisdomTree Emerging Markets SmallCap Dividend Index	-0.64%	-0.64%	6.61%	4.75%	3.42%	N/A
MSCI Emerging Markets Small Cap Index	1.01%	1.01%	7.65%	2.93%	0.50%	2.11%

Sources: WisdomTree, Zephyr StyleADVISOR. You cannot invest directly in an index. Past performance is not indicative of future results.

SHOW ME THE RISK-ADJUSTED RETURNS!

+ **WTEMHY demonstrated lower standard deviations than the MSCI EM across the three-year, five-year and since-inception periods. WTEMHY's beta was between 8% and 18% lower than that of the MSCI EM over the three-year, five-year and since-inception periods. These positive risk-adjusted returns can also be exhibited through a positive alpha[28] over the five-year and since-inception periods.**
+ **WTEMSC demonstrated lower standard deviations than the MSCI EM Small Cap across the three-year, five-year and since-inception periods. WTEMSC's beta was between 4% and 12% lower than that of the MSCI EM Small Cap over the three-year, five-year and since-inception periods. These positive risk-adjusted returns can also be exhibited through a positive alpha compared to the MSCI Emerging Markets Index over these same periods.**

FIGURE 8: HONING IN ON STANDARD DEVIATION [6/1/2007–12/31/2014]

Risk Comparison (Standard Deviation as of December 31, 2014)					
	1-Year	3-Year	5-Year	8/1/2007-12/31/2014	6/1/2007-12/31/2014
WisdomTree Emerging Markets Equity Income Index	14.24%	14.49%	17.25%	21.59%	21.39%
MSCI Emerging Markets Index	13.59%	15.21%	18.55%	25.43%	25.26%
WisdomTree Emerging Markets SmallCap Dividend Index	10.59%	13.96%	17.78%	24.12%	N/A
MSCI Emerging Markets Small Cap Index	9.35%	14.24%	18.56%	27.47%	27.35%

FIGURE 9: HONING IN ON BETA VS. MSCI EM [6/1/2007–12/31/2014]

Beta Comparison as of December 31, 2014 vs. MSCI Emerging Markets Index					
	1-Year	3-Year	5-Year	8/1/2007-12/31/2014	6/1/2007-12/31/2014
WisdomTree Emerging Markets Equity Income Index	1.02	0.92	0.90	0.82	0.82
MSCI Emerging Markets Index	1.00	1.00	1.00	1.00	1.00
WisdomTree Emerging Markets SmallCap Dividend Index	0.74	0.86	0.92	0.92	N/A
MSCI Emerging Markets Small Cap Index	0.62	0.87	0.95	1.05	1.05

Sources: WisdomTree, Zephyr StyleADVISOR. You cannot invest directly in an index. Past performance is not indicative of future results.

[28] Alpha: Measure of risk-adjusted performance that compares how the constituents move relative to a benchmark.

WHY CONSIDER DIVIDEND PAYERS IN EMERGING MARKETS TODAY?

The MSCI EM has a history extending back to December of 1987[29] and thus encompasses a variety of market environments. Our goal is to construct a framework allowing us to analyze the valuation levels of the MSCI EM over a period of over 25 years. While one can never know future performance with certainty, we do believe it useful to know whether current valuation levels look closer to being expensive, inexpensive or just about average.

YEAR-END DIVIDEND YIELD AS A POTENTIAL VALUATION INDICATOR

We believe that the MSCI EM's dividend yield is an important indicator of its valuation. In fact, as of December 31, 2014, more than 98% of the MSCI EM's weight was in companies that had paid at least one dividend over the preceding 12 months, indicating a strong dividend-paying culture in the region.

With respect to comparisons to its own historical levels, our research shows that the MSCI EM's starting trailing 12-month dividend yield at the beginning of a calendar year had a strong relationship to the subsequent performance over the next 12-month period.

The MSCI EM has over 25 full calendar years of index data for which year-end trailing 12-month dividend yields can be calculated. We divided these years into two baskets sorted by the trailing 12-month dividend yield as of December 31 of each year:

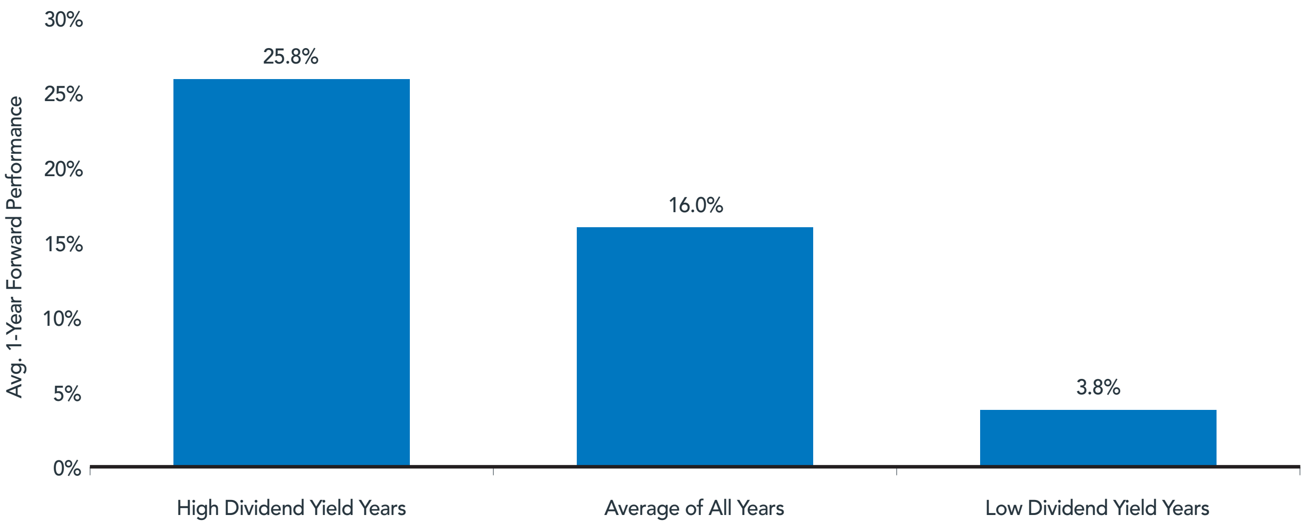
+ **"High Dividend Yield Years":** Years in which the starting trailing 12-month dividend yield was above the median[30] trailing 12-month dividend yield for the MSCI EM. The median trailing 12-month dividend yield was 2.34%.
+ **"Low Dividend Yield Years":** Years in which the starting trailing 12-month dividend yield was below the median trailing 12-month dividend yield for the MSCI EM.

PERFORMANCE: WHERE THE RUBBER MEETS THE ROAD

We think the figure below paints a clear picture of the differences in returns between periods classified as High Dividend Yield Years and those classified as Low Dividend Yield Years.

[29] Start date for available data for the MSCI Emerging Markets Index.
[30] Median: The value within a dataset at which 50% of all observations occur above and 50% occur below.

FIGURE 10: ANALYSIS OF MSCI EMERGING MARKETS INDEX PERFORMANCE FOLLOWING HIGH AND LOW DIVIDEND YIELD YEARS [12/31/1988–12/31/2014]



Sources: WisdomTree, MSCI. You cannot invest directly in an index. Past performance is not indicative of future results. 1-year forward performance is calculated by using the index values of the MSCI EM at the end of each calendar year and the subsequent forward year.

- **Squarely in the High Dividend Yield Year Range:** As of December 31, 2014, the MSCI EM exhibited a trailing 12-month dividend yield of 3.11%. There were eight calendar years that started with a higher value, and the average return over those years was approximately 58%. While this past performance cannot guarantee any particular future return, we do believe that 3.11% is a strong potential valuation indicator relative to the performance history of the MSCI EM.
- **Big Dispersion from High to Low:** We've certainly pointed to this analysis before, and we'll bring it up again and again to emphasize its importance. The three bars in figure 10 make the statement that valuation is of paramount importance for the MSCI EM. On average, returns of the High Dividend Yield Years eclipsed those of the Low Dividend Yield Years by over 22%.

CONCLUSION

There is little question that when one considers the picture of economic growth going forward that emerging markets should be important contributors. As investors continue to look for ways to add that exposure to their portfolios, we'd like to remind them of a few things:

- **Many Emerging Market Companies Are Also Dividend Payers:** A dividend focus in and of itself does not cut the potential investment landscape down significantly.
- **All Dividend Payer's Aren't Created Equal:** That's why we created Indexes that focus on relatively higher-yielding dividend payers, dividend payers with growth potential and small caps. Tools exist to emphasize certain characteristics in how one seeks to gain exposure.

+ **Anchoring to Changes in Relative Value:** A dividend focus, especially with regard to Index weighting, provides a disciplined way to focus on whether prices have moved beyond fundamentals at a regularly spaced interval.

We've seen that WTEMHY's and WTEMSC's performance in real time has been strong, especially when accounting for the level of risk compared to their market capitalization-weighted benchmarks. Given that we don't see overall interest or attention to EM equities dissipating in the near future, tools that focus on dividend payers could be of special interest.

Unless otherwise stated, data source is WisdomTree.

WisdomTree Emerging Markets Dividend Index: A cash dividend-weighted index measuring the performance of dividend-paying equities incorporated in emerging markets. WisdomTree Emerging Markets Equity Income Index: A subset of the WisdomTree Emerging Markets Dividend Index, measuring the performance of the higher-yielding stocks as measured by trailing 12-month dividend yields; weighted by cash dividends. 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; weighted by cash dividends. WisdomTree Emerging Markets Dividend Growth Index: A fundamentally weighted index designed to track the performance of dividend-paying emerging market companies that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by trailing 12-month cash dividends. 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. 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 Emerging Markets Small Cap Index: A broad market cap-weighted index showing the performance of small-cap equities across 21 emerging market countries defined as "emerging markets" by MSCI. MSCI Greece Index: A free float-adjusted market capitalization-weighted equity index designed to measure the performance of the Greek equity market. MSCI Qatar Index: A free float-adjusted market capitalization-weighted equity index designed to measure the performance of Qatar's equity market. MSCI United Arab Emirates Index: A free float-adjusted market capitalization-weighted equity index designed to measure the performance of the equity market of the United Arab Emirates.