

Are You Forgetting About Global Small Caps for Income?

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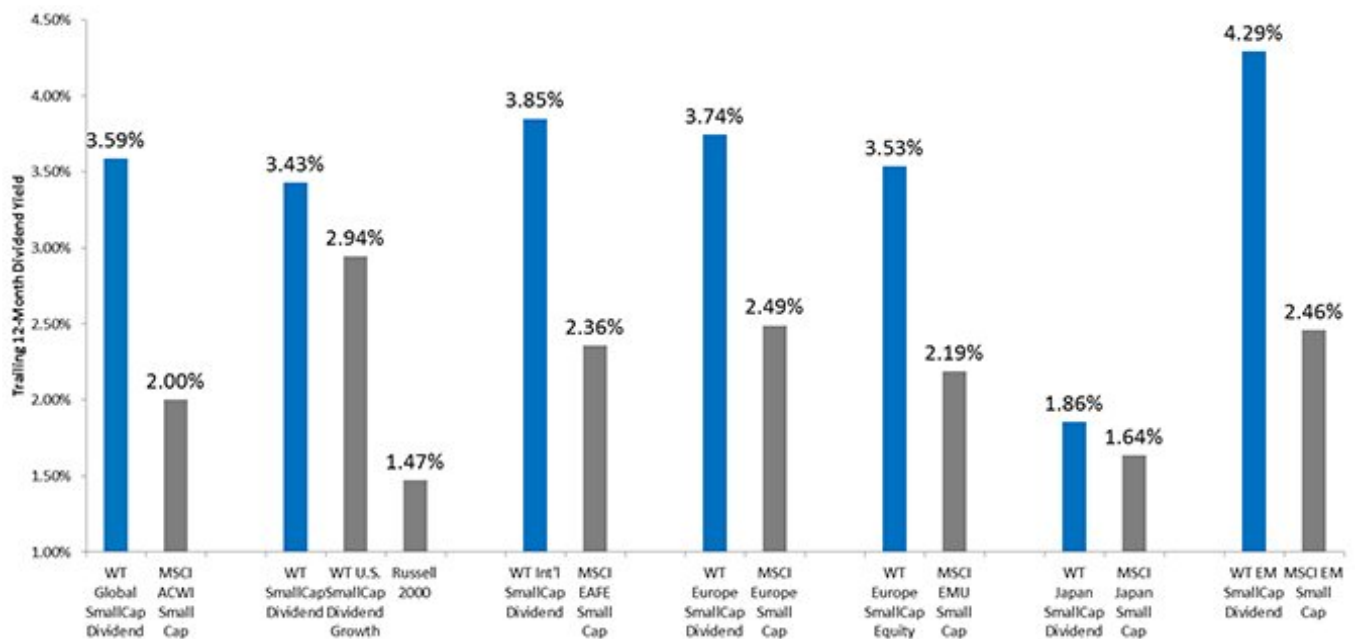
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Many investors need their portfolios to generate income, and this percentage is expected to increase as the baby boomers transition into retirement. But higher-yield asset classes are coming under pressure as treasury yields in the U.S. increase on expectations that the Federal Reserve (Fed) is going to raise interest rates. One asset class we feel is often overlooked but that can provide diversification and offer high income potential is small caps, especially international developed and emerging market small caps.

Why Small Caps for Income? Many investors wrongly assume that small-cap companies can't afford to pay dividends because their main focus is on growth and they need to reinvest their earnings to support that growth. We feel that looking at just the Russell 2000 Index as a proxy for all small caps incorrectly stereotypes all small-cap companies, because many small caps throughout the developed international and emerging markets offer higher dividend yields than both large- and small-cap companies in the United States. Many small-cap companies have proven business models with relatively stable earnings, and we believe these companies have the ability to pay out dividends to shareholders and grow them over time.

The Fundamental Difference WisdomTree's fundamental Index methodology is notably different from a market capitalization-weighted approach. When WisdomTree applies its dividend methodology, it includes only dividend-paying companies and then weights these companies by their dividends. Each Index is then rebalanced annually by adjusting relative weights based on trends in the underlying fundamentals to help manage valuation risk. When you combine these elements, it tends to produce very different trailing 12-month dividend yields. Below we will compare a cross-section of WisdomTree's small-capitalization Indexes across the global landscape with common market cap-weighted small-cap indexes to highlight the differences in the global small-cap opportunity set. **Small-Cap Trailing 12-Month Dividend Yields**



Sources: WisdomTree, Bloomberg, 8/7/15. Past performance is not indicative of future results.

• **Look Outside the United States for Higher Yields** – Whether looking at the large-cap or the small-cap indexes (displayed above), one typically sees higher trailing dividend yields outside the United States. The Russell 2000 Index had the lowest dividend yield of all the indexes examined above, and the [WisdomTree Emerging Markets SmallCap Dividend Index](#) had the highest—over 280 basis points higher, in fact. We also think it is impressive that international developed small caps can offer twice the yield of U.S. small caps, as the [WisdomTree International SmallCap Dividend Index](#) offered an advantage of over 230 basis point to the Russell 2000.

• **Eurozone Small Caps Also Offer Income Advantage** – It is important to note that the yield advantage of the [WisdomTree Europe SmallCap Equity Index](#) was over five times that of the German 10-year government bond and more than 3.5 times that of the French 10-year government bond. The European Central Bank is still in the very early innings of its quantitative easing program; as a result, we feel interest rates in the region could remain low for the foreseeable future.

• **Japanese Small Caps Offer Advantage over Government Bonds** – Japanese investors have traditionally invested a majority of their assets in cash or Japanese government bonds (JGBs), which turned out to be a profitable strategy during a period with little or no inflation. Now, with the government's 2% inflation target, we believe investors will move out of cash and into equities to protect their purchasing power. The [WisdomTree Japan SmallCap Dividend Index](#) offered a yield advantage over four times that of the JGB yield, which we believe should be very enticing.

Important Risks Related to this Article

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.

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development.

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.