

Dissecting the Strong Performance of Australian Equities in Q1 2013

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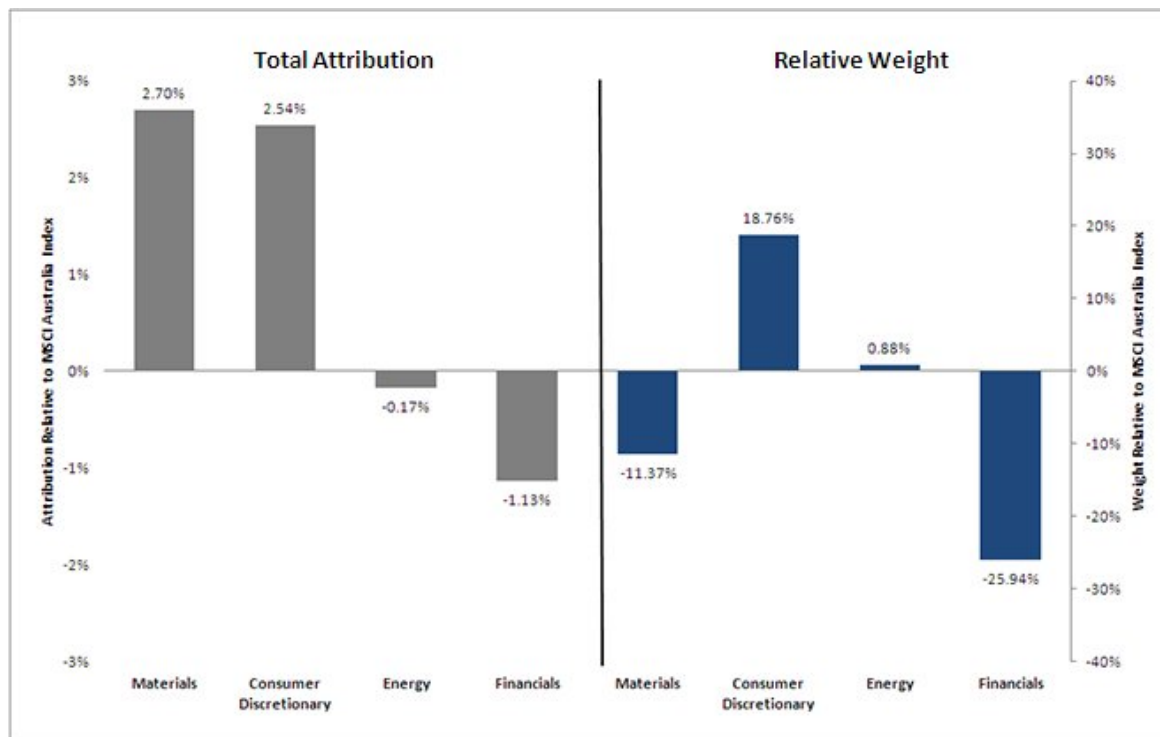
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Most investors tracking the markets know that the [S&P 500 Index](#) and the Dow Jones Industrial Average have reached record highs, finally surpassing October 2007 levels. A few weeks back I noted my [strong view on Australian equities](#), and I continue to believe Australian equities are an important market to watch, given their connection to commodity prices and to the Asian growth story. And Australia also had a very strong first quarter of 2013. **Australian Equities Deliver in Q1 2013** The [MSCI Australia Index](#) returned over 9% for the quarter, a level fairly comparable to the 10.61% for the S&P 500 Index and well ahead of the -1.62% for the [MSCI Emerging Markets Index](#). As we parse this performance, we see:

- **Double-Digit Sectors:** Information Technology, Financials, Consumer Staples, Consumer Discretionary and Industrials all returned greater than 12.7% for the first quarter of 2013. That's 5 out of 10 sectors.
- **Single Negative Sector:** Materials was the only sector to deliver negative returns for the first quarter of 2013.
- **Detrimental Weight Distribution** Obviously, the ideal portfolio for this past quarter would be one heavily weighted toward the five sectors with double digit returns and lightly weighted toward the Materials sector. Now, the MSCI Australia Index is simply a market capitalization-weighted measure of the performance of Australian equities, so we wouldn't expect it to position in this way, but its actual distribution of sector weights is worth noting:
- **Concentrated Bets:** Over the quarter, the average weight to Financials was nearly 50%, and the average weight to Materials was over 20%. This means that approximately 70% of the index's weight is in these two sectors—with performance significantly influenced by how they do.
- **Six Sectors Below 5% Weight:** Of the previously discussed five sectors with better than 12.7% performance during Q1 2013, three had weights lower than 5%. There was performance to be had, but weighting by market capitalization largely steered around it.

Is There Another Option? While market capitalization is definitely the most widely used method to weight equity indexes, it certainly isn't the only way. We believe that Australian equities in particular offer a good case study of one potential risk to this approach: concentration. *The largest firms do not always make the best investments.* **WisdomTree's Approach Added Significant Value** The [WisdomTree Australia Dividend Index](#) selects up to the 10 largest dividend-paying firms by market capitalization within each of the 10 sectors, with a minimum market capitalization requirement of \$1 billion. Qualifying firms are then weighted on the basis of their dividend yields, leading to significantly different constituent weights than a market capitalization-weighted methodology. As of March 31, 2013, both approaches had approximately 70 constituents, so one approach is not necessarily broader than the other. *Past performance is not indicative of future results.* In the first quarter of 2013, the WisdomTree Australia Dividend Index outperformed the MSCI Australia Index, its

market capitalization-weighted benchmark, by 4.61%. Let's look at the key drivers in terms of an [attribution analysis](#):



Source: Bloomberg

Both attribution and relative weight are for the WisdomTree Australia Dividend Index as compared to the MSCI Australia Index.

Attribution uses the period 12/31/2012 to 3/31/2013. Relative weight takes the average WisdomTree Australia Dividend Index weight minus the average MSCI Australia Index weight from 12/31/2012 to 3/31/2013. Past performance is not indicative of future results.

• **Strongest Boost to Relative Performance:** The strongest boost to relative performance came from the Materials sector, where the WisdomTree Australia Dividend Index had a nearly 11.5% under-weight. BHP Billiton LTD, a greater than 11% average weight within the MSCI Australia Index for the quarter, was down slightly over 10%. The WisdomTree Australia Dividend Index still included this rather well-known firm, but its average weight was only about 1.2%. • **Tilting Toward Consumer Discretionary:** Consumer Discretionary represented a nearly 20% overweight for the WisdomTree Australia Dividend Index against the MSCI Australia Index. Within this strongly-performing sector, WisdomTree's specific Consumer Discretionary stocks outperformed those of the MSCI Australia Index by more than 8.2%, helped by 6 firms that delivered double-digit returns. Many of these firms related to either real estate or vacation planning, so we believe they could indicate positive potential for the Australian economy. • **Biggest Detractor:** The Financials sector was actually a strong performer, and since WisdomTree's Index was almost 26% under-weight, this positioning detracted from its relative performance. At each rebalance, the WisdomTree Australia Dividend Index caps its maximum weight to any sector at 25%. Similar to the Consumer Discretionary sector's strong performance, we believe that such performance by the Financials sector may also be indicative of confidence regarding Australia's economic prospects. **Conclusion** The fact of the matter is that there will likely be times when each of the 10 sectors takes its turn as the strongest-performing segment within Australia's equity market, no matter the approach. We believe that for passive indexes,

greater diversification helps mitigate the risk of having large weights on the worst-performing sectors. **Data sources are WisdomTree and Bloomberg.**

Important Risks Related to this Article

You cannot invest directly in an index. Diversification does not eliminate the risk of experiencing investment losses.