

Don't Forget about the “Little Guys”

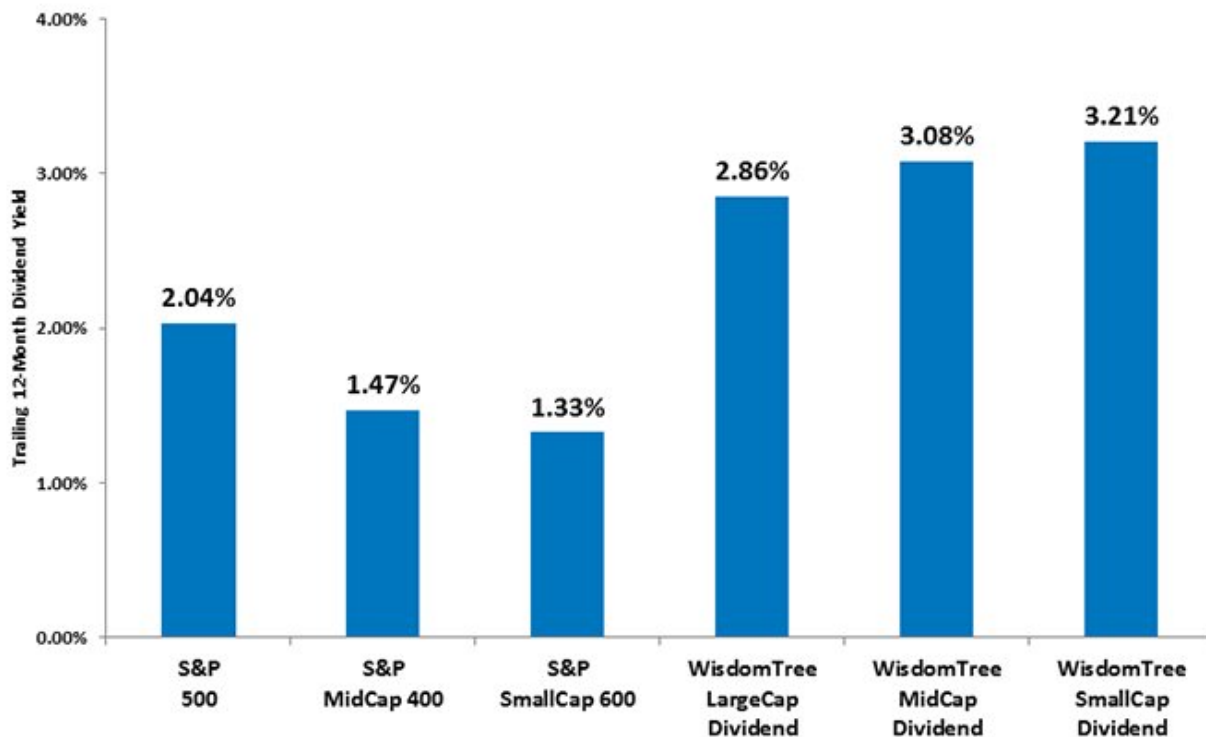
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The equity market has been extremely focused on when the Federal Reserve (Fed) is going to raise interest rates, and expectations are consistently changing with the release of any relevant data point. Consensus is that the Fed will abandon its zero interest rate policy at some point over the next year, but the timing of this first interest rate hike has been highly debated. Even more uncertainty surrounds the rate hike trajectory and the longer-term target level of interest rates. What is not debated is the fact that many investors need their portfolios to generate income, and this percentage is expected to increase as the baby boomers transition into retirement. But with interest rates still near record lows across the globe, many investors continue to look beyond traditional asset classes for income generation. We think that they mistakenly overlook mid- and small-cap dividend payers. We believe mid- and small-cap dividend payers deserve a larger allocation in most investors' long-term portfolios—particularly portfolios targeting income strategies—for both their current income and potential growth characteristics. **In Search of Income: Look to Mid- and Small Caps** We believe that many investors mistakenly assume that mid- and small-cap companies are solely focused on growth and therefore reinvest their earnings instead of paying them out in the form of dividends. When looking at traditional market cap-weighted indexes for the United States in particular, this assumption seems to be accurate. Going down the size spectrum, from the [S&P 500](#) (large cap) to the [S&P 400](#) (mid-cap) and the [S&P 600](#) (small cap), in the Standard and Poor's index family of market cap-weighted indexes illustrated in figure 1, the indexes that focus on larger market capitalization companies have higher trailing 12-month dividend yields. However, this does not necessarily have to be the case; there are many profitable mid- and small-cap companies that can afford to, and do, pay dividends. 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 dividend payers. When WisdomTree applies its domestic dividend methodology, it includes only dividend-paying companies and then weights these constituents based on their *Dividend Streams*®. These elements tend to produce very different trailing 12-month dividend yields for WisdomTree's LargeCap, MidCap and SmallCap Dividend Indexes.

Figure 1: Market Cap Weighting vs. *Dividend Stream* Weighting



Sources: WisdomTree, Standard and Poor's, as of 3/31/15. Past performance is not indicative of future results. You cannot invest directly in an index.

- In the current environment, WisdomTree's domestic Dividend Indexes turn this way of thinking on its head—the WisdomTree SmallCap Dividend Index has a yield advantage over the WisdomTree MidCap Dividend Index, and the WisdomTree MidCap Dividend Index has a yield advantage over the WisdomTree LargeCap Dividend Index. **Figure 2: Market Cap Weighting vs. Dividend Stream Weighting by Sector**

	WisdomTree LargeCap Dividend	S&P 500	Yield Difference	WisdomTree MidCap Dividend	S&P MidCap 400	Yield Difference	WisdomTree SmallCap Dividend	S&P SmallCap 600	Yield Difference
Index	2.86%	2.04%	0.82%	3.08%	1.47%	1.61%	3.21%	1.33%	1.88%
Consumer Discretionary	2.27%	1.51%	0.76%	2.59%	0.99%	1.60%	2.86%	0.84%	2.02%
Consumer Staples	3.05%	2.64%	0.41%	2.01%	1.04%	0.97%	3.42%	1.56%	1.86%
Energy	3.47%	2.97%	0.50%	5.33%	1.27%	4.06%	3.07%	0.69%	2.38%
Financials	2.39%	1.92%	0.47%	3.81%	2.78%	1.03%	4.04%	2.81%	1.23%
Health Care	2.51%	1.47%	1.04%	1.36%	0.33%	1.03%	3.85%	0.31%	3.54%
Industrials	2.56%	2.19%	0.37%	1.82%	1.10%	0.72%	2.63%	0.95%	1.68%
Information Technology	2.35%	1.55%	0.80%	2.04%	0.53%	1.51%	2.26%	0.44%	1.82%
Materials	2.78%	2.00%	0.78%	1.87%	1.82%	0.05%	2.54%	1.09%	1.45%
Telecommunication Service	5.12%	5.06%	0.06%	9.93%	2.26%	7.67%	4.28%	2.08%	2.20%
Utilities	3.69%	3.68%	0.01%	3.40%	3.16%	0.24%	3.27%	3.35%	-0.08%

Sources: WisdomTree, Standard and Poor's, as of 3/31/15. Past performance is not indicative of future results. You cannot invest directly in an index.

- Weighting eligible companies in our Indexes by dividends, rather than by market cap, enables us to magnify the effect dividends have on performance and potentially raise a portfolio's trailing 12-month dividend yield. Unlike weighting by dividend yield, which can concentrate weights in the highest-yielding sectors, WisdomTree's process of being broadly inclusive enables our core dividend Indexes to remain

properly diversified across sectors while also increasing income. **Managing Valuation Risk** Another important thing to consider when investing in mid- and small-cap companies, which typically trade at higher multiples as a result of their higher growth potential, is managing valuation risk. With market capitalization-weighted indexes, when constituents increase in price compared to other stocks, they gain greater weight and increase their impact on the performance of the index. WisdomTree Indexes employ a rules-based rebalancing mechanism that adjusts relative weights based on underlying dividend trends. During the rebalancing process, which occurs once per year for each Index, the relationship between price change and dividend growth is measured. WisdomTree's Dividend Index rebalance process typically is driven by both:

- Dividend growth: Faster dividend growers see weight increased
- Relative performance:
 - Underperformers typically see weight increased
 - Outperformers often see weight decreased

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.