

Election Day Fallout: Financials Sector in Focus and Dividend ex Financials as a Solution

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Prior to the November 6 election, financials had been enjoying quite the performance ride in 2012 as one of best-performing sectors in the [S&P 500 Index](#). However, on November 7, 2012, the day following the re-election of President Obama to a second term, many of the larger U.S. banks declined significantly. **Why the fall? A few potential explanations:** 1) **Cashing In on Intra-year Gains:** After the strong run this year, investors may have taken some of their capital gains in financials to the bank before facing potentially higher capital gains taxes in 2013. Anytime a sector has such a strong run compared to other sectors, it certainly becomes susceptible to investors taking profits and redeploying their funds elsewhere—especially given the president's proposal to raise capital gains taxes on higher-income investors. 2) **Regulation and anti-banker sentiment to continue:** Investors are concerned about the financial sector's potential moving forward due to the election results. With the re-election of President Obama, the increased regulations of the Dodd-Frank Act are now unlikely to be repealed. Some of the run-up in financials may have been a belief that Governor Romney had the potential to come in and scale back some of the harsher regulations contained in this law. 3) **Subdued growth outlook:** Another potential explanation for the decline could be that financials are particularly leveraged to economic growth—meaning that their business prospects are very sensitive to economic growth expectations—and when viewed through the (admittedly limited) prism of the S&P 500 Index's large sell-off following the election, one could reason that this was a lowering of economic growth expectations being factored in. **The WisdomTree Dividend ex-Financials Fund (DTN)—Maintain Equity Exposure but Exclude Financials** While it's still too early to see if the one-day sell-off will continue to the end of 2012 and beginning of 2013, thereby reversing the strong intra-year performance, we believe some investors may want to consider dividend ex-financials strategies as a way to hedge the risk of this type of sell-off in financials. Along with Luciano Siracusano, our Chief Investment Strategist, and Christopher Gannatti, a Research Analyst, I published a [post-election commentary](#) that discussed why we believe the prospects for higher dividend taxes is unlikely, in our view, to dramatically reduce the demand for dividend-paying stocks. Our research showed that the market environment had a much greater potential to impact returns over various tax rate climates than did the tax environment. There are also many tax-insensitive investors who we think have the potential to take advantage of those who are selling dividend-paying stocks held in taxable accounts for fear of potentially higher taxes on dividends. DTN, our [Dividend ex-Financials Fund](#), is one strategy that can hedge against the type of sell-off we saw in financials on November 7, 2012, the day following the election. The Fund tracks an Index that takes a diversified approach to U.S. equities with relatively high dividend yields¹ in the nine sectors outside of Financials—and we have done prior research emphasizing that stocks in relatively higher-yielding equity

sectors²(S&P 500 Consumer Staples Index, S&P 500 Health Care Index and S&P 500 Telecommunication Services Index) are not as expensive as many might think ([click here for full research](#)). We believe DTN offers a means to generate continued exposure to dividend-paying U.S. equities while avoiding the financial sector—all the more important as a potential source of income when interest rates remain at historic lows³.

¹The WisdomTree Dividend ex-Financials Index selects a maximum of 10 stocks with the highest indicated dividend yields from each of the nine sectors outside of Financials as of the date of index screening, 11/30 of each year. Indicated dividend yields tax the company's indicated annual dividends divided by the share price.

²These are three heavily weighted sectors within the WisdomTree Equity Income Index, which focuses on selecting the 30% of stocks from within the WisdomTree Dividend Index with the highest indicated dividend yields.

³Refers to the current policy of the U.S. Federal Reserve and chairman Ben Bernanke, who has stated that interest rates will remain exceptionally low until 2015. Christopher Gannatti is a registered representative of ALPS Distributors, Inc.

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