

How the Europe Small Cap Portfolio Changed at the Rebalance

Published July 17, 2014

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A key differentiator of the WisdomTree Index methodology is our annual rebalance to focus on changes in relative value. In this blog, we will zoom in on how this approach led to changes in exposure in the WisdomTree Europe SmallCap Dividend Index (WT Europe Small)—an Index that had some of the strongest gains since the last rebalance. In particular, WT Europe Small was up over 50% since the implementation date of the last rebalance (June 21, 2013). Below is a look at how the Index changed both by sector and by country—with a view to how these segments of the market performed. Typically, the strongest-performing parts of the market will see their weight reduced at the rebalance unless their dividend growth matched those strong increases. And that is what you see in each of the cases below.

Figure 1: Changes in Sector Exposure for WT Europe Small

	Sectors of WT Europe SmallCap Dividend	Prior Weight ¹	Sector Performance ²	New Weight ³	Change in Weight	Performance of Sector Relative to Index
Underperforming Sectors	Health Care	5.1%	38.1%	4.3%	-0.8%	-11.9%
	Utilities	0.8%	41.7%	3.1%	2.3%	-8.4%
	Materials	7.7%	45.6%	7.1%	-0.6%	-4.5%
	Consumer Staples	6.4%	45.8%	5.6%	-0.8%	-4.3%
	Industrials	26.1%	46.4%	28.8%	2.7%	-3.6%
Outperforming Sectors	Information Technology	14.3%	52.9%	14.5%	0.2%	2.8%
	Energy	2.6%	52.9%	2.5%	-0.1%	2.9%
	Consumer Discretionary	15.2%	53.1%	13.3%	-1.9%	3.1%
	Financials	17.2%	53.5%	17.8%	0.6%	3.5%
	Telecommunication Services	4.6%	98.8%	3.0%	-1.6%	48.8%
		Prior Weight ¹	Average Sector Performance ²	New Weight ³	Change in Weight	Average Performance of Sector Relative to Index
Sectors That Underperformed		46.1%	43.5%	48.9%	2.8%	-6.5%
Sectors That Outperformed		53.9%	62.2%	51.1%	-2.8%	12.2%

¹As of 5/31/13, constituents in the current WT Europe Small.

²Measured from 6/21/13 to 5/31/14.

³New weights determined by the 5/31/14 Index screening.

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

Utilities and Industrials saw the largest incremental increases in weight. These were underperforming sectors; it makes sense that exposure would be increased to sectors that had underperformed. The largest weight reductions occurred in Consumer Discretionary and Telecommunication Services. The Telecom

sector in particular had a blowout year, with the stocks in WT Europe Small in this sector up nearly 100%. No other sector had anything close to this performance. **Figure 2: Changes in Country Exposure for WT Europe Small**

Countries of WT Europe SmallCap Dividend		Prior Weight ¹	Country Performance ²	New Weight ³	Change in Weight	Performance of Country Relative to Index
Underperforming Countries	Belgium	1.5%	29.2%	3.3%	1.8%	-20.8%
	Norway	7.8%	30.5%	2.5%	-5.3%	-19.6%
	France	2.5%	38.4%	2.8%	0.4%	-11.7%
	Netherlands	4.0%	39.9%	2.5%	-1.5%	-10.2%
	United Kingdom	25.0%	40.8%	31.1%	6.1%	-9.3%
	Portugal	0.1%	44.1%	2.0%	1.9%	-5.9%
	Finland	2.0%	45.3%	9.0%	7.1%	-4.7%
Outperforming Countries	Sweden	15.7%	50.0%	13.5%	-2.2%	0.0%
	Austria	2.2%	55.2%	2.0%	-0.3%	5.1%
	Switzerland	8.5%	57.6%	4.6%	-3.9%	7.5%
	Germany	10.3%	62.9%	8.5%	-1.8%	12.9%
	Spain	4.0%	63.4%	2.0%	-2.1%	13.3%
	Ireland	2.6%	64.7%	3.1%	0.5%	14.6%
	Denmark	1.7%	70.3%	2.3%	0.7%	20.2%
	Italy	12.1%	76.2%	10.7%	-1.4%	26.2%
		Prior Weight ¹	Average Country Performance ²	New Weight ³	Change in Weight	Average Performance of Country Relative to Index
Countries That Underperformed		42.8%	38.3%	53.3%	10.5%	-11.7%
Countries That Outperformed		57.2%	62.5%	46.7%	-10.5%	12.5%

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In aggregate, countries that outperformed the broad Index had returns that ranged from 50% to approximately 77%. Three of the four best country returns were in the peripheral European countries Italy, Ireland and Spain. This speaks to the recovery that occurred in the bond yield spreads for these countries as well. In aggregate, these outperforming countries saw their weight reduced by 10.5 percentage points. **The Foundation of this Process Rests on Fundamentals** Market-capitalization-weighted indexes tend to hold greater exposures to securities (therefore also to countries and sectors) that have appreciated in price because this also leads to an increase in market capitalization. What is happening in WT Europe Small is that weight is being lowered to sectors—and even more notably, to countries—that have outperformed, and weight is being added to sectors and countries that have underperformed. Why is this? Because these are precisely the sectors and countries that have seen greater relative dividend growth. For the full research on the WisdomTree European Indexes rebalance, [click here](https://www.wisdomtree.com/us/insights/blog/how-the-europe-small-cap-portfolio-changed-at-the-rebalance).

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