

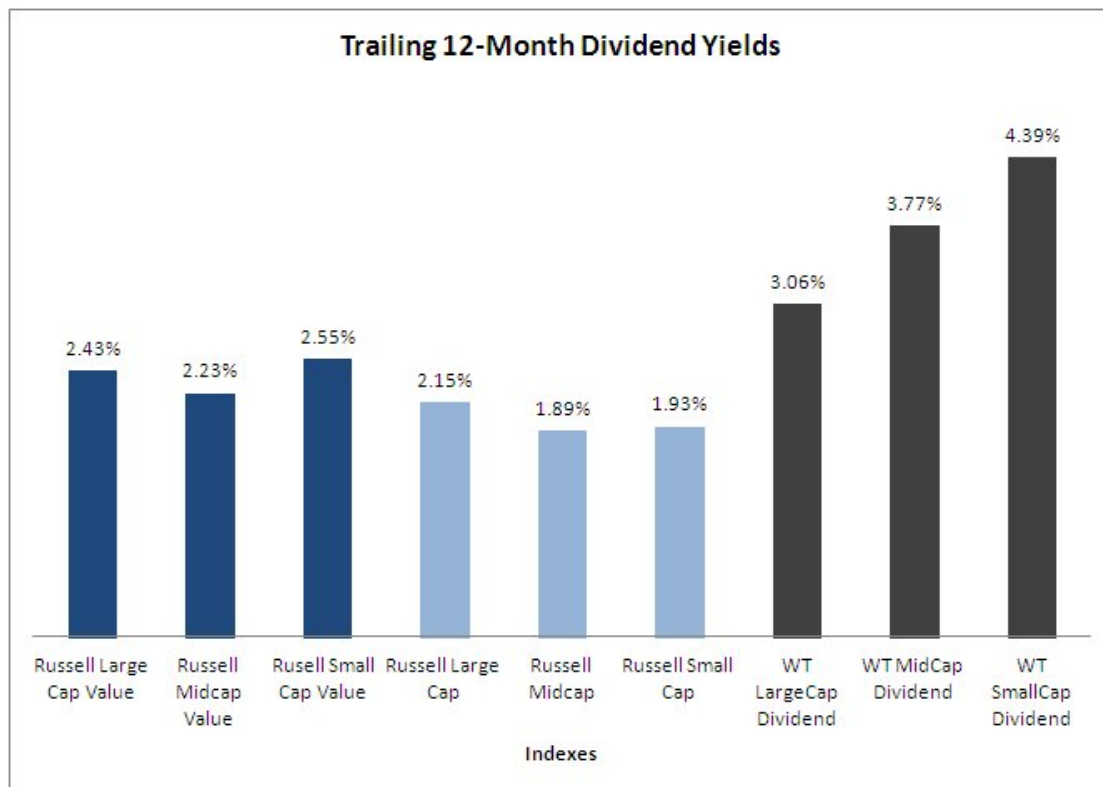
In Search of Income: Consider Mid and Small Caps

Published April 22, 2013

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When investors think of dividends, they tend to think of mature large-cap companies as the primary source. Many investors assume that mid- and 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. If you take a look at traditional market cap-weighted indexes, this assumption seems to be accurate. Within this piece, we will illustrate certain characteristics of different market capitalization equity size segments through the use of a series of Russell Indexes, each selected for the broadness of its exposure to that particular set of stocks. For full rationale behind choosing these indexes for the comparison, please read our research [here](#). Going down the size spectrum in the Russell index family of market cap-weighted indexes illustrated in figure 1, from Russell 1000 (Large) to Russell Midcap and Russell 2000 (Small Cap), the indexes focused on larger-market-capitalization companies have higher trailing 12-month dividend yields. The "value" sides of each size-based index holds a mixed story—the Russell 1000 Value Index has a higher trailing yield than the Russell Midcap Value Index but comes up slightly short against the Russell 2000 Value Index. Interestingly, the reverse is true for WisdomTree's Dividend Indexes: smaller-cap indexes display higher income levels. While it's important to note that dividend income is not the objective of the Russell indexes, differences in methodology can help explain why this occurs. First, WisdomTree only includes dividend-paying companies. Second, WisdomTree weights its constituents by their indicated dividend streams. Combined, these elements can cause very different trailing 12-month dividend yields for WisdomTree's large-, mid- and small-cap Dividend Indexes. Weighting eligible companies in our indexes by their indicated dividend streams enables us to magnify the effect dividends have on performance. 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. While market cap-weighting may be broader in scope, dividend weighting may increase dividend yields. **Figure 1: Market Cap-Weighting vs. Dividend Stream Weighting**



Sources: WisdomTree, Bloomberg (02/28/13).

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 had a yield advantage over the WisdomTree MidCap Dividend Index, and the WisdomTree MidCap Dividend Index had a yield advantage over the WisdomTree LargeCap Dividend Index.
- The WisdomTree SmallCap Dividend Index had a trailing 12-month dividend yield advantage of more than 1.8% over its market cap-weighted index peers, the Russell 2000 Value and the Russell 2000 indexes.
- The WisdomTree MidCap Dividend Index had a trailing 12-month dividend yield advantage of more than 1.4% over its market cap-weighted index peers, the Russell Midcap Value and the Russell Midcap indexes.

Weighting by Fundamentals: The Dividend Difference We believe dividends provide an objective measure of company profitability and have theoretical and empirical importance in determining stock values. Weighting eligible companies in our Indexes by their indicated dividend streams enables us to magnify the effect dividends have on performance. Each stock eligible for inclusion in an Index is weighted by its share of the dividend stream (which is the sum of regular cash dividends paid by all the companies in the Index). In a recent market insight, we evaluated how various indexes allocate weights to companies in different dividend yield buckets. We concluded here:

- **Higher Weights in Highest-Dividend Stocks:** For stocks with dividend yields greater than 4%, both WisdomTree MidCap and SmallCap Indexes have more than twice the weight, 25% and 32%, respectively, of their market cap-weighted value peers. The Russell Midcap Value and the Russell 2000 Value indexes have 20% and 40%, respectively, weight in companies with no indicated dividend yields.
- **Non-Payers Allocations:** All Russell indexes are market capitalization weighted and, as such, place the largest weights on firms with the largest market capitalizations. This means they will all have weight in non-dividend paying stocks (20%

for the Russell Midcap value and 40% for the Russell 2000 Value), which, of course, are ineligible for the WisdomTree Dividend Indexes. **Conclusion** In our opinion, mid- and small-cap companies are important tools for providing diversification benefits and increased potential return. Specifically, we think that mid- and small-cap dividend-paying companies deserve a larger share than they're currently being allocated by market cap-weighted indexes. Allocation to mid- and small-cap dividend-paying companies can increase trailing 12-month dividend yield. At WisdomTree, we do things differently. We build our Indexes and the ETFs designed to track them with proprietary methodologies, smart structures and/or uncommon access to provide investors with the potential for income, performance, diversification and more. In the mid- and small-cap market, we believe our approach can help investors more successfully capture a higher level of income from smaller companies. For more information on the subject, read our research [here](#).

Important Risks Related to this Article

Dividends are not guaranteed and a company's future abilities to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.