

Introducing Currency Hedging to Global ex U.S. Real Estate

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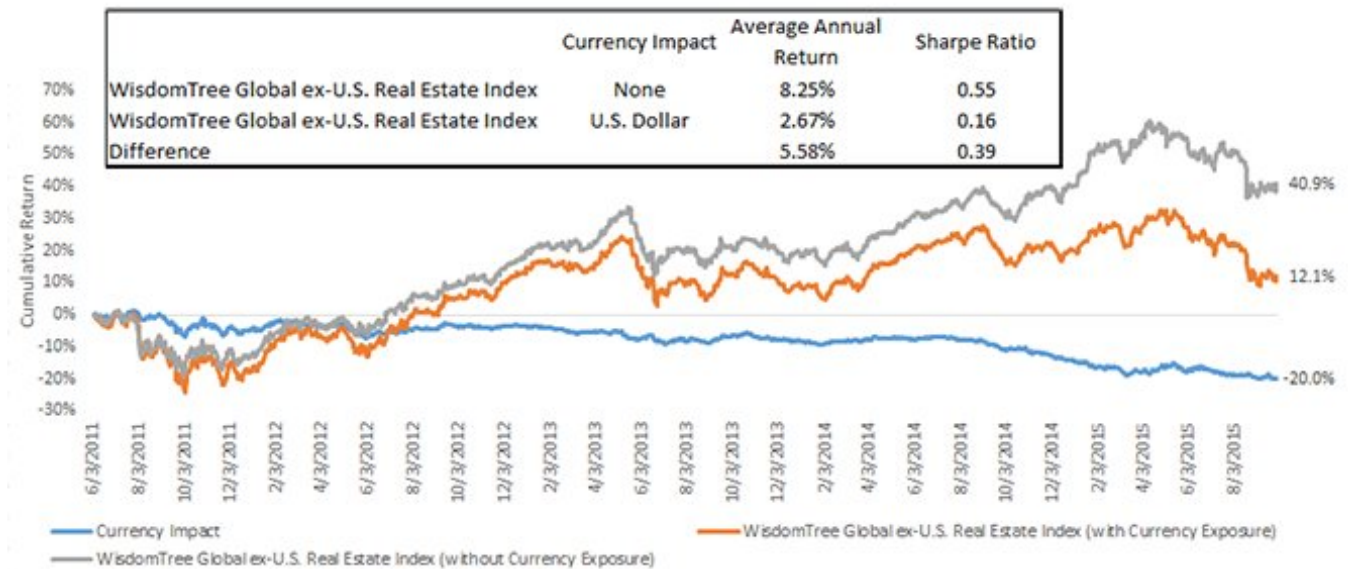
At WisdomTree, we introduced in 2009 the concept of currency-hedged equities to the exchange-traded fund (ETF) structure—a concept that caught fire subsequent to the introduction of Abenomics in Japan in late 2012.¹ Since then, similar excitement has taken hold of eurozone equities and is beginning to take hold more broadly in developed international equities.² The Bottom Line: We believe investors have awakened to the “currency factor,” which we’ve seen can have rather significant impacts on the risk /return profile of different investments over time. **Currency Hedging Meets Global ex-U.S. Real Estate** Real estate occupies an interesting asset class in the current market environment. One of the more attractive potential attributes of real estate is that of rising income streams, thereby providing the potential to keep pace with inflation. We don’t have notable inflation today, but all of the central bank policies that contribute to making currency hedging interesting may lead to higher inflation in the future. The current low-interest rate stance, seen from the perspective of developed market central banks, could, however, make the relatively higher dividend yields of real estate attractive presently, as income-generating assets. **The critical question:** Does global ex-U.S. real estate represent an interesting valuation opportunity today compared to other asset classes? If so, accessing it while seeking to neutralize the challenges and headwinds that could come from a stronger U.S. dollar could be of particular interest. **How Does WisdomTree Focus on Global ex-U.S. Real Estate?** At WisdomTree, we have a history of designing Indexes that weight securities by their fundamentals, and the case of the [WisdomTree Global ex-U.S. Real Estate Index](#) is no different. This Index weights each constituent by dividends paid. What does this mean? Well, the simplest way to see that is by looking at the difference in dividend yield versus a similar universe of securities³:

- **FTSE EPRA/NAREIT Global ex US Index:** This Index has a dividend yield of approximately 3.3%, achieved by weighting constituents on the basis of float-adjusted market capitalization.
- **WisdomTree Global ex-U.S. Real Estate Index:** This Index has a dividend yield of approximately 4.4%, achieved by weighting constituents on the basis of the income they generated over the prior annual cycle.⁴

Gauging the Attractiveness of Global ex-U.S. Real Estate It’s worth noting that, when looking at real estate globally, approximately 60% of the opportunity set is outside of the United States, as compared to equities broadly, where slightly more than half of the opportunity set lies abroad.⁵

- **Low Interest Rates Could Continue:** Taking the top five country exposures in the MSCI AC World ex-US Index, we see the following 10-year government bond yields: Japan, 0.3%; United Kingdom, 1.8%; France, 0.8%; Switzerland, -0.33%; and Germany, 0.4%.⁶
- **Real Estate Is Currently Interesting Compared to Fixed Income:** WisdomTree’s Global ex-U.S. Real Estate Index weights constituents by the income they generate, and while the risk profile of these assets is different from that of government bonds, the current income advantage may be

of interest. Comparing the aforementioned country exposures, we see: Japan, 1.64%; United Kingdom, 3.05%; France, 4.30%; Switzerland, 4.39%; and Germany, 2.59%.⁷ **Don't Let Currency Movements Swamp the Attractiveness of the Asset Class** We've written extensively about currency exposure having the potential to add uncompensated risk over time. The WisdomTree Global ex-U.S. Real Estate Index has been around for more than four years, so we looked to quantify the currency impact from a risk and return perspective over that period. **How WisdomTree's Index Has Performed during a "Strong Dollar" Period**



Sources: WisdomTree, Standard & Poor's, with data from 6/6/11 to 9/30/15. 6/6/11 corresponds to the inception date of the WisdomTree Global ex-U.S. Real Estate Index. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms in the chart, please visit our [glossary](#). • On a cumulative basis, we see that the currencies represented in the WisdomTree Global ex-U.S. Index universe depreciated 20.0% over the period against the U.S. dollar. The difference in average annual returns between the WisdomTree Global ex-U.S. Index measured with currency and without currency impact amounted to nearly 5.6% per year. • On a risk-adjusted basis, we see that the Sharpe ratio increased by 0.39 when the impact of currency was excluded. **How to Strategically Allocate to Global ex-U.S. Real Estate** In reality, we understand that this period was characterized by dollar strength. However, we pose this question: Is an allocation to global ex-U.S. real estate being made in order to take advantage of a particular movement in currency compared to the U.S. dollar, or is the allocation more due to the attributes of the asset class, such as the income-generating potential? Since we think that exposure to the income-generating assets is of primary importance, we think that approaches designed to mitigate the impact of currency movements could be of interest, and that is why we created the WisdomTree Global ex-U.S. Hedged Real Estate Index. 1Source: Bloomberg. 2Developed international equities refers to the MSCI EAFE Index universe. 3Source: Bloomberg, with data as of 10/28/15. 4Refers to the period of payments occurring over the 12 months prior to September 30 of each year, the annual screening date for this Index. 5Source: Bloomberg, with data as

of 10/28/15. Real estate universes: FTSE EPRA/NAREIT Global ex US Index and FTSE EPRA/NAREIT United States Index. Equity universe: MSCI ACWI Index. ⁶Source: Bloomberg, with data as of 10/28/15. ⁷Source: Bloomberg, with data as of 10/28/15.

Important Risks Related to this Article

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.

Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments.

Investments in real estate involve additional special risks, such as credit risk, interest rate fluctuations and the effect of varied economic conditions.