

On Japanese Central Bank Action, Japan Quality Factor in Focus

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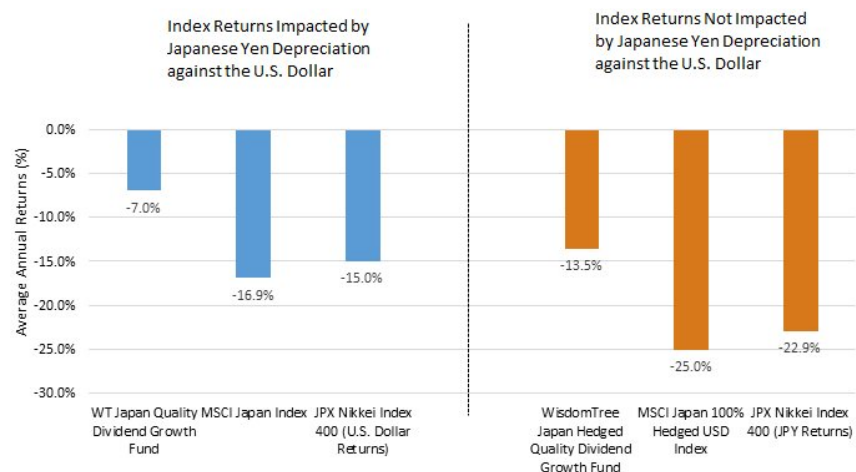
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The Bank of Japan surprised the markets by expanding its monetary stimulus program in January with the introduction of a new tool we'll call "NIRP" negative interest rate policy. The key bottom line we see from this action: Japan remains extraordinarily committed to achieving its 2% inflation goal and will not hesitate to expand into pursuing new policies if it continues to fall behind on its inflation mandate. In that vein, we expect the central bank to continue taking this deposit rate more negative over time. The central bank's commitment to stimulate the economy, along with corporate reforms designed to encourage better shareholder returns and capital distributions, are two of the many reasons we are bullish on Japanese equities in the long term. But how should one best invest in Japan, especially to capitalize on rising shareholder distributions? First there is a question of currency risk. Many of the monetary policies introduced by Japan have driven the yen down versus the U.S. dollar. Some of the yen weakness abated in 2015 and 2016, as volatility picked up and the yen strengthened with elevated risk sentiment.¹ WisdomTree believes yen currency risk is uncompensated risk and would advocate for hedging currency exposure to Japan. It helps that as Japan takes rates more negative, an investor is typically paid the relative interest rate differentials of higher U.S. interest rates and negative interest rates in Japan to hedge the yen. But WisdomTree has tools for Japan, including both unhedged and hedged exposures for the same underlying equity strategy. **Japan Quality Dividend Growth ETFs: Both Yen Hedged and Unhedged** WisdomTree launched two innovative Japanese exchange-traded funds (ETFs) in 2015 tied to WisdomTree's quality factor Indexes: a currency-hedged version, the [WisdomTree Japan Hedged Quality Dividend Growth Fund \(JHDG\)](#), and an unhedged ETF, the [WisdomTree Japan Quality Dividend Growth Fund \(JDG\)](#)². WisdomTree views its quality factor approach as an important differentiating factor from the JPX-Nikkei Index 400, which also has a focus on return on equity (ROE) in driving stock selection. Both of WisdomTree's quality Indexes for Japan select the 300 companies that rank best on quality factors (three-year average ROE and three-year average return on assets [ROA]) and a growth factor (based on long-term earnings growth expectations). There is a high overlap with the companies in the [WisdomTree Japan Quality Dividend Growth Index](#) and the JPX-Nikkei Index 400 (246 companies in are in BOTH Indexes, comprising more than 96% of the weight of the WisdomTree Japan Quality Dividend Growth Index), but we would say that the WisdomTree Index has the faster-growing and lower-leverage segment of the JPX-Nikkei Index 400.³ **Has WisdomTree's Approach Been Effective?** In order to zero in on this question from the standpoint of stock selection, we looked to analyze the performance of JDG and JHDG. We compared the unhedged Fund to the MSCI Japan and JPX-Nikkei 400 Indexes that were impacted by the yen's depreciation against the U.S. dollar, and we compared the hedged fund to the MSCI Japan

and JPX-Nikkei 400 Indexes that were not impacted by this depreciation. Please see here for standardized returns of JHD and JHDG.

Focusing on Quality Has Outperformed the Market (Both Hedged & Unhedged)



Source: Bloomberg, with period from 5/28/15 to 2/8/16, the live period for the WisdomTree Funds shown. You cannot invest directly in an Index.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

Looking at a table of the sector exposures of the WisdomTree Japan Quality Dividend Growth Funds (both share the same constituents and sector exposures) and the market capitalization-weighted MSCI Japan Index, there are a few notable sector tilts worthy of discussion:

- 1) The WisdomTree Japan Quality Dividend Growth Funds (both the hedged and unhedged versions) have been significantly under-weight Financials (with weights averaging less than 5% versus close to 20% in the MSCI Japan Index), due to the inclusion of ROA as a factor in the selection process. Financials tend to have high leverage and typically low return on assets, so they tend to receive less weight in WisdomTree's Japan Quality Dividend Growth Funds. Since the launch of these Indexes, Financials has been among the weakest-performing sectors and has been dragging down the MSCI Japan Index. This has been the second biggest contribution to relative performance for the WisdomTree approach.
- 2) The biggest contribution to relative performance has come from a sector in which the relative weight differential is smaller, but the stock selection impact has been much greater: the Telecommunication Services sector. WisdomTree Japan Quality Dividend Growth Funds have had about a 6% average over-weight to this sector, but the average stock return from the sector was much higher than that of the MSCI Japan Index.
- 3) The biggest drag in performance for the WisdomTree Japan Quality Dividend Growth Funds has been the 3.6% over-weight and selection in the Industrials

sector. This also has been a weak-performing sector, but the value added from other sectors more than made up for this sector's drag in performance.

Attribution: WisdomTree Japan Quality Dividend Growth Funds (JDG & JHDG)

Sector	% Average Weight			Total Return (USD %)			Local Returns (JPY %)			Total Attribution ¹ (in U.S. Dollars) (%)
	JDG/JHDG	MSCI Japan	+/-	JDG/JHDG	MSCI Japan	+/-	JDG/JHDG	MSCI Japan	+/-	
Totals	100.0	100.0	0.0	-6.31	-12.12	5.81	-12.61	-18.15	5.54	5.81
Telecommunication Services	11.2	5.3	5.7	25.37	8.73	16.64	16.76	1.26	15.50	2.97
Financials	4.7	19.5	-14.8	-5.91	-23.17	17.25	-12.37	-28.44	16.07	1.69
Consumer Staples	10.7	7.4	3.2	14.07	11.98	2.10	6.24	4.29	1.95	1.07
Consumer Discretionary	24.3	22.0	1.9	-13.28	-16.39	3.11	-19.23	-22.13	2.90	0.87
Information Technology	12.7	10.4	2.0	-13.55	-17.40	3.85	-19.49	-23.07	3.58	0.50
Materials	7.2	5.6	1.4	-19.16	-19.46	0.30	-24.71	-24.99	0.28	-0.01
Energy	0.1	0.9	-0.7	-1.85	-15.43	13.57	-2.55	-21.24	18.68	-0.02
Utilities	0.1	2.6	-2.5	1.68	-4.38	6.06	0.96	-10.94	11.91	-0.33
Health Care	6.3	7.7	-1.5	7.68	12.65	-4.96	0.29	4.91	-4.62	-0.70
Industrials	22.8	18.8	3.6	-16.77	-13.48	-3.28	-22.48	-19.42	-3.06	-0.73

Source: Bloomberg, with period from 5/28/15 to 2/8/16, the live period for the WisdomTree Funds shown. You cannot invest directly in an Index.

¹Total Attribution: refers to the portion or entire return that is derived from or attributable to a particular subset of a portfolio.

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For investors looking to add exposure to Japan, WisdomTree has been known for its currency-hedged approach to exporter companies in its primary Japan ETF, the [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#). But this is not the only broad-based way to allocate to Japan that WisdomTree offers. Whether it is an unhedged ETF for those who believe the yen may rise, or a Fund for those who do not want currency exposure in a hedged ETF, both of our Japan Quality Dividend Growth ETFs (JDG for unhedged and JHDG for hedged) represent important exposure that we believe compares favorably to traditional Japanese benchmarks.

1Source: Bloomberg, with levels of the yen versus the U.S. dollar studied from 4/13 (initiation of qualitative and quantitative monetary easing) to 2/16/16.

2The WisdomTree Japan Hedged Quality Dividend Growth Fund (JHDG) was designed to track the returns, before expenses, of the WisdomTree Japan Hedged Quality Dividend Growth Index. The WisdomTree Japan Quality Dividend Growth Fund (JDG) was designed to track the returns, before expenses, of the WisdomTree Japan Quality Dividend Growth Index.

3Sources: WisdomTree, Bloomberg, as of 2/5/16, based on ROE, ROA and long-term earnings growth estimates.

4Source for numbered paragraphs: Bloomberg, with data from 3/3/14 to 2/5/16.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing their investments on certain sectors may be more vulnerable to any single economic, regulatory or sector-specific development. This may result in greater share price volatility.

The Funds focus their investments in Japan, which can be impacted by the events and developments in Japan that can adversely affect performance. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. As these Funds can have a high concentration in some issuers, the Funds can be adversely impacted by changes affecting those issuers. The Funds invest in the securities included in, or representative of, their Indexes regardless of their investment merit, and the Funds do not attempt to outperform their Indexes or take defensive positions in declining markets.

The currency-hedged Funds use various strategies to attempt to minimize the impact of changes in the Japanese yen against the U.S. dollar, which may not be successful. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Due to the investment strategy of these Funds, they may make higher capital gain distributions than other ETFs. Please read each Fund's prospectus for specific details regarding each Fund's risk profile.