

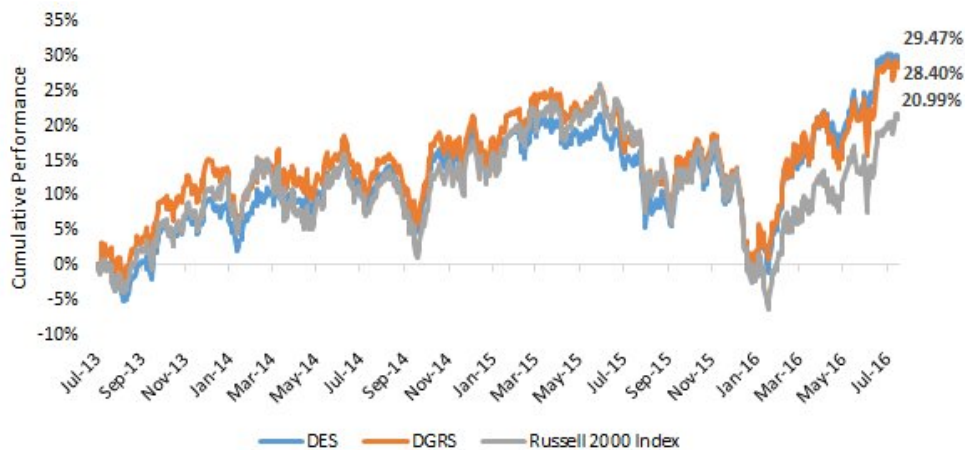
Small Cap Dividends and Quality Adding Value

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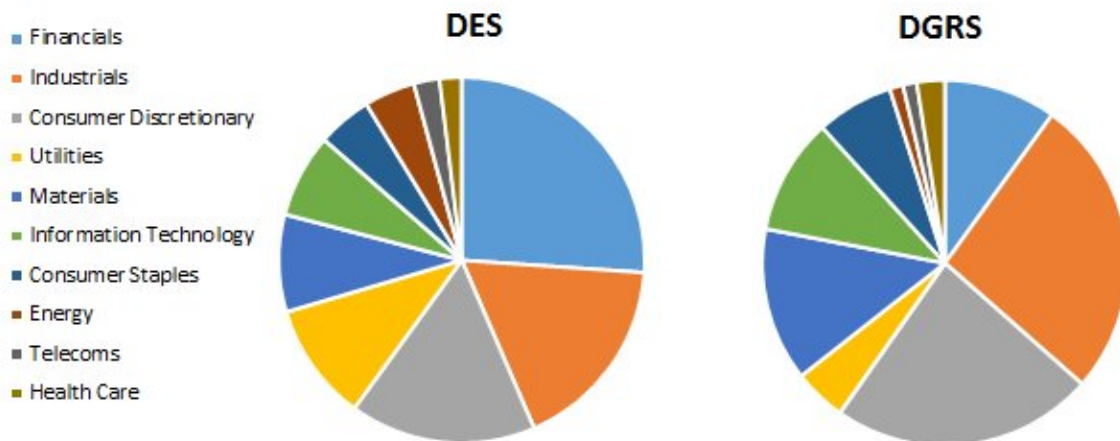
There are numerous dividend-focused exchange-traded funds (ETFs) and active managers. But how many small-cap dividend strategies for the U.S. market can you find? Very few, but WisdomTree has two unique strategies, both of which are creating value-added approaches over traditional small-cap benchmarks. When WisdomTree launched its first funds 10 years ago, we recognized the value of focusing on the size factor in building portfolios and were the first ETF issuer to build a robust family of global small-cap ETFs—including the first [European](#), [Japanese](#), [emerging markets](#) and [developed international small-cap](#) ETFs. For the U.S. markets, WisdomTree's two dividend-oriented small-cap strategies are: • **WisdomTree SmallCap Dividend Fund (DES)**: A broad cross-section of the dividend-paying small-cap market that recently passed 10 years of real-time results • **WisdomTree U.S. SmallCap Quality Dividend Growth Fund (DGRS)**: Focuses on the higher-quality growth segment of DES; this Fund recently passed its three-year anniversary in July. Interestingly, despite their different focal points and segments of the dividend-paying market to which they provide exposure, both DES and DGRS outperformed the Russell 2000 Index by over 200 basis points (bps) per year over the three years since DGRS launched. Let's review the case for dividend-paying small caps.



Sources: WisdomTree, Bloomberg, 7/25/13–8/10/16. Past performance is not indicative of future results. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. Double-digit returns were achieved primarily during favorable market conditions. Investors should not expect that such favorable returns can be consistently achieved. A fund's performance, especially for very short time periods, should not be the sole factor in making your investment decision.

[Click here for standardized performance of DES.](#) [Click here for standardized performance of DGRS.](#) **Dividends in Small Caps?** Many have ignored mid- and small-cap dividend opportunities. One explanation for this is that when one looks at market cap-weighted indexes and goes down in size from large to mid- to small caps, one tends to see dividend yields decrease from 2.1% to 1.7% to 1.5%, based on the S&P family of indexes on August 12.¹ The story completely reverses, though, when looking at a dividend-weighted index family. Shifting from a cap-weighted universe to a dividend universe, one increases the dividend yield moving from large caps to mid-caps to small caps. The dividend yields on a dividend-weighted Index from WisdomTree increased from 3.0% to 3.2% to 3.5% for the [WisdomTree LargeCap Dividend Index](#), the [WisdomTree MidCap Dividend Index](#) and the [WisdomTree SmallCap Dividend Index](#).² One explanation for this is that in a cap-weighted universe that includes non-dividend payers, there are more companies in “growth” stages that are using their capital to grow—or even just to break a profit, in many cases, for an index like the Russell 2000. We have recently discussed how the typical small-cap company in the Russell 2000 has been a serial share issuer, as 20% of the Russell 2000 tends to be allocated to unprofitable stocks that need to raise capital to fund their growth. [This has led to as much as a 2% drag in terms of how much earnings have to grow](#) just for the earnings per share growth over recent years. **Small-Cap Share Issuers versus Share Buybacks** One of the dynamics of selecting stocks with high return on equity (ROE) and return on assets (ROA) like DGRS does is that companies included tend to have greater profit levels that can be used for returning cash to shareholders via dividends and buybacks. While the Index that DGRS is designed to track has a dividend yield of 2.3%, still higher than the Russell 2000 and even the [S&P 500 Index](#), it has a net buyback yield of +1.87%. This means companies in this Index are

reducing shares outstanding, which is one factor that can lead to more positive *per share* dividend growth in the future. **Quality Approach: Less Utilities, REITs Compared to Small-Cap Dividend Payers** It is interesting that in 2016, both small-cap dividend payers and the quality small-cap dividend payers are outperforming the Russell 2000 by over 600 basis points. But they have done so with quite different sector and industry exposures. • For DES, the top sector exposure is Financials at 26%, with a large allocation to real estate investment trusts (REITs) (16% of DES). • DGRS had just 10% in Financials and less than 2% in REITs. • Utilities is another sector that was more prevalent in DES than DGRS. • DGRS tilts weight to Industrials, Consumer Discretionary and Technology companies.



Sources: WisdomTree, Bloomberg as of 8/12/16. Subject to change.

Diversify Your Dividends with Small Caps One of the more popular active dividend-growth strategies in the market was recently closed to new investors. One benefit to utilizing an index-based approach is that the broad cross-section of companies included allows for great investment capacity. As investors re-examine how they obtain their dividend exposure in the growth side of the dividend market, we'd encourage them to consider small-cap dividend payers as an underowned segment that can help to diversify and provide differentiated exposure from other popular dividend strategies. 1Source: Bloomberg. 2Sources: WisdomTree, FactSet as of 8/12/2016.

Important Risks Related to this Article

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

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