

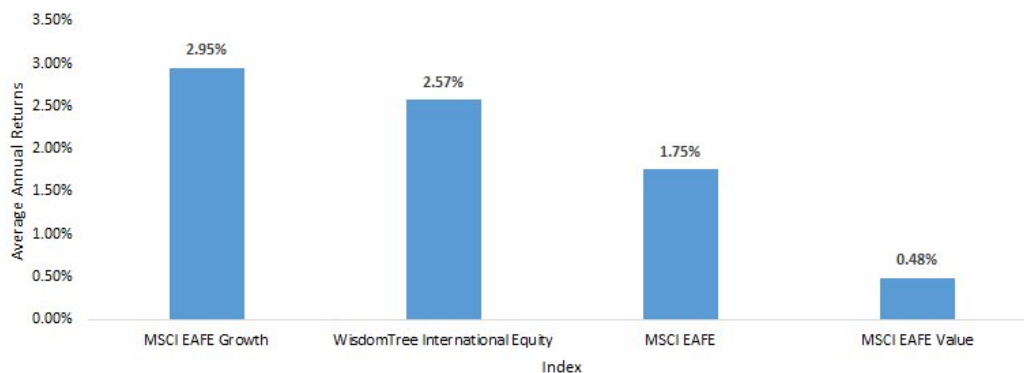
The Income Factor in Developed International Equities

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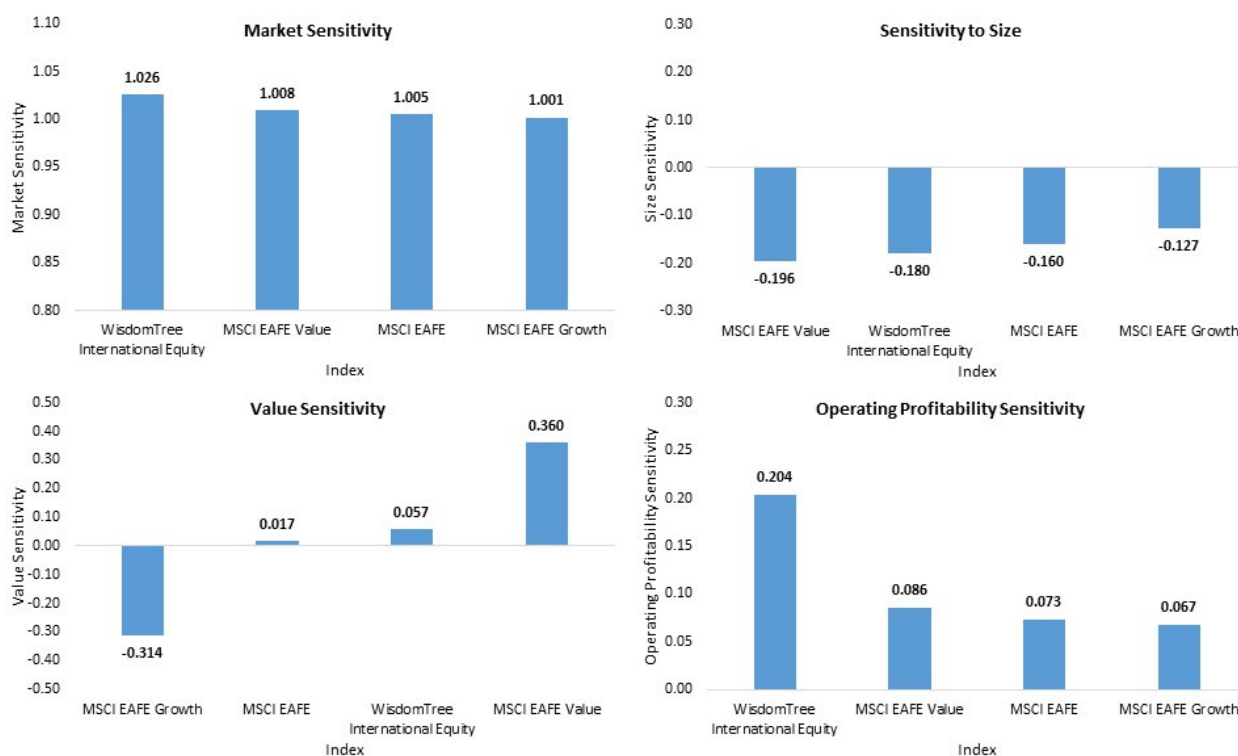
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It's interesting that investors will often slice and dice their U.S. equity exposures in almost endless fashion but focus only on the MSCI EAFE Index when looking abroad. If anything, the factor discussion becomes even more interesting when you look outside the United States, because, in these less-efficient markets, disciplined strategies governed by a systematic focus on factors could have greater potential to outperform over time. **A Factor Aligned with Investment Goals** Similar to what we [wrote about regarding factors in the U.S.](#), it is difficult to picture clients saying that they need size or momentum or minimum volatility on an individual basis. In our experience, it is much more common to think of these as tools, which can then lead to the construction of portfolios more aligned with the goals of investors. At WisdomTree, we've developed what we call the income factor in developed international stocks, through the [WisdomTree International Equity Index](#). • This strategy seeks to include all constituents within the same 21 developed markets in the MSCI EAFE Index that have paid regular cash dividends over the annual cycle that ends May 31 of each year. Beyond the application of WisdomTree market capitalization and liquidity requirements, there is not meant to be any real stock selection. • These qualifying constituents are then weighted on the basis of the cash dividends they have paid over the annual cycle leading up to the annual Index screening date. The critical consideration here is that the weighting methodology is designed to not introduce other biases, such as might be seen with either a dividend yield or dividend-per-share-weighted approach, which may tilt toward smaller-capitalization firms. If we can quantify the tilts seen over nearly 10 years of performance history for the WisdomTree International Equity Index, we can then understand what the income factor is really tapping into in developed international equities. **Growth Outperformed Value**



Sources: WisdomTree, Bloomberg. Data is from 6/1/06 to 3/31/16. You cannot invest directly in an index. 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.

For definitions of indexes in the chart, visit our [glossary](#). • Just as we saw in the United States over this period, the growth style outperformed the value style within the developed international equity markets. The WisdomTree International Equity Index outperformed both the MSCI EAFE and MSCI EAFE Value Index indexes over this period. **The Developed International Income Factor Introduces Tilts Different from the USA Income Factor**



Sources: WisdomTree, Bloomberg. Data is from 6/1/06 to 3/31/16. You cannot invest directly in an index.

• **The Income Factor Has Greater Market Sensitivity Abroad Than at Home:** In the United States, we saw that the [WisdomTree Dividend Index](#), in its execution of the income factor, delivered a market sensitivity below 1.0. The WisdomTree International Equity Index, on the other hand, delivered a market sensitivity of about 1.03. This tells us that, on a relative basis, the WisdomTree International Equity Index could be apt to more fully capture both upward and downward market moves. One reason for this may be that mid-cap and small-cap growth stocks in developed international markets are much more likely to pay dividends, giving the WisdomTree International Equity Index broader coverage compared to the WisdomTree Dividend Index in the United States.

• **The Income Factor Has Fewer Large-Cap Tilts Abroad Than at Home:** Since a greater proportion of mid-cap and small-cap stocks in developed international markets pay dividends, there tends to be less of a pronounced bias toward large caps in the WisdomTree International Equity Index. We see here that it is fairly in line with both the MSCI EAFE Value and MSCI EAFE indexes.

• **The Value Tilt of the Income Factor Melts Away in Developed International Markets:** While the U.S.-focused WisdomTree Dividend Index exhibited a clear tilt toward value, the WisdomTree International Equity Index turned out to be closer to a core strategy, not tilting significantly toward either the value or the growth end of the spectrum.

• **The Income Factor Tilted toward Robust Operating Profitability in Developed International Markets:** The most notable common thread between the WisdomTree Dividend Index and the WisdomTree International Equity Index was the tilt toward robust operating profitability. Taking the same concept of an extremely broad Index of dividend-paying stocks in two non-overlapping equity markets led to this similar result. WisdomTree's first dividend-oriented equity Indexes just passed their 10-year anniversary. The WisdomTree International Equity Index, a competitor to the MSCI EAFE Index for long-term, strategic international exposures, shows that dividend weighting was much more than a value-tilted strategy. In a market environment where growth outperformed value by almost 250 basis points per year, this Index outperformed the MSCI EAFE Index. We believe this was caused by the quality factor tilt. This Index had nearly double the profitability factor exposure of the MSCI EAFE Value Index, largely because the latter just searches for the lowest-priced stocks in a market, with no consideration for quality. Dividends are very commonly associated with attributes of profitability and quality, as firms must have good profits to consistently pay and grow their dividends. These companies that can grow dividends are the ones that receive greater weights in WisdomTree's Indexes through the annual rebalancing process.

Important Risks Related to this Article

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