

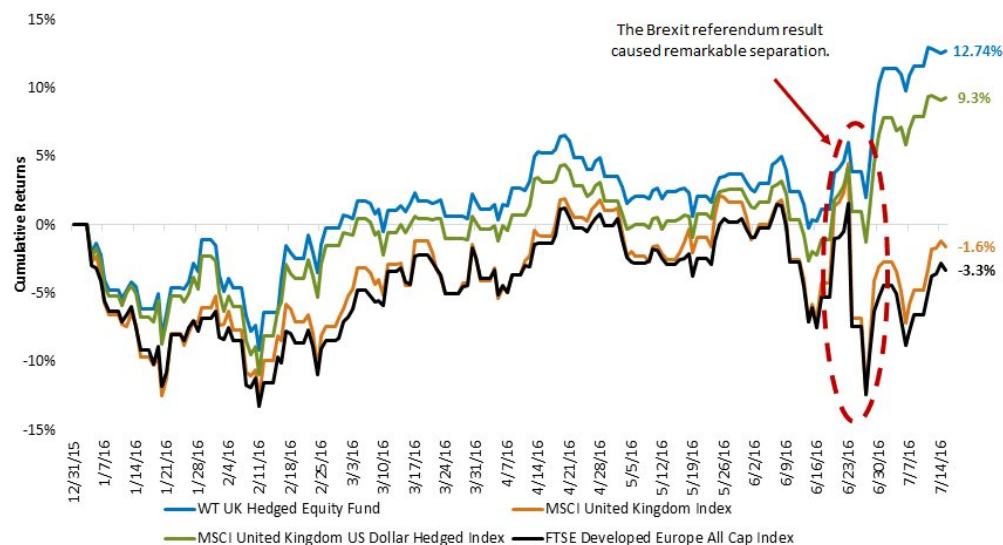
Why Is This UK Strategy Significantly Outperforming European Markets?

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The Brexit vote occurred last month, creating uncertainty about the United Kingdom's role and future in the European economy, yet the [WisdomTree United Kingdom Hedged Equity Fund \(DXPS\)](#) has been up 12.74% year-to-date (YTD) as of July 15, 2016, while a broader index of European stocks—the FTSE Developed Europe All Cap Index—is down 3.3% YTD in 2016.¹ What is happening here? For starters, DXPS employs a currency hedge—and thus has not been affected by the sharp falloff in the value of the British pound following the Brexit vote. Traditional exposures to European stocks typically include two components of returns: the foreign stock prices and the foreign currency moves against the U.S. dollar. Broad European strategies², which have as much as 30% exposure to the British pound, saw as much as a negative 12.8%³ impact on these stocks in the two weeks following Brexit. But there is something more than just the currency hedge in the works. The United Kingdom is home to many global companies that generate their revenues outside the UK. With a fall in the British pound, these companies are becoming more competitive in the global markets and their stock prices have been rising. Further, WisdomTree has an exporter orientation and screen in its WisdomTree United Kingdom Hedged Equity Index, which DXPS seeks to track before fees. The screen is designed to exclude stocks that derive more than 80% of their revenue from within the United Kingdom as of the annual rebalance. Comparing DXPS to the MSCI United Kingdom US Dollar Hedged Index (which also mitigates the risk of a depreciating pound by hedging), one can see there has been more than a 3 percentage point outperformance for DXPS year-to-date, as of July 15, 2016. Factoring in the British pound depreciation against the U.S. dollar, the MSCI United Kingdom Index, in U.S. dollar terms, was down 1.6% over this same YTD period. Another way to illustrate the outperformance of UK exporters: Germany's DAX is down 6.3% YTD as of July 15 priced in euros, while, to reiterate, DXPS is up 12.74%. [Click here for standardized performance of DXPS.](#)



Sources: WisdomTree, Bloomberg, with data shown for the period from 12/31/15 to 7/15/16. You cannot invest directly in an index.

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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.

What Are the Lessons? Currency-hedged exchange-traded funds (ETFs) have gained market share as a way to allocate to international stocks, largely on specific views for certain markets and currencies such as European markets and the euro and Japanese markets and the yen. The moves in the British pound this year are another illustration of how currency hedges can be valuable additions to international allocations. Where does the British pound go from here? No one knows for sure, and that is largely why we believe currency hedging has strategic value. Unless you take the view that the British pound is now inexpensive and bound to appreciate, we believe that currency hedging adds to the risk profile of UK stocks without adding to the expected return profile. We have been emphasizing that currency can offer uncompensated risk—and that there is no model to say that the British pound will always go up in value—so why always bet on that occurring unless you have a strong conviction that the British pound is going to increase against other currencies? There may be some value players, contrarians who react to sharp falls as an opportunity. I am sympathetic to thinking the market often overreacts, and perhaps the large drop in the pound is an example of such an opportunity. But it is equally possible we have not seen the full fallout of divergent trends in monetary policies, where it seems the U.S. Federal Reserve is on a path to normalizing (on some delayed timeline), while all eyes are on the next August meeting for the Bank of England to potentially expand monetary stimulus. **There Is More Than One Way to Incorporate Currency Hedges into Portfolios** The one long-term international investment strategy I would not advocate: being fully unhedged all the time, unless you believe these foreign currencies are structurally appreciating (i.e., the dollar is in long-term decline). There may be some investors who believe that. But most of those voting to remain unhedged think currency nets out and it effectively doesn't matter. We argue that the last four to five years show that

currency can be quite significant and no one can tell you exactly where we are in that cycle today. I believe investors should either adopt a passive hedging program to help reduce the volatility of international stocks or adopt a dynamic hedging program that looks at multiple factors such as interest rate differentials, value and momentum of currencies to help determine how much currency exposure should be hedged. For what it's worth, this dynamic model of the [WisdomTree Dynamic Currency Hedged International Equity Index](#) suggests being 83% hedged on the British pound as of our latest signal, measured at the end of June 2016. [Learn more about the benefits of a dynamically hedged approach.](#) 1Sources: WisdomTree, Bloomberg, with data from 12/31/15 to 7/15/16. 2Refers to the FTSE Developed Europe All Cap Index. 3Source: Bloomberg, with data from 6/23/16 to 7/7/16.

Important Risks Related to this Article

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