

You Don't Need an Active Manager for Small Caps

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We continue to see money flow out of traditional mutual funds and into exchange-traded funds (ETFs), but there is still more than \$8 trillion in equity-focused mutual funds, more than four times the amount invested in ETFs.¹ For decades, active managers have “sold” their investment process to investors looking for higher returns, but many managers have failed to deliver. According to S&P Dow Jones, more than 82% of large-cap active managers underperformed the [S&P 500 Index](#) over a 10-year period. And although it is commonly believed that active management works best in inefficient environments, such as small caps, active managers actually underperformed here too. Over the same 10-year period, more than 87% of small-cap active managers underperformed the [S&P SmallCap 600 Index](#).² WisdomTree introduced its first set of small-cap ETFs in 2006, and our record calls conventional wisdom into question and supports the findings of S&P. In fact, some of WisdomTree's best performance against active and passive peers alike has been in the small-cap asset class.

Managing the Most Important Risk: Valuation We think investors have a tendency to get excited about future growth potential and risk bidding up security prices past their fundamentals. We believe this risk tends to be greater in the small-cap space where you have higher growth expectations and more speculative companies, or companies that are not profitable or pay dividends. To confront this risk, [the WisdomTree ETFs](#) and the Indexes they track are rebalanced annually. In essence, the process takes a detailed look at the relationship between the underlying fundamentals and price performance. Once a year, WisdomTree's fundamental Indexes add weight to stocks that have become less expensive and take weight away from stocks that have become more expensive, compared to their fundamentals. WisdomTree believes this forced discipline to sell high and buy low at regular intervals, especially after large performance moves, is critical to an index seeking to build a strong performance record over time.

Proof in Performance Each of the WisdomTree ETFs below is designed to track the returns of a WisdomTree fundamental Index, before fees and expenses. All of them have a track record of more than five years, with the majority having more than nine years of live performance history, and we look to compare them to active managers and ETFs in their respective Morningstar categories.

Percentage of Peers Beaten In Respective Morningstar Category

Fund Name	Ticker	Fund Inception	Morningstar Category	1-Year	3-Year	5-Year	Since Fund Inception*
WisdomTree Europe SmallCap Dividend ETF	DFE	6/16/2006	Europe Stock	82%	100%	100%	83%
WisdomTree SmallCap Dividend ETF	DES	6/16/2006	U.S. Small Value	68%	56%	70%	60%
WisdomTree EM SmallCap Dividend ETF	DGS	10/30/2007	Diversified Emerging Markets	55%	56%	70%	95%
WisdomTree Int'l SmallCap Dividend ETF	DLS	6/16/2006	Foreign Small/Mid Value	49%	55%	69%	76%
WisdomTree SmallCap Earnings ETF	EES	2/23/2007	U.S. Small Blend	37%	60%	65%	88%
WisdomTree Japan SmallCap Dividend ETF	DFJ	6/16/2006	Japan Stock	43%	29%	63%	64%

Number of Funds in Each Respective Category				
Morningstar Category	1-Year	3-Year	5-Year	Since Fund Inception*
Europe Stock	123	95	87	71
U.S. Small Value	436	379	314	226
Diversified Emerging Markets	865	586	371	245
Foreign Small/Mid Value	70	57	40	26
U.S. Small Blend	802	657	592	457
Japan Stock	47	35	25	15

Sources: WisdomTree, Morningstar Direct, as of 6/30/15. *Since Fund Inception refers to the closest month-end date following intramonth inception date. Past performance is not indicative of future results. Morningstar proprietary ratings reflect historical risk-adjusted performance as of 6/30/15. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three, five- and ten-year (if applicable) Morningstar Rating metrics. 2015 Morningstar, Inc. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance, rankings and ratings are no guarantee of future results. The Percent Rank in Category is the funds' total-return percentile rank relative to all funds within the same Morningstar Category and is subject to change each month. Regarding number of funds, 1 = Best and 100 = Worst.

• **Impressive Long-Term Record:** All of the WisdomTree ETFs displayed above outperformed the majority of their peer group over the most recent five-year and respective since-inception periods. We find it impressive that the [WisdomTree Emerging Markets SmallCap Dividend ETF](#) outperformed 95% of its peer group since inception. Contrary to what many might initially believe—that you need active managers to outperform in small caps or inefficient asset classes—the evidence over this period may suggest otherwise.

Why Fundamentally Weighted ETFs? Although we do not believe active management is necessary to provide compelling long-term returns, we do think it is important to invest with a disciplined focus on valuations. WisdomTree Indexes, and the ETFs designed to track them, use rules-based methodologies to weight companies by their underlying fundamentals, such as dividends or earnings, because we believe that prices are not always the best determinant of a security's value. Furthermore, WisdomTree rebalances its Indexes annually to adjust for relative value to help manage valuation risks, and we are pleased with the results thus far. 1Source: Investment Company Institute. Refers to U.S. listed. As of 6/30/15. 2Sources: S&P Dow Jones Indices LLC, CRSP, as of 12/31/14.

Important Risks Related to this Article

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development.