

THE DIFFERENCE A REBALANCE CAN MAKE

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I believe in the importance of rebalancing a portfolio back to target allocations each year. But how many indexes follow this advice? [Market cap-weighted](#) indexes, for example, may add and remove companies each year, but as they are weighted based on market capitalization, they would not necessarily be sensitive to potential changes in the relationship between share price and [fundamental value](#). At [WisdomTree](#), we rebalance our Indexes annually based on changes in [relative value](#). For our Global and Emerging Market Indexes, this occurs in June. Some of the largest changes at this year's global rebalance occurred in our Emerging Market Indexes, specifically the [WisdomTree Emerging Markets Equity Income Index](#) (WTEMHY). An apt illustration of the relative value of a rebalance can be seen through an analysis of the top 10 added and deleted constituents for this Index. -The top 10 additions to the WTEMHY had an average [price-to-earnings \(P/E\) ratio](#) of about 5x while the top 10 deletions had average P/E ratio of over 15x. -The top 10 deletions had positive price performance averaging about 4% from May 31, 2011, through May 31, 2012, but displayed negative [trailing 12-month dividend-per-share](#) growth over that same period. These stocks outperformed the [MSCI Emerging Markets Index](#), which returned -20.32% over this period, by nearly 25 percentage points. This fact, combined with their declining dividends, is why we deleted them. -The WTEMHY was significantly under-weighting the equities of China and Russia prior to the rebalance because their share prices were high relative to their trailing 12-month dividends. But this year key additions were made to these two countries, because their stock prices were down and their dividends up. I believe emerging markets will continue to provide the bulk of global economic growth in the coming years. And I know that weighting an equity portfolio by a measure of fundamental value such as dividends helps manage [valuation risk](#)—which is critical in emerging markets. That's why it's so important to rebalance indexes—and portfolios—every year. *Read more about our [emerging market rebalance](#) here. Find out more about our [dividend approach](#) to equities.*

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