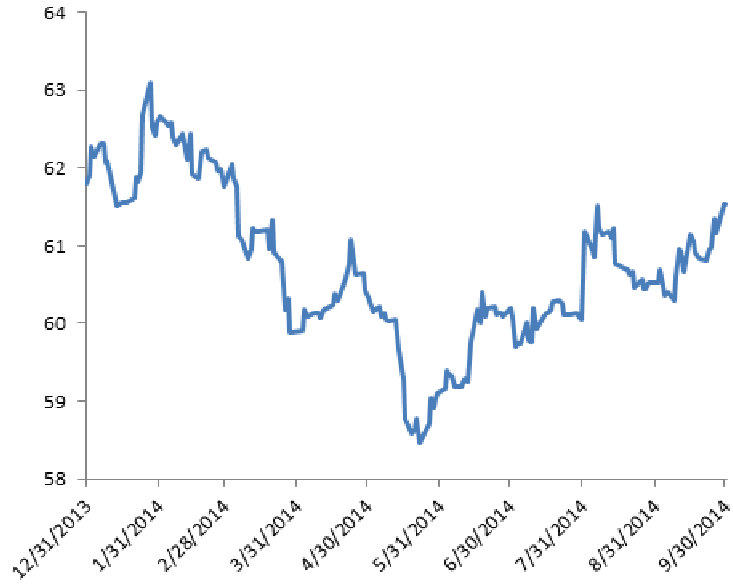
WHAT'S NEXT FOR THE INDIAN RUPEE?

Bradley Krom — U.S. Head of Research
10/22/2014

On September 30, 2014, Indian prime minister Narendra Modi met with President Obama during his first official visit to the U.S. since he was sworn in as prime minister four months ago. For Modi, this meeting marks the end of an ambitious foreign policy schedule that included meetings with leaders from nearly every major economy around the world. While the details of these discussions were not made public, the message from Modi's public speeches has been clear: India is open for business. In advance of any formal changes in policy, we highlight a way to position for a resurgence in Indian growth through investments in the Indian rupee. Even before the election results were fully counted in May, Indian currency and equity markets were reacting. After touching all-time lows last year, the rupee surged on the optimism that the reform-minded Modi would push through an agenda to improve Indian economic competitiveness. Today, Indian equity markets remain near their recent highs, up nearly 30% year-to-date. However, recent concerns about changes in Federal Reserve (Fed) policy and a general increase in risk aversion have seen the rupee fall back to pre-election levels. In our view, the rupee represents an attractive way to play Modi's turnaround story in India. It also offers high short-term interest rates (8% implied yield for one month forward), specifically in relation to perceived risk in the currency. The rupee's carry per unit of volatility is one of the highest among EM currencies (only China and Peru are higher). As we detail below, we believe the recent positive developments could support continued rupee appreciation through year-



Source: Bloomberg, as of 9/30/14. Lower values imply Indian Rupee appreciation against the U.S. dollar. Past performance is not indicative of future results.

end. **Indian Rupee, 12/31/13-9/30/14** *For definitions of terms and Indexes in the chart, visit our glossary.* **#1: All Emerging Markets Are Not Created Equal** As our equity team noted in a recent blog post, India has been a bright spot for emerging market investors so far this year. As the market began pricing in the prospect of a Modi victory, equity markets rallied in anticipation. Although equity markets are up nearly 30% year-to-date, we believe that positive economic momentum could continue to push markets higher. As we noted in previous pieces, foreign investor flows into the Indian equity market can have a significant impact on the value of the rupee. Should these flows persist, we believe that they could support rupee appreciation. **#2: Credit Rating Agencies Are Taking Notice** On September 26, 2014, the credit rating agency Standard & Poor's revised its outlook from negative to neutral. In their report, analysts noted that the political environment had shown a marked improvement. This could potentially support the government's ability to implement reforms, spur growth and improve its fiscal performance.[1] From the currency's perspective, we believe that improved investor sentiment could support foreign investment. Longer term, S&P noted that, should per capita GDP increase to 5.5%, this increase could support a credit rating upgrade from BBB-. **#3: Knock on Effects of Sound Central Banking** Just over a year ago, Raghuram Rajan, the governor of the Reserve Bank of India, set out to strengthen the Indian economy from the ground up. After a series of interest rate hikes, his hawkish stance has finally started to bring inflation under control. Now that prices are beginning to stabilize, growth is starting to accelerate. As growth rebounds, it attracts foreign investor flows, helping to strengthen the currency and control inflation further. Also, after lessons learned during the "taper tantrum" last summer, Rajan has made significant strides in strengthening India's primary balances. Since November 2013, Standard Chartered estimates that foreign exchange reserves have increased from $258 billion to $330 billion.[2] Should the currency unexpectedly come under pressure, we believe that India is in a much-improved position to utilize these reserves in managing currency volatility. Ultimately, the performance of Indian assets will largely be dictated by the effectiveness of government reforms in unlocking India's economic potential. While excitement over these prospects has led to a rapid rise in Indian equities, a recent decline in the rupee could signal an attractive entry point for positions in the rupee. With short-term interest rates at 8.0%[3], we believe that attractive levels of carry augment the positive reform story and could continue to support flows into the rupee for the remainder of 2014. [1]Source: S&P, as of 9/26/14. [2]Source: Standard Chartered, as of 9/29/14. [3]Source: Bloomberg, as of 9/30/14.

Important Risks Related to this Article

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

Short-term rates : the rate of interest on a debt instrument maturing in two years or less.

Carry : The amount of return that accrues from investing in fixed income or currency forward contracts.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Flows : Monetary investment from foreign investors.

Credit ratings : An assessment of the creditworthiness of a borrower in general terms or with respect to a particular debt or financial obligation. Credit assessment and evaluation for companies and governments is generally done by a credit rating agency such as Standard & Poor's, Moody's or Fitch.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

BBB- : Standard & Poor's credit rating that implies the borrower has adequate capacity to meet financial commitments, but may be more vulnerable to adverse economic conditions. This rating represents the lowest level of investment-grade.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Foreign exchange reserves : The total balance of foreign currency deposits and bonds held by a central bank or monetary authority.