

# SECTOR IMPACTS OF THE 2014 INDIA REBALANCE

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Each year, the [WisdomTree India Earnings Index \(WTIND\)](#) separates itself from its [market capitalization-weighted](#) counterparts with its annual rebalance. Simply put:

- Companies whose share prices have appreciated significantly but whose earnings have not kept pace would tend to see their weights decreased. If firms have seen their earnings go negative, they are deleted.
- Companies whose earnings have increased but whose share prices haven't responded correspondingly would tend to see their weights increased. If firms have become profitable, they are eligible to be added. This approach retains sensitivity to [relative value](#). Additionally, we can see impacts in sector weightings, which are important in assessing how WTIND may respond to shifts or reforms in monetary or fiscal policy.

**Showcasing**

		Old Weight <sup>1</sup>	Sector Performance <sup>2</sup>	New Weight <sup>3</sup>	Change in Weight	Performance of Sector Relative to WTIND <sup>4</sup>	3-Year Correlation of Respective MSCI India Sector Index to INR <sup>5</sup>
Underperforming Sectors	Telecommunication Services	0.9%	32.7%	1.9%	1.0%	-34.7%	0.48
	Consumer Staples	3.5%	33.7%	4.3%	0.7%	-33.7%	0.37
	Information Technology	13.3%	37.1%	17.1%	3.8%	-30.3%	-0.10
	Energy	18.7%	51.2%	19.6%	0.8%	-16.2%	0.62
	Utilities	5.9%	59.7%	5.9%	0.0%	-7.7%	0.66
Outperforming Sectors	Materials	8.4%	62.6%	8.5%	0.0%	-4.8%	0.58
	Health Care	5.2%	70.9%	4.1%	-1.1%	3.5%	0.24
	Financials	26.6%	87.7%	25.0%	-1.7%	20.3%	0.72
	Consumer Discretionary	9.9%	89.1%	9.1%	-0.8%	21.7%	0.64
	Industrials	7.5%	137.8%	4.7%	-2.9%	70.5%	0.75

  

	Old Weight <sup>1</sup>	Average Sector Performance <sup>2</sup>	New Weight <sup>3</sup>	Change in Weight	Average of Sector Performance Relative to WTIND	Average MSCI India Sector 3-Year Correlation to INR
Sectors that Underperformed	50.7%	46.1%	57.2%	6.5%	-21.2%	0.44
Sectors that Outperformed	49.3%	96.4%	42.8%	-6.5%	29.0%	0.59
Cyclicals	84.5%	77.6%	83.9%	-0.6%	10.2%	0.53
Defensives	15.5%	49.2%	16.1%	0.6%	-18.1%	0.44

Sources: WisdomTree, Bloomberg, as of 8/31/14. Past performance is not indicative of future results. You cannot invest directly in an index.

<sup>1</sup>Index weight before 8/31/14 screening.

<sup>2</sup>Performance of specified sector within WTIND between last year's rebalance date and 8/31/14.

<sup>3</sup>Index weight after rebalance, based on 8/31/14 screening.

<sup>4</sup>Performance of specified sector within WTIND between last year's rebalance date and 8/31/14 minus performance of WTIND.

<sup>5</sup>Correlation of each respective MSCI India Sector Index to the Indian Rupee (INR) for the three-year period ending 8/31/14. MSCI India sector indexes were used due to lack of WTIND sector indexes.

Cyclicals: Refers to cyclical sectors, namely Information Technology, Energy, Materials, Financials, Consumer Discretionary and Industrials.

Defensives: Refers to defensive sectors, namely Telecommunication Services, Consumer Staples, Utilities and Health Care.

## WTIND's Sector Positioning

• **Cashing In on Strong Gains:** The Industrials sector was WTIND's best-performing sector between rebalances, returning 137.8%. As a result, the sector saw the largest weight reduction at the 2014 rebalance—in the area of 3%. Of the 71 companies that carried over from the prior rebalance, 15 saw reductions in weight. This sector represents the best example of taking weight from stocks that have grown expensive and redeploy it to opportunities that haven't appreciated as strongly.

• **High Exposure to Economically Sensitive Sectors:** WTIND has an 83.9% weight to the cyclical sectors. As we discussed in a [prior blog post](#), these sectors tend to coincide with areas of the economy that have the potential to benefit from the reform agenda set forth by prime minister Narendra Modi and his government. The Industrials sector, mentioned earlier, is certainly a beneficiary. Indeed, we see that over the past year, the cyclical sectors have led the rally in the markets, beating the broad WT India Earnings Index by 10.2%, while the defensive sectors have underperformed WTIND by 18.1%. Although the weight to cyclicals didn't change much in aggregate, what transpired

was that weight was taken from Financials and Industrials and largely distributed to Information Technology, a sector that didn't benefit as strongly from the rally.<sup>1</sup> • **Less Sensitivity to the Indian Rupee:** The 2013 rebalance coincided largely with Raghuram Rajan taking the helm at the Reserve Bank of India. India's currency, the rupee, had been quite [volatile](#), and confidence needed to be restored. Some of the hardest-hit sectors of India's equity market leading up to the 2013 rebalance were those that [correlated](#) closely with the rupee, and WTIND's process added weight to those undervalued areas. Between the 2013 and 2014 Index screenings, the rupee was much more stable and even appreciated almost 10%.<sup>2</sup> Sensitivity to the rupee therefore helped performance, and the rupee-sensitive sectors rallied. At the 2014 Index screening, the sensitivity to relative value steered exposure away from some of these outperforming sectors, thereby removing some of the Index's overall sensitivity to the rupee. The annual rebalance process is a key element of WisdomTree's Index methodology that can help manage [valuation risks](#). After seeing the progress that India has made on the policy front, the market response has been strong. As we move forward, attentiveness to valuation has the potential to become more important as stocks begin to trade less on expectations of reforms and more on bottom-line results. <sup>1</sup>Sources for entire bullet: Bloomberg, Standard & Poor's. <sup>2</sup>Source: Bloomberg; refers to the rupee vs. U.S. dollar exchange rate from 8/31/13 to 8/31/14.

#### Important Risks Related to this Article

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## **DEFINITIONS**

**Market capitalization-weighting** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Relative value** : The relationship between a particular attribute, e.g., a dividend, and the firm's share price compared to that of another firm.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;.

**Correlation** : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

**Valuation risk** : The risk of buying or over-weighting a particular stock that has appreciated significantly in price relative to its dividends, earnings or any other fundamental metric.