



**FIND
THE BALANCE
BETWEEN**

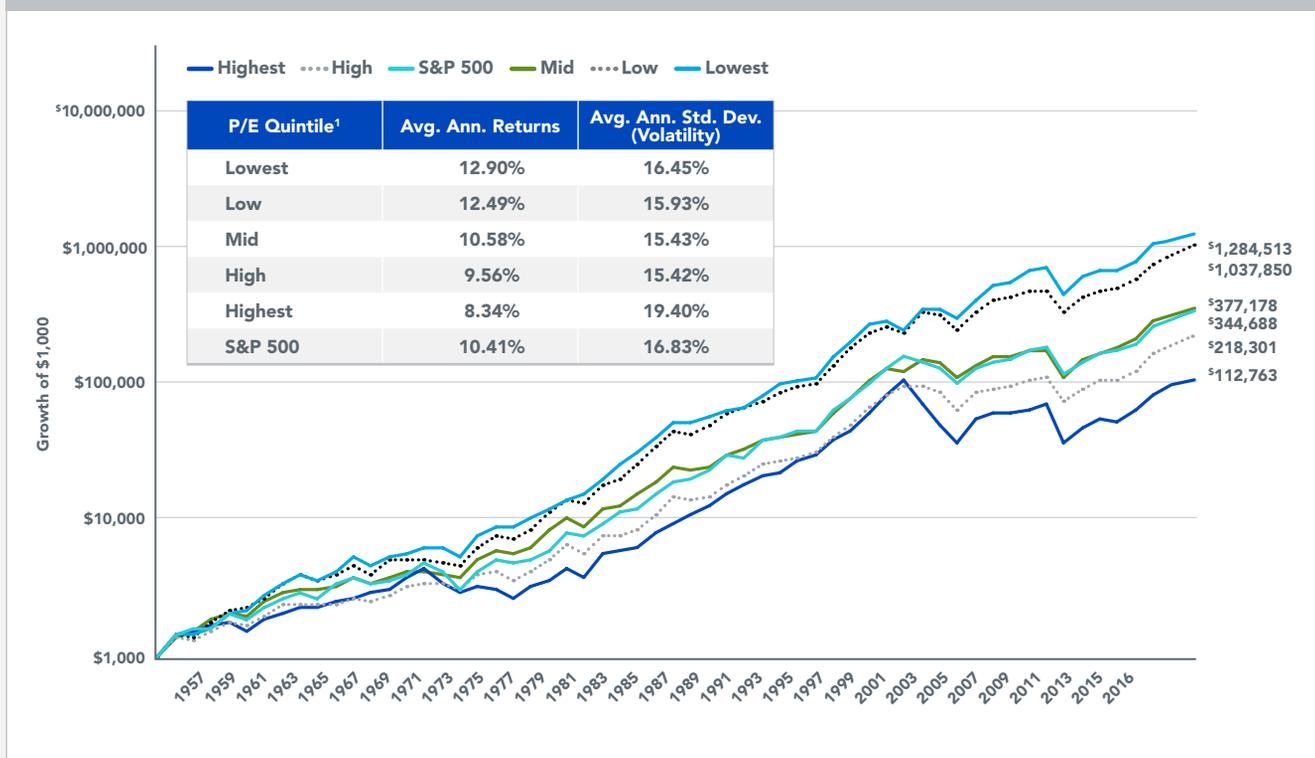
**VALUATION
AND
PERFORMANCE**

HIGHER VALUATIONS ≠ HIGHER RETURNS

As an investor, you want the valuations for the companies you invest in to climb. But when those valuations don't reflect the true underlying value of the company, sector or market you're invested in, you may pay the price in more ways than one. Not only are you paying a higher price for the security or fund but you are also taking on higher risks—and typically far less reward than you may expect.

In his book *The Future for Investors*, Professor Jeremy Siegel—a senior advisor at WisdomTree—demonstrated that stocks with lower price-to earnings (P/E) ratios outperformed those with higher P/E ratios.

Cumulative Growth of \$1,000 based on relative P/E Quintiles from 12/31/1957 to 12/31/2016



Sources: Jeremy Siegel, *The Future for Investors* (2005), with updates to 2016. Universe: S&P 500 Index.
 Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.
 Standard deviation (Volatility): measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

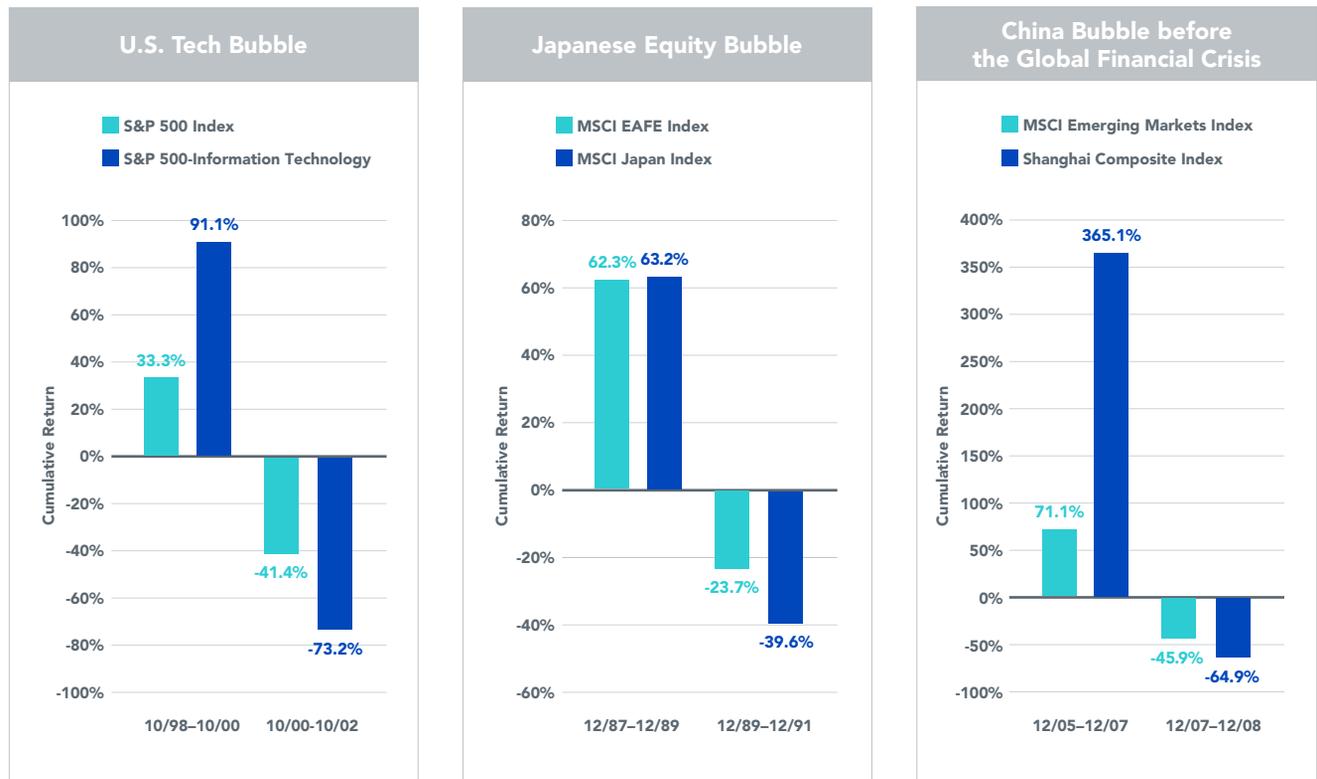
Stocks with lower P/E ratios not only outperformed those with higher ratios but the S&P 500 as well—and with lower volatility too.

¹ Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

THE TROUBLE WITH BUBBLES

Overvaluations of one or two securities may not be such a huge risk, but high valuations of sectors and markets can be. In fact, experience has taught us that bubbles occur with surprising frequency—and the challenge with bubbles is that they tend to burst.

In the late 1990s, U.S. investors saw growth stocks, with triple-digit P/E ratios, hijack the S&P 500, commanding the largest weights in the index as their market capitalizations² soared. And when this happens, market cap-weighted indexes can subject investors not only to higher risks but also to huge losses when they crash from these unsustainable levels. For example, the S&P 500 declined over 41% from October 2000 through October 2002, after trading as high as 31x earnings in March 2000. Japanese stocks declined nearly 40% from December 1989 through December 1991 after trading at 67x earnings. And the Shanghai stock market declined over 65% in 2008, after trading above 40x earnings in 2007.



Sources: WisdomTree, Bloomberg. Dates are for the illustrated “bubbles.” Past performance is not indicative of future results. You cannot invest directly in an index. For non-U.S. examples, performance shows equities only and does not include any impact of foreign currency changing in value against the USD.

A key to managing the risk of bubbles may be to manage valuations.

² Market cap: Share prices x the number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.



THE KEY TO LOWER P/E RATIOS

ANNUAL REBALANCE PROCESS

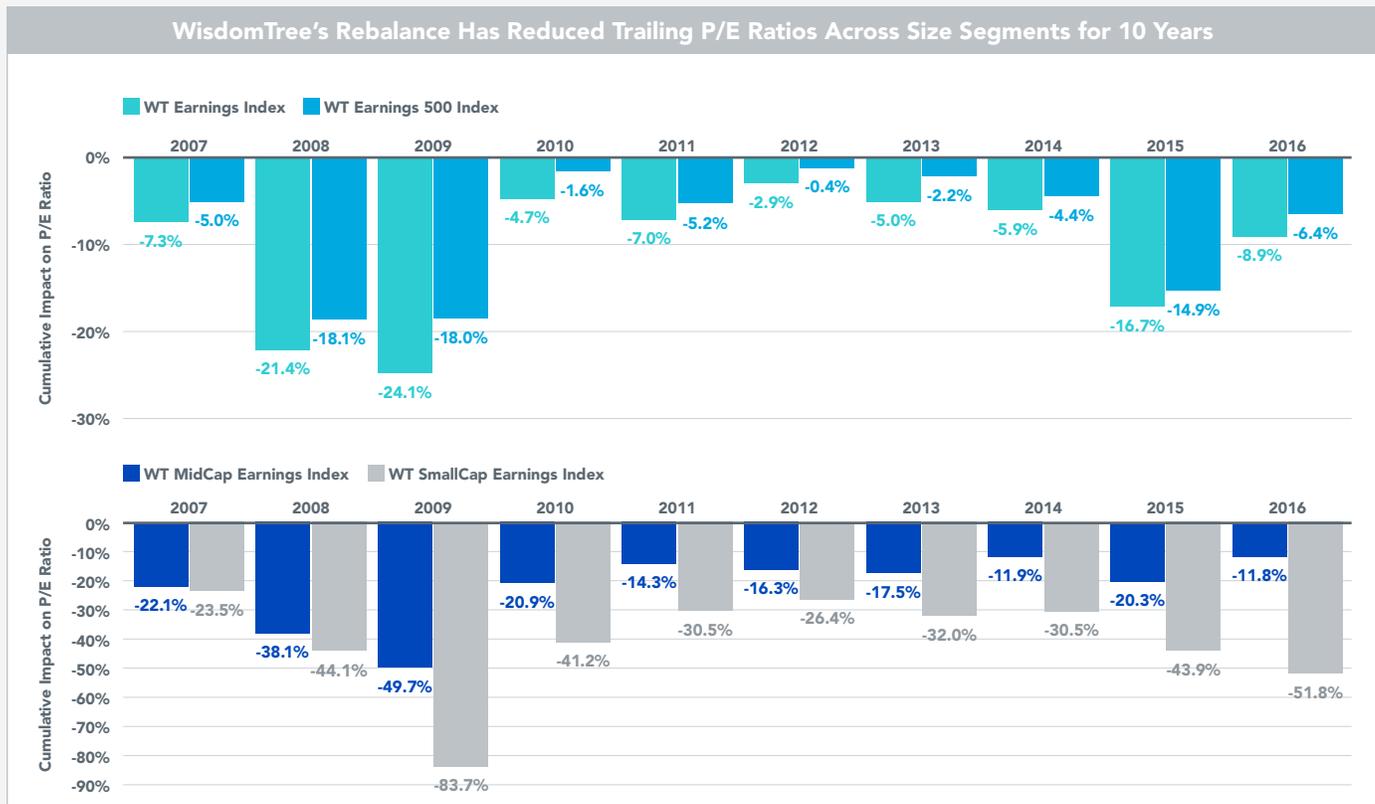
Perhaps the most critical part of the process is the annual rebalance. Once a year, we not only adjust the weights of each Index component back to relative value, but we also eliminate any company with negative earnings. We believe this has been the key to maintaining our lower P/E ratios and helping to ensure that investors do not overpay for the markets.

Stock Price During Year	Earnings Change	Weight Change at Rebalance
↗	Up	Depends on which rose more
	Flat	Decrease
	Down	Decrease
↔	Up	Increase
	Flat	Unchanged
	Down	Decrease
↘	Up	Increase
	Flat	Increase
	Down	Depends on which fell more

Source: WisdomTree hypothetical illustration.

CONTINUAL FOCUS ON VALUATION

This rebalance process has led to a reduction in P/E ratios in every size segment every year.



Sources: WisdomTree, Bloomberg, as of 12/31/16. Past performance is not indicative of future results. You cannot invest directly in an index.

Rebalancing to relative value helped WisdomTree Earnings Indexes reduce P/E ratios for 10 years.

WEIGHTING BY EARNINGS

Most indexes, and the exchange-traded funds (ETFs) that track them, weight stocks by market capitalization—a method that assumes price is always the best measure of true value. WisdomTree’s earnings ETFs, however, weight companies by the earnings they generated rather than by market cap. This approach can lower the P/E ratio for the given market, helping to manage the valuations and magnifying the effect that earnings have on risk and return characteristics.

Company	Market Cap ¹ (Bil.)	Earnings Stream (Bil.)	P/E Ratio	Market Cap Weighting			Earnings Weighting		
				Market Cap Weight	Investment	Weighted P/E Ratio ²	Earnings Weight	Investment	Weighted P/E Ratio ²
A	\$500.00	\$25.00	20x	55.56%	\$55,556		33.33%	\$33,333	
B	\$250.00	\$25.00	10x	27.78%	\$27,778		33.33%	\$33,333	
C	\$150.00	\$25.00	6x	16.67%	\$16,667		33.33%	\$33,333	
Totals	\$900.00	\$75.00			\$100,000	12.00x		\$100,000	9.47x

Source: WisdomTree. Hypothetical example for illustrative purposes only. Does not reflect an actual investment.

Weighting by earnings can reduce overall P/E ratios—essentially lowering the price of the market.

THE PROOF IS IN THE P/E

Theories are nice, but investors want results. And as you can see below, in every major domestic equity market, WisdomTree Indexes have far lower P/E ratios than their cap-weighted counterparts, while maintaining broad asset class exposure.

Cap-weighted index P/E ratios	WT Earnings-weighted Index P/E ratios	WisdomTree Earnings Index Discount	10 Year Correlation
S&P Composite 1500 Index: 21.3x	WT Earnings Index: 15.4x	-27.70%	0.99
S&P 500 Index: 20.8x	WT Earnings 500 Index: 15.5x	-25.48%	0.99
S&P Mid Cap 400 Index: 25.9x	WT MidCap Earnings Index: 16.2x	-37.45%	0.98
MSCI USA Small Cap Index: 35.0x	WT SmallCap Earnings Index: 12.2x	-65.14%	0.96

Sources: WisdomTree, Bloomberg, Trailing P/E as of 11/30/16 (the last screening date). Past performance is not indicative of future results. You cannot invest directly in an index.

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.

WisdomTree’s weighting methodology lowered the price of these markets by 20% to over 36%.

GET BACK TO BUYING LOW, SELLING HIGH

Consensus investment wisdom teaches us to buy low and sell high. But when valuations climb, traditional cap-weighted indexes and funds may cause investors to do the exact opposite. Weighting by earnings can help reduce P/E ratios so investors can get back to buying low and selling high—a practice that can not only reduce risk but may also lead to outperformance.

WisdomTree pioneered the concept of earnings weighting, offered the first family of earnings-weighted ETFs, and it offers the largest family of fundamentally weighted earnings and dividend ETFs all over the world.

Learn more about the power of earnings at [WisdomTree.com](https://www.wisdomtree.com).

Index definitions:

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

Russell 3000 Index: Measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

S&P MidCap 400 Index: Provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an ongoing basis.

S&P SmallCap 600 Index: Market capitalization-weighted measure of the performance of small-cap equities within the United States, with constituents required to demonstrate profitability prior to gaining initial inclusion.

ABOUT US

At WisdomTree, we do things differently. Our ETFs are built with proprietary methodologies, smart structures and/or uncommon access to provide investors with the potential for income, performance, diversification and more. We sponsor a family of distinct ETFs that span asset classes and countries around the world.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. U.S. investors only: To obtain a prospectus containing this and other important information, please call 866.909.9473, or visit www.WisomTree.com. Read the prospectus carefully before you invest. There are risks involved with investing, including the possible loss of principal. Past performance does not guarantee future results.

There are risks associated with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country or sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, real estate, currency, fixed income and alternative investments include additional risks. Due to the investment strategy of certain Funds, they may make higher capital gain distributions than other ETFs. Please see prospectus for discussion of risks.

