

# WISDOMTREE INDIA EARNINGS INDEX REBALANCE TAKEAWAYS

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Each year, WisdomTree screens the investable Indian equity market for the [rebalance](#) of the [WisdomTree India Earnings Index \(WTIND\)](#). First, WisdomTree calculates the [Earnings Stream](#) of India's equity market to identify firms that have generated positive cumulative [profits](#). Then qualifying companies are weighted by their proportionate contribution to the total [Earnings Stream](#). Typically, firms whose price levels have declined but whose earnings have either remained constant or grown tend to see increases in their weights at the rebalance. This annual rebalance discipline anchors the Index to [fundamentals](#) and helps manage [valuation risk](#). Instead of focusing on just a [large-cap](#) subset, WisdomTree strives to encapsulate a broad measure of the Indian equity markets. As of the most recent rebalance, WTIND had 300 securities that spanned the large-, mid- and small-cap segments. The [MSCI India Index](#) had 70 companies that are primarily large cap and mid-cap. We think the limited inclusion of a large section of the small-cap universe is a significant difference between the WisdomTree approach and [market capitalization-weighting](#) methodologies.

**Size Capitalization Exposure**

	Total Index		Large Cap (>\$10 billion)		Mid Cap (\$2 billion to \$10 billion)		Small Cap (<\$2 billion)	
	WTIND	MSCI India	WTIND	MSCI India	WTIND	MSCI India	WTIND	MSCI India
Weight	100.0%	100.0%	62.0%	73.8%	23.9%	26.1%	14.1%	0.1%
Market Capitalization (\$ B)	\$1,142	\$836.7	\$644.6	\$611.4	\$349.0	\$224.4	\$149.4	\$0.9
# of Firms	300	70	27	25	78	44	195	1
P/E Ratio	12.5x	20.3x	14.0x	18.1x	11.7x	30.3x	9.3x	N/A

Sources: Bloomberg, Standard & Poor's, with data as of 8/31/15, based on WTIND Index screening. You cannot invest directly in an index. Subject to change.

## Small-Cap Exposure

**Can Increase Diversification:** Through 195 holdings, WTIND had more than 14% exposure to the small-cap segment of the Indian market, compared to only one security with less than 0.1% weight for the MSCI India Index. It is also interesting to note that the [price-to-earnings \(P/E\) ratio](#) for the small-cap segment of WTIND is around 9x earnings, which is more than 25% and 54% lower than the large-cap segment of WTIND and MSCI India, respectively. Typically, small-cap stocks might be expected to trade at higher valuations than large-cap stocks as a result of the higher expected growth potential.

**Relative Value Sector Rebalance** Next, we outline how the annual rebalance impacted sector changes for WTIND. We compare the sector composition before the [annual screening](#) to the sector composition after the rebalance. Additionally, we compare the underlying sector performance to the broad WisdomTree India Earnings Index to look at the performance of sectors that saw their weights increase or decrease. It is the interaction of earnings growth and price performance that provides the basis for determining which sectors tend to see increases or decreases in weight at the annual

WisdomTree	Index	rebalance.				Sector	Changes
		Old Weight <sup>1</sup>	Sector Performance <sup>2</sup>	New Weight <sup>3</sup>	Change in Weight	Performance of Sector Relative to WTIND	
Underperforming Sectors	Materials	5.6%	-41.4%	5.8%	0.2%	-28.7%	
	Energy	16.1%	-25.8%	17.6%	1.5%	-13.1%	
	Utilities	5.1%	-24.7%	4.4%	-0.7%	-12.0%	
	Consumer Discretionary	8.3%	-22.3%	9.3%	1.0%	-9.6%	
	Telecommunication Services	1.8%	-18.6%	2.9%	1.1%	-5.9%	
Outperforming Sectors	Financials	26.6%	-7.0%	25.3%	-1.3%	5.7%	
	Industrials	5.5%	-3.0%	5.3%	-0.2%	9.7%	
	Consumer Staples	4.8%	-1.0%	4.6%	-0.2%	11.7%	
	Information Technology	20.1%	0.3%	18.9%	-1.2%	13.0%	
	Health Care	5.9%	23.5%	5.9%	-0.1%	36.2%	
		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	
	Sectors that Underperformed	37.0%	-26.6%	40.0%	3.1%	-13.9%	
	Sectors that Outperformed	63.0%	2.6%	60.0%	-3.1%	15.3%	

Sources: WisdomTree, Bloomberg, as of 8/31/15. <sup>1</sup>Old weight is WTIND weight as of 8/31/15, before the rebalance. <sup>2</sup>Sector performance is performance from last year's rebalance to 8/31/15. <sup>3</sup>New weight is the sector weights for WTIND after rebalance based on 8/31/15 annual screening. You cannot invest directly in an index. Past performance is not indicative of future results. Subject to change.

**• Adding Weight to Underperformers and Subtracting Weight from Outperformers:** WTIND added the most weight to the Energy, Consumer Discretionary and Telecommunication sectors, all of which underperformed the WisdomTree India Earnings Index over the period. Each of these sectors had median earnings growth that was higher than median price growth, ultimately improving the relationship between earnings and prices. On the other hand, WTIND subtracted the most weight from Financials and Information Technology, two sectors that outperformed the broad Index over the period. This is another example of how the annual rebalance process acts as a forced discipline to sell high and buy low, based on underlying fundamentals.

**Financials Remain in Focus** A sector that surely stands out for India is Financials, currently accounting for about 6% of its approximate \$2 trillion [gross domestic product \(GDP\)](#). We think this sector has special underpinning in India's growth potential, and sector growth will likely be led by the commercial bank and insurance industries. Commercial bank assets are expected to grow from \$1.4 trillion (August 2015) to an enormous \$28.5 trillion by FY 2020. India's life insurance industry is one of the biggest in the world with about 360 million policies, and this is expected to increase at a compounded annual growth rate of 12% to 15% over the next five years.<sup>1</sup> A fast-growing economy, rising income levels and improving life expectancy rates are some factors that could boost earnings in this area. India's Finance Ministry and the Reserve Bank of India (RBI) have taken a host of measures to liberalize, regulate and reform the industry. Primary steps include the following:

- Strengthen & Increase Access For Investors:** Foreign institutional investor (FII) and foreign direct investment (FDI) limits merged into a composite sectoral cap of foreign investment. New composite sectoral limit for private banks is at 74%. This is encouraging as FII is relatively easier to invest and liquidate. Now unused capacity from FDI could be filled up by FII investments, giving foreign investors the opportunity to buy equities in India.
- Steps to Expand Volumes & Bolster Earnings:** Aggressive [credit targets](#) in various subsectors like agriculture (credit growth of ~12-13% YoY in 2015-16<sup>2</sup>), retail, housing, mortgage lending etc. Reform measures are targeted to encourage credit and debit transactions, ultimately helping grow earnings.
- Reduction in Corporate Taxes from 30% to 25%** Given projected growth rates, it is no surprise that Financials has been a key sector in recent budget presentations and in several other reforms launched by prime minister Narendra Modi's government. We believe an Index that smartly weighs the Financials sector can potentially participate in the tremendous growth that India in general, and Financials in India specifically, can offer.

*Unless otherwise noted data source is WisdomTree, as of 8/31/15.* <sup>1</sup>Source: Government of India, India Brand Equity Foundation. <sup>2</sup>Source: Government of India, Union Budget 2015.

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## DEFINITIONS

**Rebalance**: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

**Net profit**: A measure of profitability after accounting for all costs.

**Fundamentals**: Attributes related to a company's actual operations and production as opposed to changes in share price.

**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.

**Large-Capitalization (Large-Cap)**: A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**MSCI India Index**: A market capitalization-weighted index designed to measure the performance of the Indian equity market.

**Market Capitalization**: 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.

**Annual screening date**: The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.

**Gross domestic product (GDP)**: The sum total of all goods and services produced across an economy.

**Credit Target**: the total principal value of loan amount that a lending institution is aiming to lend.