RISK AVERSION AND DOLLAR STRENGTH

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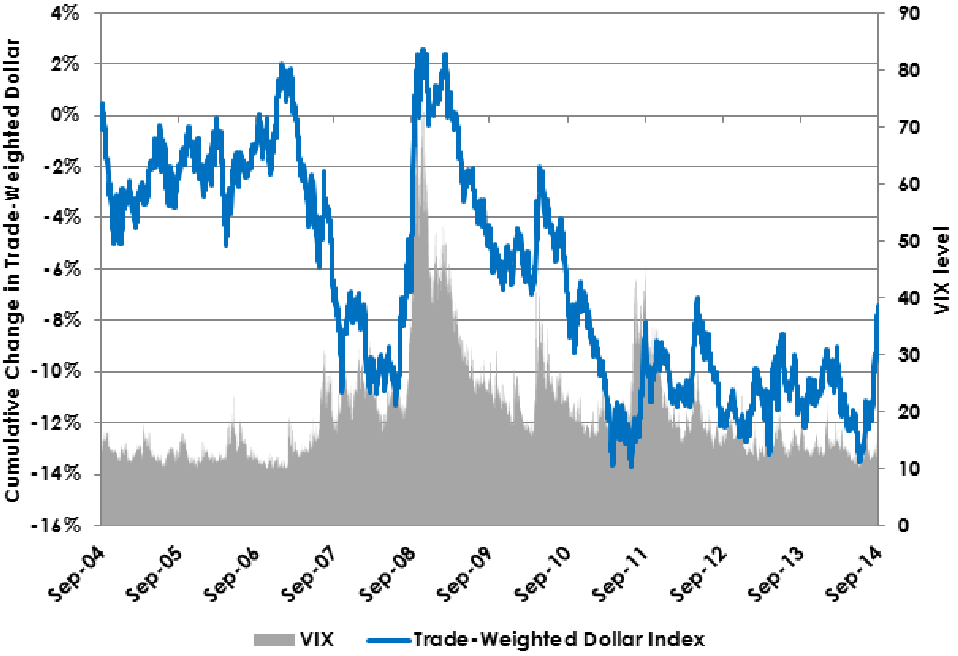
In recent blog posts, we have talked a great deal about how the U.S. dollar may be poised to rise as a result of increases in U.S. interest rates compared with interest rates in foreign markets. However, another catalyst for a stronger U.S. dollar could occur during periods of heightened volatility. Geopolitical risk and economic uncertainty around the world have recently served as a reminder of the importance of so-called "safe haven" assets, such as the U.S. dollar. Since the dollar is the primary reserve currency of the world, investors typically seek exposure to the dollar via short-term assets when market sentiment begins to shift. As we explain, the U.S. dollar can serve as an effective hedge to market uncertainty when volatility unexpectedly spikes. As the graph illustrates, increases in risk aversion tend to be associated with appreciation of the U.S. dollar against a broad basket of foreign currencies. For the purposes of this graph, we use the Chicago Board Options Exchange Volatility Index (VIX) to represent risk aversion. The VIX reflects the market's estimate of future volatility, based on a weighted average of implied volatility across options with different strike prices for the S&P 500 Index. The Barclays Capital Trade-Weighted Dollar Index measures the total returns generated by systematically holding and rolling short-term currency positions in the U.S. dollar, compared with the currencies of its principal trading partners. VIX vs. Barclays Capital Trade-Weighted Dollar Index



Sources: Bloomberg, WisdomTree, as of 9/30/14. Past performance is not indicative of future results. You cannot invest directly in an index.

While we don't anticipate that volatility will approach the levels seen during the financial crisis, current levels of volatility appear compressed when compared with historical averages.

To us, this suggests a fair degree of complacency in the market. As shown most notably in August 2010 and September 2011, volatility can unexpectedly spike at any time. During these periods, concerns about the viability of the Eurozone caused a spike in volatility across global financial markets. As a result, investors sought the safety and [liquidity](#) of the U.S. dollar. As demand for dollars increased, the value of the currency appreciated broadly against other currencies. Additionally, strategies that provide long U.S. dollar exposure tend to exhibit sharply negative correlation with international equity positions. As the table below shows, spikes in volatility tend to coincide with decreases in the prices of risky assets, such as equities. Since U.S. investors may have exposure to foreign currencies through their foreign equity positions, their returns reflect not only a decrease in the price of their stock portfolios, but potential losses from fluctuations in the currency as well.

Performance of Trade-Weighted Dollar During 10 Largest Weekly Rises in the VIX, 10/1/04- 9/30/14

Top 10	VIX Change	End Date	Dollar Gain	S&P 500 Loss	MSCI ACWI ex US Loss	Tbill Return
1	24.81	10/10/2008	4.76%	-18.14%	-21.51%	0.05%
2	18.90	5/7/2010	3.10%	-6.34%	-9.59%	0.01%
3	10.40	10/3/2008	2.90%	-9.34%	-8.54%	0.03%
4	10.27	9/23/2011	2.24%	-6.53%	-8.29%	0.00%
5	10.21	11/14/2008	0.87%	-6.11%	-6.31%	0.02%
6	9.40	1/22/2010	1.07%	-3.88%	-4.04%	0.01%
7	8.86	5/21/2010	1.01%	-4.17%	-5.27%	0.00%
8	8.80	10/24/2008	1.69%	-6.76%	-10.90%	0.02%
9	8.42	10/30/2009	0.66%	-4.00%	-4.40%	0.00%
10	8.03	3/2/2007	0.60%	-4.36%	-4.80%	0.11%

Sources: Bloomberg, WisdomTree, as of 9/30/14. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms and Indexes in the chart, visit our [glossary](#). For investors concerned about this risk, currency strategies that take long positions in the U.S. dollar may help offset some of the currency risk inherent in international equity positions. With cash offering very little income and the net [carry](#) sacrifice for dollar-biased positions relatively low, we feel that dollar-bullish strategies could offer investors appealing diversification benefits if risk spikes or the U.S. economy continues to strengthen.

Important Risks Related to this Article

Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

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You cannot invest directly in an index.

DEFINITIONS

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

Safe-haven : Characterized by being a potentially desirable focal point of investment flows during periods of increased volatility and market risk. Safe-haven is not synonymous with risk-free.

Reserve currency : A foreign currency held by a central bank or monetary authority as a long-term store of value.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

CBOE Volatility Index® (VIX®) : a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. It is the premier benchmark for U.S. stock market volatility.

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.

Barclays Trade-Weighted Dollar Bull Index : is part of the Barclays Trade-Weighted index family, which intends to reflect the appreciation or depreciation of a reference currency against a Trade-Weighted basket of other currencies.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset’s price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

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