

INTERNATIONAL QUALITY

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[Value's](#) outperformance this year has not been an exclusively U.S. phenomenon.

U.S. investors' focus has been on the collapse of tech favorites—companies like Netflix and Meta, each down more than 50% from peak market caps—and the resurgence of “old economy” sectors like Energy and Utilities.

In the developed international markets, value has similarly bested [growth](#) across [large](#), [mid-](#) and [small caps](#).

MSCI EAFE Style Indexes as of 8/15/22

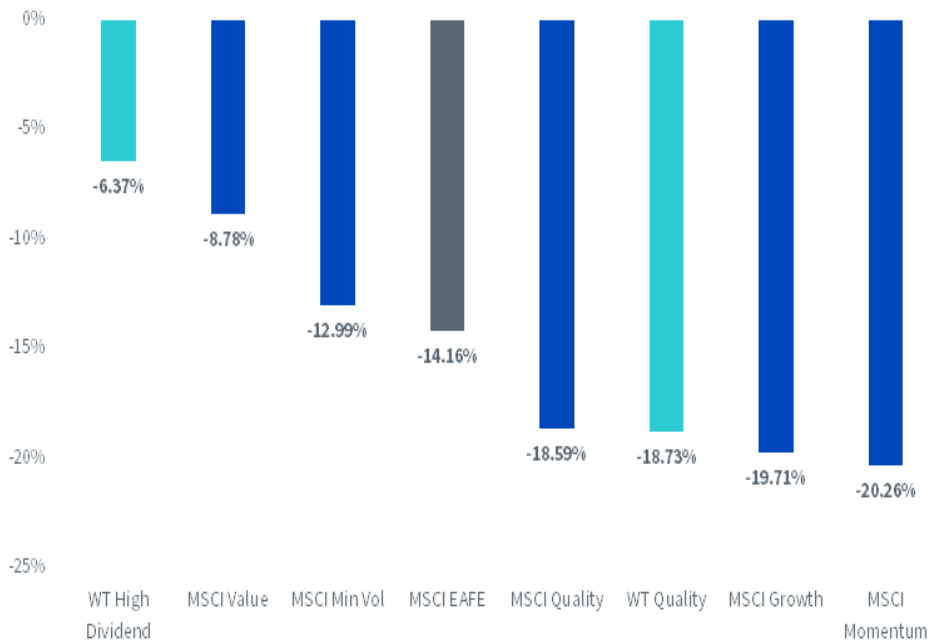
		Year-to-Date		
		Value	Blend	Growth
Large	Value	-8.01%	-13.28%	-18.73%
	Blend	-11.50%	-17.35%	-23.23%
	Small	-13.41%	-17.90%	-22.42%

Sources: WisdomTree, MSCI. Large-, mid- and small-cap indexes are the MSCI EAFE Large Cap, MSCI EAFE Mid Cap and MSCI EAFE Small Cap indexes, respectively, and their corresponding growth- and value-style indexes. Index returns are net total returns. You cannot invest directly in an index. Past performance is not indicative of future returns.

[Quality](#) indexes, particularly those focused on profitability, tend to tilt toward growth.

A growth bias has contributed to developed international quality lagging more value-tilted factors like high dividends.

Year-to-Date Developed International Index Performance as of 8/15/22



Sources: WisdomTree, MSCI. WT High Dividend = WisdomTree International High Dividend Index. MSCI Value = MSCI EAFE Value Index. MSCI Min Vol = MSCI EAFE Minimum Volatility Index. MSCI Quality = MSCI EAFE Quality Index. WT Quality = WisdomTree International Quality Dividend Growth Index. MSCI Growth = MSCI EAFE Growth Index. MSCI Momentum = MSCI EAFE Momentum Index. You cannot invest directly in an index. Past performance is not indicative of future returns.

Defining Quality

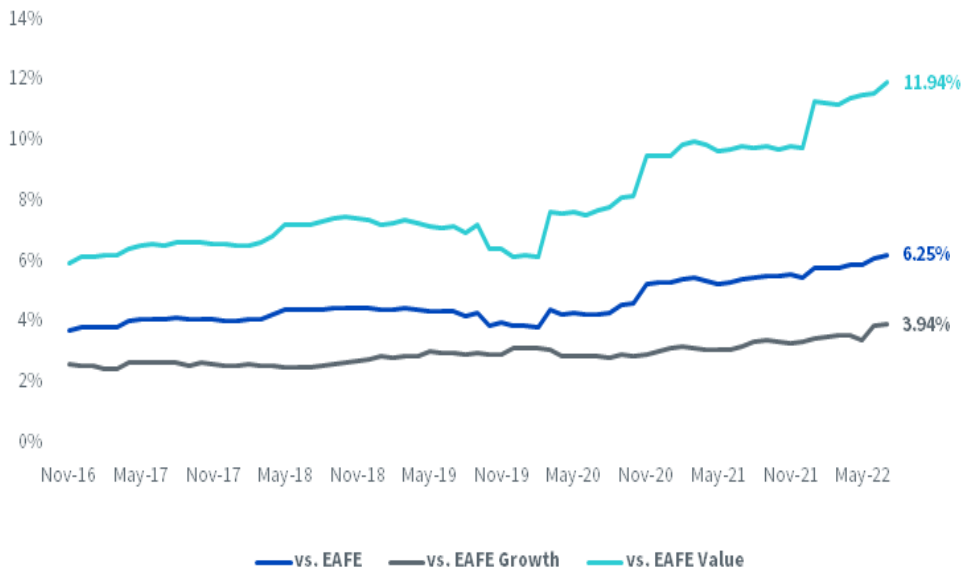
Each index provider defines quality slightly differently.

WisdomTree’s definition of quality includes metrics associated with dividend growth—the existence of a regular cash dividend, high return on equity and return on assets and high growth expectations.

The intention of including dividends as an element of quality was to combine a profitability and growth screen with an element of valuation discipline—*Dividend Stream*[®] weighting—that would better balance the risk of overpaying for high-growth/quality companies.

A rolling three-year tracking error of the [WisdomTree International Quality Dividend Growth Index](#) versus the broad market [MSCI EAFE Index](#) and its value and growth counterparts shows that the Index’s performance does track most closely to the [MSCI EAFE Growth Index](#).

WisdomTree International Quality Dividend Growth Index Rolling Three-Year Tracking Error

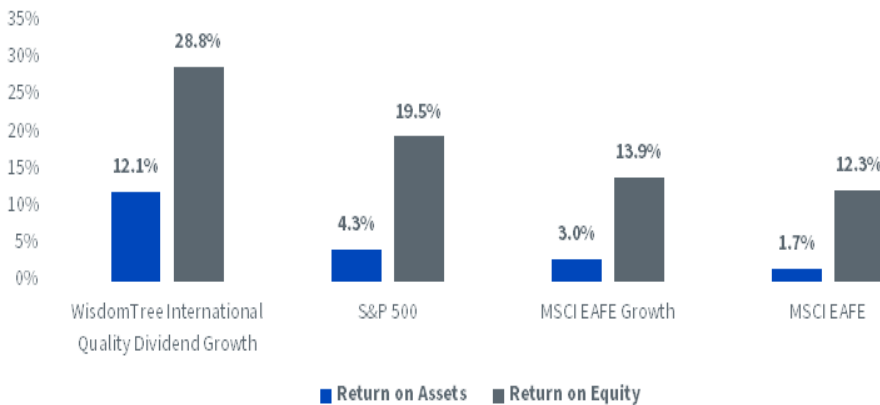
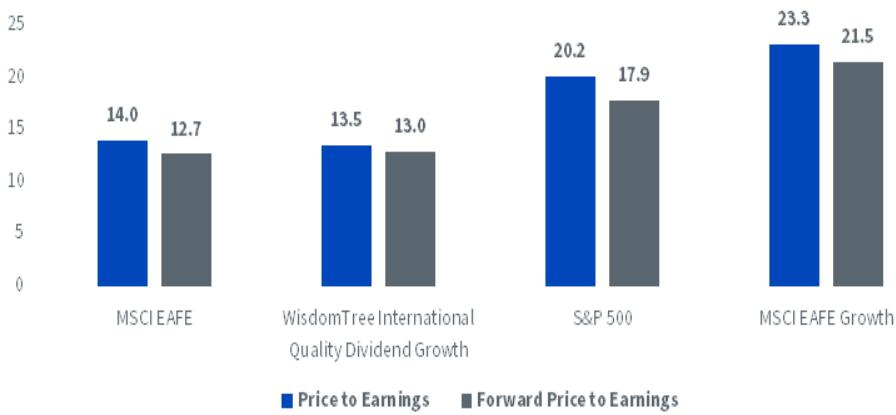


Sources: WisdomTree, MSCI, 11/30/16–7/31/22. Inception date of the WisdomTree International Quality Dividend Growth Index is 11/29/13. Past performance is not indicative of future returns. You cannot invest directly in an index.

However, the dividend-weighting process results in a quality index that has valuations more in line with the broad MSCI EAFE Index than with the MSCI EAFE Growth Index, and with premium return on equity and return on assets.

The return on equity for WisdomTree’s quality index is more than twice that of the MSCI EAFE Growth Index, and even a material improvement over the [S&P 500](#) despite lower [P/E](#) multiples.

Index Characteristics

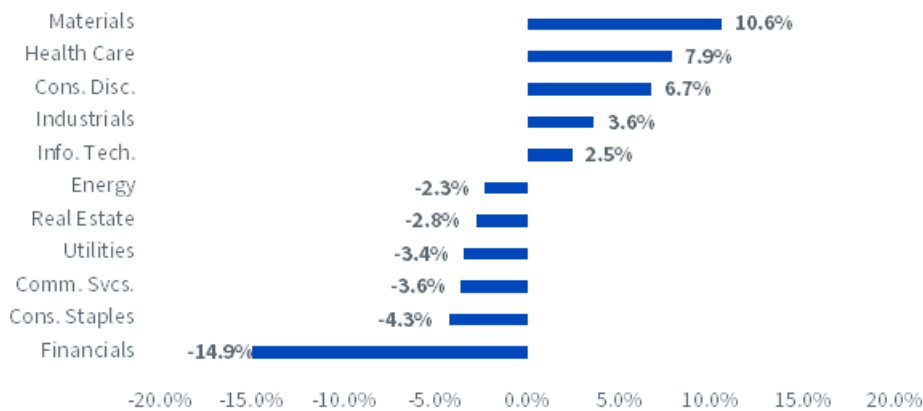


Sources: WisdomTree, MSCI, FactSet, as of 7/29/22. You cannot invest directly in an index.

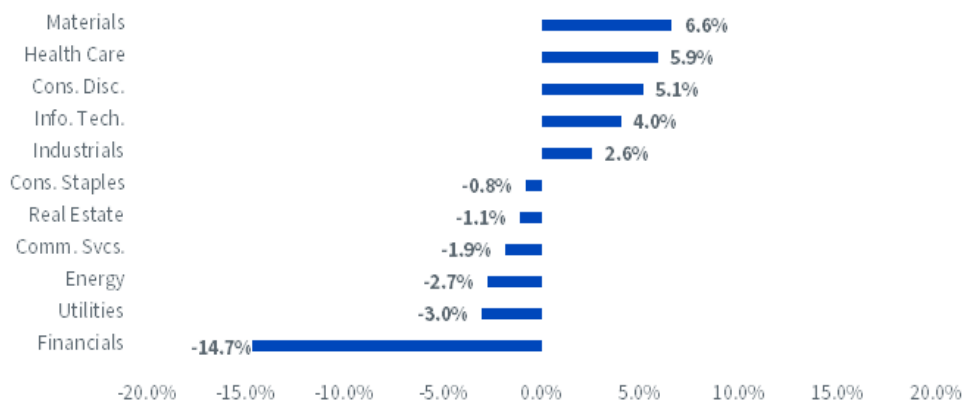
Sector and Country Allocations

Unlike indexes that constrain sectors and countries to be close (or neutral) to a benchmark, WisdomTree’s international quality index has sector and country caps of 20%. This allows for material deviation compared to the broad developed international universe with guardrails to prevent any country or sector from dominating the portfolio. Historically, the Index has been over-weight Materials, Health Care and Consumer Discretionary, and heavily under-weight Financials.

Sector Differential vs. MSCI EAFE Index as of 7/31/22



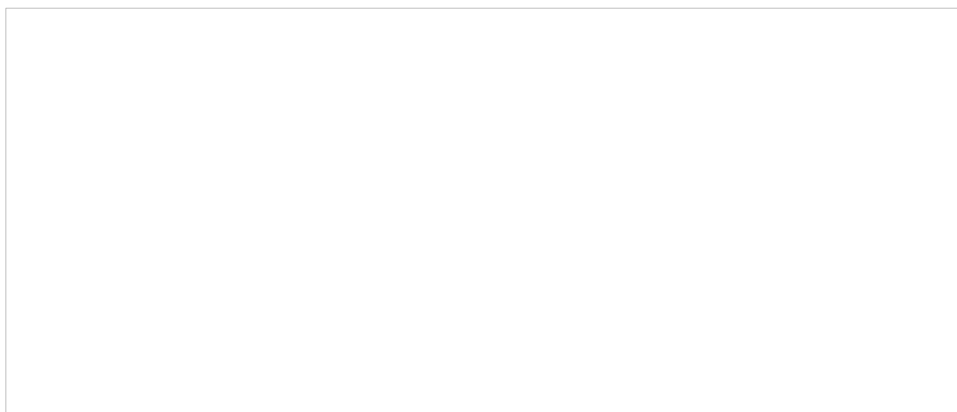
Average Sector Differential vs. MSCI EAFE Index



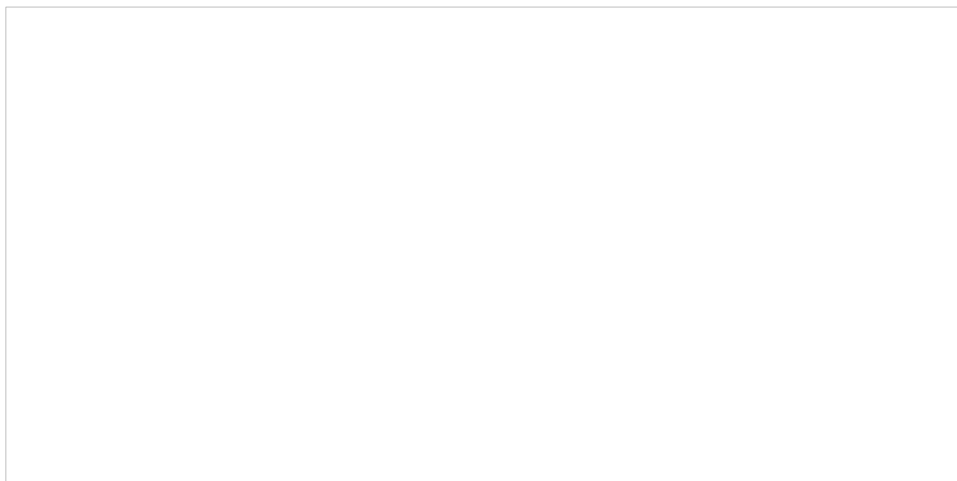
Sources: WisdomTree, FactSet, 11/30/13–7/31/22. You cannot invest directly in an index.

From a country perspective, the Index has been persistently under-weight Japan (-8% on average) and over-weight Denmark and the United Kingdom.

Country Differential vs. MSCI EAFE Index as of 7/31/22



Average Country Differential vs. MSCI EAFE Index



The MSCI EAFE Index is skewed toward value sectors like Financials and Industrials, in some ways the opposite of the growth-heavy S&P 500, which is dominated by mega-cap tech names.

While Financials has the second-highest dividend yield, the sector has below-average [ROE](#) and [ROA](#), which causes the persistent under-weight in the WisdomTree quality index.

Materials and Health Care have the highest ROE and ROA, driving the over-weights to those two sectors.

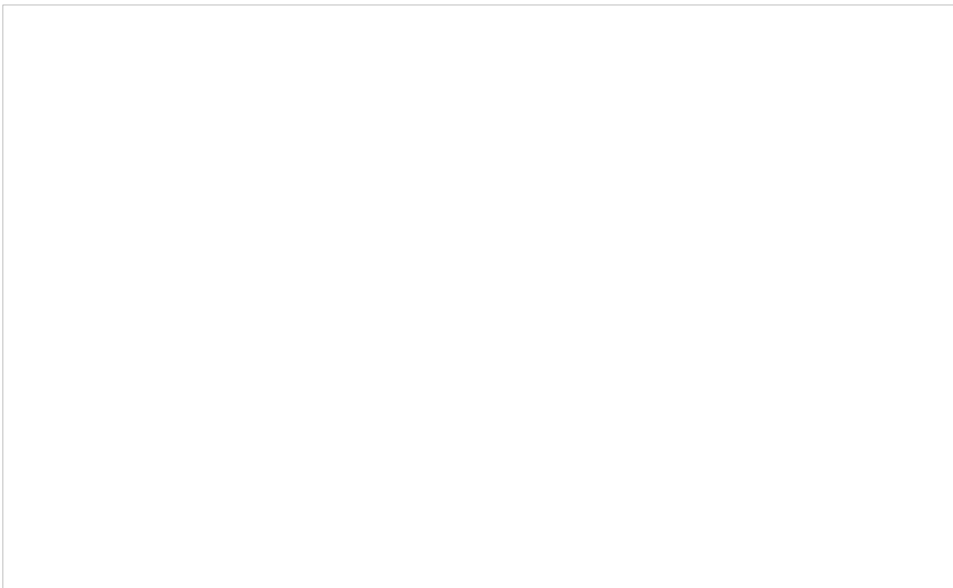
MSCI EAFE Sector Characteristics



Japan has low dividend payout ratios—although they have been increasing in recent years. Its combination of a low dividend yield and weak profitability has caused the Index to be under-weight the largest country in MSCI EAFE.

The high ROE/ROA from Denmark and the high dividend payouts from the United Kingdom help explain the over-weights to those two countries.

Top 10 Country Characteristics



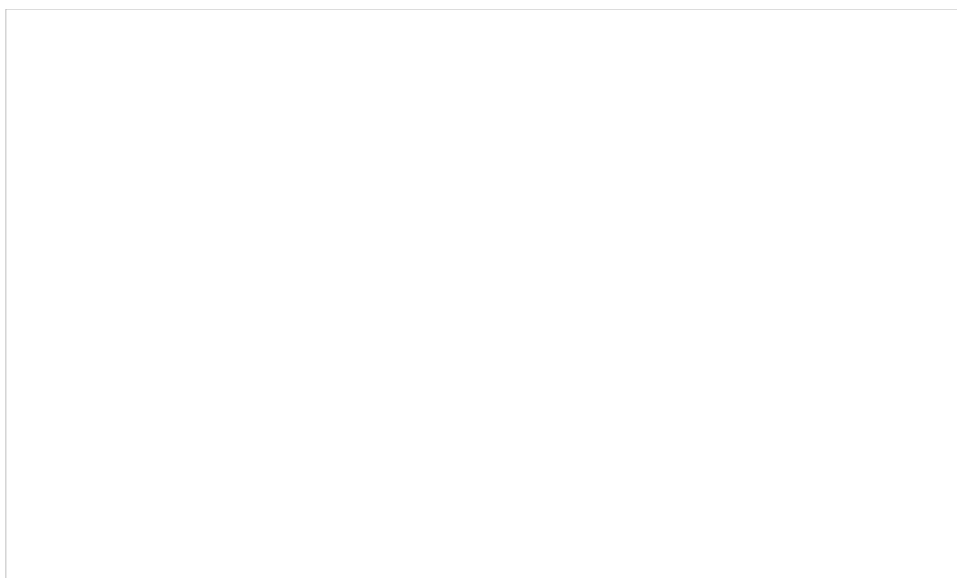
Currency Risk

In addition to the value versus growth theme, another major market theme of 2022 has been the strength of the U.S. dollar.

In local currency terms, without the impact of currency movements, the MSCI EAFE Index is down just 5.15%, more than 300 [basis points](#) better than the S&P 500 Index return of -8.8%.

With the dollar strengthening more than 10% against the euro and the yen, the unhedged MSCI EAFE Index is down more than 14%.

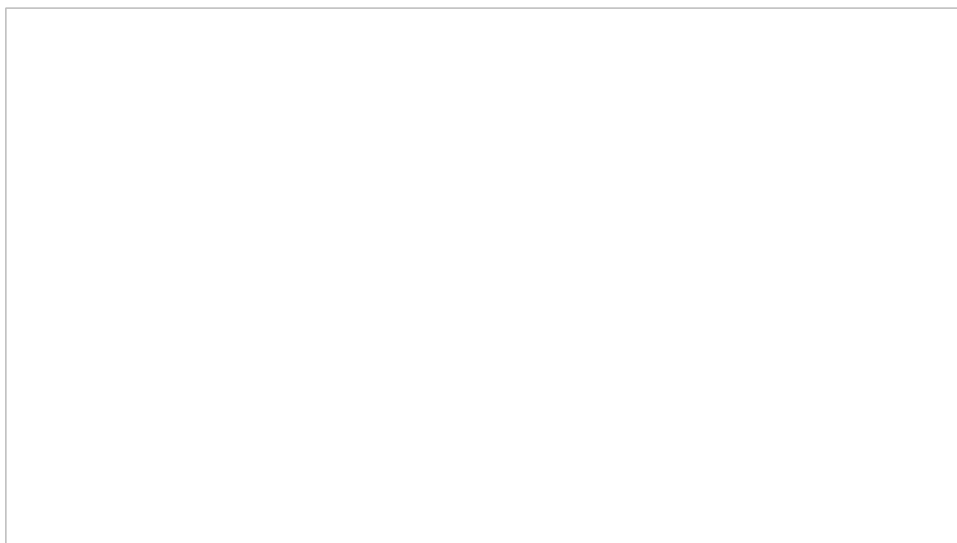
Year-to-Date Developed Market Currency Change vs. USD



In our view, [currency risk](#)—and the potential currency headwind—is an underappreciated factor when investors allocate overseas.

The [WisdomTree International Hedged Quality Dividend Growth Index](#) has the same equity basket as the WisdomTree International Quality Dividend Growth Index but aims to neutralize the impact of currency moves on performance.

Year-to-Date Index Return as of 8/16/22



Over the long run, mitigating the incremental risk of the currency exposure—along with a period of general dollar strength—has contributed to the higher [risk-adjusted returns](#) for the currency-hedged index compared to the unhedged MSCI EAFE indexes.

Index Sharpe Ratio Since 11/29/13



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.

Related Funds

- + [WisdomTree International Hedged Quality Dividend Growth Fund](#)
- + [WisdomTree International Quality Dividend Growth Fund](#)

View the online version of this article [here](#).

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.

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DEFINITIONS

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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.

Mid-Cap: Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund’s weight.

Small caps: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Quality: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Dividend Stream: Refers to the regular dividends per share multiplied by the number of shares outstanding.

MSCI EAFE Index: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

MSCI EAFE Growth Index: Market capitalization-weighted subset of stocks within the MSCI EAFE Index that have higher share prices relative to their earnings or dividends per share.

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.

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.

Return on Equity (ROE): Measures a corporation’s profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA): Firm profits (after accounting for all expenses) divided by the firm’s total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

Basis point: 1/100th of 1 percent.

Currency risk: the risk that an investment will decline in value due to a change in foreign exchange rates.

Risk-adjusted returns: Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.