THE FACTOR FORCES AT WORK

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At WisdomTree's core is the belief that it may be possible to generate greater excess return over time by taking on greater active risk and concentrating index holdings in stocks that have greater exposure to the factors that historically have been associated with excess return. We designed the WisdomTree U.S. Multifactor Index to target factors consistent with many "smart beta" approaches. But we believe our method of combining factors to maximize the potential for higher absolute and risk-adjusted returns is unique. The Index now has about nine months of live track record and has completed two quarterly rebalances, with the most recent changes highlighted below.

The WisdomTree U.S. Multifactor Index

WisdomTree blends both fundamental and technical factors to create a composite factor score for the purposes of stock selection. The composite score is an average of four factors, with value and quality being driven by fundamentals, while momentum and correlation are driven by technical factors or price. Since each factor has an equal weight, all of them are pushing or pulling the composite factor score with some force. During a market environment where you see increased volatility, correlations and return dispersions, you might expect the technical factors to generate more force through larger changes in relative rank.

At the most recent rebalance, the largest change in scores for the drops were correlation, representing 46% of the total drops, and momentum, representing a little over 31%. The largest changes in scores for the additions were momentum (47%) and correlation (31%). Now, just because we didn't see large changes in individual fundamental scores doesn't mean the Index's fundamentals remain the same. The shifts, driven by the technical factors, also influenced the composition and fundamentals of the Index.

The Index has a sector-neutral constraint, so there weren't large differences in the sectors, but there were some minor adjustments based on price changes since the last rebalance. The most notable changes to the basket are highlighted in the table below.

Index Name	Market Cap (Weighted Average $B)	Large-Cap Weight	Mid-Cap Weight	Small-Cap Weight	Dividend Yield	Net Buyback Yield	Price-to-Earnings (P/E) Ratio	Estimated Price-to-Earnings (P/E) Ratio	Return on Equity	Return on Assets
WT U.S. Multifactor (Before Rebalance)	$ 49.65	73.10%	26.90%	0.00%	1.72%	1.80%	18.5x	16.0x	16.56%	4.22%
WT U.S. Multifactor (After Rebalance)	$ 24.84	58.77%	41.23%	0.00%	1.39%	2.15%	15.3x	16.3x	18.94%	5.16%
S&P 500 Equal Weight	$ 49.72	86.60%	13.40%	0.00%	1.76%	1.68%	22.5x	17.3x	12.82%	2.95%
S&P 500	$ 199.00	97.87%	2.13%	0.00%	1.78%	1.70%	23.4x	17.8x	14.19%	3.18%

Sources: WisdomTree, FactSet, as of 3/12/18. Subject to change.

- **Tilted Toward Mid-Cap Segment:** The Index is initially weighted based on its composite factor score and volatility, which tends to result in a modified equal-weighted exposure, but it is noticeable that this rebalance saw the weighted average market cap get cut in half. The exposure to mid-cap securities, defined as $2 billion to $10 billion in market cap, saw a 15% increase to over 41%. The rebalanced Index has a larger skew to the size factor relative to even the S&P 500 Equal Weight Index.

- **Lowered Interest Rate Sensitivity:** As interest rates picked up over recent months, we witnessed increased volatility and poor performance from some of the "traditional" lower volatility and higher dividend yield securities. The risk-adjusted momentum score would have pushed the Index out of some of these types of securities, ultimately leading to a lower Index dividend yield. The aggregate dividend yields fell in nine out of the 11 sectors, with the largest reduction coming from Energy and Telecom. We find it interesting that the net buyback yield of the portfolio increased by about the same percentage as the dividend yield fell, so the total shareholder yield was essentially unchanged. The weighted average market cap and leverage of the Index were also lowered, both signs that point to lower interest rate sensitivity.

- **Stepping Up the Quality:** Since quality is one of the factors, it was no surprise to us that there was a sizable increase in the return on equity and return on asset measurements. The quality score looks at companies that are displaying strong quality metrics currently but also exhibiting an improvement in the metrics. Typically, you would expect to "pay up" for this type of quality basket, so it is encouraging to see the Index trade at a lower price-to-earnings (P/E) multiple than the S&P 500 Index.

- **Lower-Priced Earnings Basket:** Despite the fact that earnings yield is just part of the value score, the Index increased its earnings yield by over 1% (or lowered its P/E ratio by 3 points). Also, what is impressive about the trailing P/E ratio falling and the forward P/E ratio reaming stable is that the Index accomplished this feat with a substantial increase to mid-cap securities (which tend to be higher priced). On a trailing earnings basis, the Index is priced over 30% lower than both the S&P 500 Index and the S&P 500 Equal Weight Index, which should attract interest from those concerned about rising multiples in the U.S.

Diversifying Factor-Specific Risk

A key benefit of using a multifactor stock selection methodology is the potential to diversify factor-specific risk. Our research found that by picking stocks based on one factor at a time, we diluted the alpha potential of various factor exposures when they were combined. Therefore, we choose to score individual stocks based on our factor definitions rather than equally weighting the stocks selected for our distinct factor portfolios. This balance helps us select 200 stocks that tapped into multiple factors, resulting in a basket more likely to outperform in various environments.

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.

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You cannot invest directly in an index.

DEFINITIONS

Smart Beta : A term for rules-based investment strategies that don’t use conventional market-cap weightings.

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.

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.

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

Technical indicators : Type of analysis that tries to determine future price patterns using historical price patterns.

Composite Factor Score (CFS) : Taking individual measurements of factor exposures, and combining them into a single measure meant to represent multifactor exposure for a certain asset. For example, in the case of the WisdomTree U.S. Multifactor Index, the composite factor score aims to measure factor exposures to Value, Quality, Momentum and Low Correlation as they relate to a single asset..

Momentum : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

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.

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

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.

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.

Size Factor : the average returns of small portfolios minus the average returns of the large portfolios after adjusting for growth or value tendencies.

S&P 500 Equal Weight Index : Designed to track the equally weighted performance of the 500 constituents in the S&P 500 Index.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Net Buyback Yield : A company’s net share buyback is the difference between the capital raised by issuing new shares and the money the company spent on buying back any outstanding shares. A positive net share buyback means that more was spent on buying back existing shares than received from issuing new shares. Net buyback yield is the amount of a company's net buybacks divided by its market capitalization. Please note that net buyback yield does not represent a dividend paid by the company.

Shareholder Yield : A data point that references the combination of dividend yield and buyback yield.

Leverage : Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

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.

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.

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.

Earnings yield : The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.

Alpha : Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.