

# THE FUTURE OF INTERNATIONAL DIVIDEND GROWTH INDEXES

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We have recently introduced a new family of dividend growth-related Indexes focused on the U.S. equity markets. We are expanding this new “[growth](#)” methodology from the U.S. to the foreign markets with an Index screening change to an existing WisdomTree Index. To create consistency across the globe in how WisdomTree identifies dividend payers with growth characteristics, the [WisdomTree Global ex-U.S. Growth Index](#) methodology applies the same growth-oriented stock selection rules as we introduced in the [WisdomTree U.S. Dividend Growth Index](#). This new Index methodology takes effect as of the 2013 annual rebalance—or following the close of trading on June 21, 2013, with data based on an Index screening on May 31, 2013. We believe WisdomTree’s new dividend growth Indexes stand out as the only indexes to screen for dividend growth characteristics or prospects instead of just for companies that have historically raised their dividends over a given period prior to determining eligibility for a dividend growth index. We believe that past dividend practices are not always indicators of future dividend growth potential. For example, within the [WisdomTree Global ex-U.S. Dividend Index](#), WisdomTree’s most comprehensive Index of dividend payers outside the U.S., only two of the top 10 dividend payers did not decrease their dividend at least once in the past five years. Therefore, dividend growth screens based on consecutive years of payments would necessarily exclude 80% of the 10 largest payers. **Introducing the WisdomTree Global ex-U.S. Growth Index** The theme of U.S. dividend growth is certainly important, but the opportunity set of dividend payers is even larger beyond our borders. Below we outline our revised selection metrics and rationale for this new methodology focusing on dividend payers with growth characteristics:

**Earnings Growth Expectations:** This criterion is pretty simple: Firms expected to grow their earnings faster, all other things being equal, should have greater potential to increase their future dividends faster. We understand that these are only estimates, but we believe that, while there may be a lot of noise around a single company’s precise earnings growth, in aggregate the companies with higher growth expectations grow faster than those with lower expectations. And these companies have more capacity, in our opinion, to fund growing dividends.

**Quality Factor Rankings:** Our quality factor ranking is based on three-year historical averages for [return on equity \(ROE\)](#) and [return on assets \(ROA\)](#). We believe companies that generate greater profitability, controlling for any excessive use of [leverage](#), should have a greater potential to increase their future dividends than firms demonstrating lower profitability metrics. Warren Buffett often says in his annual letters that he looks for “businesses earning good returns on equity while employing little or no debt.” Since high leverage implies the use of debt, our use of a quality ranking that incorporates both ROE and ROA enables us to mitigate the use of leverage as a sole driver of what may superficially appear to be a high ROE figure. Two of our favorite quotes from Warren Buffett and his business partner on this “quality” factor:

whether we’re talking about socks or stocks, I like buying quality merchandise when it is marked down.  
– Warren Buffett, Berkshire Hathaway Inc., Annual Report, 2008 We’ve really made the money out of high quality businesses . . . If the business earns 6% on capital over 40 years and you hold it for that 40 years, you’re not going to make much different than a 6% return even if you originally buy it at a huge

discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result.

- Charlie Munger at USC Business School in 1994 Key Characteristics of WisdomTree's "Dividend Growth" Companies outside the U.S. Now that we've discussed some of our rationale behind our Index constituent selection, let's compare the characteristics of our approach to some other widely followed international equity indexes.

**Index Characteristics as of May 31, 2013 Index Screening**

	Long-Term Earnings Growth Expectations	ROE	ROA	Leverage	Earnings Retention	ROE x Earnings Retention
Qualifiers (WT Global ex-U.S. Growth Index)	14.7%	35.0%	14.0%	2.5x	71.5%	25.0%
Non-Qualifiers	7.1%	17.5%	5.8%	3.0x	54.6%	9.5%
MSCI EAFE Index	10.9%	14.5%	5.0%	2.9x	48.7%	7.1%
MSCI EAFE Growth Index	14.1%	19.7%	7.1%	2.8x	52.3%	10.3%
MSCI AC World ex-US Index	10.8%	15.2%	5.4%	2.8x	54.5%	8.3%
Sources: WisdomTree, Bloomberg						
Past performance is not indicative of future results. You cannot invest directly in an index.						

*For definitions of*

*terms and indexes, visit our [Glossary](#).*

- **Higher Growth Expectations:** The average long-term earnings growth estimates were over 7 percentage points higher for qualifiers to this Index than for non-qualifiers. They were also higher than the [MSCI EAFE Index](#), the [MSCI EAFE Growth Index](#) and the [MSCI AC World ex-US Index](#). Admittedly, these indexes are weighted by [market capitalization](#) and do not focus on dividend-paying stocks. However, we include them as widely followed international benchmarks outside the U.S., and it is a fact that the MSCI EAFE Growth Index does focus on companies that MSCI selects based on their above-average growth prospects relative to the universe defined by the broader EAFE Index.
- **The ROE/Dividend Connection:** The ROE for the qualifiers for the WT Global ex-U.S. Growth Index was almost twice as high as that of the MSCI EAFE Growth Index, the next highest. Additionally, the ROA was also basically double that of the MSCI EAFE Growth Index. This is a combination that we believe indicates that our selection criteria are focused on creating exposure to firms that are generating their profits efficiently.
- **Lower Leverage:** The qualifiers to the WT Global ex-U.S. Growth Index employ less leverage to operate their businesses than both the non-qualifiers and the broader equity market measures.

**Conclusion** while there is no way to know what will happen in the future with certainty, we believe that our dividend growth methodology applies a framework to selecting stocks with growth characteristics. We have focused on variables that we believe are key drivers of dividend growth. Companies incorporated outside U.S. markets provide a widely ranging opportunity set of dividend payers, and we believe it makes sense to provide an option that attempts to select those best positioned for potential dividend growth. *Read our full research [here](#).*

**Important Risks Related to this Article**

Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company paying dividends may cease paying dividends at any time.

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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## DEFINITIONS

**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.

**WisdomTree U.S. Dividend Growth Index**: A fundamentally weighted index designed to track the performance of dividend-paying companies in the U.S. that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by indicated cash dividends.

**WisdomTree Global ex-U.S. Dividend Index**: Designed to measure the performance of dividend-paying companies outside the United States. Weighting is by dividend stream.

**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.

**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.