

WHAT'S YOUR INDIA PORTFOLIO SENSITIVITY TO THE RUPEE?

Tripp Zimmerman – Director, Research
06/05/2014

Less than a year ago, on the back of the [Federal Reserve taper](#) talks, India's currency was sent into a tailspin on fears of its large [current account](#) vulnerabilities. For unhedged equity investors, this currency weakness detracted from their return and increased the [volatility](#). During times of volatility, the focus tends to be less on individual company [fundamentals](#) and more on macroeconomic fears. Opportunities typically present themselves during these times of heightened volatility and fear. When emotions can get in the way of making difficult portfolio allocations, wisdomTree's rules-based process makes adjustments to portfolios based on strict readings of the underlying fundamentals. At the most recent annual rebalance last September, the [WisdomTree India Earnings Index \(WTIND\)](#) added weight to companies with a high degree of sensitivity to the rupee (INR) because they were the greatest underperformers at the time. Their profits had yet to deteriorate, but the market was moving down on them. This process has also added significant value to the [WisdomTree India Earnings Fund \(EPI\)](#), which is designed to track WTIND, by focusing on these higher correlated securities, as of the most recent rebalance. These companies have performed very well during the market and currency rebound, and this blog post will break down the performance of stocks in WTIND, based on their [correlation](#) to the rupee. The key: Stocks most sensitive and more correlated to the rupee have gone up the most, and WTIND had more weight than traditional indexes in these stocks that have higher correlations to the rupee. **Rupee**

3-Yr Correlation vs. INR Quartiles	Weights (5/20/14)		Performance (9/30/13-5/20/14)		Attribution (9/30/13-5/20/14)
	WTIND	MSCI India	WTIND	MSCI India	
Less Than 0.27	21.0%	29.8%	24.62%	15.91%	2.3%
0.27 to 0.48	15.8%	17.8%	50.81%	28.44%	3.2%
0.48 to 0.58	31.2%	35.0%	61.77%	66.82%	1.9%
Greater Than 0.58	32.0%	17.4%	83.38%	76.69%	8.3%
Index Total	100.0%	100.0%	46.1%	30.4%	15.7%

Sources: WisdomTree, Bloomberg, (9/30/13-05/20/14). Correlations are calculated from 4/30/11-4/30/14 and broken into quartiles for illustrative purposes. Because WTIND's annual rebalance is in September, 9/30/13 was chosen as a start date. Correlation quartile returns are averages and calculated in U.S. dollars. Past performance is not indicative of future results. High double-digit returns are unusual and cannot be sustained. Investors should also be aware that these returns were achieved primarily during favorable market conditions. Performance, especially for very short periods, should not be the sole factor in making your investment decision. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. You cannot invest directly in an index.

Sensitivity

Correlation Over-weight Led Outperformance – WTIND's over-weight exposure to the highest correlation bucket of stocks added more than 8% of outperformance compared to the MSCI India Index. This is impressive considering it accounted for more than half the total 15.7% outperformance during the period. • **More Weight in Higher Correlated Stocks** – The WTIND had almost 2x more weight in firms with the highest rupee sensitivity and almost two-thirds of its weights in firms within the highest two correlation buckets. WTIND is currently over-weight the Financials and Energy sectors and under-weight Information Technology and Consumer Staples. Over the past three years, the former sectors showed a higher degree of correlation than the latter sectors. • **Higher Correlated Firms Outperformed** – Firms within the highest quartile outperformed firms in the lowest quartile by around 60% within both WTIND and MSCI India. Although the performance differentials among quartiles for the indexes were similar, WTIND was able

• High

to outperform over the period as a result of its over-weight to stocks within the highest correlation [quartiles](#). **Weighting by Earnings Focuses on Lower [Price-to-Earnings \(P/E\) Ratios](#)** In order to garner significant weights in the WTIND Index, the index methodology requires that a company grow its profits rather than increase its [market capitalization](#). As a result, we can generalize the impact of the rebalance as follows:

- **Typical Additions in Weight** – Firms whose share prices may have performed poorly or stayed flat but whose earnings increased
- **Typical Reductions in Weight** – Firms whose share prices may have performed quite well but whose earnings growth was negative or flat

Last year's rebalance saw a huge shift in weight to companies that were relatively cheap, which at the time were the stocks correlating highest to the rupee due to the crisis environment. At this year's upcoming rebalance, after seeing large gains in these stocks, WTIND may potentially lower weight to them—especially if their recent performance trend continues. The key for understanding the process driving the WTIND: There is a dynamic process that identifies value, and last year that value was in the stocks with the highest correlation to the rupee. **Conclusion** The Indian stock market measured in local prices had already made new all-time highs, but the market measured in dollars would still need to appreciate more than 25% to reach its 2010 highs and more than 50% to reach its early 2008 highs¹. Although the rupee has been a significant headwind for performance over the past few years, we feel the worst might be behind us and are intrigued by the recent relative strength of both the equity market and the rupee. The landslide victory in the Indian election by Prime Minister Narendra Modi and his pro-business party has been supportive of the equity markets and currency. Also, the new central bank governor, Raghuram Rajan, has helped restore market confidence in the [inflation](#)-fighting credentials of the Reserve Bank of India, by proactively hiking rates to stem inflationary pressures last year. We are optimistic that a Modi-Rajan tag team may be able to rectify India's fiscal house and unlock the country's great potential through pro-business initiatives and reforms. If investors share this positive view on the currency and general economic potential, we believe that this market and EPI could be of particular interest. ¹Source: Bloomberg, India stock market refers to the MSCI India Index, as of 5/20/14

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. This Fund focuses its investments in India, thereby increasing the impact of events and developments associated with the region, which can adversely affect performance. Investments in emerging, offshore or frontier markets such as India are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. As this Fund has a high concentration in some sectors, the Fund can be adversely affected by changes in those sectors. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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](#)

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.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Tapering: A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

Current account: The difference between a nation's total exports of goods, services and transfers, and its total imports of them.

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

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

WisdomTree India Earnings Index: A fundamentally weighted Index that measures the performance of companies incorporated and traded in India that are profitable and that are eligible to be purchased by foreign investors. Companies are weighted in the Index based on their earnings in their fiscal year prior to the Index measurement date, adjusted for a factor that takes into account shares available to foreign investors.

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.

Quartile: Statistical measure that groups a series of values into four groups after ranking them from lowest to highest. The first quartile will have the lowest values, whereas the fourth quartile will have the highest.

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.

Inflation: Characterized by rising price levels.