
HOW U.S. ECONOMY CENTRIC IS YOUR U.S. EQUITY EXPOSURE?

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Given today's increased focus on the global economy, investors are likely aware of how foreign currency movements can impact their international investments. But the U.S. dollar can affect domestic equities as well. Many U.S. companies generate a large portion of their [revenue](#) outside the United States. A strong dollar can hurt these companies' competitiveness as their goods and services become more expensive to their international clients. As a result of the recent dollar strength, many of these U.S. exporters have reported large currency headwinds as part of their earnings statements this year, which has hurt their performance compared to European and Japanese exporters, who have benefited from the yen and euro, respectively, weakening against the U.S. dollar. Jon R. Moeller, Chief Financial Officer of Procter & Gamble, summarized the challenges facing many companies during P&G's most recent earnings call:

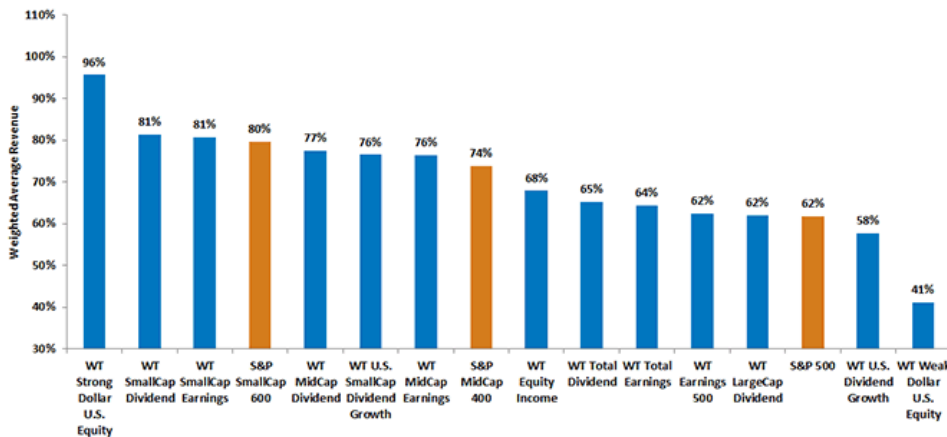
“Core earnings per share for the year were \$4.02, down 2% versus the prior year. This includes a 13-point headwind from [foreign exchange \(FX\)](#), over \$1.5 billion after tax.

“Foreign exchange will continue to be a significant sales and earnings headwind, particularly in the first two quarters. To offset the foreign exchange impacts and restore structural economics, we've taken significant price increases in some markets. We need to manage through the market contraction and [volatility](#) that naturally follow.

“We have disproportionately large positions in the markets most affected by FX. We're market leaders in Russia, the Ukraine, in Japan and in Venezuela. In contrast, many of our internationally domiciled competitors are benefiting from their weaker currencies, providing fuel for reinvestment.”¹

On the other hand, there are domestically oriented companies that may perform better when the dollar is strong, because their earnings are not driven by foreign sales. In the chart below we quantify the weighted average revenue coming from within the United States to get a sense of how sensitive an index may be to fluctuations in the dollar.

Index Weighted Average Revenue from within the U.S.



Sources: WisdomTree, FactSet, 6/30/15. You cannot invest directly in an index. Past performance is not indicative of future results.

• [WisdomTree Strong Dollar U.S. Equity Index](#) – generated the highest percentage of revenue from within the U.S. This Index includes only firms that derive more than 80% of their revenues from within the United States. These companies tend to be less impacted by a strong-dollar environment—they aren’t focused on selling their goods and services abroad, and their import costs decrease with a rising purchasing power of the dollar. The Index also tilts weight more heavily toward stocks whose returns have a higher [correlation](#) to the returns of the U.S. dollar.

• [Small- and Mid-Cap Indexes](#) – typically generate a higher percentage of their revenues from their domestic economies than do [large-cap](#) indexes. Another way to potentially steer around the negative earnings impact from a strong dollar would be to focus on small- and [mid-cap](#) companies, which tend to be less reliant on exports to drive revenue.

• [WisdomTree Weak Dollar U.S. Equity Index](#) – generated the lowest percentage of revenue from within the U.S. This Index includes only firms that derive at least 40% of their revenues from exports. These firms tend to be more impacted by a strong-dollar environment, as they are focused on selling their goods and services abroad. Similarly, during a weak-dollar period, we’d expect these firms to become more competitive in selling their goods abroad. The Index also tilts weight to stocks whose returns that are more negatively correlated (or have a lower correlation) to the returns of the U.S. dollar.

What Are Your Thoughts on the Dollar? Among the most important macroeconomic forces impacting the market have been currency changes motivated by diverging [monetary policies](#). If you believe the U.S. dollar will continue to strengthen over the coming years, as is WisdomTree’s baseline view, this can provide continued headwind to U.S. exporters. In response, we think it makes sense to favor the WisdomTree Strong Dollar U.S. Equity Index or indexes focused on mid- and small-cap companies. Conversely, if you believe the U.S. dollar trend is set to reverse, such an environment would favor U.S. exporters and the WisdomTree Weak Dollar U.S. Equity Index.

¹Procter & Gamble Q4 2015 Earnings Call Transcript, 7/30/15.

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

Revenue: Income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

Foreign Exchange (FOREX, FX): The exchange of one currency for another, or the conversion of one currency into another currency.

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

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.

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.

Monetary easing policies: Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.