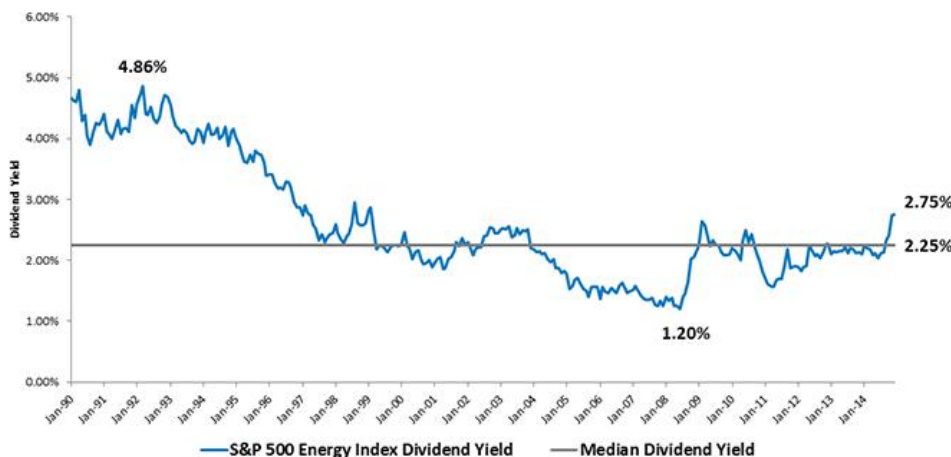


# WHAT DOES THE OIL TURMOIL MEAN FOR THE ENERGY SECTOR IN THE LONG TERM?

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One of the largest investment stories for the second half of 2014 was the precipitous decline of oil prices and its impact on the energy sector. Over the period, [West Texas Intermediate Crude Oil](#) declined 49.4%, the [S&P 500 Energy Index](#) declined 18.4% and the [Russell 2000 Energy Index](#) declined 48.7%.<sup>1</sup> As a result of the sharp price declines, the [dividend yields](#) on various energy stocks have increased. At WisdomTree, we believe that dividend yields are an important indicator of relative [valuation](#). We also acknowledge that some investors are concerned about whether current dividends are sustainable if oil remains at current levels or falls even farther. Figure 1 looks at the last 25 years of the S&P 500 Energy Index to compare the most recent dividend yields with the index's available history. In short, dividend yields at current valuations coincide with very favorable forward-looking returns in the historical study. **Figure 1: S&P 500 Energy Index Dividend Yields**



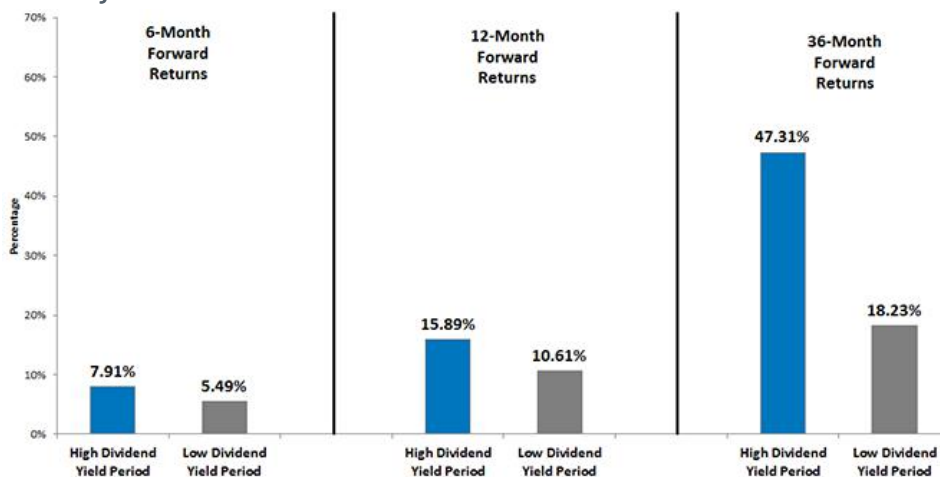
Sources: WisdomTree, Bloomberg, 1/31/90-12/31/14  
Past performance is not indicative of future results. You cannot invest directly in an index.

*For definitions of terms in the chart, please visit our [glossary](#).*

- **High Dividend Period:** As of December 31, 2014, the S&P 500 Energy Index exhibited a [trailing 12-month dividend yield](#) of 2.75%, the highest it has been in over 15 years. Also, the current dividend yield ranks in the top 30% of all observations.<sup>2</sup> - The highest recorded dividend yield over the period was 4.86%, and the subsequent three-year return was 50.4%. - The lowest dividend yield was 1.20%, and the subsequent three-year average annual return was very poor at - 8.6%.
- **Payout Ratio Not Extended:** As of December 31, 2014, the S&P 500 Energy Index had a [dividend payout ratio](#) of 36.5%, essentially in line with the S&P 500 Index's payout ratio of 35.5%. The current payout ratio for the energy sector is also in line with its historical [median](#) of 36.3% and well below the median payout ratio of 70.9% during the nineties—which coincided with a period of very depressed oil prices.

**Dividend Yield Performance Analysis** with respect to comparisons to its own historical levels,

our research shows that the S&P 500 Energy Index dividend yield had a strong relationship to the subsequent performance over the six-month, 12-month and three-year periods. The S&P 500 Energy Index had over 264 unique periods of index data for which a trailing 12-month dividend yield and subsequent forward return can be calculated. We divided these periods into two buckets, sorted by the trailing 12-month dividend yield as of each month end.<sup>3</sup> • **High Dividend Yield Period:** Periods in which the starting trailing 12-month dividend yield was above the [median trailing 12-month dividend yield](#) for the index. The median trailing 12-month dividend yield was 2.25%. • **Low Dividend Yield Period:** Periods in which the starting trailing 12-month dividend yield was below the median trailing 12-month dividend yield for the index. **Figure 2: Performance Summary of the S&P 500 Energy Index**



Sources: WisdomTree, Bloomberg, 1/31/90-12/31/14  
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• **Dispersion from High to Low:** We believe that the bars in figure 2 make the statement that valuation is of paramount importance for the S&P 500 Energy Index. On a median basis, returns of the High Dividend Yield Period eclipsed those of the Low Dividend Yield Period over each of the periods displayed above. The largest dispersion occurred over the forward 36-month period, where the high yield period outperformed the low yield period by almost 30%. While we think the dividend yield analysis is a strong and important valuation indicator for the energy sector, it is important to remember that there are also many factors that can impact returns in the short run, especially in the politically driven oil market. We also think it is important to focus on fundamentals like dividend yields and revisit those fundamentals periodically. Currently, based on the above historical analysis, the energy sector offers a potentially attractive entry point, but it would be prudent to monitor dividend trends in real time.

<sup>1</sup>Source: Bloomberg, 6/30/14?12/31/14.

<sup>2</sup>Source: Bloomberg, 1/31/90?12/31/14, based on month-end dividend yields. <sup>3</sup>Note: There are 294 unique periods in which a six-month forward return can be calculated, 288 unique periods in which a 12-month return can be calculated and 264 unique periods in which a 36-month forward return can be calculated.

**Important Risks Related to this Article**

Dividends are not guaranteed, and a company’s future ability to pay dividends may be limited. A company currently 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

**S&P 500 Energy Index**: Market capitalization-weighted measure of the performance of companies in the S&P 500 Index that are in the energy sector.

**Russell 2000 Energy Index**: Market capitalization-weighted measure of performance of the smallest energy companies in the Russell 3000 Index.

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

**Valuation**: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Trailing 12-month dividend yield**: Dividends over the prior 12-months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

**Dividend Payout Ratio**: The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.

**Median**: The median is the value within a dataset at which 50% of all observations occur above and 50% occur below.

**Median trailing 12-month dividend yield**: Dividends over the prior 12-months are added up and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.