HOW TO EVALUATE SMART BETA

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Some industry insiders are concerned that "smart beta" may simply be a fad. We don't agree. And it would seem that investors don't either. (Unsure what smart beta is? Read this.) That may seem like a pretty confident statement, but consider that numbers usually don't lie: • One-quarter of exchange-traded fund (ETF) inflows in the first 11 months of 2013—$41 billion—went into ETFs characterized as smart beta by Morningstar. Total assets in smart beta ETFs as of that point in time stood at $271 billion, approximately 17% of the total assets in ETFs.[1] • According to a new study conducted by Cogent Research (a division of Market Strategies International), more than half (53%) of institutional decision makers will increase their use of smart beta ETFs over the next three years—that's more than any other ETF category, including market capitalization-weighted ETFs (48%).[2] These two statistics alone could make smart beta the largest category of ETFs—and a primary driver of ETF growth going forward. And if this type of explosive growth continues, ETF assets could match equity mutual funds in assets under management (currently at $7.6 trillion)[3] in less than a decade. Now, while we don't believe smart beta is a trend, we do believe that investors should beware of asset managers and investments that may be jumping on this bandwagon—capitalizing on smart marketing rather than smarter investment methods. In our opinion, when it comes to identifying smart beta ETFs, investors should look for: • A rules-based, repeatable methodology that offers broad, representative exposure to an asset class • Alternative weighting methods that allow for ample investment capacity • High correlation to established benchmarks • Regular rebalancing • A proven track record on a total and risk-adjusted return basis At WisdomTree, we do things differently. In 2006, we launched one of the first families of alternatively weighted ETFs, calling them "fundamentally weighted." In fact, our family of fundamentally weighted ETFs has proven itself for more than seven years (including during the market crisis of 2008-09). How? Our ETFs are built with proprietary methodologies, smart structures or uncommon access to provide investors with the potential for income, performance, diversification and more. To learn more about smart beta, read the full paper here. In future installments, we'll discuss how WisdomTree created the first smart beta investments—and much more. [1]Source: Source: Reshma Kapadia, "No Sugarcoating: Smart-Beta ETFs Vary Widely," Barron's, 1/4/14. [2]Source: Marketwired, LP, 12/11/13. [3]Source: Investment Company Institute, as of 11/30/2013.

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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.

Market capitalization-weighting : 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.

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.

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.

Fundamental weighting : A type of equity index in which components are chosen based on fundamental criteria as opposed to market capitalization. Fundamentally weighted indexes may be based on fundamental metrics such as revenue, dividend rates, earnings or book value.