

# HOW TO MANAGE VALUATION RISK IN INDIA'S EQUITIES

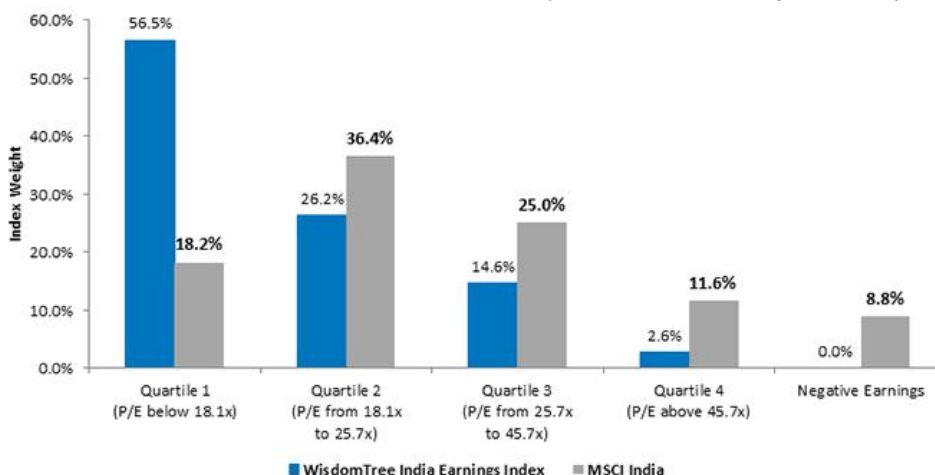
Tripp Zimmerman – Director, Research  
10/16/2015

WisdomTree believes that weighting by [market capitalization](#), which does not weight, consider or [rebalance](#) back to any measure of economic importance of the underlying constituents, may not be the best approach to indexing. Instead, we believe a disciplined strategy of anchoring allocations back to a measure of [relative value](#), based on [fundamentals](#) such as [dividends](#) or earnings, can add value over time. We also believe that this fundamental process may prove to be most important in less efficient markets, such as [small caps](#) or emerging markets. In India we focus on earnings, and the [WisdomTree India Earnings Index \(WTIND\)](#) seeks to provide broad exposure to the profitable core market of India's equities while maintaining sensitivity to [valuation](#). To help achieve this, wisdomTree weights companies in the Index by the [profits](#) they generate, rather than their market cap, and rebalances back to profitability on an annual basis. **WisdomTree's India Earnings Index rebalance process typically is driven by the following:**

- **Earnings Growth:** Companies that grow their profits see their weight increased.
- **Relative Performance:**

- Underperformers typically see their weight increased.
- Outperformers often see their weight decreased.

This process tends to shift weight to firms with lower [price-to-earnings \(P/E\) ratios](#), as illustrated in the chart below. It compares the distribution of stocks by their P/E ratios in WTIND to that of the [MSCI India Index](#), a widely followed market cap-weighted index that also measures the performance of India's equities. **P/E Ratio and Weight Distribution** WTIND's P/E ratio is approximately 12.5x—reflecting the 2015 Index screening—i.e., over 38% lower than the 20.3x P/E ratio of the MSCI India Index. The chart below provides a look at how the weight is distributed, to give a sense for why WTIND has a lower P/E ratio. **P/E Quartile Distribution**



Sources: Bloomberg, Standard & Poor's, with data as of 8/31/15, based on WTIND Index screening. You cannot invest directly in an index. Subject to change.

**Lower-Priced Stocks:** WTIND had more than 50% of its weight in the lowest-priced • More weight to

quartile, which is significantly more than the MSCI India Index. There is a natural tendency of earnings-weighted approaches to reduce weight to stocks whose prices have appreciated at a faster rate than their earnings, and concurrently to increase weight to stocks that have fallen in price despite exhibiting positive earnings growth.

- **Less Weight to Higher-Priced Stocks:** On the other hand, wisdomTree's approach has less than 3% of its weight going to the highest-priced quartile. The MSCI India Index had more than 20% of its weight in the most expensive quartile and stocks with negative earnings.
- **Negative Earnings and Speculative Stocks:** Although profitability may fluctuate throughout the year, at each annual rebalance wisdomTree requires companies to be profitable before inclusion. This requirement keeps the weight to firms that we believe tend to be more speculative and of lower quality at zero. The MSCI India Index does not share this requirement.

#### Important Risks Related to this Article

Investments in emerging, offshore or frontier markets 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.

Investments focused in India increase the impact of events and developments associated with the region, which can adversely affect performance.

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](http://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

**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.

**Rebalance**: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

**Relative value**: The relationship between a particular attribute, e.g., a dividend, and the firm's share price compared to that of another firm.

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

**Qualified dividends**: Dividend paid by corporations meeting certain criteria defined by the Internal Revenue Service and therefore eligible in certain instances to be taxed at rates below a tax filer's tax bracket on ordinary income.

**Small caps**: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**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.

**Profits**: Income that a company receives from revenue after costs and expenses are deducted.

**MSCI India Index**: A market capitalization-weighted index designed to measure the performance of the Indian equity market.