

# TEN FAST FACTS FOR DGRS'S 10-YEAR ANNIVERSARY

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[Small-cap](#) investing is tricky, and there are myriad ways to pursue [alpha](#) relative to traditional, [market cap-weighted](#) benchmarks like the [Russell 2000](#). Managers routinely combine factors to obtain exposure and experiment with different weighting mechanics, hoping their preferred small-cap recipe delivers improved risk-adjusted returns.

We are no exception. This past month, the [WisdomTree U.S. SmallCap Quality Dividend Growth Fund \(DGRS\)](#) celebrated 10 years since inception. Like its [large-cap](#) sibling (the [WisdomTree U.S. Quality Dividend Growth Fund, DGRW](#)), [DGRS](#) applies one of WisdomTree's flagship factor methodologies to the U.S. small-cap space by marrying quality and dividend growth, alongside size.

In honor of its 10-year anniversary, here are 10 "fast facts" about [DGRS](#) to consider for a U.S. small-cap allocation:

**1. Category leadership:** [DGRS](#) was recently promoted to a 4-star fund ranking within the Morningstar U.S. Small Value universe, a testament to its performance leadership since inception. It finished in the top 28th percentile of all 326 funds in the category and delivered 0.87% of outperformance (at NAV) compared to the category index over the 10-year period.

*Ranking as of 10/31/23. The Morningstar Rating™ for funds, or "star rating," is calculated for managed products with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance.*

*The top 10% of products in each product category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars, and the bottom 10% receive one star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three- and five-year Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns.*

**2. A performance track record of success:** Although [DGRS](#) impressed within its Morningstar category, it has succeeded against the most recognized small-cap gauges as well. It consistently outperformed both the Russell 2000 and [Russell 2000 value](#) benchmarks over the short-, medium- and long-term, and in some cases, by several hundred basis points.

PERFORMANCE as of 8/9/2023			Cumulative Returns			Average Annual Total Returns					
Ticker	Fund	Inception Date	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 7/25/2013 - 8/9/2023
<a href="#">DGRS</a>	WisdomTree U.S. SmallCap Quality Dividend Growth Fund (NAV)	7/25/2013	5.34%	11.11%	11.04%	6.09%	14.01%	5.94%	8.09%	8.29%	8.29%
RU2000	Russell 2000 Index	12/31/1969	3.62%	10.48%	10.59%	1.01%	8.51%	4.12%	7.72%	-	7.65%
RU2000V	Russell 2000 (Value) Index	12/31/1969	5.97%	13.22%	7.86%	-0.21%	14.11%	4.09%	7.15%	-	6.98%

Source: WisdomTree Fund Comparison tool, as of 8/9/23. DGRS expense ratio = 0.38%, as of 6/30/23. Past performance is not indicative of future results. You cannot invest directly in an Index. The performance data quoted represents past performance and is no guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end performance, click here.

**3. Volatility reduction:** Perhaps most impressive is the risk profile of [DGRS](#), which looks quite like the prevailing volatility of the Russell 2000 and Russell 2000 Value indexes. Small caps are already a high-risk segment of U.S. equity markets due to their size and business lines, so incremental volatility for most investors is only added with an abundance of caution and a reasonable expectation of additional return compensation. [DGRS](#) delivered impressive outperformance with virtually identical volatility to the broader small-cap market, providing strong risk-adjusted returns due to its factor methodology.

VOLATILITY (STANDARD DEVIATION) as of 6/30/2023			Average Annual Volatility					
Ticker	Fund	Inception Date	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 7/31/2013 - 6/30/2023
<a href="#">DGRS</a>	WisdomTree U.S. SmallCap Quality Dividend Growth Fund (NAV)	7/25/2013	27.57%	21.50%	24.03%	-	19.58%	19.58%
RU2000	Russell 2000 Index	12/31/1969	23.40%	21.57%	23.84%	19.50%	-	19.48%
RU2000V	Russell 2000 (Value) Index	12/31/1969	25.15%	22.34%	24.66%	20.03%	-	20.03%

Source: WisdomTree Fund Comparison tool, as of 6/30/23. Past performance is not indicative of future results. You cannot invest directly in an Index.

**4. Consistency in recent cycles:** [DGRS's](#) outperformance, coupled with reduced volatility, is not a temporary success story, either. It persisted over some of the most volatile market periods in recent memory. Over the past three- and five-year periods, which included the pandemic-induced market collapse of 2020, the subsequent recovery and bull market of 2021, followed by the steady declines of 2022, [DGRS](#) has captured more [upside](#) and virtually identical [downside](#) compared to broader small caps. This led to capture ratios above 100% over these periods, indicative of the Fund's success.

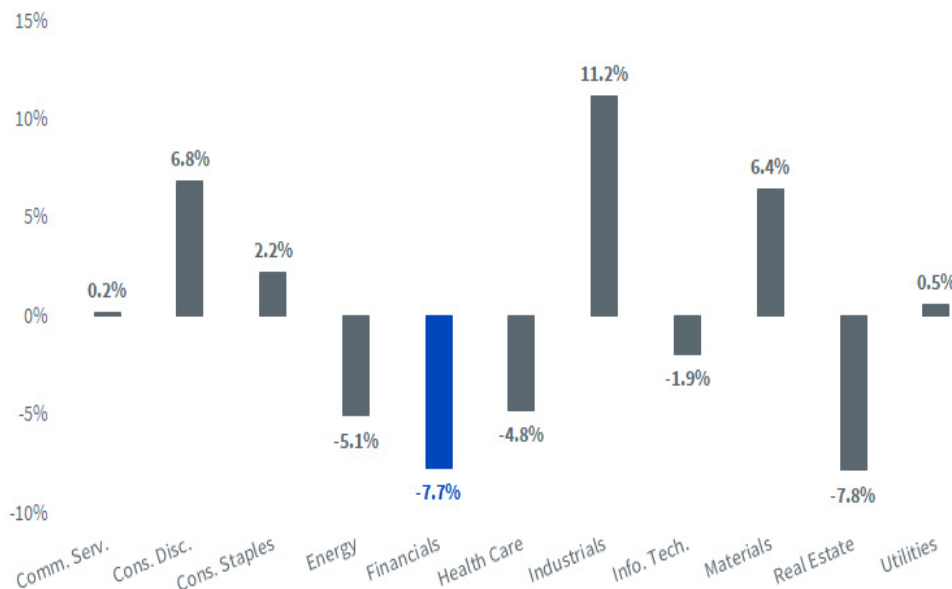
UP CAPTURE (RUSSELL 2000 INDEX) as of 6/30/2023								
Ticker	Fund	Inception Date	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 7/31/2013 - 6/30/2023
DGRS	WisdomTree U.S. SmallCap Quality Dividend Growth Fund (NAV)	7/25/2013	123.22%	109.98%	105.60%	-	97.75%	97.75%

DOWN CAPTURE (RUSSELL 2000 INDEX) as of 6/30/2023								
Ticker	Fund	Inception Date	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 7/31/2013 - 6/30/2023
DGRS	WisdomTree U.S. SmallCap Quality Dividend Growth Fund (NAV)	7/25/2013	126.96%	95.84%	100.02%	-	97.38%	97.38%

Source: WisdomTree Fund Comparison tool, as of 6/30/23. Past performance is not indicative of future results. You cannot invest directly in an index.

**5. Reduced bank exposure:** while the regional banking crisis from earlier this year remains a foremost concern, it’s important to realize that [DGRS](#) is structurally underweight in these banks due to its factor methodology. Banks, by the nature of their business and balance sheets, tend to have higher [returns on equity \(ROE\)](#) and lower [returns on assets \(ROA\)](#), two key ingredients within a quality framework. WisdomTree’s quality methodology allocates to companies that score highly on both measures, and the low ROA of companies in the small-cap bank universe meaningfully reduces their exposure in [DGRS](#). As of July, [DGRS](#) has less than half the diversified and regional bank exposure of the Russell 2000 Value Index, at 7% versus 16%. At the sector-level, [DGRS](#) has averaged nearly an 8% underweight allocation to Financials over the past five years. If banking concerns remain top of mind within the small-cap space, investors may be comforted by single-digit exposures within [DGRS](#) when many other small-cap factor strategies regularly have over 10% exposure.

**Historical Average Sector Over/Underweights versus Russell 2000 value**



Sources: WisdomTree, FactSet, as of 7/31/23. Past performance is not indicative of future results. You cannot invest directly in an index.

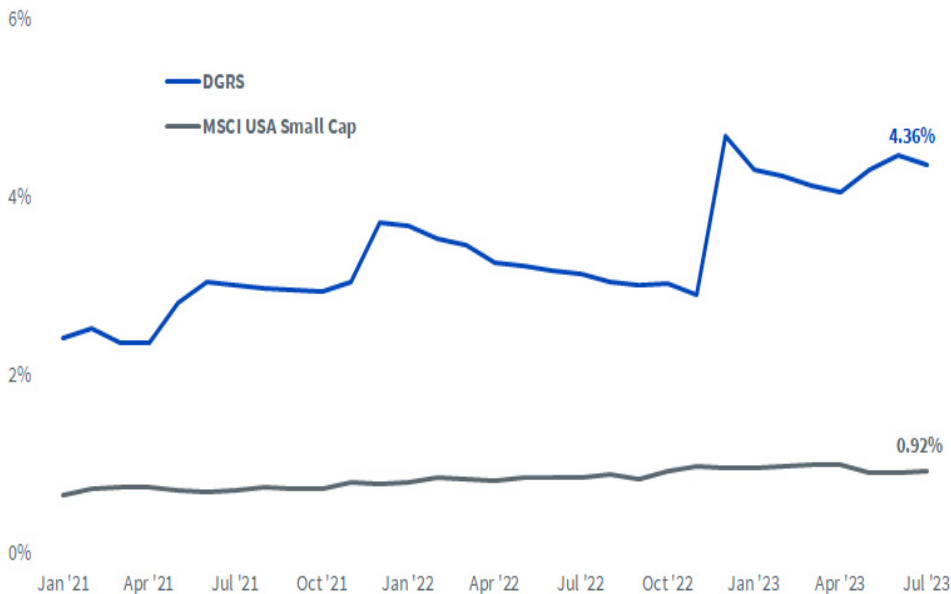
**6. Factor success in small-cap markets:** Factor investing has become increasingly important for small caps. Decades of research efforts studied the validity of the “size premium,” the concept that small caps will eventually outperform larger companies over time. Initial results confirmed its existence, and it appeared that investors (those who could endure the inherent riskiness of small caps) would be rewarded over the long term.

However, subsequent studies<sup>1</sup> indicate that the relationship has deteriorated over the last few decades, suggesting instead that small-cap success is predicated on which companies you own and which you do not. Pairing quality and size became imperative. It enables small-cap allocators to target the healthier corners of the small-cap market while avoiding broader swaths of junky companies. [DGRS's](#) quality dividend growth methodology packages the robustness of quality, the income potential of value and inherent size exposure for a factor blend that may have more long-term success than size alone.

**7. Quality promotes margin defense:** Earlier this year, I wrote a blog post demonstrating that quality companies can potentially hedge inflation due to improved price power. The logic was that they can pass off rising labor and input costs to their customers via higher prices, which defends their profit margins while inflation erodes them for more vulnerable businesses. This holds true today, even as we move past peak [inflation](#) in the U.S.

If we look at the top two deciles of companies ranked by wisdomTree's quality methodology within [DGRS](#), we find that their aggregate profit margin is roughly 3.5% greater than they are within the [MSCI USA Small Caps Index](#) universe. Since these are stocks common to both, the improvement is a direct result of [DGRS's](#) weighting scheme. By dividend-weighting a high-quality stock basket, [DGRS](#) delivers robust profit margins during periods when inflation introduces margin pressure. In our view, this highlights another shortcoming of market cap-weighting U.S. small caps.

**Profit Margins of Top 2 Deciles by WT Quality Score among Common Holdings**



Sources: WisdomTree, FactSet, as of 7/31/23. You cannot invest directly in an index.

**8. Quality tilts to healthier small-cap companies:** wisdomTree's quality framework is designed to deliver more exposure to stronger, healthier, efficient companies, evidenced by improvements in ROE and ROA. These measure the efficiency of equity capital and asset usage in delivering profits for the firm, and [DGRS](#) excels versus the broader small-cap and small-cap value markets by design. These companies and their business lines may be more insulated from cyclical economic weakness due to stronger financials and efficient operations, providing a potential defensive boost to a portfolio.

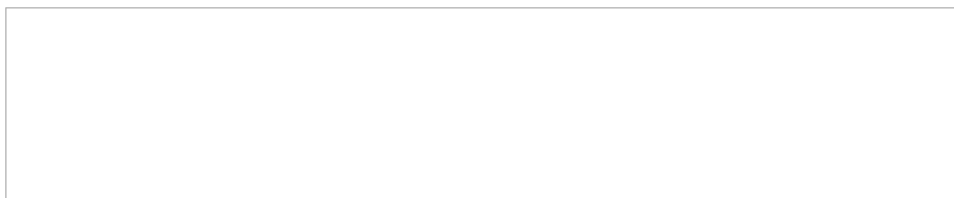
**9. Emphasizing profits:** Perhaps just as important is a reduced allocation to companies that are currently unprofitable based on trailing 12-month earnings. There's a preponderance of unprofitable companies in the U.S. small-cap universe, such that they make up roughly 25% of both the Russell 2000 and Russell 2000 Value indexes, but [DGRS](#) almost avoids them entirely. As of July-end, [DGRS](#) has about one-fifth the exposure

to unprofitable companies that the Russell indexes provide. Once again, the WisdomTree quality framework results in allocations to companies with stronger underlying financial health and proven track records of generating profits.

Comparative Quality Metrics (as of 7/31/23)	DGRS	Russell 2000 Value	Russell 2000
ROE	16.0%	7.1%	6.7%
ROA	3.8%	1.4%	1.3%
% of Negative Earners	4.6%	22.7%	27.8%

Sources: WisdomTree, FactSet, as of 7/31/23. You cannot invest directly in an index.

**10. No sacrifice on valuations:** Investors might reasonably expect that the improved quality profile of [DGRS](#) would result in steep valuations relative to the broader market. Fortunately, however, that’s not the case. At the end of July, [DGRS](#) traded at multiples modestly higher than the Russell 2000 value on a forward and trailing earnings basis but below those of the Russell 2000 core small-cap market. Once again, this is a by-product of the underlying methodology. The emphasis on fundamentals directly results in reduced valuations, allowing investors to avoid having to pay lofty premiums in exchange for improved quality profiles.



Cheers to 10 years, [DGRS](#)! May the next 10 be just as fruitful.

<sup>1</sup> Clifford Asness, Andrea Frazzini, Ronen Israel, Tobias J. Moskowitz, Lasse H. Pedersen, “Size Matters, If You Control Your Junk,” *Journal of Financial Economics*, Volume 129, Issue 3, 2018, Pages 479-509, ISSN 0304-405X, <https://doi.org/10.1016/j.jfineco.2018.05.006>, (<https://www.sciencedirect.com/science/article/pii/S0304405X18301326>)

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## DEFINITIONS

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

**Alpha**: Can be discussed as both risk-adjusted excess return relative to a specific benchmark, or absolute excess return relative to a benchmark. It is sometimes more generally referred to as excess returns in general.

**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.

**Russell 2000 Index**: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

**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.

**Russell 2000 Value Index**: measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

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

**Upside capture**: A measure of how one index performs during periods when a benchmark index is moving in the positive direction. A value of 100% indicates that both would tend to move upward at the exact same pace.

**Down Capture**: Measure of the performance of an investment relative to a benchmark index during a down market.

**Return on Equity (ROE)**: Measures a corporation’s profitability by revealing how much profit a company generates with the money shareholders have invested.

**Return on assets (ROA)**: Firm profits (after accounting for all expenses) divided by the firm’s total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Inflation**: Characterized by rising price levels.