DIVIDEND GROWTH STRATEGIES MUST BE MARRIED WITH A VALUATION FOCUS

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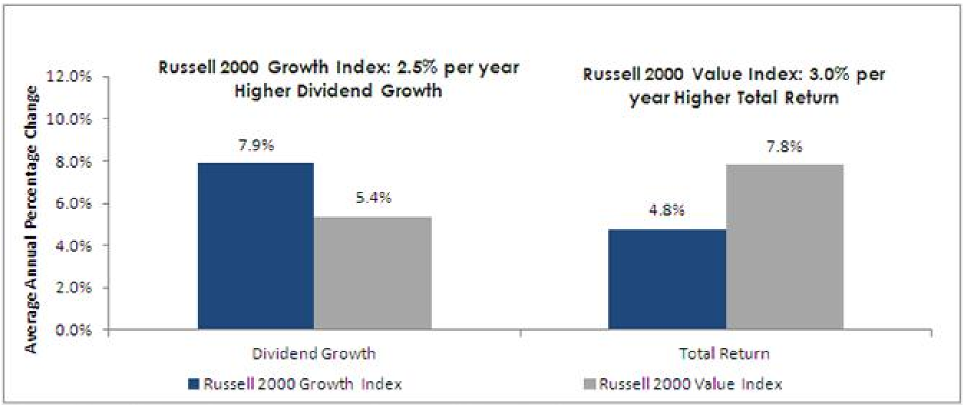
Broadly speaking, there are two areas of focus when it comes to dividends: • **Dividend Yield** : Here, the focus is on generating high income levels for a given share price. • **Dividend Growth:** Here, the focus is not necessarily the level of current income but rather the potential for future growth of that income. The truth is, both dividend yield and dividend growth have a crucial role to play in the generation of total returns. Dividend yield is sensitive to the share price paid at a current point in time to obtain a particular dividend per share and serves as a barometer for whether the valuation is "expensive" or "inexpensive" compared to alternative options. Dividend growth is another critical component, but one that is uncertain and drives value more over time (as opposed to at present) as companies increase cash flows to shareholders. **Dividend Growth Gaining Attention Today** Currently, many investors are wondering how to position their portfolios if interest rates start to rise from the historically low levels that we've seen since the 2008–09 global financial crisis. The concept of dividend growth has been appealing, as many believe the highest dividend yield stocks have become more expensive in the search for yield.[1] If rates do rise and provide more competition for higher-dividend-yielding stocks, we may see a rotation into more dividend growth-oriented strategies. **An Important Lesson for All Investors** An important mantra in real estate is "Location, location, location." With respect to investments, an equally important mantra is "Valuation, valuation, valuation." There is a natural tendency to focus on one attribute to the exclusion of all others. What happens when one focuses on growth potential to the exclusion of price considerations? In the chart that follows, we show the Russell 2000 Growth Index (Small Cap Growth) and the Russell 2000 Value Index (Small Cap Value) over the 15 years ending June 30, 2013. While not an exhaustive list of every past period, we believe it makes a very important point: **Higher Dividend Growth ? Higher Total Return (15-Year Period ending 6/30/2013)**



Source: Russell. Past performance is not indicative of future results.

Average Annual Returns as of June 30, 2013

	1-Year	3-Year	5-Year	10-Year
Russell 2000 Growth Index	23.74%	19.99%	8.89%	9.62%
Russell 2000 Value Index	24.84%	17.35%	8.60%	9.30%

Source: Russell. Past performance is not indicative of future results.

Total Return Comes from Three Factors In essence, Small Cap Growth exhibited higher dividend growth over this period—the attribute that many investors are focused on today. However, Small Cap Value outperformed. How is this possible? Remember the mantra: valuation, valuation, valuation. There are three components of total return: 1. Starting dividend yield (the starting valuation) 2. Dividend growth over the period[2] 3. Return from valuation changes over the period[3] One can deconstruct the components of total return for any equity index in this fashion. Over the 15-year period we studied, from June 30, 1998, to June 30, 2013, while Small Cap Growth had 2.5% higher dividend growth per year, its starting dividend yield was 1.63% lower 15 years ago (.39% for Small Cap Growth vs. 2.02% for Small Cap Value as of June 30, 1998) and it lost about 3.5% per year to valuation changes (-3.49% per year for Small Cap Growth versus .45% per year for Small Cap Value from June 30, 1998 to June 30, 2013). Small Cap Growth started the period expensive and saw its valuation ratios compress[4] compared to Small Cap Value—despite exhibiting faster dividend growth. While it lagged in dividend growth, Small Cap Value made up this difference because it had a low starting valuation ratio that expanded[5] and contributed positively to returns. **The Marriage of Two Philosophies: Dividend Growth *Selection* and *Dividend Stream*® Rebalancing** WisdomTree is known for *Dividend Stream* weighted Indexes that incorporate a rules-based rebalancing program for its family of dividend-based equity Indexes. The weighting process creates scalability for any investments built to track these Indexes, but it also introduces a critical relative value rebalancing mechanism to anchor weights back to the *Dividend Stream*. The methodology is evaluating price changes versus dividend changes to determine where to add or subtract weight—and it is a critical part for how WisdomTree focuses on the valuation mantra. In April of 2013, WisdomTree launched its U.S. Dividend Growth Index (large-cap) as well as the U.S. SmallCap Dividend Growth Index to provide exposure to dividend-paying stocks with growth characteristics. This focus on dividend growth potential is achieved through the selection requirements of the methodology. This is an essential point: While WisdomTree has designed its growth Indexes to *select* on growth potential, they *weight* and rebalance back to the *Dividend Stream*, incorporating a sensitivity to valuation. **Conclusion** The small-cap segment, as represented by the Russell 2000 Growth versus Value example, often carries the highest expectations for growth—and investors often ignore the valuation or the price they are paying for that growth. We believe the new WisdomTree U.S. SmallCap Dividend Growth Index offers a compelling solution for those looking for growth-oriented small-cap strategies but who also want a dividend-based valuation discipline incorporated in the methodology. [1]"The highest dividend yield stocks" refers to those within the defensive sectors, most notably within the S&P 500 Consumer Staples, Health Care, Telecommunication Services and Utilities indexes. [2]Dividend growth over the period: Refers to the average annual growth in trailing 12-month dividends, in this case from 6/30/1998 to 6/30/2013. [3]Return from valuation changes over the period: Average annual measure in the change in price level relative to dividend level. Positive values indicate that prices have increased faster than dividend growth, resulting in less dividends per unit of share price and, ultimately more expensive dividends [4]Valuation ratios compressing is another way to reference the negative 3.5% per year negative return from valuation changes. [5]The expanding valuation ratio is another way to reference a positive return from valuation changes.

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DEFINITIONS

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.

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.

Starting dividend yield : Refers to the trailing 12-month dividend yield for an equity index at the start of a period, in this case 6/30/1998, 15 years ago.

Dividend Stream : Refers to the regular dividends per share multiplied by the number of shares outstanding.

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