

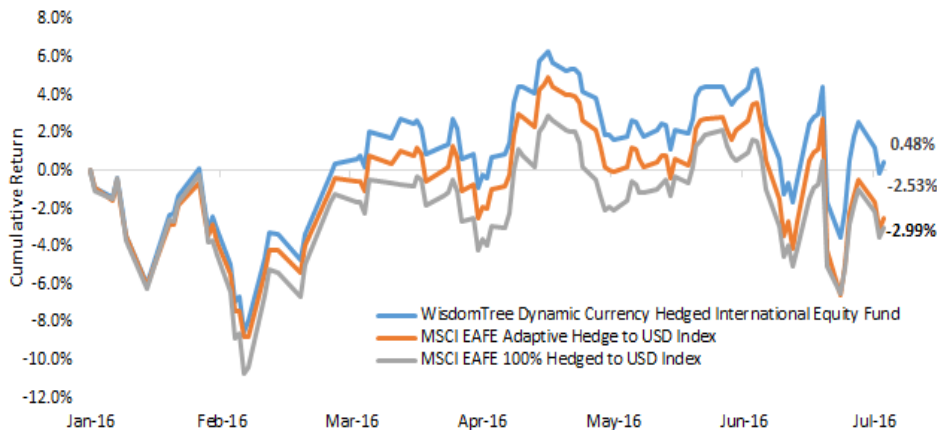
IS DYNAMIC FX HEDGING THE FUTURE OF INTERNATIONAL EQUITY INVESTING?

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In early January 2016, WisdomTree launched a set of Funds that we consider to be the future of international equity portfolio management: a family of exchange-traded Funds (ETFs) that incorporate a dynamic element to the management of currency risk. For as far back as we can remember, investors in the U.S. have primarily defaulted to accepting currency risk when investing abroad—but that default assumption has changed over the last five years, since the concept of [currency-hedged](#) ETFs, a field in which WisdomTree has been a key player, entered the U.S. market in 2009. The [volatility](#) we've seen in currency markets this year re-emphasizes why currency hedging is of *strategic* importance to portfolios, in our view. In a period of two weeks, the British pound (GBP) dropped from a value of GBP1.50 to the dollar to below GBP1.30¹ to the dollar because of political uncertainty following the [Brexit](#) decision. What happened to UK stocks? They outperformed European markets on the idea that a weaker currency would support their multinational companies. If U.S. investors are diversifying away from U.S. stocks to buy inexpensive stocks around the world, why have they been betting on the pound? There is no logical reason why betting on the pound *always and forever* would add value to your portfolio as a U.S. investor. For the last seven to eight years, and this year in particular, the pound has been a major drag on investors' international results. The only case, in my opinion, to take on developed world currency risk is if you have a particular viewpoint on those currencies appreciating more tactically. It would be easy to look backward and say you should not have taken on this British pound risk. But how can you proactively determine whether you want that currency risk looking *forward*? WisdomTree developed a family of strategies that look at the most important factors and determinants of exchange rate movements. Those three factors are [interest rate differentials](#), [momentum](#) and [value](#). You may have heard the phrase "value and momentum everywhere." In our view, those two factors have worked in currency risk management. Our Index process, developed in conjunction with Record Currency Management, added interest rate differentials (or [carry](#)) to value and momentum, as interest rates are also known to influence currency moves. At the very least, by not hedging currencies that are expensive to hedge due to a high carry cost (as is now the case in Australia), you can turn the cost of hedging more into your favor by hedging only when you are paid to do so (as you are today in the euro, yen and Swiss franc). **How'd You Do in Real Time? The Results Are Encouraging** Now that we have six months of real-time results for this international family of dynamically hedged ETFs, we can evaluate how they've done during a period of perplexing currency moves and [volatility](#). Last year was a very strong dollar period in which currency hedging strategies took in meaningful assets and hedging added value. In the first half of 2016, the yen has been surprisingly strong and the euro was also up prior to the Brexit vote. Below we show the results for the [WisdomTree Dynamic Currency Hedged International Equity Fund \(DDWM\)](#) compared to a fully hedged and adaptively hedged index from MSCI since the inception of DDWM. The real-time results show a good start for the WisdomTree approach.

[For standardized performance of DDWM, visit the Fund page.](#)

International Equity Cumulative Return (1/7/16-7/7/16)



Sources: WisdomTree, Bloomberg. You cannot invest directly in an index.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns 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. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

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

[Learn more about our dynamic currency-hedging approach here.](#)

One of the key value-added features has been the [hedge ratio](#) on the British pound: our hedge ratio has been 83.3% since 12/28/15. The [value signal](#) has a half-hedge on it, but the momentum and interest rate differential signals we used have suggested to hedge the pound since the U.S. [hiked rates](#) and U.S. investors were being paid a marginal amount to hedge the pound. One of the reasons dynamic hedging is currently outperforming fully hedged strategies is that the yen has appreciated this year and dynamic hedging with WisdomTree had incorporated a 50% hedge ratio on the yen since late 2015, when the momentum signal rolled over. While interest rates are a slow-moving signal (i. e., when do you think the Bank of Japan will have a higher interest rate than the U.S.?), momentum is a faster-moving signal, and that hedge ratio can be raised if there is a catalyst that sparks another round of yen weakness. Investors may keep wondering: Is it too late to switch to a currency-hedged approach? Our short answer: Currency hedging for broad international mandates hasn't even meaningfully started. It is not too late. Adopting a dynamic hedging approach with WisdomTree's rules-based process moves you from subjectively determining a hedge ratio and second-guessing yourself and toward a disciplined approach to currency risk management. The signals currently suggest being roughly half-hedged for the total FX exposure in a broad international strategy, with

the highest hedge ratio actually being the British pound at 83% and the euro and yen each at 50%. We believe these are a good guide and also suggest (based on assets under management levels of unhedged funds) that investors may be taking on too much currency risk when they invest abroad.

¹Source: Bloomberg, period from 12/16/15 to 7/7/16.

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For more investing insights, check out our [Economic & Market Outlook](#)

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DEFINITIONS

Currency hedging: Strategies designed to mitigate the impact of currency performance on investment returns.

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

Brexit: an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

Interest Rate Differentials: The Difference between the 2 Year interest rate swaps of the United Kingdom vs. the United States.

Momentum Factor: Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Carry: The amount of return that accrues from investing in fixed income or currency forward contracts.

Hedge Ratio: The specified percentage of currency exposure being hedged, with 0% indicating that none of the currency exposure is being hedged and 100% indicating that all of the currency exposure is being hedged.

Value Signal: Signal using purchasing power parity (PPP), an academic concept stating that exchange rates should adjust so that equivalent goods and services cost the same across countries, after accounting for exchange-rate differences in order to contribute to a view as to whether a currency might be under or overvalued.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.