

# WHAT DOES EARNINGS GROWTH TELL US ABOUT THE MARKET

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At WisdomTree, we believe strongly in relative value [rebalancing](#). The act of rebalancing constituents of an index back to their [fundamental](#) values is important, given our belief that stocks often overshoot their underlying fundamentals. Consequently, investors run the risk of paying too much for stocks that have become more expensive compared to their [fair value](#). A disciplined strategy of reweighting allocations back to attractively valued stocks, through the annual rebalance process, is an important element in managing market [valuation risks](#). Below we start with a discussion of how the [Earnings Stream](#) grew between the 2014 and 2015 Index [screening dates](#)—as the *Earnings Stream* is the key factor that drives exposures in the [WisdomTree Earnings Index](#) family. **Figure 1: Gauging the *Earnings Stream* over Time (as of 11/30/15 Index Screening)**

Earnings Stream by Sector (\$bn)	11/30/2007	11/30/2008	11/30/2009	11/30/2010	11/30/2011	11/30/2012	11/30/2013	11/30/2014	11/30/2015	Earnings Growth: 11/30/2014-11/30/2015	Cumulative Earnings Growth
Consumer Discretionary	\$87.50	\$79.10	\$52.60	\$89.63	\$110.94	\$117.97	\$135.59	\$132.45	\$137.88	4.1%	57.6%
Consumer Staples	\$78.60	\$83.70	\$77.92	\$86.17	\$96.12	\$92.91	\$103.11	\$99.34	\$99.13	-0.2%	26.1%
Energy	\$119.40	\$162.50	\$53.70	\$87.21	\$130.50	\$119.27	\$111.84	\$117.31	\$54.84	-53.3%	-54.1%
Financials	\$248.00	\$110.30	\$72.11	\$133.07	\$155.45	\$167.96	\$214.39	\$243.83	\$260.00	6.6%	4.84%
Health Care	\$83.00	\$94.30	\$84.22	\$89.72	\$101.99	\$100.54	\$105.85	\$110.34	\$115.14	4.4%	38.7%
Industrials	\$107.70	\$105.30	\$59.19	\$83.19	\$105.71	\$113.97	\$117.66	\$141.66	\$129.71	-8.4%	20.4%
Information Technology	\$103.80	\$124.80	\$90.28	\$152.26	\$183.32	\$191.81	\$192.20	\$200.18	\$207.92	3.9%	100.3%
Materials	\$36.00	\$39.00	\$14.76	\$30.04	\$45.36	\$33.26	\$36.54	\$38.72	\$31.88	-17.7%	-11.4%
Telecommunication Services	\$21.60	\$22.90	\$15.01	\$25.05	\$24.04	\$16.25	\$20.17	\$25.16	\$22.29	-11.4%	3.2%
Utilities	\$33.60	\$32.70	\$26.87	\$33.50	\$32.51	\$27.12	\$31.43	\$34.45	\$35.60	3.3%	5.9%
<b>Total Earnings Stream</b>	<b>\$919.50</b>	<b>\$854.60</b>	<b>\$546.66</b>	<b>\$809.84</b>	<b>\$985.92</b>	<b>\$981.07</b>	<b>\$1,068.79</b>	<b>\$1,143.43</b>	<b>\$1,094.39</b>	<b>-4.3%</b>	<b>19.0%</b>

Sources: WisdomTree, Standard & Poor's. Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

**• Negative Earnings Stream Growth in 2015:** The *Earnings Stream* contracted 4.3% in 2015, driven by the decline of earnings in the Energy and Materials sectors. Although aggregate earnings declined, the broad market is still relatively healthy, with more than 2,000 profitable companies whose *Earnings Stream* total \$1.09 trillion. If you remove the Energy sector, the *Earnings Stream* would have grown 1.31% over the period.

**• Financial Earnings Make New High:** Before the financial crisis and as of the 2007 Index screening, the Financials sector's *Earnings Stream* was \$248 billion. At the bottom, the 2009 Index screening, the Financials sector's earnings had collapsed by about 70% to just \$72 billion. As one sign the financial companies are moving beyond the crisis, the earnings of the Financials sector at this rebalance were \$260 billion, up 6.6% on the year and now 4.8% above the previous all-time high. The Financials sector exhibited the highest earnings growth on both a dollar and percentage basis over the period.

**• Information Technology Leaders:** The Information Technology sector saw its U.S. *Earnings Stream* grow the fastest over the last eight years, doubling earnings from 2007 through 2014. As a result, the Information Technology sector saw its percentage of total earnings grow from 11.3% to 19.0%, and it now represents the second most profitable sector. The growth in earnings is an important element of the annual rebalance. The other critical factor is stock price performance. Rebalancing back to the *Earnings Stream* forces a discipline to sell stocks that have become more expensive—in other words, selling stocks that have appreciated compared to their earnings.

**Figure 2: WisdomTree Earnings Index Rebalance Trends (as of 11/30/15)**

Weight Change	Median <i>Earnings Stream</i> ® Growth	Median Total Return
Raised	17.5%	1.0%
Lowered	-22.7%	7.1%
All	0.2%	3.5%

Sources: WisdomTree, Bloomberg. Median *Earnings Stream* growth and median total return are from 11/30/14 to 11/30/15. Past performance is not indicative of future results. You cannot invest directly in an index.

**• Companies Growing Their Earnings Saw Weight Increase:** The companies that saw their weight increase at the rebalance had a median earnings growth of 17.5%, which was greater than the median earnings growth of all companies (at 0.2%). Companies that saw their weight lowered at the rebalance had a median earnings contraction of 22.7%. **• Underperformers Typically Saw Weight Increase:** Performance is also a key driver of relative changes. The typical stock that saw its weight increase had a median total return that was 2.5 percentage points lower than the median of all stocks. **• Outperformers Reduced at Rebalance:** The typical stock that saw its weight lowered at the rebalance had a median total return that was 3.6 percentage points above all stocks. This is one of the keys to managing valuation risks. **Importance of Incorporating a Relative Rebalance** The WisdomTree annual rebalance is a key element of the added value of WisdomTree's Index methodology and can help manage valuation risks. WisdomTree's Earnings Indexes use earnings growth as a key factor in determining which companies get increased weight at a rebalance. We think the aggregate earnings decline may act as a reminder of why it is important to focus on fundamentals and incorporate a relative value rebalance in the investment process.

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.

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## DEFINITIONS

**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.

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

**Fair value**: Also known as "eNAV." It is essentially an indicative value (IV) that is made in real time by calculating the basket value on every underlying tick and by adjustments that account for updated market new.

**Valuation risk**: The risk of buying or over-weighting a particular stock that has appreciated significantly in price relative to its dividends, earnings or any other fundamental metric.

**Earnings Stream**<sup>®</sup>: Earnings per share x the number of shares outstanding. For an index, these totals are added for all constituents.

**Annual screening date**: The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.