HOW TO MANAGE ONE OF INDIA'S MOST IMPORTANT RISKS

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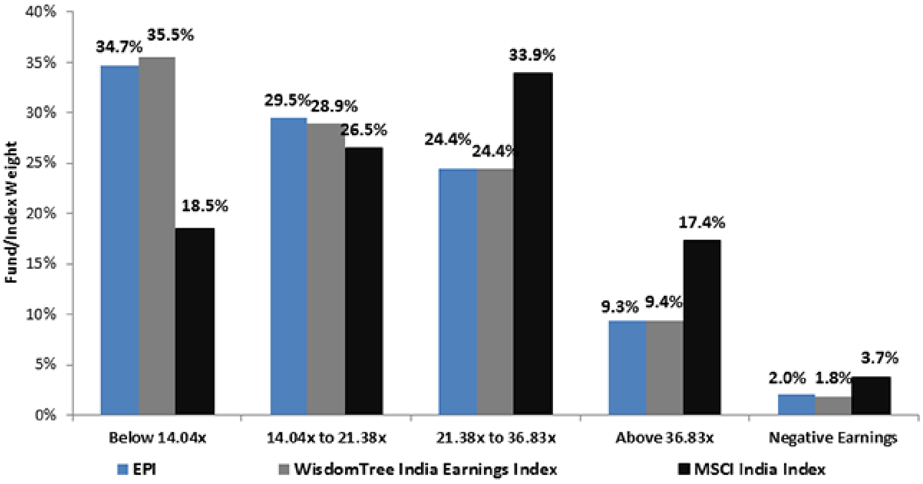
04/14/2015

India's equity market performance has been remarkable over the past year—20.7%[1]. Emerging markets were basically flat over this period, and U.S. equities were up about 12.7%[2]. In short, India was one of the best performing equity markets in the world. **With Remarkable Performance May Come Valuation Risk** A greater than 20% return in an environment where broader emerging market equities were flat leads to a critical question: Are India's equities becoming expensive? One way to look at this is through the change in price-to-earnings (P/E) ratio over this period[3] : • **Rising Multiple:** The MSCI India Index saw its P/E ratio go from 17.5x to 20.1x over this period, an increase of approximately 15%. • **Lower P/E Tilts:** The WisdomTree India Earnings Fund (EPI) saw its P/E ratio go from 11.9x to 14.6x over this same period, an increase of approximately 22%. **A Rally Driven by Multiple Expansion** Over this period, the biggest factors contributing to the performance of India's equities were related to expectations of a more positive future—with the transition to Prime Minister Narendra Modi's Bharatiya Janata Party (BJP) government front and center. It is not surprising that multiple expansion rather than earnings growth drove the story—earnings growth has yet to respond to this initial excitement as strongly as the initial price appreciation. *But how is it that EPI's P/E ratio started about 30% lower than that of the MSCI India Index and—even with greater multiple expansion on a percentage basis—remained about 30% lower at the end of the period?* This is really the crucial question because we know that the nature of the rally in India's equities has led to the chance of an increased risk of India's equities becoming expensive. **The Answer** There are two core components within the methodology of the WisdomTree India Earnings Index (which EPI tracks after costs, fees and expenses) that we believe drive the results that we have seen: **1) Annually Rebalancing Back to a Measure of Relative Value:** Instead of continuing to own stocks in greater proportions due to increasing market capitalization—which can certainly relate to rising share prices—the road to greater weight within the WisdomTree India Earnings Index is paved through increasing profits. Firms that increase in share price but do not increase their earnings would typically see reductions in weight at the annual rebalance. **2) Weighting Profitable Companies by Their Profits:** As of March 31, 2015, the WisdomTree India Earnings Index had 282 constituents. At the annual rebalance, each of these firms had to prove its capability to generate positive profits over the fiscal year leading up to August 31, 2014—the index screening date. Positive profits must be maintained in order to remain within the Index at the next rebalance, and the biggest profit generators receive the biggest weights. Below, we examine how these two components of the methodology influence the distribution of constituents by P/E ratio for both the WisdomTree India Earnings Index, and EPI. The market capitalization-weighted benchmark for both EPI and the WisdomTree India Earnings Index is the MSCI India Index, which we also include for reference. **The Result: Tilting Greater Exposure to Lower P/E Stocks**



Source: Bloomberg, with data as of 3/31/15. Quartiles formed based on the 3/31/15 P/E ratios of the underlying constituents of the MSCI India Index, the market capitalization-weighted performance benchmark for EPI. Past performance is not indicative of future results. You cannot invest directly within an Index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index.

- **Approximately Two-Thirds of EPI's Weight Is in Stocks Below the Median P/E Ratio of the MSCI India Index:** The median P/E ratio of the MSCI India Index is 21.38x. As EPI tracks the return of its underlying Index, it is apparent that it is positioned more heavily in less expensive corners of India's equity market. The P/E ratio distribution of the MSCI India Index is VERY different with more than 50% of its weight in stocks with P/E ratios above this same median value.[4]
- **Approximately One Quarter the Exposure to Companies with Negative Earnings:** We think this is remarkable, in that EPI had 233 holdings as of March 31, 2015, and the MSCI India Index had 65 constituents as of this same date. It may be surprising to learn that an investor can venture into exposure to small cap companies without necessarily needing to sacrifice exposure to those firms that are generating profits.[5]

The Importance of Managing Valuation Risk in India's Equities There are a lot of reasons for excitement surrounding India, and there is little question that the market has great potential. However, we always find it important to remind people that managing valuation risk is one of the single most important things to do in any equity market. We believe that EPI is a tool designed with that potential in mind.

[1]Refers to the performance of the MSCI India Index from 3/31/2014 to 3/31/2015, sourced from Bloomberg. [2]Refers to the performance of the MSCI Emerging Markets Index and S&P 500 Index from 3/31/2014 to 3/31/2015, sourced from Bloomberg. [3]Source for bullets: Bloomberg. P/E ratios measured on percentage change basis from 3/31/2014 to 3/31/2015. [4]Source for bullet: Bloomberg, with data as of 3/31/2015. [5]Source for bullet: Bloomberg, with data as of 3/31/2015.

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DEFINITIONS

Emerging market : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

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.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

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

WisdomTree India Earnings Index : A fundamentally weighted Index that measures the performance of companies incorporated and traded in India that are profitable and that are eligible to be purchased by foreign investors. Companies are weighted in the Index based on their earnings in their fiscal year prior to the Index measurement date, adjusted for a factor that takes into account shares available to foreign investors.

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

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.

Median : The median is the value within a dataset at which 50% of all observations occur above and 50% occur below.

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

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as “emerging markets” by MSCI.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor’s Index Committee designed to represent the performance of the leading industries in the United States economy.