ELECTION DAY FALLOUT: FINANCIALS SECTOR IN FOCUS AND DIVIDEND EX FINANCIALS AS A SOLUTION

Jeremy Schwartz – Global Chief Investment Officer
11/13/2012

Prior to the November 6 election, financials had been enjoying quite the performance ride in 2012 as one of best-performing sectors in the S&P 500 Index. However, on November 7, 2012, the day following the re-election of President Obama to a second term, many of the larger U.S. banks declined significantly. **Why the fall? A few potential explanations: 1) Cashing In on Intra-year Gains:** After the strong run this year, investors may have taken some of their capital gains in financials to the bank before facing potentially higher capital gains taxes in 2013. Anytime a sector has such a strong run compared to other sectors, it certainly becomes susceptible to investors taking profits and redeploying their funds elsewhere—especially given the president's proposal to raise capital gains taxes on higher-income investors. 2) **Regulation and anti-banker sentiment to continue:** Investors are concerned about the financial sector's potential moving forward due to the election results. With the re-election of President Obama, the increased regulations of the Dodd-Frank Act are now unlikely to be repealed. Some of the run-up in financials may have been a belief that Governor Romney had the potential to come in and scale back some of the harsher regulations contained in this law. 3) **Subdued growth outlook:** Another potential explanation for the decline could be that financials are particularly leveraged to economic growth—meaning that their business prospects are very sensitive to economic growth expectations—and when viewed through the (admittedly limited) prism of the S&P 500 Index's large sell-off following the election, one could reason that this was a lowering of economic growth expectations being factored in. **The WisdomTree Dividend ex-Financials Fund (DTN)—Maintain Equity Exposure but Exclude Financials** While it's still too early to see if the one-day sell-off will continue to the end of 2012 and beginning of 2013, thereby reversing the strong intra-year performance, we believe some investors may want to consider dividend ex-financials strategies as a way to hedge the risk of this type of sell-off in financials. Along with Luciano Siracusano, our Chief Investment Strategist, and Christopher Gannatti, a Research Analyst, I published a post-election commentary that discussed why we believe the prospects for higher dividend taxes is unlikely, in our view, to dramatically reduce the demand for dividend-paying stocks. Our research showed that the market environment had a much greater potential to impact returns over various tax rate climates than did the tax environment. There are also many tax-insensitive investors who we think have the potential to take advantage of those who are selling dividend-paying stocks held in taxable accounts for fear of potentially higher taxes on dividends. DTN, our Dividend ex-Financials Fund, is one strategy that can hedge against the type of sell-off we saw in financials on November 7, 2012, the day following the election. The Fund tracks an Index that takes a diversified approach to U.S. equities with relatively high dividend yields[1] in the nine sectors outside of Financials—and we have done prior research emphasizing that stocks in relatively higher-yielding equity sectors[2](S&P 500 Consumer Staples Index, S&P 500 Health Care Index and S&P 500 Telecommunication Services Index) are not as expensive as many might think (click here for full research). We believe DTN offers a means to generate continued exposure to dividend-paying U.S. equities while avoiding the financial sector—all the more important as a potential source of income when interest rates remain at historic lows[3]. [1]The WisdomTree Dividend ex-Financials Index selects a maximum of 10 stocks with the highest indicated dividend yields from each of the nine sectors outside of Financials as of the date of index screening, 11/30 of each year. Indicated dividend yields tax the company's indicated annual dividends divided by the share price. [2]These are three heavily weighted sectors within the WisdomTree Equity Income Index, which focuses on selecting the 30% of stocks from within the WisdomTree Dividend Index with the highest indicated dividend yields. [3]Refers to the current policy of the U.S. Federal Reserve and chairman Ben Bernanke, who has stated that interest rates will remain exceptionally low until 2015. Christopher Gannatti is a registered representative of ALPS Distributors, Inc.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund's prospectus for specific details regarding the Fund's risk profile. The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's ("S&P"), a division of The McGraw-Hill Companies, Inc., and is licensed for use by WisdomTree Investments, Inc. Neither MSCI, S&P nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

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.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.