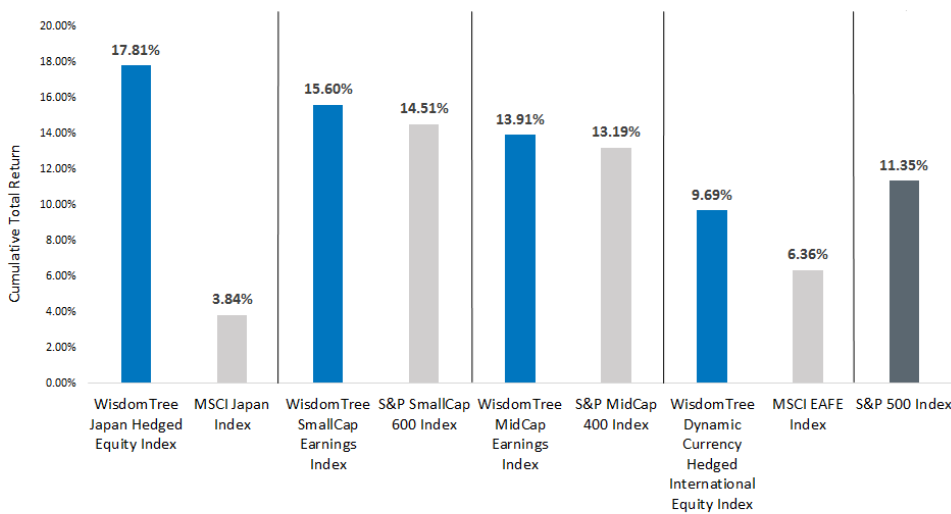


THE FED MOVES: WHAT IT MAY MEAN FOR EQUITIES

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After the election of Donald Trump as president on November 8, markets saw the [10-Year Treasury yield](#) rise an impressive 75 [basis points \(bps\)](#) to its peak of 2.6% on December 15. The 10-year recently touched that peak again on March 9. From the presidential election through March 9, the U.S. dollar rallied 4.3%, according to the [Bloomberg Dollar Spot Index](#). Given the recent [rate hike](#), and that many market participants believe there are additional rate hikes on the horizon, what are the equity asset classes that may benefit from rising rates and a rising dollar? We begin that discussion with what has performed well following President Trump's victory through the recent peak of the 10-Year Treasury yield on March 9.¹

Equity Asset Class Returns since the Presidential Election, 11/8/16–3/9/17



Sources: WisdomTree, Bloomberg as of 3/9/16. Past performance is not indicative of future results. You cannot invest directly in 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. 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](#).

U.S. Mid- and Small Caps

Since the presidential election, markets have seen significant rallies in indexes more exposed to [mid-](#) and [small-cap](#) companies. In general, smaller-capitalization companies tend to outperform during rising rate environments. This is the case for a variety of reasons, including greater sensitivity to expectations for U.S. [gross domestic product \(GDP\)](#) growth, weaker headwinds from a rising dollar compared to global [large caps](#) and, specific to this rising rate period, the [expectation of corporate tax cuts](#). Although the

promise of regulatory relief for the financial and health care sectors—and the impact that potential repatriation of foreign profits could have on multinational technology stocks—have led large caps to outperform mid- and small-cap stocks thus far in 2017, mid- and small-cap stocks may rally in the second half of the year if tax cuts or tax reform passes later in the summer. As we can see from the chart above, mid- and small caps have outperformed the [S&P 500 Index](#), which returned 11%, since the election in November. But in the mid- and small-cap asset classes, using profitable companies and then weighting them based on their earnings has generated excess returns compared to traditional [beta](#) benchmarks that weight companies by [market capitalization](#).

[Hedged](#) Japanese Equities

During this postelection rising rate and rising dollar period, Japanese equities performed quite well depending on how they were positioned. With an almost 14% difference between the [currency-hedged](#) WisdomTree Index and the [unhedged MSCI Japan Index](#), one can observe just how potent currency movements can be when considering returns. But the [WisdomTree Japan Hedged Equity Index](#) takes it one step further, including only [dividend-paying](#) companies, weighting by their share of the [Dividend Stream®](#) and tilting exposure toward exporters who stand to benefit from a depreciating yen relative to the dollar. One reason WisdomTree believes so strongly in tilting toward exporters and neutralizing currency exposure is because of the historical tendency for Japanese equities to be negatively [correlated](#) to the yen. If interest rates head higher in the U.S., we believe this may result in further depreciation of the yen, which could prove to be an additional catalyst for Japanese stocks.

Managing Currency Risk Internationally

Much like we saw in Japan, a rising dollar can erode returns when investing overseas. One way to reduce this risk is with a strategy that [dynamically hedges](#) foreign currencies monthly to mitigate the impact of currency risk in a rising dollar environment. We see above how the [WisdomTree Dynamic Currency Hedged International Equity Index](#) outperformed the [MSCI EAFE Index](#) over this period. The Index uses three signals—[momentum](#), [interest rate differentials](#) and relative [valuations](#)—to determine how much of each foreign currency exposure should be neutralized at the end of each month. This led to the Index having an aggregate currency-[hedge ratio](#) between 67% and 75% from November to March. Currently, the WisdomTree Index is 68% hedged for the month of March. We believe dynamic currency hedging is a potentially valuable tool, not just for rising rate periods, but also to intelligently manage currency risk in the core of your portfolio over full market cycles.

Conclusion

Looking at the most recent rising rate period, it is clear that these asset classes, when positioned appropriately, outperformed. Yet, as many of us know, past performance is not indicative of future results. But if you believe that recent movements in the 10-Year Treasury and the U.S. dollar might continue, and that the most recent rising rate period could be indicative of the one that may occur, these asset classes may be worth keeping an eye on. WisdomTree offers exchange-traded funds (ETFs) in these asset classes through the [WisdomTree MidCap Earnings Fund \(EZM\)](#), the [WisdomTree SmallCap Earnings Fund \(EES\)](#), the [WisdomTree Japan Hedged Equity Fund \(DXJ\)](#) and the [WisdomTree Dynamic Currency Hedged International Equity Fund \(DDWM\)](#).

Unless otherwise noted all data is from Bloomberg as of 3/9/2017

¹This recent 10-Year peak is as of the writing of this blog on March 9

Important Risks Related to this Article

Performance, especially for very short time periods, should not be the sole factor in making your investment decision.

There are risks associated with investing, including possible loss of principal. Funds focusing their investments on certain sectors, regions and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility.

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in currency involve additional special risks, such as credit risk, interest rate fluctuations, derivative investments which can be volatile and may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As certain Funds can have a high concentration in some issuers, they can be adversely impacted by changes affecting those issuers. Due to the investment strategy of certain Funds they may make higher capital gain distributions than other ETFs.

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

View the online version of this article [here](#).

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DEFINITIONS

Treasury yield: The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

Basis point: 1/100th of 1 percent.

Bloomberg Dollar Spot Index (BBDXY): Tracks the performance of a basket of ten leading global currencies versus the U.S. dollar. Each currency in the basket and their weight is determined annually based on their share of international trade and FX liquidity.

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.

Mid-Cap: Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

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

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

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.

Beta: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

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.

Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

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

Unhedged: Strategy that includes the performance of both the underlying asset as well as the currency in which it is denominated. The performance of the currency can either help or hurt the total return experienced.

MSCI Japan Index: A market cap-weighted subset of the MSCI EAFE Index that measures the performance of the Japanese equity market.

Dividend: A portion of corporate profits paid out to shareholders.

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

Correlation: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Dynamic Hedge: Strategy in which a currency hedge can be varied (as opposed to targeting a constant level) and change over the course of time.

MSCI EAFE Index: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

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.

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

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.

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.