FOLLOW THE RULES WITH MID-CAP ALLOCATIONS

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Teenagers can be a handful, but your U.S. mid-cap equity allocation doesn’t have to be.

On February 23, WisdomTree celebrated the 14th birthday of its U.S. core equity ETF family, and the WisdomTree U.S. MidCap Fund (EZM) got to blow out the candle.

Launched in 2007, EZM pioneered our rules-based, earnings-weighted methodology, an alternative to market capitalization-weighted strategies that track mid-cap Indexes like the S&P 400 or Russell Midcap Index.

While WisdomTree has always believed in the size premium for mid- and small-cap companies, we find that what you own is more important than owning them outright. That means it’s important to be selective in your pursuit of healthy, opportunistic mid-cap companies, and we think that EZM’s rules-based approach is designed to deliver exactly that.

A Perfect Storm for Valuations

EZM’s 14th birthday comes at an interesting time. Early in 2021, equity market valuations are at historic highs, boosted by an unprecedented backdrop of accommodative monetary policy, fiscal stimulus, the specter of inflation and more.

The Russell Midcap Index’s P/E is 43x as of January 31 and has been more than 40x since November. The sky-high multiple is also almost twice its average of 22x since EZM’s inception. This has also been the only period that the Index’s P/E has been more than 40x since EZM launched in February 2007, indicating investors’ willingness to pay historically high multiples.

Even the Russell Midcap Value Index is not immune to steep valuations, which is both ironic and concerning when you remember that value investing is predicated on identifying companies with fundamental health and not overpaying for them.

EZM, on the other hand, has a P/E ratio of 17x, a fraction higher than its average since inception of 15.4x.

Remember, EZM’s underlying Index selects and weights companies by their contribution to the *Earnings Stream* (using trailing 12-month earnings), signaling that a methodology that favors greater earnings can explicitly keep valuations in check.

	Price-to-Earnings (P/E) Comparison			
Fund / Index	P/E Ratio	Percentile Rank (over 14-year history of EZM)	Average P/E Ratio	Premium to Average
EZM	17.0x	74.8%	15.4x	10.5%
Russell Midcap	42.8x	98.8%	22.1x	94.0%
Russell Midcap Value	37.0x	94.6%	20.8x	78.3%

Sources: WisdomTree, FactSet, as of 1/31/21. You cannot invest directly in an index. Past performance is not indicative of future results. Percentile Rank: A value closer to 100% indicates the P/E ratio is high relative to history. A value closer to 0% indicates the P/E ratio is low relative to history. Premium to Average indicates how much higher, in percentage terms, the current P/E ratio is relative to its average P/E ratio over history.

A Junk Rally in Equities

Suffice it to say, valuations are stretched, and the TINA (“there is no alternative” to equities) mantra seems here to stay. Investors can’t seem to get enough equity exposure, and they’re consequently buying up speculative companies with underlying health concerns in the process.

Take a look at the percentage of unprofitable companies in the Russell Midcap Index. **The weight of those with negative earnings is the highest it's been dating back to 2007.** Unprofitable mid-cap companies weren't even this prevalent during the depths of the financial crisis.

This harsh reality sheds a spotlight on an earnings-weighted strategy that favors companies with stronger profits. EZM epitomizes this: The weight of unprofitable companies that constitute it is less than 5%, a tick higher than its meager long-term average of 3%. Historically, the highest weight of companies to ever make their way into EZM was during the global financial crisis in 2008, and the numbers have hardly come close since then.

	% of Negative Earners Over Time		
Fund / Index	Range (2/2007 - 1/2021)	Weight as of 1/31/21	Average (since EZM Inception)
EZM	0.1% - 18.2%	4.8%	2.9%
Russell Midcap	3.6% - 18.6%	18.6%	7.8%
Russell Midcap Value	2% - 23.4%	13.4%	8.2%

Sources: WisdomTree, FactSet, as of 1/31/21. You cannot invest directly in an index. Past performance is not indicative of future results.

Pure-Play Mid-Cap Exposure

It's 10 p.m.… Do you know where your mid-caps are?

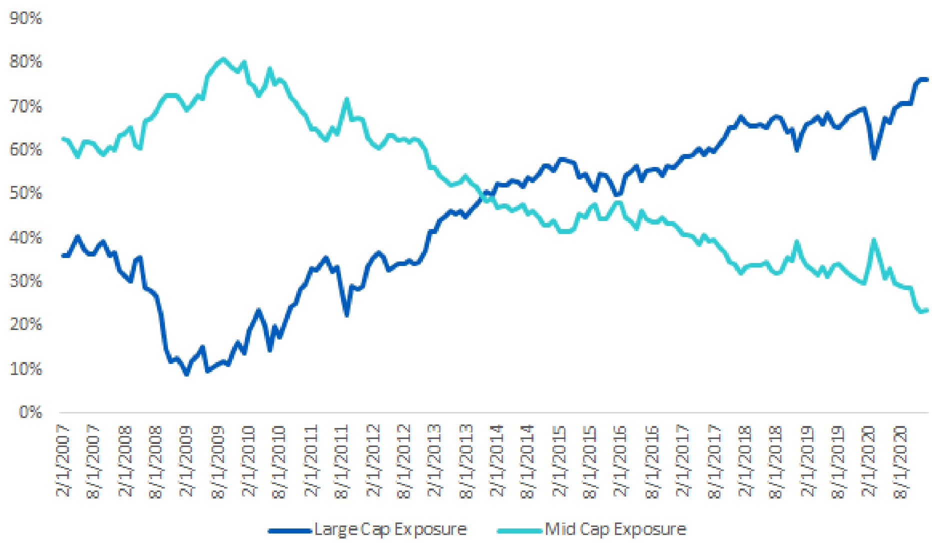
They're not in the Russell Midcap Index.

While equity markets have rallied to new highs from the throes of the pandemic, the Russell Midcap Index has started to look like a mid-cap Index in name only. As of January 31, the percentage of companies WisdomTree classifies as mid-cap (with market capitalizations between $2 and $10 billion) has steadily fallen to about 24% of the Index. Meanwhile, [large-cap]() companies (with market caps more than $10 billion) make up the remaining 76%.

Let that sink in.

Three-quarters of a mid-cap Index is effectively large cap. Investors using funds to track that Index are literally only getting about a quarter of what they think they're getting, and the trend has exacerbated since the end of the financial crisis.

Size Exposure in The Russell



Sources: WisdomTree, FactSet, as of 1/31/21. You cannot invest directly in an index. Past performance is not indicative of future results.

Compare that to EZM, where the benefits of a rules-based, earnings-weighted methodology that rebalances once a year are evident.

The percentage of mid-cap weight in the Fund? 99%.

The percentage of large-cap companies in the Fund? 0%.

The proof is in the pudding.

Compared to conventional, market cap-weighted strategies dedicated to mid-cap exposures, EZM has proven its worth over a 14-year history. It delivers pure-play mid-cap exposure with an emphasis on profitability and valuation control due to its unique methodology.

In today's market, it is vital to defend against exorbitant valuations and segments that bleed upward along the size spectrum, all while preserving profitability. Fortunately, the WisdomTree U.S. MidCap Fund can do all three, and it has a 14-year history to prove it.

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You cannot invest directly in an index.

DEFINITIONS

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.

Earnings-weighted : Earnings for all constituents in an index are added together, and individual constituents are subsequently weighted by their proportional contribution to that total.

Market capitalization-weighting : 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.

Russell Midcap Index : The Russell Midcap Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Size : Characterized by smaller companies rather than larger companies by market capitalization. This term is also related to the Size Factor, which associates smaller market-cap stocks with excess returns vs the market over time.

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

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.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

Inflation : Characterized by rising price levels.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Russell MidCap Value Index : measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

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 tim.

Junk Bond : A high-yield or non-investment grade bond. Junk bonds are fixed-income instruments that carry a rating of 'BB' or lower by Standard & Poor's, or 'Ba' or below by Moody's. Junk bonds are so called because of their higher default risk in relation to investment-grade bonds.

Speculative stocks : Higher-risk, more aggressive stock with uncertain prospects