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# 2020 RESOLUTION: STRENGTHEN YOUR CORE EQUITY ALLOCATION

Kara Marciscano – Associate, Research  
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In 2007 [WisdomTree launched its U.S. Core Equity Index family](#) of four earnings-weighted Indexes that challenged the market cap-weighting status quo.

To this day, the [Core Equity Index](#) family is constructed with the conviction that [market capitalization](#) does not provide the best estimate of a company's fundamental [value](#).

These Core Equity Indexes weight companies by their proportionate share of the [Earnings Stream®](#)—and each company's weight is calculated based on the dollar amount of its earnings relative to the total earnings generated by Index constituents over the trailing 12 months.

In WisdomTree's view, market cap weighting can leave investors overly exposed to areas of the market where [fundamentals](#) don't justify prices. We believe that just as noisy share prices can provide a flawed measure of value, simply accepting a company's reported earnings at face value can result in suboptimal allocations for investors.

Since its inception, our Core Equity Index family has weighted constituents by their core earnings, which adjust reported net income to arrive at a more relevant measure of company earnings from continuing, regular operations.

WisdomTree recently licensed core earnings data from New Constructs, a technology-driven fundamental data provider. New Constructs combines expertise from its accounting background with cutting-edge technology to parse through financial filing complexities in seeking to calculate a more accurate measure of profitability. The attributes of the New Constructs core earnings dataset were recently featured in a Harvard Business School and MIT Sloan paper.<sup>1</sup>

## 2019 Rebalance Results

Our U.S. Core Equity Index family includes the [Total Market \(WTEI\)](#), [LargeCap \(WTEPS\)](#), [MidCap \(WTMEI\)](#) and [SmallCap \(WTSEI\)](#) Indexes.

The Indexes rebalance every December according to a disciplined and consistent [methodology](#).

We can credit several foundational tenets in the methodology for the group's strong track record of outperformance.

### *Earnings weighting & Relative Value Rebalancing*

Weighting by earnings typically lowers the [price-to-earnings ratio \(P/E\)](#) of the index. It does this by removing the role that stock multiples play in determining a company's value. This process is designed to reward companies that have generated more earnings growth than price appreciation with a larger weight in the index, and vice versa. In contrast, a market cap-weighted index assigns the largest weight to the company with the greatest price appreciation, without considering any fundamental growth.

### *Exclusion of Negative Earners*

Eliminating unprofitable firms over the trailing 12 months typically lowers the P/E ratio and helps increase the quality of the index. This constraint is especially powerful in the [small-cap](#) segments of the market, where unprofitable firms tends to be most prevalent.

The results of the December 2019 rebalance demonstrate this well.

The P/E ratios decreased across our Core Equity Index family for the 13th consecutive year, and all Indexes are currently priced at significant discounts to their benchmarks (figure 1).

WisdomTree’s Core Indexes also exhibit high quality characteristics, with aggregate levels of [Return on Equity \(ROE\)](#) and [Return on Assets \(ROA\)](#) above or in line with the market capitalization weighted performance index benchmarks.

Figure 1: Valuations & Profitability

Trailing-Twelve-Month Price-to-Core Earnings Ratio					Core Return-on-Equity & Core Return-on-Assets		
<b>WTPEPS</b>						<b>ROE</b>	<b>ROA</b>
Before Rebalance	After Rebalance	S&P 500	Russell 1000	Russell 1000 Value	WTPEPS	15.6%	2.8%
18.9x	17.9x	24.0x	24.9x	20.4x	S&P 500	14.3%	3.3%
					Russell 1000	13.6%	3.1%
					Russell 1000 Value	10.3%	2.2%
<b>WTMEI</b>						<b>12.8%</b>	<b>2.5%</b>
Before Rebalance	After Rebalance	S&P MidCap 400	Russell MidCap	Russell MidCap Value	S&P MidCap 400	9.6%	2.3%
16.7x	13.4x	23.1x	27.2x	22.7x	Russell MidCap	10.4%	2.6%
					Russell MidCap Value	9.2%	2.2%
<b>WTSEI</b>						<b>12.6%</b>	<b>3.2%</b>
Before Rebalance	After Rebalance	S&P 600 SmallCap	Russell 2000	Russell 2000 Value	S&P 600 SmallCap	7.5%	2.1%
14.4x	9.4x	26.4x	48.2x	27.0x	Russell 2000	5.2%	1.2%
					Russell 2000 Value	5.6%	1.3%

Sources: WisdomTree, New Constructs, FactSet. Before Rebalance metrics calculated using Index constituents and weights prior to the rebalance as of 12/20/2019. After Rebalance metrics calculated using Index constituents and weight after the rebalance as of 12/23/2019. 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.

For definitions of Indexes in the chart, please visit our [glossary](#).

We believe earnings weighting offers a compelling alternative to market capitalization weighting, and our U.S. Core Equity Indexes have the solid performance history to support our earnings-weighted approach.

Since inception, our Indexes have delivered returns above or consistent with their market-cap weighted performance benchmarks (figure 2). Importantly, the Core Equity Index Family has amassed this track record over a period in which growth-style investing has generally outperformed value. Given our [valuation](#)-sensitive methodology, it is quite impressive that the returns of our Indexes have beaten or been on par with their market cap-weighted benchmarks.

Having just closed out a decade of growth outperformance, it’s prudent to examine recent market shifts and what we believe they may mean for the 2020s.

Value investing<sup>2</sup> began closing the gap to growth investing<sup>3</sup> in August 2019. Since then, value stocks have surpassed their growth counterparts by 3.9%, with the S&P 500 Value Index returning 13.5% compared to 9.7% for the S&P 500 Growth Index.<sup>4</sup>

We believe these earnings-weighted, value-tilted strategies are positioned to outperform, especially if the value tide continues to turn.

Figure 2: Performance of the Core Equity Index Family

Performance		
	2019	Since Inception
<b>WTSEI</b>	<b>32.9%</b>	<b>8.8%</b>
S&P 500	31.5%	8.7%
Russell 1000	31.4%	8.8%
Russell 1000 Value	26.5%	6.6%
<b>WTMEI</b>	<b>25.2%</b>	<b>9.5%</b>
S&P MidCap 400	26.2%	8.9%
RussellMidCap	30.5%	8.6%
Russell MidCap Value	27.1%	7.5%
<b>WTSEI</b>	<b>22.3%</b>	<b>8.4%</b>
S&P 600 SmallCap	22.8%	8.8%
Russell 2000	25.5%	7.3%
Russell 2000 Value	22.4%	5.8%

Source: WisdomTree. 2019 performance is for the period 12/31/2018–12/31/2019. Since Inception performance is for the period 2/1/2007–12/31/2019. Past performance is not indicative of future results.

### WisdomTree Core Equity ETFs

Our U.S. Core Equity Funds seek to track the price and yield performance before fees and expenses of our eponymous indexes.

Our [U.S. Total Market Fund \(EXT\)](#), from which our market cap-specific Funds are derived, tracks the performance of profitable companies within the broad U.S. stock market, weighted by earnings.

Our [U.S. LargeCap Fund \(EPS\)](#) tracks the 500 largest companies within EXT, while our [U.S. MidCap \(EZM\)](#) and [U.S. SmallCap \(EES\)](#) Funds track the remaining 75% and 25% in market capitalization of EXT, respectively, after the largest companies are removed.

Our earnings-weighted Funds can add value over market capitalization peers lacking a corrective mechanism to reduce exposure to overextended [valuations](#). EXT, EPS, EZM and EES can be a smarter and more valuation sensitive way, in our view, for investors to achieve broad-based market exposure at the core of their U.S. equity exposure.

*Unless otherwise stated, data source is WisdomTree, FactSet as of 12/31/2019.*

<sup>1</sup>Ethan Rouen, Eric C. So and Charles C. Y. Wang, Core Earnings: New Data and Evidence (1/9/20). Harvard Business School Accounting & Management Unit Working Paper No. 20-047, October 2019.

<sup>2</sup>A style of investing with the primary objective of selecting companies with low valuations.

<sup>3</sup>A style of investing with the primary objective of selecting companies with the high fundamental growth.

<sup>4</sup>Source: S&P Global for the period 8/30/19–1/6/20.

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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](#)

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**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.

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You cannot invest directly in an index.

## DEFINITIONS

**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.

**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 time.

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

**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.

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

**Return on Equity (ROE)**: Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Return on assets (ROA)**: Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**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.