Why Investors Might Want to Hedge the Euro

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"To resolve its debt crisis, Europe has to continue to cut social spending and reform its labor laws, but it must also engage in a massive stimulus program. One result: The euro is likely to fall sharply, perhaps to the point where $1 equals €1."

- *Barron's*, July 16, 2012

The sovereign debt crises in Europe, and struggling European economies, have been hurting equity prices in Europe. A recent *Barron's* cover story proclaimed that Europe was selling at historic 40-year valuation[1] lows compared to the U.S. equity markets. Of course, there are plenty of risks to investing in European equity. Two of the most prominent ones include:

+ **Heavy exposure to financials in traditional European indexes, which are heavily leveraged[2] and exposed to the European debt crisis and economic slowdown**
+ **For U.S. investors, exposure to the euro, which many believe has room to fall to parity with the U.S. dollar—or below**

There are many European companies with a global revenue base that would stand to benefit from a weakening euro, as their goods and revenue become more attractive in the global market. WisdomTree wants to give investors the ability to capitalize on this theme with a Fund that addresses the two greatest risks to European equities: it neutralizes exposure to the euro and provides relatively little overall exposure to European financials.

WisdomTree expects to restructure its International Hedged Equity Fund (HEDJ) on or about August 29, 2012, to accomplish this goal.

[1] 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.
[2] Leverage: Calculated as total assets divided by total equity. Higher numbers indicate greater potential risk, because asset write-downs will have larger negative impacts on equity.

The new Europe Hedged Equity Fund (HEDJ) will provide exposure to European dividend-paying companies that derive more than 50% of their revenues from countries outside Europe, while hedging the single euro currency. The changes to the Fund's objective aim to:

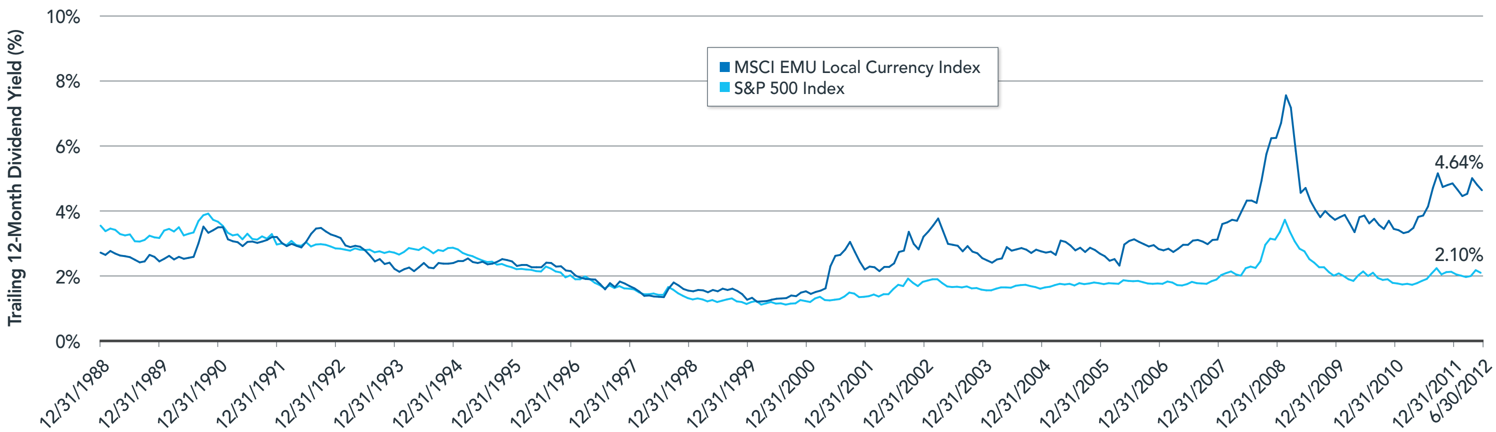
+ **Focus on one theme: The Fund will change its objective from hedging multiple currencies versus the U.S. dollar in a broad international basket to an export-oriented portfolio of euro-traded, dividend-paying companies while having to hedge only the euro vs. the U.S. dollar.**
+ **Provide access to exporters poised to benefit from a weakening euro: In a weakening euro but healthy European export scenario, a euro hedged equity strategy may provide greater returns than an unhedged portfolio of European stocks. Conversely, in an environment in which the euro is appreciating and global demand for goods is low, the Europe Hedged Equity Fund may underperform an unhedged portfolio of European stocks.**
+ **Improve operational efficiency: By hedging a single currency rather than multiple currencies, we anticipate tighter trading spreads[3], which may result in greater trade volumes and interest in HEDJ.**

CONCERNS ABOUT EUROPE'S FUTURE HAVE CREATED ATTRACTIVE VALUATIONS

Risks are elevated in Europe, to be sure. But European equity prices relative to U.S. equity prices are near historic lows.[4] Consider that the trailing 12-month dividend yield[5] for the MSCI EMU Local Currency Index[6], which will be the market cap-weighted benchmark for the WisdomTree Europe Hedged Equity Fund, is more than double that of the S&P 500 Index (as of June 30, 2012) and is trading at the widest yield differential to U.S. equities since the stock market lows in 2009. Favorable dividend yield differentials suggest that the market is "inexpensive" and many European companies are trading at more attractive valuation levels than their counterparts in the U.S. We are not suggesting that valuation is the sole consideration for investors, but hedging the euro could remove a major concern for many U.S. investors seeking equity exposure in this region.

[3] Tighter trading spreads (market): Where volume is high, trading is active and highly competitive, and consequently spreads between bid and ask prices are narrow. The goal for those trading foreign exchange currencies is a narrower spread indicating lower transaction cost.
[4] Source: Bloomberg.
[5] Trailing 12-month dividend yield: Dividends over the prior 12 months are added up and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.
[6] The MSCI EMU Local Currency Index captures large- and mid-cap representation across the 11 developed market countries in the EMU and provides local currency returns, which are not translated back to U.S. dollars.

FIGURE 1: TRAILING 12-MONTH DIVIDEND YIELD: MSCI EMU LOCAL CURRENCY INDEX VS. S&P 500 INDEX
[12/31/1987–6/30/2012]



Sources: MSCI, S&P, WisdomTree
Past performance is not indicative of future results.

DOES THE EURO REFLECT THE STRENGTH OR THE WEAKNESS OF THE EUROPEAN MONETARY UNION (EMU)?

FIGURE 2: DOLLARS PER EURO [12/31/1998–6/30/2012]

Source: Bloomberg
Past performance is not indicative of future results.

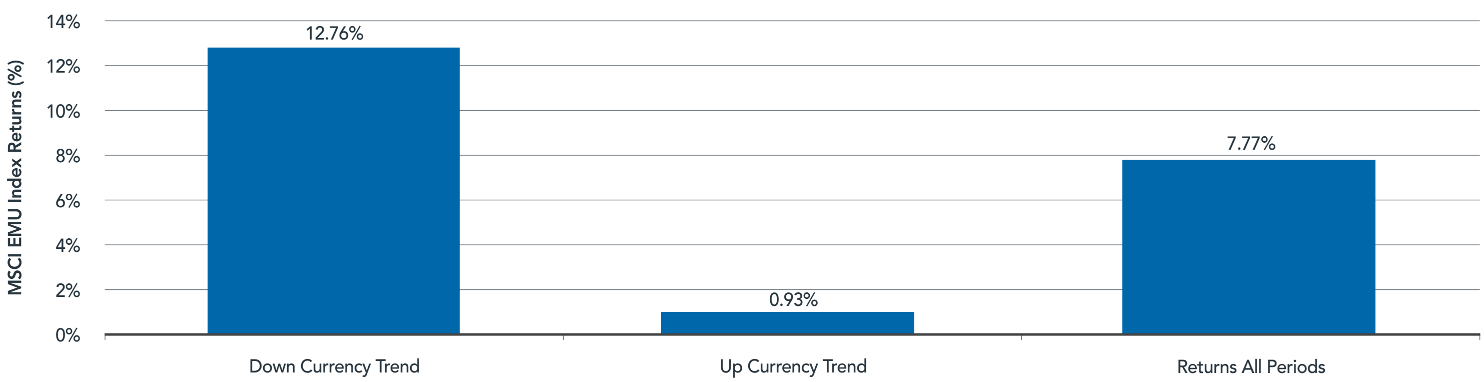
The euro has not only made transacting in Europe more convenient among the bloc of 17 euro-denominated countries and enabled economic growth in the region since it was adopted, but it has also emerged as an international currency of exchange. The euro experienced a strong appreciation from $.83 to the euro (in October of 2000) to a high of nearly $1.60 per euro, or almost a doubling of the euro from late 2000 to the highs in April 2008. As the debt crisis has taken hold of the market, the euro has weakened almost 25% from its peak in April 2008. The weakening euro could actually be helpful for some companies in Europe. A weakening euro may help boost the competitiveness of European exports and could benefit a number of companies.

BEST TIME TO OWN EUROPEAN EQUITIES: DURING DECLINING CURRENCY ENVIRONMENTS

The following graph illustrates when European equities had the best returns (since December 31, 1987) and the importance of hedging currency exposure. We evaluated the returns of the MSCI EMU Index[7] during times of rising and declining currency trends.

+ **During declining currency periods, the MSCI EMU Index in local currency returned 12.76% annualized (since December 31, 1987), which was about 5 percentage points greater than the Index return for all periods, both appreciating and depreciating currency scenarios, of 7.77%.**
+ **During rising currency periods, the MSCI EMU Index in local currency returned just 0.93% annualized.**
+ **The "down currency" returns are important, considering the euro is off its 2008 highs of $1.60 to around $1.23 as of July 17, 2012.**
+ **This historical analysis suggests that equities have done better during down currency periods, but importantly, to achieve these local market returns, U.S. investors must hedge their currency exposure.**

FIGURE 3: MSCI EMU INDEX IN LOCAL CURRENCY [12/31/1987–6/30/2012]



Sources: MSCI EMU Index—Local currency and U.S. dollar, WisdomTree
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.

Europe has recently been mired in turmoil, and both its equity market and the euro have exhibited uncertainty. However, investors may find that the markets mirror sovereign risks rather than specific company fundamentals, which creates opportunities for those aware of the risks. One of the primary risks for investors remains the currency movements of the euro compared to the U.S. dollar, but we think exporters who can execute in such an environment could benefit from a weakening euro, which may stoke demand for their products in the global market. If this scenario plays out, an investor may be better positioned in a portfolio of dividend-paying equities that derive more than half their revenues beyond Europe while hedging the euro. In that type of environment we believe that a hedged equity strategy focusing on dividend-paying exporters in Europe has the potential to outperform a strategy that overlooks the impact of a depreciating euro for U.S. investors.

[7] The MSCI EMU (European Economic and Monetary Union) Index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of countries within the EMU.

WISDOMTREE PROVIDES EXPOSURE TO GLOBAL EXPORTERS WHILE HEDGING EURO RISK

The WisdomTree Europe Hedged Equity Fund is designed to track the performance of the WisdomTree Europe Hedged Equity Index[8]. The Index provides exposure to dividend-paying companies in Europe that derive more than half their revenues outside Europe, while hedging the euro. Euro weakness is likely to help these companies on balance.

+ **Since the euro began weakening in April of 2008 and through June 30, 2012 ("the period"), the MSCI EMU Local Currency Index experienced a negative cumulative return of nearly 30%.**
+ **Exporters stand apart: The average return of the top 10 European companies with revenue outside Europe was a positive 30.66% over the period, showing a clear contrast between these global exporters versus the MSCI EMU Index.**
+ **Bear in mind that the euro declined about 20% cumulatively during the period.**
+ **Lower correlations to euro from exporters: Additionally, the average correlation[9] to the euro of the top 10 European companies with revenue outside Europe was 0.33 over the period, while the MSCI EMU Index had a significantly higher correlation of 0.53 over the period.**

FIGURE 4: WISDOMTREE EUROPE HEDGED EQUITY INDEX TOP 10 HOLDINGS: CORRELATION TO EURO, AND, LOCAL RETURNS [4/30/2008–6/30/2012]

Ticker	Name	Weight (%)	Correlation to Euro	Cumulative Euro Returns (%)	Annualized Euro Returns (%)	Annualized USD Returns (%)
ABI BB	Anheuser Busch InBev NV	5.00	0.22	97.70%	17.76%	12.04%
UNA NA	Unilever NV	5.00	0.04	45.15%	9.35%	4.03%
DAI GY	Daimler AG	4.83	0.34	-20.92%	-5.47%	-10.07%
BAYN GY	Bayer AG	4.32	0.34	17.10%	3.86%	-1.19%
SAN SM	Banco Santander SA	4.23	0.46	-47.38%	-14.27%	-18.44%
SAN FP	Sanofi-Aventis	4.15	0.17	51.07%	10.40%	5.04%
SAP GY	SAP AG	4.06	0.28	55.95%	11.25%	5.84%
BMW GY	Bayerische Motoren Werke AG (BMW)	4.05	0.44	79.55%	15.07%	9.48%
BBVA SM	Banco Bilbao Vizcaya Argentaria SA	3.48	0.51	-52.92%	-16.53%	-20.59%
MC FP	LVMH-Moët Hennessy - Louis Vuitton	3.36	0.46	81.26%	15.33%	9.73%
	Top 10 Average		0.33	30.66%	4.67%	-0.41%

Sources: S&P, Bloomberg, WisdomTree
Holdings as of 7/2/2012. Holdings subject to change. Past performance is not indicative of future results.
You cannot invest directly in an index.
As of 7/2/2012, the WisdomTree Europe Hedged Equity Fund did not hold any of these companies.

[8] The WisdomTree Europe Hedged Equity Index is designed to provide exposure to European equities while at the same time neutralizing exposure to fluctuations between the Euro and the U.S. dollar. The Index is based on dividend paying companies in the WisdomTree DEFA Index that are domiciled in Europe and are traded in Euros, have at least $1 billion market capitalization, and derive at least 50% of their revenue in the latest fiscal year from countries outside of Europe. The component securities are weighted in the Index based on annual cash dividends paid with the following caps: maximum individual position capped at 5%, maximum sector weight capped at 25%, and maximum country weight capped at 25%.

[9] Correlation: A statistical measure of how an index moves in relation to another index or model portfolio. A correlation ranges from -1 to 1. A correlation of 1 means the two have moved in lockstep with each other. A correlation of -1 means the two indexes have moved in exactly opposite directions. The correlation for all indexes is against the S&P 500 Index.

FIGURE 5: MOST RECENT CURRENCY DOWN TREND [4/30/2008–6/30/2012]

Index	Cumulative Returns (%)	Annualized Returns (%)
MSCI EMU Local Currency Index	-29.18%	-7.95%
MSCI EMU Index - USD	-42.28%	-12.35%
Change in Euro	-18.92%	-4.91%

Sources: Bloomberg, WisdomTree
Past performance is not indicative of future results.

WISDOMTREE EUROPE HEDGED EQUITY INDEX (EURO HEDGED INDEX) VALUATION CHARACTERISTICS BY SECTOR AND COUNTRY

A current snapshot of the country and sector valuation composition best illustrates the regions and markets that are trading relatively inexpensively compared to the U.S. equity market, i.e., higher yield, lower price-to-book ratio[10] and lower price-to-earnings ratio[11]. It also shows how much exposure is allocated to various countries and sectors. Highlights:

+ **Stronger country positions: The core European economies represent the three largest weights in the Euro Hedged Index, with Germany, France and the Netherlands representing almost 70% of the exposure in the index in aggregate, and Germany and France each representing approximately 25%.**
+ **Under-weight the banks: Financials, the sector most exposed to sovereign debt troubles, is the largest weighted sector in the MSCI EMU Index, but the third-lowest weighted sector in the Euro Hedged Index. The Euro Hedged Index is most exposed to two Consumer sectors (Staples and Discretionary) along with Industrials and Health Care.**
+ **Favorable valuations versus the U.S.: As we noted earlier, valuations appear to be more favorable in Europe than in the U.S. When we compare the Euro Hedged Index to the S&P 500 Index[12], we see more attractive valuations in aggregate for the trailing 12-month dividend yield, the price-to-book ratio and the P/E ratio. The Euro Hedged Index compared to the S&P 500 Index had a higher yield advantage: 3.60% vs. 2.16%; a lower price-to-book ratio: 1.37x vs. 2.14x; and a lower P/E ratio: 11.26x vs. 12.08x.**

[10] Price-to-book ratio: A financial measure used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of an index by the latest quarter's book value.
[11] 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.
[12] S&P 500 Index: Capitalization-weighted index of 500 stocks selected by the Standard & Poor's Index Committee, designed to represent the performance of the leading industries in the U.S. economy dollar invested.

FIGURE 6: WISDOMTREE EUROPE HEDGED EQUITY INDEX [As of July 2, 2012]

Country	Weight (%)	Trailing 12-Month Dividend Yield (%)	P/B Ratio	P/E	Sector	Weight (%)	Trailing 12-Month Dividend Yield (%)	P/B Ratio	P/E
Germany	25.44%	3.30%	1.60x	10.96x	Consumer Staples	21.76%	2.71%	2.29x	14.59x
France	24.26%	2.82%	1.78x	12.61x	Consumer Discretionary	19.48%	3.86%	1.37x	9.24x
Netherlands	18.35%	3.38%	1.91x	11.58x	Industrials	15.49%	3.64%	1.58x	11.53x
Spain	9.11%	2.46%	0.66x	13.04x	Health Care	12.21%	3.02%	1.73x	14.97x
Belgium	7.42%	2.07%	1.61x	14.93x	Materials	9.48%	2.95%	1.13x	11.82x
Finland	7.03%	7.06%	1.05x	12.11x	Information Technology	8.38%	5.32%	1.24x	14.58x
Italy	4.30%	3.22%	1.76x	11.97x	Financials	7.86%	2.55%	0.58x	
Portugal	3.00%	11.25%	1.27x	9.21x	Energy	2.89%	2.43%	2.58x	11.49x
Austria	0.70%	2.94%	3.37x	11.84x	Telecommunication Services	2.46%	13.60%	1.03x	9.21x
Ireland	0.09%	1.40%	3.27x	11.34x					
Portfolio	100%	3.60%	1.37x	11.26x	Portfolio	100%	3.60%	1.37x	11.26x
S&P 500 Index Portfolio	100%	2.16%	2.14x	12.08x	S&P 500 Index Portfolio	100%	2.16%	2.14x	12.08x

Sources: Bloomberg, WisdomTree
Data as of July 2, 2012. Holdings subject to change.
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CONCLUSION

As relative valuations of European equities rest near historic lows and the potential for a weakening euro increases, investors may be well-served to consider a strategy that provides exposure to export-oriented European companies, while hedging the impact of the euro. While uncertainties in Europe remain, investors could potentially benefit from an equity allocation to European exporters who stand to benefit from a depreciating euro as their goods become more attractive in the global market and simultaneously hedging the currency risk.

Unless otherwise stated, data source is WisdomTree.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, call 866.909.WISE (9473) or visit wisdomtree.com. Read the prospectus carefully before you invest.

There are risks associated with investing, including possible loss of principal. 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 and interest rate fluctuations. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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