ETF Observer

November 2014

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ETF Insight

An October Air Pocket

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October was a characteristically exciting month in global markets. The S&P 500 shed almost 6% before finishing the month by notching a fresh all-time high. Many of the bears that emerged from hibernation mid-month to herald the beginning of the end of a protracted bull run were left scratching their heads. Those who ignored all this noise were—as always—all the better for having done so.

Our asset flows data indicate that investors were putting on their rally caps, as a combined $11.3 billion in new capital poured into the three S&P 500 ETFs (SPY, IVV, and VOO). Meanwhile, aggregate bond ETFs (AGG and BND) were amongst the beneficiaries of the exodus from PIMCO Total Return in the wake of Bill Gross' departure (you can find a comprehensive update on the matter from our Manager Research team here).

It was also a busy news month. M&A activity and new developments in non-transparent actively managed exchange-traded products made headlines. We cover these items in more detail in our "News" section.

This month's installment of ETF Observer features four articles and two fund spotlights from our Passive Strategies research team. In the first article, Tom Boccellari dissects changes in the yield curve into three components and highlights the potential drawbacks of duration as a measure of a bond portfolio's sensitivity to changes in interest rates. Mike Rawson follows with a detailed analysis of a strategic beta fund that doubles down as stocks get cheaper, highlighting the potential benefits of the contrarianism embedded in the rebalancing methodology of PowerShares FTSE RAFI US 1000 (PRF). Patty Oey picks up from there with an assessment of current opportunities within emerging-markets equities. Patty argues that the "R" (Russia) and the "C" (China) in the "BRICs" are likely to remain cheap for some time, but that the "I" (India) might be a compelling opportunity at current valuations. Alex Bryan then contributes an assessment of the potential diversification benefits and income-generating potential of REITs. Lastly, this month we spotlight WisdomTree Europe Hedged Equity ETF (HEDJ) and iShares JPMorgan USD Emerging Market Bond (EMB).

Best,

U.S. Market Barometer

1 Month

US Market 2.69%	Value	Core	Growth
	1.29%	3.75%	2.98%
Large Cap 2.34%	0.65%	3.69%	2.64%
Mid Cap 3.03%	2.10%	3.42%	3.54%
Small Cap 5.58%	6.06%	5.36%	5.31%

YTD

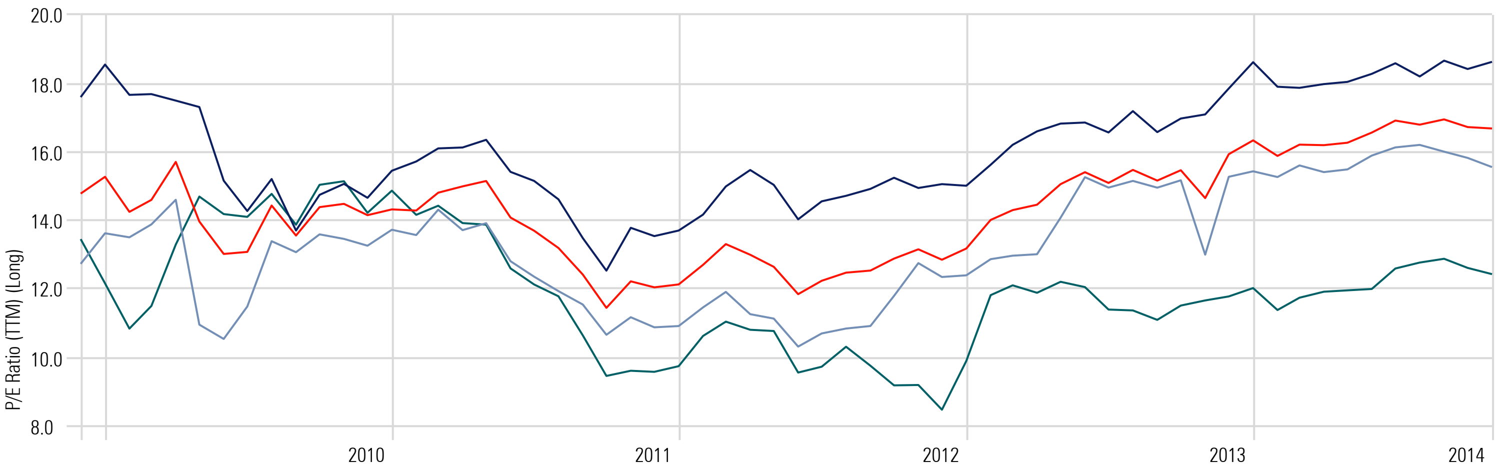
US Market 10.22%	Value	Core	Growth
	7.76%	12.09%	10.85%
Large Cap 10.96%	7.64%	12.66%	12.60%
Mid Cap 9.50%	8.57%	12.26%	7.89%
Small Cap 4.40%	6.60%	5.94%	0.59%

1 Year

US Market 16.33%	Value	Core	Growth
	14.21%	17.13%	17.65%
Large Cap 17.18%	14.26%	17.61%	19.64%
Mid Cap 15.30%	14.34%	17.28%	14.44%
Small Cap 10.32%	13.39%	11.81%	5.75%

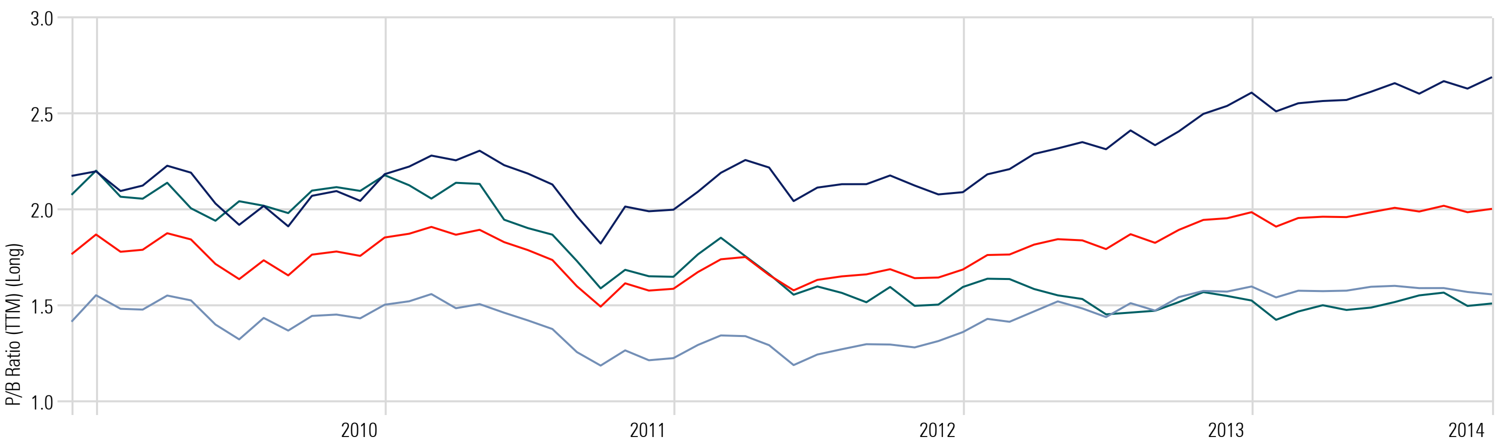
Price/Earnings

Time Period: 01/11/2009 to 31/10/2014



Price/Book Value

Time Period: 01/11/2009 to 31/10/2014



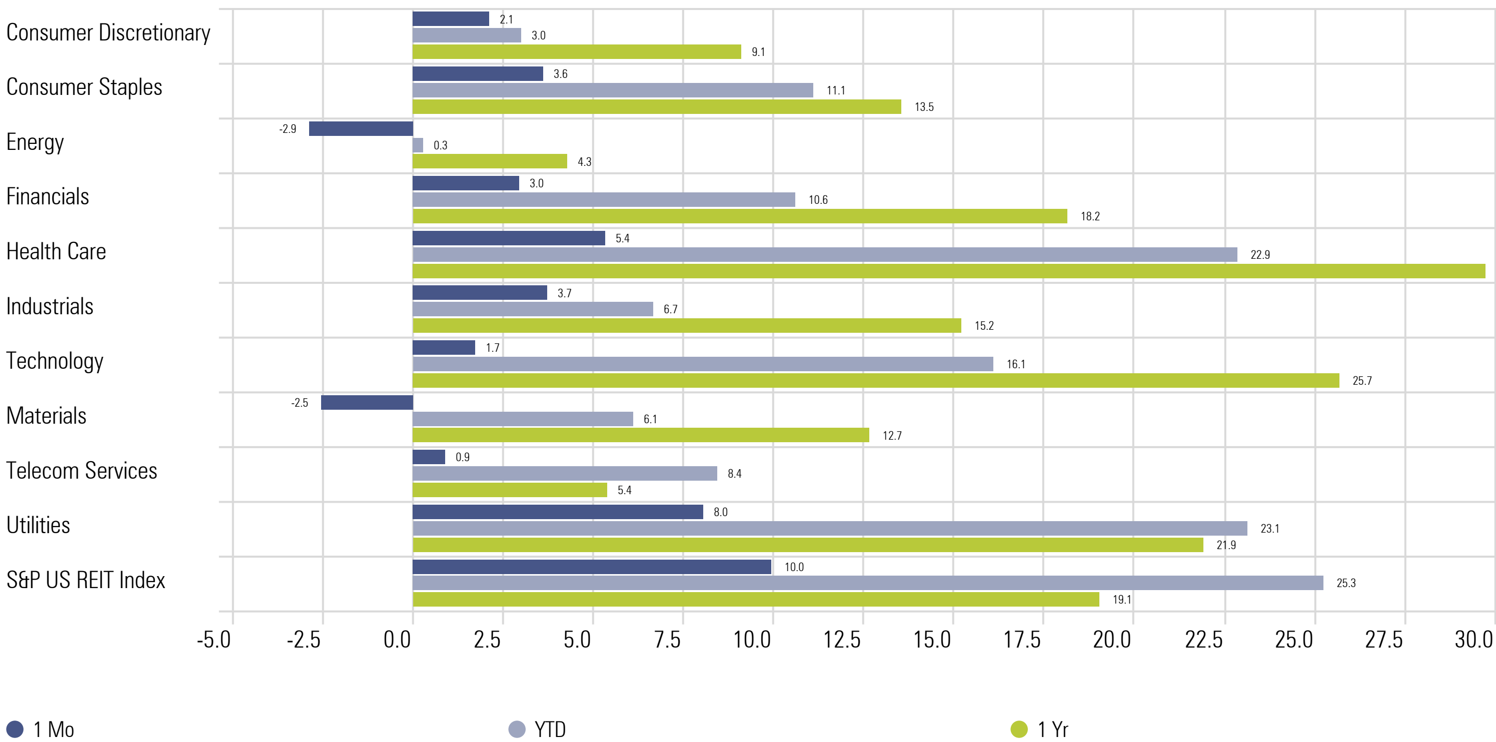
S&P 500 TR USD
MSCI ACWI NR USD
MSCI EAFE NR USD
MSCI EM NR USD

Market Performance

Trailing Total Returns

U.S. Equity Market	1 Month	YTD	1 Year	3 Yr Annlzd	5 Yr Annlzd	10 Yr Annlzd	15 Yr Annlzd
S&P 500 TR USD	2.44	10.99	17.27	19.77	16.69	8.20	4.61
Wilshire 5000 Total Mkt TR USD	2.76	10.04	16.15	19.56	16.87	8.61	5.32
DJ Industrial Average TR USD	2.16	6.86	14.48	16.22	15.30	8.42	5.74
NASDAQ 100 TR USD	2.71	16.92	24.73	22.39	21.40	11.73	3.68
Russell 2000 TR USD	6.59	1.90	8.06	18.18	17.39	8.67	8.36
Global Equity Market							
MSCI ACWI NR USD	0.70	4.46	7.77	12.98	10.57	7.09	4.04
MSCI EAFE NR USD	-1.45	-2.81	-0.60	9.68	6.52	5.81	3.52
MSCI EM NR USD	1.18	3.63	0.64	3.24	4.64	10.54	8.95

S&P 500 Sectors



Trailing Total Returns

U.S. Fixed Income Market	1 Month	YTD	1 Year	3 Yr Annlzd	5 Yr Annlzd	10 Yr Annlzd	15 Yr Annlzd
Barclays US Agg Bond TR USD	0.98	5.12	4.14	2.73	4.22	4.64	5.61
Markit iBoxx Liquid IG TR USD	1.20	7.65	7.23	5.56	7.10	5.86	6.48
BofAML US HY Master II TR USD	1.14	4.79	5.85	9.24	10.26	8.12	7.59
Morningstar Short-Term US Govt TR	0.38	0.95	0.81	0.65	1.36	2.85	3.77
Morningstar Short-Term Corp TR	0.37	1.80	1.91	2.98	3.34	3.69	4.75
Morningstar Intermediate US Govt TR	1.05	3.42	1.77	1.46	3.67	4.55	5.65
Morningstar Intermediate Corp TR	0.86	4.61	4.35	5.28	6.12	5.64	6.69
Morningstar Long-Term US Govt TR	2.28	13.71	9.36	3.59	6.77	6.33	7.36
Morningstar Long-Term Corp TR	1.68	11.40	10.38	6.51	8.49	6.95	7.85
S&P Preferred Stock TR USD	1.13	12.91	12.16	9.15	10.41	5.07	—

Top 10 ETF Providers

		Est. Net Flow ($Mil)			Market Share: Total Net Assets ($Bil) Present			One Year Ago		
Name	**# of ETFs**	**1-Mo**	**YTD**	**1-Yr**	**10-14**	**Mkt Sh%**	**Rank**	**10-13**	**Mkt Sh%**	**Rank**
iShares	293	15,873.03	58,286.12	63,885.65	738.64	38.58	1	646.60	39.44	1
State Street	140	6,648.74	3,438.35	15,188.60	413.67	21.61	2	373.32	22.77	2
Vanguard	67	7,303.94	55,055.00	62,260.38	408.26	21.32	3	322.36	19.66	3
PowerShares	163	(1,440.82)	(6,233.49)	(4,209.97)	97.32	5.08	4	92.35	5.63	4
WisdomTree	68	761.29	1,401.01	2,991.54	36.73	1.92	5	32.87	2.00	5
First Trust	87	(427.76)	8,162.88	10,027.94	29.27	1.53	6	17.17	1.05	9
Guggenheim	68	(219.13)	5,621.88	7,538.90	28.29	1.48	7	19.24	1.17	8
ProShares	146	(824.15)	1,782.09	2,584.53	26.48	1.38	8	25.75	1.57	6
Schwab	21	1,173.30	6,499.60	7,708.69	24.65	1.29	9	15.34	0.94	10
Van Eck	62	743.97	1,454.70	1,278.95	21.77	1.14	10	23.82	1.45	7

Top 15 ETF Inflows in October

		Est. Net Flow ($Mil)			Market Share: Total Net Assets ($Bil) Present			One Year Ago		
Name	**Ticker**	**1-Mo**	**YTD**	**1-Yr**	**10-14**	**Mkt Sh%**	**Rank**	**10-13**	**Mkt Sh%**	**Rank**
SPDR® S&P 500 ETF	SPY	5,238.13	(195.32)	11,313.73	184.93	9.66	1	157.23	9.59	1
iShares Core S&P 500	IVV	4,303.58	8,246.02	12,302.16	67.09	3.50	2	47.10	2.87	4
iShares 1-3 Year Treasury Bond	SHY	3,514.11	3,515.03	3,413.67	11.76	0.61	34	8.32	0.51	42
iShares Core US Aggregate Bond	AGG	2,095.58	5,283.64	6,127.30	21.10	1.10	17	14.63	0.89	21
iShares Short Treasury Bond	SHV	1,874.42	1,411.39	1,179.88	4.22	0.22	95	3.04	0.19	104
Vanguard S&P 500 ETF	VOO	1,815.80	7,390.16	9,176.58	24.38	1.27	13	12.56	0.77	28
iShares iBoxx $ High Yield Corporate Bd	HYG	1,699.17	(817.24)	(2,180.63)	14.27	0.75	26	16.58	1.01	18
Vanguard Total Stock Market ETF	VTI	1,297.24	5,608.60	6,377.39	48.32	2.52	4	36.53	2.23	8
iShares 7-10 Year Treasury Bond	IEF	1,238.41	2,385.30	1,908.16	6.21	0.32	64	4.25	0.26	80
Consumer Staples Select Sector SPDR® ETF	XLP	1,110.32	1,809.02	1,687.32	9.06	0.47	50	6.66	0.41	54
Vanguard Total Bond Market ETF	BND	1,080.22	5,829.90	6,863.07	24.06	1.26	14	16.90	1.03	16
SPDR® Barclays 1-3 Month T-Bill ETF	BIL	919.46	795.90	818.79	1.87	0.10	166	1.05	0.06	205
Utilities Select Sector SPDR® ETF	XLU	896.18	1,384.68	653.82	6.90	0.36	55	5.47	0.33	68
Energy Select Sector SPDR® ETF	XLE	728.07	2,192.52	1,797.18	10.29	0.54	42	8.40	0.51	40
SPDR® S&P MidCap 400 ETF	MDY	681.56	(1,109.78)	(2,660.58)	14.65	0.77	25	16.22	0.99	19

Top 15 ETF Outflows in October

		Est. Net Flow ($Mil)			Market Share: Total Net Assets ($Bil) Present			One Year Ago		
Name	**Ticker**	**1-Mo**	**YTD**	**1-Yr**	**10-14**	**Mkt Sh%**	**Rank**	**10-13**	**Mkt Sh%**	**Rank**
iShares MSCI Emerging Markets	EEM	(2,650.91)	(3,173.35)	(6,098.67)	37.01	1.93	7	44.74	2.73	5
iShares Core S&P Mid-Cap	IJH	(2,173.16)	(1,616.67)	(1,049.74)	21.88	1.14	16	21.28	1.30	10
Vanguard FTSE Europe ETF	VGK	(2,005.61)	(662.06)	482.71	11.68	0.61	36	12.06	0.74	31
PowerShares QQQ ETF	QQQ	(1,499.57)	(9,705.66)	(8,144.00)	40.47	2.11	6	41.43	2.53	6
Technology Select Sector SPDR® ETF	XLK	(1,482.70)	(2,195.40)	(1,897.86)	12.50	0.65	30	12.85	0.78	27
Materials Select Sector SPDR® ETF	XLB	(1,220.23)	(670.95)	(477.48)	3.93	0.21	101	3.81	0.23	91
SPDR® Gold Shares	GLD	(1,076.49)	(1,977.86)	(4,790.61)	27.73	1.45	8	37.11	2.26	7
iShares MSCI United Kingdom	EWU	(775.59)	(70.13)	196.16	3.17	0.17	120	3.27	0.20	102
Financial Select Sector SPDR® ETF	XLF	(699.96)	(160.41)	1,024.60	18.49	0.97	19	15.35	0.94	20
ProShares Ultra MidCap400	MVV	(580.19)	(1,312.55)	(1,186.57)	0.18	0.01	613	1.53	0.09	168
PIMCO 0-5 Year High Yield Corp Bd ETF	HYS	(576.41)	(231.29)	(66.36)	3.31	0.17	115	3.44	0.21	99
iShares MSCI EMU	EZU	(557.18)	244.09	1,684.65	7.63	0.40	54	6.61	0.40	55
iShares US Industrials	IYJ	(504.10)	(339.49)	(255.83)	1.29	0.07	207	1.45	0.09	171
iShares US Healthcare	IYH	(451.68)	(81.72)	(52.04)	2.33	0.12	145	1.81	0.11	151
Consumer Discret Sel Sect SPDR® ETF	XLY	(439.26)	(1,132.55)	(963.51)	6.36	0.33	60	6.94	0.42	51

ETF News

New Developments for Non-Transparent Actively Managed ETPs

And M&A activity heats up as traditional asset managers jockey for position in the ETF industry.

Janus buys VelocityShares

On October 13, Janus Capital Group (JNS) announced that it was acquiring VS Holdings, Inc.—the parent firm of ETP provider VelocityShares. Janus is paying $30 million in cash for VS, and the deal is expected to close by year end. What Janus is getting in VelocityShares is a varied lineup of exchange-traded notes (including the infamous TVIX) and a handful of relatively new (all less than two years old) strategic beta and alternative ETFs with collective assets of over $2 billion. Notably, Janus is not acquiring an existing exemptive relief which would allow it to issue its own ETFs. Velocity Shares currently leverages ALPS' and Exchange-Traded Concepts' exemptions and does not possess its own. On November 6, Janus updated its own exemptive relief filing, as it is seeks the SEC's permission to issue actively-managed ETFs.

Goldman Sachs in Talks to Buy Index IQ

Days after news of Janus' acquisition emerged, Reuters reported that Goldman Sachs was in talks to buy ETF provider Index IQ. The deal would make sense from a strategic point of view as Goldman would obtain IndexIQ's existing exemptive relief and a small but fast-growing lineup of alternative ETFs. Goldman has been rumored for some time to be mulling a foray into ETFs. The firm initially filed for its own exemptive relief years ago and filed for active exemptive relief earlier this year. Also, Goldman's asset management arm has been keen to capitalize on investors' growing interest in liquid alternatives.

SEC Denies Precidian Request

Towards the end of the month, the SEC denied Precidian's filing for actively managed non-transparent ETFs:

"the Commission preliminarily believes that the specific features proposed by the Applicants that would cause the proposed ETFs to operate without transparency fall far short of providing a suitable alternative to the arbitrage activity in ETF shares that is crucial to helping keep the market price of current ETF shares at or close to the NAV per share of the ETF.

Accordingly, the Commission preliminarily believes that it is not in the public interest or consistent with the protection of investors or the purposes fairly intended by the policy and provisions of the Act to grant the exemptive relief under section 6(c) that the Applicants seek."

We share the SEC's concerns, and have voiced them previously in this very publication.Though the SEC's ruling isn't necessarily a death knell for Precidian's structure, it is clearly a major setback.

SEC Gives ETMFs the Green Light

In early November, the SEC gave the green light to Eaton Vance's filing for exchange-traded managed funds (ETMFs). We believe that this unique type of ETP passed muster in large part because of the manner in which it will trade. The "NAV-plus" trading mechanism ensures that investors will receive end of day net asset value for their purchases and sales (much as they currently do for traditional mutual funds), though they will pay a spread (which will be pocketed by market makers) on their transactions. This structure theoretically preserves some of the prospective benefits of an ETP wrapper—most notably lower costs (no recordkeeping costs or 12b-1 fees) and improved tax efficiency (owing to in-kind redemptions). That said, investors will lose the ability to trade at intraday prices and need to navigate what is an entirely new—and still unproven—trading mechanism.

U.S. ETF Industry Data Dashboard

Morningstar data as of November 1, 2014

Industry Vitals

Total # of ETPs currently listed	1,663
ETFs	1,452
Total ETF Assets	$1.89 trillion
ETNs	211
Total ETN Assets	$27.6 billion
Total ETP Assets	$1.92 trillion

Active ETFs

Actively Managed ETFs	126
Total Assets	$17.4 billion
% of Total ETP Assets	0.91%
New Active ETFs Launched in October	10

Coming and Going	October	YTD
New Launches	18	179
Delistings/Closures	24	67
Net Change	-6	112

Notable ETF Filings in October

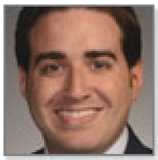
- WisdomTree Brazil Bond Fund
- WisdomTree Brazilian Real Strategy
- Source Euro STOXX 50 Hedged ETF
- iShares MSCI Saudi Arabia Capped ETF
- iShares MSCI Emerging Workforce ETF
- PureFunds Cyber Security ETF

Perspective

Trouble With the (Yield) Curve

Because interest rates do not always move in tandem, investors need to pay close attention to the yield curve and spreads to gauge risk.

October 10, 2014



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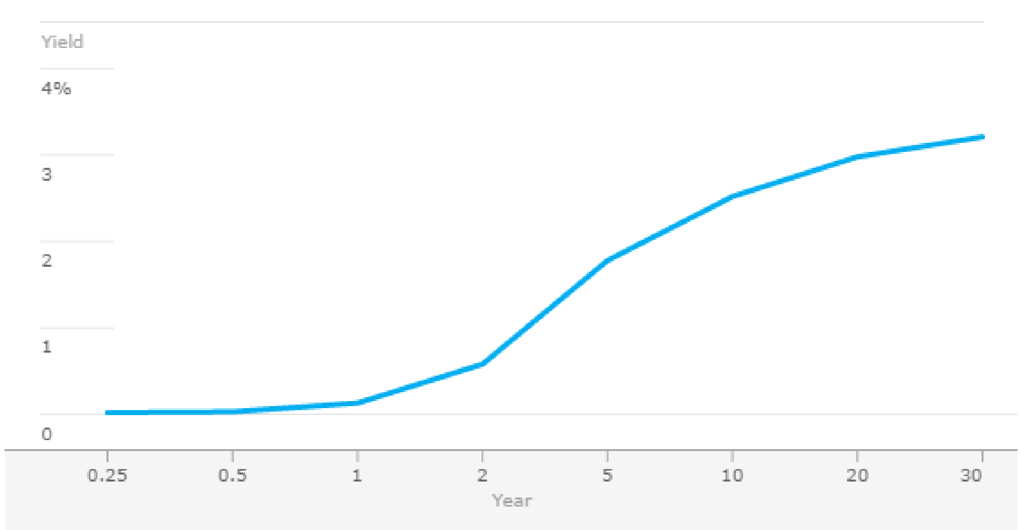
For more than a year, the term "interest rate" has struck fear among bond investors. These fears intensified recently after Federal Reserve comments sparked speculation that the Fed will begin to increase the federal-funds rate early next year. After all, as interest rates rise, most bond prices decline.

Investors often use duration to estimate a bond's interest-rate sensitivity. It approximates the change in a bond's price for an incremental interest-rate change. For example, a bond with a duration of five years might lose 5% of its value for a 1% increase in interest rates. However, this approximation is only accurate for small and parallel changes in interest rates across the yield curve.

The yield curve, in its simplest form, shows interest rates at a point in time for U.S. Treasuries with differing maturities.

Yield Curve as of September 30, 2014



Board of Governors of the Federal Reserve System/FRED

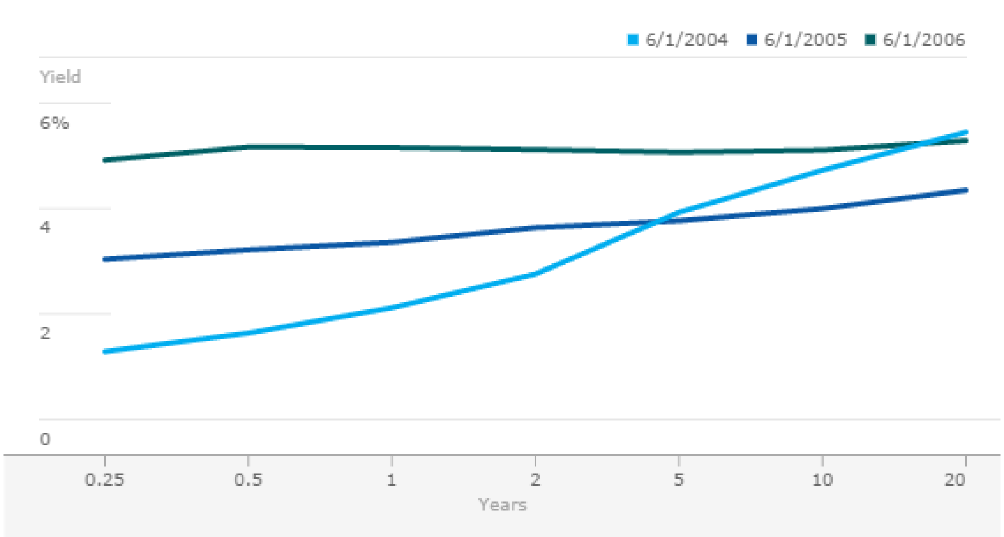
In normal markets, as the time to maturity increases so does the yield. This is intuitive because interest-rate risk tends to increase with maturity, and investors demand compensation for this risk. Investors' expectations of future short-term rates also influence the shape of the yield curve. If investors believe short-term rates will fall in the near term, the yield curve may become flat, or even inverted, where long-term interest rates are lower than short-term rates. A flattening or inverted yield curve is often interpreted as a sign that the economy is starting to cool and that the Fed may start to lower short-term rates. In contrast, a steepening yield curve usually points to a strong economy with increased inflation expectations.

With all of these variables at work, interest-rate changes are rarely linear. We can break changes in the yield curve into three components: changes in the level of rates (which is usually the most important), slope of the yield curve, and its curvature. The slope of the yield curve measures the difference between short- and long-term yields. When there is a twist in the yield curve, it is becoming flatter or steeper. The curvature of the yield curve can change when short- and long-term rates move more than intermediate-term rates, or vice versa.

In the previous chart, the yield curve is considered steep because of the large difference between long- and short-term interest rates. This is partially due to the Fed's decision to keep the federal-funds rate near zero. With fear that the Fed may begin to increase the federal-funds rate, investors should pay close attention to how the yield curve moves.

For example, during the last increase in the federal-funds rate in June 2004, the curve began to flatten. During the next two years, the yield curve continued to flatten and eventually inverted.

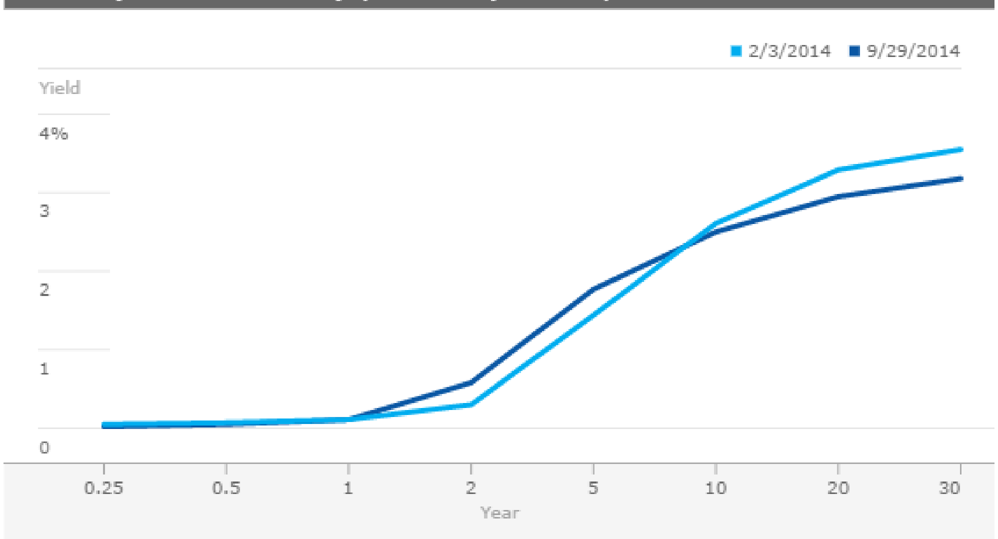
Yield Curve During the Last Federal-Funds Rate Increase



Board of Governors of the Federal Reserve System/FRED

This is an important concept because it shows that short-term bond funds are not always the safest investment in a rising interest-rate environment. It is possible that short-term interest rates rise while long-term rates remain the same or even fall. For instance, from February through September 2014, the five-year Treasury yield increased to 1.78% from 1.44%, and the 30-year Treasury yield decreased to 3.21% from 3.55%. During this time period, iShares 3-7 Year Treasury Bond (IEI) (4.6-year duration) lost 0.41% while iShares 20+ Year Treasury Bond (TLT) (17.1-year duration) gained 6.36%.

Treasury Yield Curve: February 3, 2014 vs. September 29, 2014



Board of Governors of the Federal Reserve System/FRED

The table below shows that the price performance of a bond fund depends on the interest-rate change of comparable maturity. When a fund's comparable Treasury yield increased, like the two- and five-year Treasury, its price declined. Conversely, when a fund's comparable Treasury yield decreased, like the six-month, 10-, 20- and 30-year Treasury, those funds' prices increased. It's not enough to know interest rates might rise--investors must know what interest rate will move, and by how much.

Price Returns of iShares Treasury ETFs vs. Interest-Rate Changes, Feb.-Sept. 2014

	Ticker	Duration (Years)	Benchmark Treasury-Yield Change	Price Return
iShares Short Treasury Bond	SHV	0.5	-0.04	-0.02%
iShares 1-3 Year Treasury Bond	SHY	1.9	0.28	-0.05%
iShares 3-7 Year Treasury Bond	IEI	4.6	0.34	-0.41%
iShares 7-10 Year Treasury Bond	IEF	7.6	-0.09	0.94%
iShares 10-20 Year Treasury Bond	TLH	9.7	-0.31	2.90%
iShares 20+ Year Treasury Bond	TLT	17.1	-0.34	6.63%

Sources: Morningstar Direct, iShares.com, and analyst calculations.

Corporate Bonds and Mortgages
Corporate bonds and mortgage-backed securities (MBS) add an additional layer of complexity to interest-rate sensitivity because, in addition to interest-rate risk, investors' tolerance for credit risk also affects their interest rates. These bonds must offer higher yields than duration-matched Treasuries to compensate investors for the risk that the borrower might default. This is known as the credit risk premium.

Much like the Treasury yield curve, corporate-bond and MBS spreads are not always consistent and can move differently across different credit qualities and maturities. For instance, the spreads between the yields of Aaa and Baa corporate bonds during the past 20 years, as measured by the difference between the Moody's Seasoned Aaa and Baa Corporate Bond Index's yield relative to the 20-year Treasury, has varied between 0.5% and 3.4%.

Historic Credit Spread Between Aaa and Baa Corporate Bonds

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Investors might have expected iShares Intermediate Credit Bond's (CIU) price (4.7-year average maturity) to decline like iShares 3-7 Year Treasury Bond as the five-year Treasury yield increased. However, CIU appreciated as corporate credit spreads continued to tighten relative to Treasuries. While corporate bonds of similar maturity to Treasury bonds generally have smaller durations because of their higher yields, it is possible that they could lose more value if the risk-premium widens. Click here for Morningstar's David Sekera's corporate-bond outlook.

Options for Rising Rates

Ultra-short-term bond investors will be protected from most interest-rate changes. While the chance for principal loss is small, investors should pay attention to yield to maturity and costs, which can erode most--if not all--of an investor's returns. For example, SPDR Barclays 1-3 Month T-Bill ETF (BIL) takes virtually no credit and interest-rate risk. However, its 0.1345% expense ratio is greater than its yield to maturity (0.02%), which virtually guarantees a negative return.

Short-term bond investors should consider investment-grade floating-rate bond funds like iShares Floating Rate Bond (FLOT). While traditional fixed-coupon bonds pay a consistent income stream, their prices adjust down when interest rates rise. In contrast, floating-rate bonds' payments adjust with interest rates, so their prices don't have to.

Investors may want to avoid funds in the intermediate-term bond Morningstar Category, like iShares Core U.S. Aggregate Bond (AGG), because of their sensitivity to rising rates. While they have less sensitivity to interest rates than long-term bond funds, intermediate-term interest rates have historically increased more in rising interest-rate environments as the yield curve flattens.

While long-term interest rates have historically had little sensitivity to short-term interest-rate increases, long-term bonds still have great sensitivity to even small changes in long-term interest rates. Investors who need access to their capital in the short- to intermediate-term should avoid long-term bonds because of the increased risk of principal loss. They may still be appropriate for long-term investors because the higher coupon payment can help offset principal losses and provide greater total returns in the long run.

Perspective

A Value Strategy That Doubles Down When Stocks Get Cheaper

Market-cap-weighted indexes can work against a contrarian value strategy.

October 22, 2014

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Value investors get compensated for taking contrarian bets, particularly when it is agonizing to do so. Sam Zell, known as "the grave dancer" for his penchant for buying companies as they emerged from bankruptcy, sold his Equity Office Properties Trust near the peak of the real estate market in 2007. In the depths of the financial crisis, Warren Buffett took a large stake in Goldman Sachs, which was desperate for capital at the time.

It is very difficult to sell stable companies and buy unstable companies during periods of uncertainty. Index funds are supposed to take emotion out of the equation and remove our behavioral biases. But traditional value indexes don't do a great job of replicating the behavior of contrarian investors. As a result of its market-cap-weighting approach, the Russell 1000 Value Index actually increased its exposure to relatively stable companies such as Exelon Corp (EXC), Intel (INTC), Bristol-Myers Squibb (BMY), and CVS Health Corp (CVS) in the wake of the 2008 financial crisis. At the same time, it decreased exposure to the most beaten-down value stocks, such as General Electric (GE) and Citigroup (C).

Market-cap weighting can prevent traditional value indexes from behaving like a contrarian value manager. When a value stock appreciates in price, it will become a large part of the value index even if its price appreciation means that it is less of a bargain. However, a non-market-cap-weighted value index is not forced to increase its weight in such stocks.

For instance, the FTSE RAFI US 1000 Index, which PowerShares FTSE RAFI US 1000 ETF (PRF) tracks, weights its holdings according to book value, sales, cash flows, and dividends, rather than market capitalization. This unique approach caused the fund to cut its exposure to companies that weathered the 2008 market downturn better than their peers such as Wal-Mart (WMT), Exxon Mobil (XOM), Verizon (VZ), Johnson & Johnson (JNJ), Procter & Gamble (PG), and Pfizer (PFE). It used the proceeds to fund a dramatic increase in exposure to beaten-down stocks such as Bank of America (BAC), Citigroup, General Electric, Ford (F), Dow Chemical (DOW), Alcoa (AA), and Altria Group (MO).

To illustrate how a market-cap index works compared with a fundamentally weighted index, consider the following indexes based on two companies. Company A has a market cap of $120 and a book value of $100 for a book/price ratio of 0.83. Company B has a market cap of $60 and a book value of $80 for a book/price ratio of 1.33. Company B exhibits stronger value attributes as it sells at a higher book/price than Company A. Yet, it represents a smaller portion of the market-cap-weighted index than the book value weighted index, as the table below illustrates. Suppose that as we move to period 2, Company A's price has appreciated to $140, but its book value is unchanged. Company A's book/price is now 0.71 and it now exhibits weaker value characteristics. However, it is now a bigger part of the market-cap-weighted index because its price has appreciated. The market-cap-weighted index now has a less attractive book/price overall. Also in period 2, Company B's book value increased from $80 to $90, but its price is unchanged. It is now a bigger part of the book value weighted index and that index will have a lower value overall.

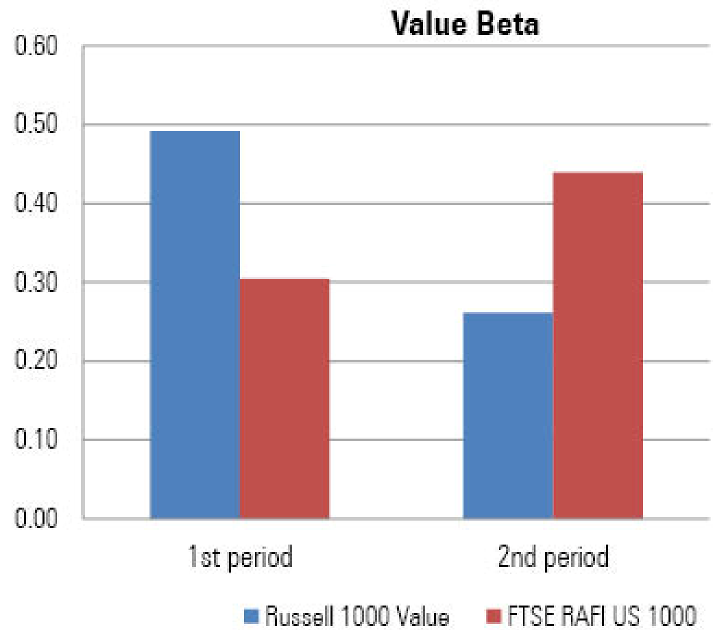
Illustration of Index Changes	Market Cap	Book Value	Market Cap Index Weight (%)	Book Value Index Weight (%)	Book/Price
Period 1					
Company A	120	100	67	56	0.83
Company B	60	80	33	44	1.33
Period 2					
Company A	140	100	70	53	0.71
Company B	60	90	30	47	1.50

While most fundamentally weighted indexes exhibit a similar value tilt to traditional value indexes, their dynamic rebalancing approach may allow them to more effectively profit from mean reversion in valuations. To compare the value characteristics of the FTSE RAFI US 1000 Index with those of the Russell 1000 Value Index, I regressed their monthly returns against a multifactor model that included a value factor. The value factor is defined as a portfolio long a basket of stocks with high book/price values and short a basket of stocks with low book to price values. The more sensitive the portfolio's returns are to the value factor, the deeper its value tilt. In the table below, I display only the value factor, even though this was a multifactor regression.

Over the entire period (12/2003 to 8/2014), the FTSE RAFI index had a value beta of 0.35, only slightly less than the 0.40 for the Russell 1000 Value index. This means that it tended to increase in value by 0.35% for each 1 percentage point that deep value stocks outperformed high growth stocks included in the value factor portfolio, holding everything else constant. This represents the average beta over the entire period. However, if we break it up into two periods, before and after the financial crisis, we see substantial variation in the value beta. The value beta for the FTSE RAFI Index increased from 0.30 in the first period to 0.44 in the second. Meanwhile, the value beta for the Russell 1000 Value Index fell in the second period. Yet value stocks performed much better in the second period, as stocks in the long short value stock basket returned 9.45% in the second period compared with negative 3.26% in the first period. Value stocks performed better, in part, because they were selling at a larger discount to the market. So the FTSE RAFI index had a higher sensitivity to value stocks just as value stocks were performing better. This may be because its alternative weighting approach causes it to bet big when valuations are most attractive.

Value Beta for Two Indexes During Two Time Periods	Value Beta		Return % (Annualized)		
	Russell 1000 Value	FTSE RAFI US 1000	Value Stocks (Long/Short)	Russell 1000 Value	FTSE RAFI US 1000
Entire Period	0.40	0.35	3.09	9.04	10.60
Sub Periods					
12/2003-3/2009	0.49	0.30	-3.26	-3.30	-3.90
4/2009-8/2014	0.26	0.44	9.45	22.9	27.40

Source: Morningstar Analysts



Source: Morningstar Analysts

A value investor should be willing to take bigger value bets when stocks become cheaper. Certain strategic beta funds may be better able to accomplish this than traditional, market cap weighted funds. Some of the ETFs that use non-market cap weighting include PRF, Guggenheim S&P 500 Equal Weight ETF (RSP), WisdomTree LargeCap Dividend ETF (DLN), and Guggenheim S&P 500 Pure Value ETF (RPV).

Perspective

Where Are the Opportunities in Emerging Markets Today?

We take a closer look at India, Taiwan, and Malaysia.

October 29, 2014

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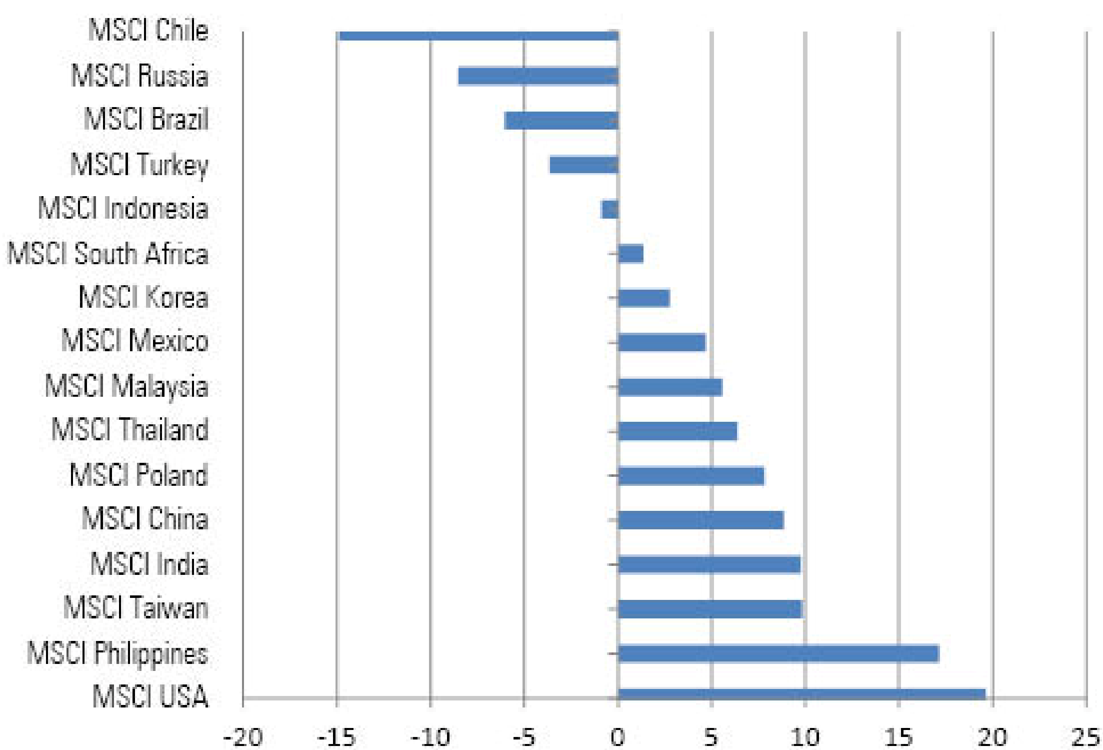
It is difficult to find attractively valued assets today. Interest rates in the developed world remain near record lows, and investors continue to pour into riskier assets, driving up valuations. U.S. stocks have enjoyed a five-year rally, with the S&P 500 currently trading at a trailing 12-month price/earnings multiple of 18 times, above their historical average of 15 times. Certain pockets of the emerging markets are also trading at lofty valuations, thanks to new market-friendly reforms (Mexico) or a relatively strong near-term growth outlook (the Philippines).

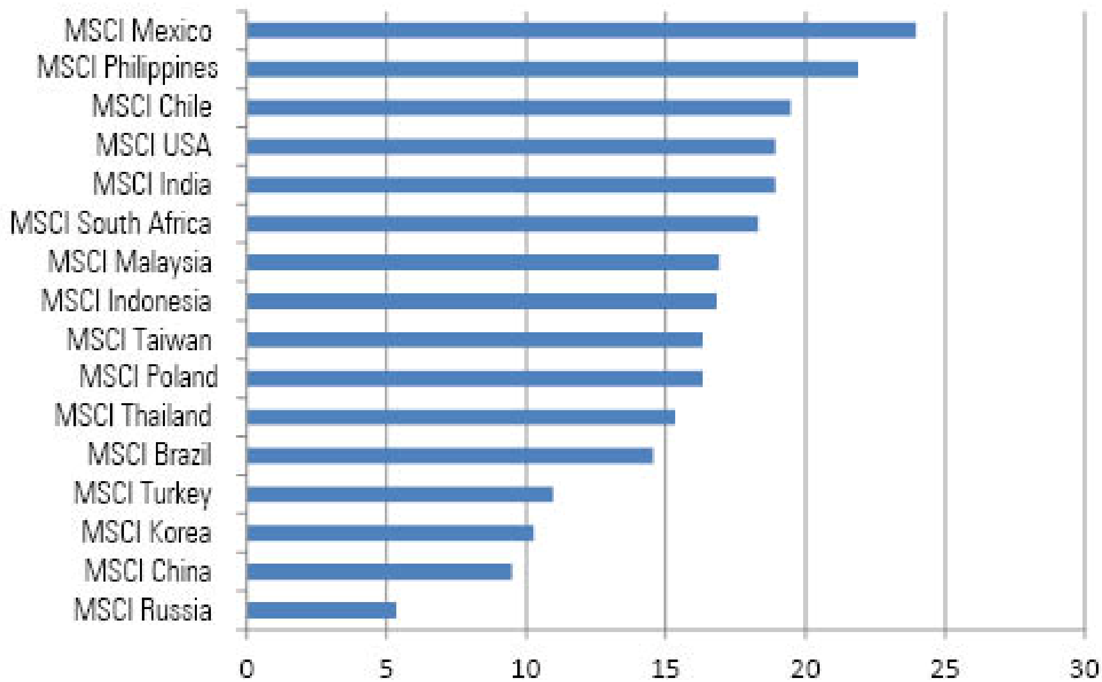
Markets trading at depressed valuations, such as Russia and China, are likely to remain cheap in the medium term. Russian firms are operating in a weak domestic environment that is further hampered by Western sanctions and falling oil prices. As for China, many large firms, which used to enjoy a relatively oligopolistic operating environment, face an uncertain future as the government pursues a confounding reform agenda that tries to combine both market liberalization and state-control ideologies.

Trailing 12-Month P/E Ratios



- source: MSCI. Data as of Sept. 30, 2014.

Annualized 2-Year Returns



- source: Morningstar Direct. Data as of Sept. 30, 2014. The MSCI indexes are market-cap-weighted and denominated in U.S. dollars.

India

India has been one of the best-performing markets this year (the MSCI India Index is up 25% year to date)--so now might not seem to be the best buying opportunity. Both domestic and foreign investors have fueled a strong rally based on their optimism that newly elected Prime Minister Narendra Modi will foster a more business-friendly regulatory environment, as he did when he was the leader of the Gujarat state in western India. But there is a new catalyst that may help sustain the rally in the near term: falling oil prices. Historically, one of India's challenges has been the government's inability to cut fuel subsidies. These subsidies (the diesel subsidy is estimated to cost $10 billion a year) have increased the country's fiscal deficit, hindered its ability to spend on infrastructure, and negatively affected its credit rating. But Modi used the recent decline in oil prices as an opportunity to end the diesel subsidy earlier this month, at a time when it would have a relatively small impact on consumers. Lower oil prices should also result in many positive knock-on effects on the domestic economy, as India imports about 70% of its oil needs. Pressure on the country's current account is easing and inflation is falling, which may prompt India's central bank to lower rates earlier than expected. Consumers, with more money in their pockets, are feeling more confident. This improving macroeconomic environment, combined with Modi's ambitious reform plans, may create a virtuous cycle and set the stage for India's long-awaited next phase of growth.

There are 10 India-focused funds in Morningstar's database--five passively managed ETFs, and five actively managed funds. The five ETFs each track different benchmarks, and as such their portfolios have slightly different average market capitalizations and sector exposures. While four of the passively managed funds are fairly similar, WisdomTree India Earnings ETF (EPI) has a heavier weighting in the energy sector and a lower weighting in the consumer sector, relative to its ETF peers. This fund also has a lower average market capitalization. Matthews India (MINDX) is an actively managed open-end fund that carries a Morningstar Analyst Rating of Bronze. This fund is heavy in consumer (which represent 27% of its portfolio) and industrial (18%) names and has no exposure to energy names. Those comfortable with the closed-end fund structure can consider India Fund (IFN) and Morgan Stanley India (IIF). Each fund has a 20-year track record.

India Funds	Inception	AUM $Mil	# of Hldgs	Avg Mkt Cap $Mil	Total Ret YTD	Morn Risk-Adj Ret 3 Yr	Morn Risk-Adj Ret 5 Yr	Annual Fee %
ETFs and ETNs								
WisdomTree India Earnings	2/22/08	2,020	231	12,890	28.4	-2.1	-5.3	0.83
iShares MSCI India	2/2/12	1,524	68	19,972	24.3	NA	NA	0.67
iShares India 50	11/18/09	707	54	21,948	27.5	1.7	NA	0.94
PowerShares India	3/5/08	550	52	20,095	25.4	0.0	-4.2	0.82
iPath MSCI India	12/19/06	374	0	19,972	25.6	0.9	-3.4	0.89
Actively Managed Open- and Closed-End Funds								
India Fund Inc Common	2/23/94	884	31	13,148	29.3	4.8	0.1	1.33
Matthews India	10/31/05	858	38	2,994	51.5	8.0	5.0	1.13
MS India Investment Common	2/25/94	433	49	9,067	35.3	7.2	0.9	1.29
Eaton Vance Greater India	5/2/94	275	39	12,946	32.9	0.2	-3.3	1.88
Wasatch Emerging India	4/26/11	46	71	1,933	34.5	9.0	NA	1.95

Return data through Sept. 30, 2014.

Taiwan

Taiwan is the world's largest supplier of contract computer-chip manufacturing services and is a major producer of LCD panels, DRAM computer memory, networking equipment, and consumer electronics. These technology companies account for a significant portion of Taiwan's economic output, and Taiwan-focused funds tend to have an average 50% weighting in the tech sector. The outlook for these tech companies is healthy. Gartner, in its latest worldwide devices forecast, said that it expects personal computers to grow at a low-single-digit rate over the next few years, driven by a refresh cycle. This is a reversal from the declines seen in recent years as PCs lost market share to tablets and mobile phones. Tablet unit sales are expected to continue rising, albeit slower than the 11% growth rate in 2014, and demand for mobile phones is expected to grow about 5% in 2015. We also note that some of Taiwan's largest tech companies, such as Taiwan Semiconductor (TSM) and Hon Hai, are key players in Apple's (AAPL) supply chain. In its fourth-quarter results, Apple said it is still seeing significant backlog for its new iPhones and expects strong sales in China. On the domestic front, the macroeconomic environment in Taiwan is stable. Manufacturing data remains positive, unemployment is falling, and Moody's said in August that the outlook for Taiwan's banking system remains stable.

There are four Taiwan-focused funds in our database. iShares MSCI Taiwan (EWT) tracks a market-cap-weighted index, whereas the First Trust and SPDR ETFs track fundamentally weighted indexes. The sector weightings of these three funds are similar, but the First Trust and SPDR ETFs are tilted toward mid-caps, relative to the iShares fund. There is one actively managed option: Taiwan Fund (TWN), which is a closed-end fund. However, in January 2014, the fund changed investment managers from Martin Currie/APS Asset Management to Allianz Global Investors.

Taiwan Funds	Inception	AUM $Mil	# of Hldgs	Avg Mkt Cap $Mil	Total Ret YTD	Morn Risk-Adj Ret 3 Yr	Morn Risk-Adj Ret 5 Yr	Annual Fee %
ETFs								
iShares MSCI Taiwan	6/20/00	3,045	106	14,712	7.1	8.0	3.3	0.61
First Trust Taiwan AlphaDEX	2/14/12	26	43	5,988	11.6	NA	NA	0.80
SPDR MSCI Taiwan Quality Mix	9/17/14	6	101	10,411	NA	NA	NA	0.40
Actively Managed Open- and Closed-End Funds								
Taiwan Fund Common	12/23/86	163	53	2,211	-2.1	4.7	3.5	1.96
GMO Taiwan III	10/4/02	157	48	5,113	7.4	6.1	4.6	1.39

Return data through Sept. 30, 2014.

Malaysia

As a smaller market, Malaysia is often overlooked, but it is home to many well-run firms exposed to positive growth trends. The country’s leaders have stated that their goal is for the economy is to reach "developed status" by the end of the decade. To achieve this, Prime Minister Najib Razak is dismantling subsidies, boosting education standards, and increasing his focus on attracting foreign investment. Malaysia already ranks favorably in the eyes of foreign investors--according to the World Bank’s Ease of Doing Business Survey, Malaysia ranked number 6, the highest among emerging-markets countries and higher than many developed countries. There is only one Malaysia-focused fund, iShares MSCI Malaysia (EWM). The banks (which account for about a third of the portfolio) have healthy balance sheets and many are now regional operators following acquisitions of smaller players in neighboring countries. In the medium term, these banks should benefit from the government's initiatives to turn Kuala Lumpur into a major financial center, particularly in the area of Islamic banking. Another important area of the Malaysian economy is the palm oil sector, as Malaysia is the world's largest exporter of palm oil. Palm oil plantations are owned primarily by conglomerates, which in this fund may be classified as industrial, consumer discretionary, or consumer staples firms, depending on their mix of business. Demand from China, weather, and global demand are key drivers for palm oil prices. Although this sector is very volatile, the stock prices of the publicly listed conglomerates that own palm oil plantations are less so thanks to their diverse mix of businesses.

Malaysia Fund	Inception	AUM $Mil	# of Hldgs	Avg Mkt Cap $Mil	Total Ret YTD	Morn Risk-Adj Ret 3 Yr	Morn Risk-Adj Ret 5 Yr	Annual Fee %
ETF								
iShares MSCI Malaysia	3/12/96	740	45	11,082	-0.1	NA	NA	0.51

Return data through Sept. 30, 2014.

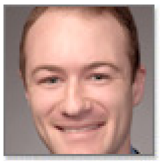
Investing has never been easy, and investing in emerging-markets equities can be particularly challenging. A category that is typically painted with broad brush strokes, the emerging-markets group is composed of more than 20 countries with very different economic environments, regulatory frameworks, and degrees of capital market development. Simple screens, such as P/E ratios and trailing return data, can serve as good starting points to gauge individual markets’ valuation and momentum, but a closer inspection is necessary, as it will often reveal a plethora of drivers, some expected and some unexpected. Those willing do a little homework may uncover interesting buying opportunities.

Perspective

Diversification Benefits of REITs

REITs look richly valued right now, but they have potential as a long-term diversifier and source of income.

November 5, 2014



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While real estate represents a significant portion of most homeowners' wealth, it rarely comes up in discussions about asset allocation. Instead, investors typically allocate their portfolios between stocks and bonds and determine their exposure to real estate primarily as a function of their housing needs. But a strategic allocation to real estate in a portfolio could make sense for investors seeking to improve diversification and generate income. Real estate investments share some characteristics with both bonds and stocks. A large portion of the returns on real estate come from rent payments, which are usually fixed in the short term, like a bond. Similar to stocks, real estate investments can appreciate in value and generate income growth, if market rents increase. Yet historically, the real estate market has exhibited low correlations with stocks and bonds, suggesting it can offer good diversification benefits.

A primary residence allows homeowners to save on rent and participate in any appreciation in local real estate values. But it is illiquid and undiversified and does not offer any income. Affluent individuals could purchase investment properties and rent them out to generate income, but without a very large asset base, it is difficult to get diversified exposure to the real estate market through direct ownership. Equity real estate investment trusts, or REITs, help solve this problem. These are publicly traded companies that own and manage income-generating real estate properties. While most REITs hold many properties, many focus on a narrow segment of the real estate market, such as shopping malls or health-care facilities. In order to further improve diversification, investors can hold a portfolio of REITs through a low-cost fund, like Vanguard REIT ETF (VNQ). As an added benefit, REITs offer much better liquidity than a direct investment in real estate because investors can trade small stakes in these trusts without triggering any transactions in the primary real estate market.

Despite their advantages, equity REITs appear to be more highly correlated with the stock market than physical investments in real estate. From 1978 through September 2014, the FTSE NAREIT All Equity REITs Index was 0.58 correlated with the S&P 500. That figure increased to 0.78 over the past decade, attributable in no small part to the subprime crisis. In contrast, the NCREIF Property Index, which measures the appraised value of commercial real estate properties each quarter, was only 0.09 correlated with the S&P 500 since 1978.

Part of that seeming low correlation is an illusion. Infrequent appraisals smooth out fluctuations in actual market values, which may artificially deflate the index's correlation with the stock market. They also cause the NCREIF Property Index to lag actual changes in real estate values. Even so, REITs do behave more like stocks than physical real estate investments. S&P started to include REITs in its equity indexes in October 2001, and they are now represented in most broad stock indexes. However, REITs only represent about 3.6% of the CRSP US Total Market Index.

REITs are required to distribute at least 90% of their income to investors, which allows them to avoid paying corporate taxes and gives them higher yields than most stocks. The bad news is that most of their distributions are taxed as ordinary income. Because REITs distribute such a large share of their income, they may be more likely to cut their distributions than other firms if business sours. However, high payout rates don't tell the whole story. Net income includes depreciation charges that often exceed the economic depreciation of REITs' assets. As a result, REITs' cash flows often exceed their accounting income, so some may still have a bit of a cushion to support their distributions even if income falls.

Unlike many other income-oriented assets, REITs are not defensive assets with a low risk profile. They represent a leveraged claim on real estate assets, which amplifies the effect of fluctuating real estate values on their prices. This idea should be familiar to homeowners. For example, suppose a homeowner puts a $50,000 down payment on a $200,000 house and borrows the rest. If the value of the house increases 10% to $220,000, the return on the homeowner's equity is 40% (ignoring interest and additional equity paid in) because the amount the owner needs to repay is fixed. This same "leveraging effect" works in reverse if prices fall. Because REITs generally own properties that are largely financed with debt, they can experience large swings in value from small changes in property values.

This may explain why the FTSE NAREIT All Equity REITs Index was about 4 times more volatile than the NCREIF Property Index from 1978 through September 2014. However, part of this difference is due to the appraisal smoothing effect that understates the true volatility of the property values in the NCREIF index. During that time, the FTSE NAREIT All Equity REITs Index was also slightly more volatile than the S&P 500.

Investors have been rewarded for accepting this risk. From 1972 through September 2014, the FTSE NAREIT All Equity REITs Index generated a 12% annualized return, while the S&P 500 posted 10.5%. Not surprisingly, almost two thirds of the REIT index's return came from distributions, which are largely derived from rental income. Investors should have modest expectations for capital gains. Over the very long term, commercial real estate values should not grow faster than their potential occupants' sales, while residential real estate prices should not exceed household income growth. Faster growth requires real estate buyers to finance an ever greater portion of their purchases with debt. While debt-fueled growth can last for multiple decades, it is ultimately unsustainable. Debt financing allows REITs to parlay modest capital gains into attractive returns. But rental income will likely continue to generate a significant portion of their total returns.

Despite their tie to property values and rents, REITs have generally not been a good hedge against inflation in the short term. The FTSE NAREIT All Equity REITs Index's rolling three-year returns were only 0.13 correlated with changes in the Consumer Price Index since December 1972. Investors concerned about inflation may be better off in Treasury Inflation-Protected Securities, which offer a more direct hedge against inflation.

Given the importance of debt to the real estate market, it seems logical that REITs should be sensitive to changes in long-term interest rates. Rising interest rates can increase REITs' debt financing costs if they rely on floating-rate debt or need to issue new debt. Higher rates can make real estate more expensive to prospective buyers, which may reduce the prices they are willing to pay. Real estate valuations can also fall because higher rates reduce the present value of the cash flows a property will likely generate in the future. These effects work in reverse if rates fall. But interest rates don't change in isolation. They tend to increase as the economy strengthens, which often coincides with rising rents and real estate prices.

In order to assess the net effect of changing interest rates on REITs' performance, I ran a regression analysis. I used the equity market risk premium and monthly changes in the 10-year treasury rate from 1972 through September 2014 to explain the returns of the FTSE NAREIT All Equity REITs Index over T-bills. It turned out that there was no significant relationship between changes in the 10-year Treasury rate and the performance of the REIT index over the full period. However, that has changed over the past decade. During that span, the FTSE NAREIT All Equity REITs Index declined in value by 3.8% for each percentage-point increase in the 10-year Treasury rate (and vice versa), controlling for its exposure to the stock market. This suggests that interest-rate risk is important to monitor. If interest rates tick up significantly, without a corresponding improvement in the economy, it could hurt REITs' performance.

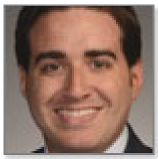
Investors should also be cautious about the relatively high valuations U.S. REITs now command. The 15 holdings in VNQ that Morningstar's equity analysts cover have an average price/fair value multiple of 1.12 (1.14 on an asset-weighted basis) as of this writing. At the end of September, the fund's holdings were trading at 33.8 times forward earnings, nearly twice the corresponding figure for the CRSP US Total Market Index (17.4). But as a result of their asset-laden balance sheets, they look slightly cheaper relative to book value.

High valuations and interest-rate risk are good reasons not to immediately overweight REITs. However, they can offer good diversification benefits over the long run. Rising interest rates could cause valuations to recede and offer investors an opportunity to reap these benefits more cheaply. If nothing else, REITs are worth watching.

ETF Spotlights

Spotlighting Currency-Hedged Europe & Emerging Markets Bonds

Morningstar analyst insight, plus two complimentary full-length ETF research reports.



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WisdomTree Europe Hedged Equity ETF HEDJ

This ETF's currency hedging can protect investors if the euro weakens relative to the U.S. dollar and reduces volatility. Moreover, the fund's focus on dividend-paying stocks gives investors exposure to quality holdings.

While the valuations of the fund's holdings currently look attractive, continued risk in the eurozone can continue to weaken valuations. The fund's unique strategy screens for dividend-paying stocks that trade in the Eurozone, but generate at least half of their revenues outside of Europe. As a result, the fund may be a suitable core position for U.S. investors looking to profit from a potential rebound in the eurozone, while limiting currency and region-specific risk.

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iShares JPMorgan USD Emerging Markets Bond EMB

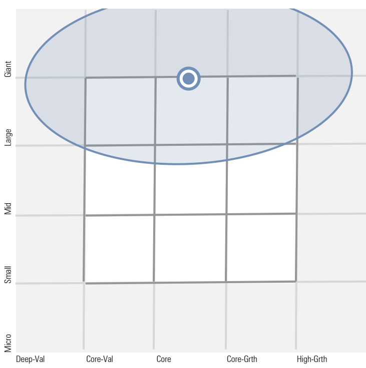
The U.S. dollar has been rising and likely will remain strong in the medium term, thanks to a relatively healthier U.S. economy and the expectation that the U.S. will normalize its monetary policy before the eurozone and Japan. In a strong U.S. dollar environment, investors considering emerging-markets bonds to diversify their portfolios may want to focus on funds that invest in U.S. dollar-denominated sovereign debt, such as iShares J.P. Morgan USD Emerging Markets Bond (EMB) or PowerShares Emerging Markets Sovereign Debt ETF (PCY), both of which are currently yielding above 4%. While a strong U.S. dollar makes it more expensive for emerging-markets sovereigns to repay their dollar-denominated debt, we note that for the most part, emerging-markets countries have ample foreign reserves. In addition, most emerging-markets countries' U.S. dollar debt is nowhere near levels seen in the mid-1990s--at that time, high levels of U.S. dollar-denominated debt helped contribute to the Asian financial crisis.

WisdomTree Europe Hedged Equity ETF HEDJ

Morningstar Rating™
★★★★

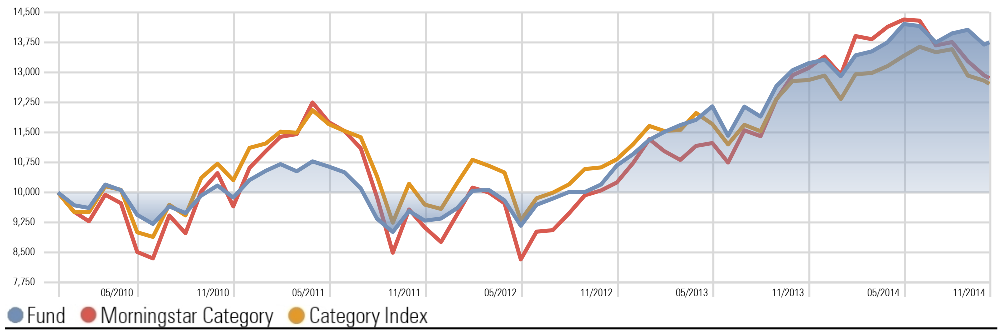
Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Europe Stock	MSCI ACWI Ex USA NR USD	WisdomTree Europe Hedged Equity TR USD

Style Map



Performance

Time Period: 01/01/2010 to 10/11/2014



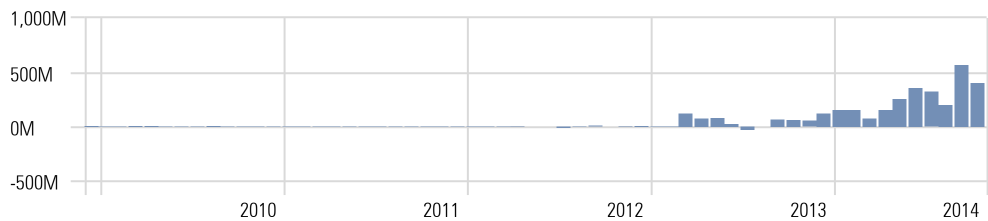
Snapshot

Inception Date	31/12/2009
Expense Ratio %	0.58
Assets (millions)	3,757
Avg Dly Vol (3 Mo)	1,053,652
12 Month Yield %	1.73
Portfolio Date	11/11/2014
Distribution Freq	Quarterly
ETN	No
Replication Method	Physical-Sample
Fund Lgl Structure	Open Ended Investment Company

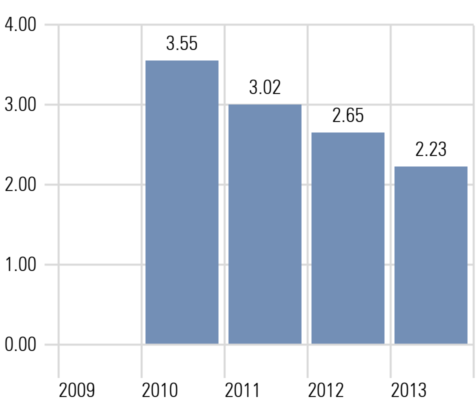
Annual Returns %

	2009	2010	2011	2012	2013	YTD
WisdomTree Europe Hedged Equity ETF	—	3.12	-9.30	17.18	21.51	3.24
MSCI ACWI Ex USA NR USD	41.45	11.15	-13.71	16.83	15.29	-1.59
US ETF Europe Stock	44.99	6.15	-17.42	22.48	24.76	-4.02

Monthly Fund Flows (millions)



Annual Income Return %



Risk/Return Analysis (3 years)

	ETF	Cat Index	Cat Avg
Standard Deviation %	10.66	13.23	15.20
Arithmetic Mean %	1.06	0.70	0.94
Sharpe Ratio	1.18	0.63	0.76
R-Squared	65.91	—	81.48
Beta	0.65	—	1.04
Alpha %	7.18	—	2.64
Treynor Ratio	19.50	—	10.62
Sortino Ratio	1.99	0.94	1.23

Suitability

By Thomas Boccellari 09/10/2014

Despite the risks they face, eurozone stocks may offer good diversification benefits to U.S. investors. However, currency risk is a very real threat. Low to negative interest rates across the eurozone, coupled with lackluster growth, could cause the euro to weaken relative to the U.S. dollar. WisdomTree Europe Hedged Equity ETF HEDJ offers investors a way to gain exposure to European stocks, while hedging this currency risk.

But even after taking most of the currency risk out of the equation, European stocks still face considerable risks amid a backdrop of weak demand and economic uncertainty across the eurozone. This may explain why most broad European stock indexes are trading at a discount to their U.S. counterparts. However, this macroeconomic risk may present investors with an opportunity to buy quality multinational names that happen to be based in the eurozone at reasonable valuations. This fund attempts to offer exposure to these types of stocks. It screens for dividend-paying stocks trading in the eurozone that generate more than half of their revenues outside of Europe. It then weights its holdings by cash dividends paid. This may be a suitable core position for U.S. investors looking to profit from a potential rebound in the eurozone, while limiting currency and region-specific risk.

The fund’s dividend screening and weighting approach helps keep volatility low. Because the fund screens for stocks that pay cash dividends, more mature and stable companies anchor the portfolio. This, along with the fund’s currency-hedging program and focus on global companies, can significantly reduce volatility. For instance, the fund’s standard deviation of returns (9.9%) since August 2012, when it adopted its current index, was considerably less than the non-currency-hedged, market-cap-weighted MSCI EMU Index’s (14.5%).

WisdomTree Europe Hedged Equity ETF HEDJ

Morningstar Rating™
★★★★

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Europe Stock	MSCI ACWI Ex USA NR USD	WisdomTree Europe Hedged Equity TR USD

Fundamental View

The eurozone continues to suffer from structural problems. On Oct. 7, the International Monetary Fund cut its 2015 global growth because of troubles in Europe. Inflation, currently an anemic 0.3%, continues to trend lower month-over-month. The amount available for bank lending has fallen significantly and stunted growth, and poor manufacturing and service demand has kept unemployment in excess of 11%.

However, this fund's focus on multinational companies helps limit its exposure to the European economy. Its focus on dividend-payers also helps reduce volatility, giving investors exposure to a portfolio of companies with relatively stable businesses and good profitability. For instance, over the trailing 12 months through September, the fund's holdings generated a higher return on invested capital (10.2%) than the broad market-cap-weighted eurozone MSCI EMU Index (9.2%). Dividends constrain managers' ability to invest in low return projects or make acquisitions and tend to be associated with shareholder-friendly management teams. Many of the fund's holdings are well-regarded household names, such as Anheuser-Busch InBev BUD and L'Oreal SA LOR.

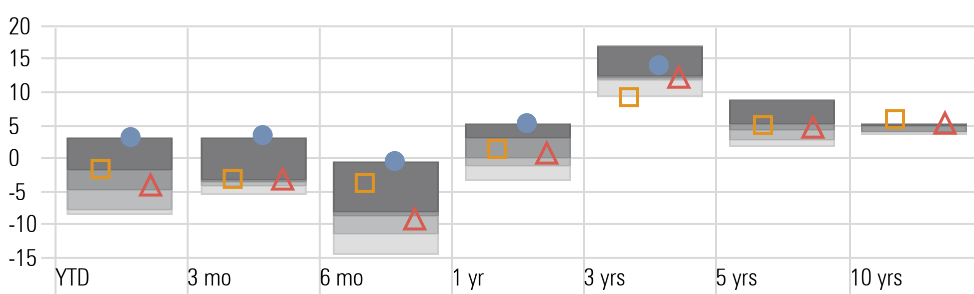
However, this quality orientation comes at a price. At the end of September, the fund's price-to-forward earnings multiple (17.0) was slightly higher than MSCI EMU Index's (16.2).

The fund is not without its risks, however. Because the fund does not employ a dividend-quality screen, there is a risk that the fund's holdings can cut their dividend during periods of economic turmoil. This could hurt the fund's performance because of the negative message that dividend cuts signal.

Trailing Returns Relative to Peer Group %

Peer Group (5-95%): Exchange Traded Funds - U.S. - Europe Stock

Top Quartile 2nd Quartile 3rd Quartile Bottom Quartile



Fund Morningstar Category Category Index

	YTD	3 mo	6 mo	1 yr	3 yrs	5 yrs	10 yrs
WisdomTree Europe Hedged Equity ETF	3.24	3.74	-0.21	5.53	14.13	—	—
MSCI ACWI Ex USA NR USD	-1.59	-3.14	-3.55	1.50	9.35	5.10	6.19
US ETF Europe Stock	-4.02	-2.89	-8.88	0.85	12.40	4.84	5.36

Morningstar Fundamental Analysis

Fair Value Estimate	57.41
Valuation Rating	—
Price/Fair Value	0.99
# of Holdings Covered	50
# of Holdings	125

Economic Moat %

Wide Moat	23.05
Narrow Moat	40.44
No Moat	12.90

Fundamental Ratios

	ETF	Cat Index	Cat Avg
Net Margin %	8.62	14.32	10.69
Return on Equity %	14.99	15.61	15.64
Return on Assets %	5.17	6.00	6.03
Debt to Capital %	35.18	31.93	35.19

Value and Growth Measures

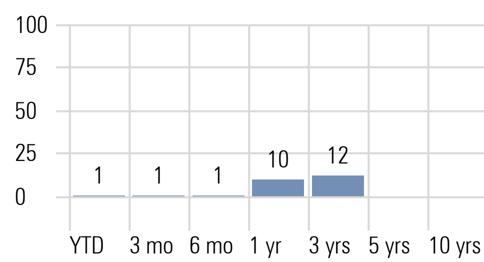
	ETF	Cat Index	Cat Avg
Price/Proj. Earnings	17.33	14.79	16.21
Price/Book	1.87	1.57	1.65
Price/Sales	0.99	1.05	0.97
Price/Cash Flow	10.30	8.35	9.04
LT Earnings Growth %	9.23	10.85	8.85
Sales Growth %	2.27	-16.40	-5.83
Cash Flow Growth %	-2.68	2.71	-11.11
Book Value Growth %	1.49	-19.90	-3.19

Market Performance Statistics

Time Period: 01/01/2010 to 10/11/2014

	ETF	Cat Index	Cat Avg
Up Capture Ratio %	81.27	100.00	120.24
Down Capture Ratio %	78.56	100.00	120.95
Max Drawdown %	-19.95	-27.46	-34.29
Max Gain %	66.19	61.49	81.13
Best Month %	6.38	10.53	13.50
Worst Month %	-7.50	-11.36	-14.34

Total Return Percentile Rank in Category



WisdomTree Europe Hedged Equity ETF HEDJ

Morningstar Rating™
★★★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Europe Stock	MSCI ACWI Ex USA NR USD	WisdomTree Europe Hedged Equity TR USD

Portfolio Construction

The fund tracks the WisdomTree Europe Hedged Equity Index, which offers concentrated exposure to more than 100 dividend-paying large- and mid-cap stocks in developed Europe. The index weights its holdings by annual cash dividends paid. Individual security weights are capped at 5%, while sector and country weights are capped at 25%. To qualify for inclusion in the index, each stock must be domiciled in the eurozone, trade in euros, have a market cap in excess of $1 billion, and derive at least 50% of its revenue outside Europe. The fund uses forward currency contracts and futures to hedge euro exposure.

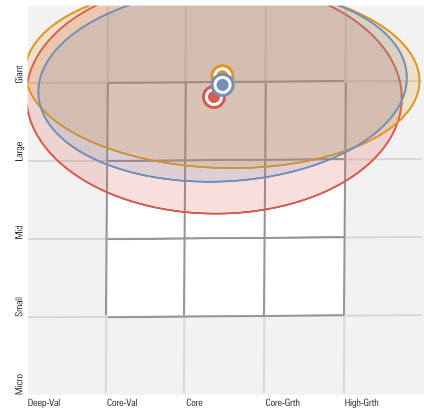
Relative to the MSCI EMU Index, the fund offers greater exposure to consumer defensive, consumer cyclical, and industrials and less exposure to financial services, utilities, and energy sectors. The index is rebalanced annually in June. France (24.8%), Germany (24.7%), and Spain (19.9%) are the fund's largest country weightings.

The fund changed its strategy and benchmark at the end of August 2012. The previous strategy focused on a currency-hedged portfolio of broad-based, dividend-paying, developed international stocks. After the switch, the index changed its focus from developed international stocks to countries in the eurozone that derive most of their revenue outside of the eurozone.

	ETF	Cat Index	Cat Avg
Avg Market Cap (mil)	40,152	30,645	30,713
12 Month Yield %	1.73	—	—
Market Price	56.99	196.33	—

	ETF	Cat Index	Cat Avg
Turnover Ratio %	28.00	—	14.74
% Asset in Top 10	45.31	9.20	16.18
# of Holdings	125	1,829	703

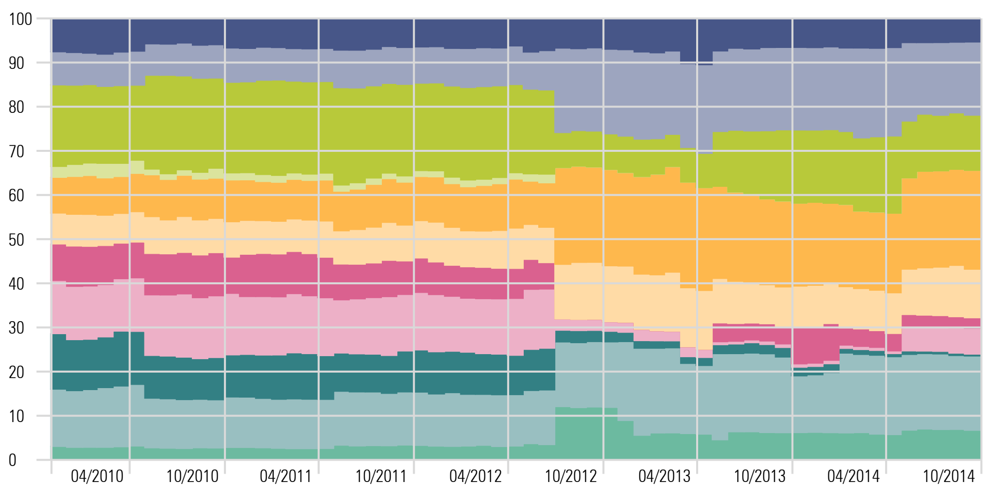
Holdings Based Style Map



Market Cap %

	ETF	Cat Index	Cat Avg
Giant	60.67	56.91	51.90
Large	27.84	33.42	26.30
Mid	10.68	9.56	17.58
Small	0.82	0.10	3.64
Micro	0.00	0.01	0.58

Equity Sector Breakdown History



Current Equity Sector Breakdown %

	ETF	Cat Index	Cat Avg
Basic Materials	—	—	—
Consumer Cyclical	—	—	—
Financial Services	—	—	—
Real Estate	—	—	—
Consumer Defensive	—	—	—
Healthcare	—	—	—
Utilities	—	—	—
Communication Services	—	—	—
Energy	—	—	—
Industrials	—	—	—
Technology	—	—	—

Top 10 Holdings

Portfolio Date: 11/11/2014

	Ticker	Portfolio Weighting %
Anheuser-Busch Inbev SA	ABI	6.52
Telefonica SA	TEF	5.89
Banco Bilbao Vizcaya Argentaria SA	BBVA	5.00
Unilever NV DR	UNA	4.50
Sanofi	SAN	4.46
Banco Santander SA	SAN	4.40
Daimler AG	DAI	4.05
Siemens AG	SIE	4.01
Bayer AG	BAYN	3.46
L'Oreal SA	OR	3.01

Equity Region %

	ETF	Cat Index	Cat Avg
North America	—	—	—
Latin America	—	—	—
Japan	—	—	—
Australasia	—	—	—
Asia Developed	—	—	—
Asia Emerging	—	—	—
United Kingdom	—	—	—
Europe Developed	—	—	—
Europe Emerging	—	—	—
Africa/Middle East	—	—	—

WisdomTree Europe Hedged Equity ETF HEDJ

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★★★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Europe Stock	MSCI ACWI Ex USA NR USD	WisdomTree Europe Hedged Equity TR USD

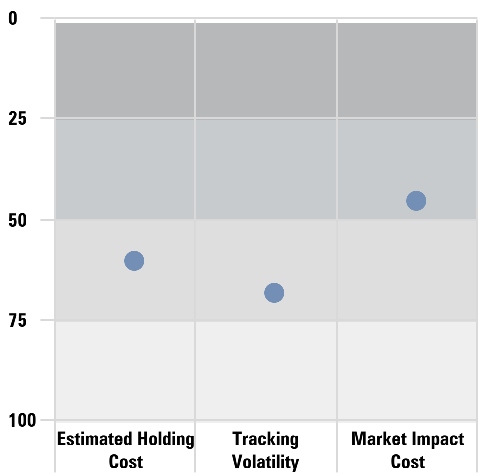
Fees

The fund's 0.58% expense ratio is not the lowest in the Europe stock exchange-traded fund category or even the lowest currency-hedged European ETF. Over the trailing three years through August, the fund has lagged its benchmark by 0.48%, slightly less than the amount of its expense ratio.

Expenses

	ETF	Cat Avg
Gross Expense Ratio %	0.58	0.48
Net Expense Ratio %	0.58	0.43
Expense Waiver	—	—
Expense Waiver Expiration Date	—	—
Expense Waiver Type	—	—
Prospectus Date	01/08/2014	—

Percentile Rank Relative to ETF Universe



Total Cost Analysis Data Points

Estimated Holding Cost %	0.40
Tracking Volatility %	0.55
Market Impact Cost %	0.02

Estimated Holding Cost is essentially the difference between the ETF return and the benchmark return and represents the realized cost of replicating the benchmark. Lower costs indicate that the ETF is doing a better job of matching its benchmark while minimizing costs.

Tracking Volatility measures the uncertainty with which an ETF tracks a benchmark. A higher tracking error indicates a wider confidence interval for expected performance around the benchmark. Lower numbers and ranks are better.

Market Impact Cost represents the liquidity of the ETF and is based on the average market price movement in percent caused by a $100,000 trade in the ETF. Calculated as the residual volatility unexplained by movements in NAV and the previous day's premium or discount, scaled by average dollar volume traded. Lower numbers and ranks are better.

Alternatives

Deutsche X-trackers MSCI Europe Hedged Equity DBEU (0.45% expense ratio) offers currency-hedged exposure to Europe. Unlike HEDJ, DBEU weights its holdings by market cap and uses the broader MSCI Europe Index that includes non-eurozone countries such as the United Kingdom and Switzerland.

Investors looking for a less expensive European ETF may consider Vanguard FTSE Europe ETF VGK (0.12% expense ratio). Unlike HEDJ, VGK does not hedge its currency risk. This fund weights by market cap and includes stocks in Switzerland and the United Kingdom.

Operations

Longest Tenured Manager	Multiple
Manager Tenure (Longest)	4.92
Manager Tenure (Average)	4.92
Exchange	NYSE ARCA
Web Address	www.wisdomtree.com

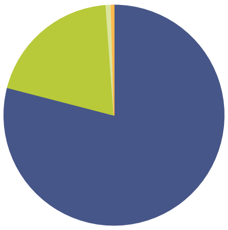
iShares JPMorgan USD Emerg Markets Bond EMB

Morningstar Rating™
★★★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Emerging Markets Bond	Barclays US Agg Bond TR USD	JPM EMBI Global Core TR USD

Fixed Income Asset Allocation

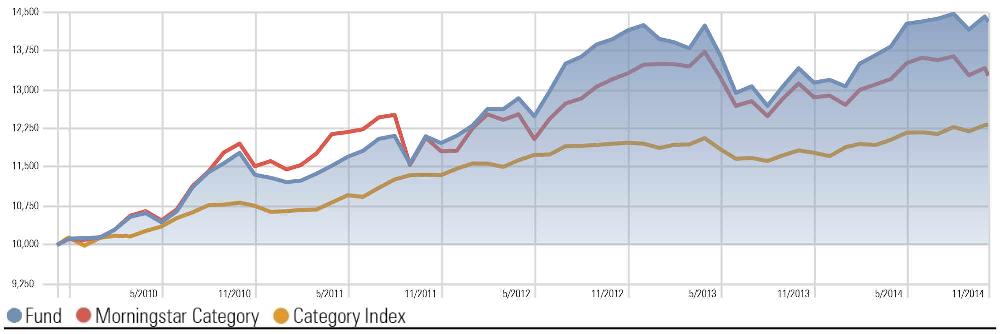
Portfolio Date: 10/31/2014



	%
Government	79.0
Municipal	0.0
Corporate	19.8
Securitized	0.8
Cash & Equivalents	0.4
Derivative	0.0

Performance

Time Period: 11/8/2009 to 11/7/2014



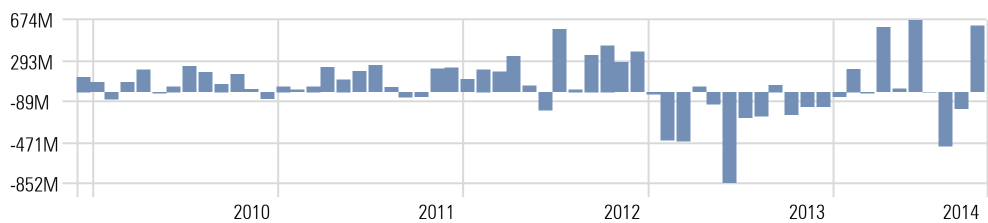
Snapshot

Inception Date	12/17/2007
Expense Ratio %	0.60
Assets (millions)	5,096
Avg Dly Vol (3 Mo)	891,101
12 Month Yield %	4.24
Portfolio Date	11/10/2014
Distribution Freq	Monthly
ETN	No
Replication Method	Physical-Sample
Fund Lgl Structure	Open Ended Investment Company

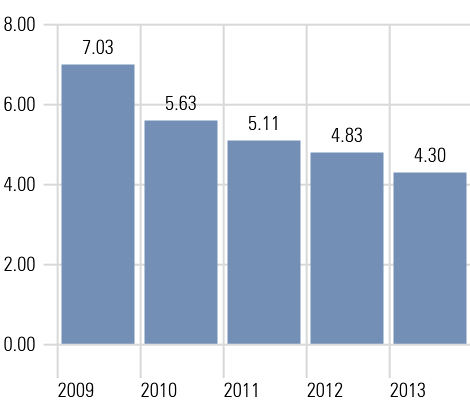
Annual Returns %

	2009	2010	2011	2012	2013	YTD
iShares JPMorgan USD Emerg Markets Bond	27.20	11.47	7.20	17.64	-7.42	8.50
Barclays US Agg Bond TR USD	5.93	6.54	7.84	4.21	-2.02	5.20
US ETF Emerging Markets Bond	30.25	15.08	1.73	14.05	-4.43	3.03

Monthly Fund Flows (millions)



Annual Income Return %



Risk/Return Analysis (3 Years)

	ETF	Cat Index	Cat Avg
Standard Deviation %	7.72	2.70	7.72
Arithmetic Mean %	0.51	0.23	0.26
Sharpe Ratio	0.79	0.99	0.55
R-Squared	42.91	—	23.08
Beta	1.87	—	1.38
Alpha %	1.09	—	-0.68
Treynor Ratio	3.19	—	4.88
Sortino Ratio	1.21	1.66	0.84

Suitability

By Patricia Oey 10/6/2014

IShares J.P. Morgan USD Emerging Markets Bond EMB is suitable for use as a satellite holding within a diversified fixed-income allocation. This fund tracks an index composed of U.S. dollar-denominated debt issued by emerging-markets sovereigns.

U.S. dollar-denominated emerging-markets bonds have historically exhibited low correlations to U.S. bonds. This is due to the fact that emerging-markets sovereign bonds carry credit risk, whereas U.S. Treasuries are "risk free." During the past five years, the correlation between EMB's benchmark index and the Barclays U.S. Aggregate Bond Index has been 0.47.

EMB only holds U.S.-dollar-denominated bonds. As such, it does not have any direct foreign-currency exposure. Some investors may prefer to invest in local-currency bonds, which can provide more diversification through exposure to local rate trends and foreign currency. This foreign-currency exposure can provide a boost if emerging-markets currencies appreciate against the U.S. dollar, and it can be a downer if they slide versus the greenback. In addition, local-currency debt tends to carry higher credit ratings, relative to hard-currency debt. This is because it can be difficult for countries with weak fundamentals to issue local-currency bonds, and as a result tend to issue hard-currency debt. At this time, the average credit rating for the issues in this ETF's portfolio is BB. During the last few years, this fund's yield has fluctuated between 4% and 5%.

Relative to U.S. bonds, U.S. dollar-denominated emerging-markets bonds are more volatile, and therefore may not be suitable for those who use their fixed-income allocation as portfolio ballast. During the last three years, the standard deviation of monthly returns for the Barclays U.S. Aggregate Bond Index was 2.8% versus 7.4% for EMB. Emerging-markets bonds have enjoyed an uptick in interest among foreign investors during the last few years given issuers' relatively healthy fundamentals and higher yields. As a result, the asset class is now more sensitive to developments in the global macroeconomic environment and fund flows from overseas. A spike in global volatility or deteriorating fundamentals in emerging markets can quickly trigger sudden portfolio outflows. Capital flight will negatively impact the short-term performance of emerging-markets bonds and this exchange-traded fund.

iShares JPMorgan USD Emerg Markets Bond EMB

Morningstar Rating™
★★★★

Morningstar Category	**Category Index**	**Prospectus Benchmark**
US ETF Emerging Markets Bond	Barclays US Agg Bond TR USD	JPM EMBI Global Core TR USD

Fundamental View

Emerging-markets credit profiles have improved significantly during the last 20 years. After the crises of the 1990s in Latin America, Asia, and Russia, many countries implemented sound fiscal and monetary policies and now have average debt/GDP levels that are lower than those within the developed world. Other positive trends include a stable growth outlook, high levels of foreign reserves, greater central bank independence, and flexible currency regimes.

The sovereign debt crisis in Europe and aggressive quantitative easing in the U.S. and other developed nations have led some investors to re-evaluate the creditworthiness of these countries. Many developed nations continue to sport solid credit ratings despite having lofty debt levels and anemic growth. Meanwhile, many emerging markets still have relatively lower credit ratings despite the fact that they have relatively low debt levels and comparatively better growth prospects. There is growing belief that, despite emerging-markets sovereigns' lower credit ratings, they may actually be better long-term credit risks. So while this fund's average credit rating is borderline investment grade, the actual credit risk of this fund's constituents may actually be better than what their ratings suggest.

Thanks to improving fundamentals and relatively higher yields in emerging markets, demand for emerging-markets debt has skyrocketed during the last few years. In the five years leading up to the 2008 financial crisis, flows into U.S.-listed emerging-markets debt funds (which include both mutual funds and ETFs) averaged around $1 billion a year. In 2010 and 2011, this figure jumped to $15 billion a year, followed by a record $28 billion in 2012. Strong growth in supply (new bond issuance) and demand (rising allocations) are positive, long-term trends for emerging-markets issuers. However, the downside to these trends is that emerging-markets bonds are now more susceptible to global sentiment. In 2013, concerns about the impact of the tapering of the U.S. Federal Reserve's asset-purchase program on the emerging markets resulted in a flare-up in volatility and average declines of 7% across emerging-markets bond funds in 2013.

As is the case with all bond funds, rising interest rates are a risk to this ETF. EMB's portfolio duration (a measure of interest-rate sensitivity) as of this writing was seven years, which is higher than the Barclays U.S. Aggregate Bond Index’s five years. EMB's portfolio duration of seven years implies that--all else equal--for every 1 percentage point increase in rates, this fund's value is expected to decline about 7%.

Fund Credit Quality

	ETF	Cat Avg
AAA %	0.00	6.28
AA %	4.66	4.20
A %	15.98	18.38
BBB %	45.83	43.05
BB %	9.08	12.66
B %	6.03	7.90
Below B %	8.38	2.99
Not Rated %	10.05	4.54

Coupon Range

	ETF	Cat Avg
0 to 1 %	0.00	3.12
1 to 2 %	1.55	0.54
2 to 3 %	2.74	1.78
3 to 4 %	7.57	4.77
4 to 5 %	14.71	8.39
5 to 6 %	21.85	18.94
6 to 7 %	22.21	18.85
7 to 8 %	16.63	18.60
8 to 9 %	4.94	8.43
9 to 10 %	2.41	7.17
10 to 11 %	1.51	0.99
11 to 12 %	1.15	1.16
12 to 15 %	0.84	0.56
15+ %	0.00	0.23

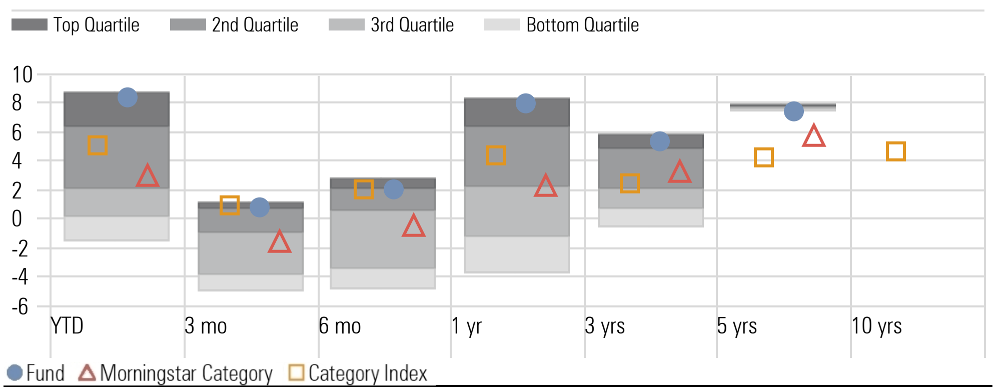
Market Performance Statistics

Time Period: 12/18/2007 to 11/7/2014

	ETF	Cat Index	Cat Avg
Up Capture Ratio %	21.08	100.00	12.54
Down Capture Ratio %	-5.86	100.00	-12.00
Max Drawdown %	-30.90	-5.08	-30.88
Max Gain %	127.42	41.19	119.34
Best Month %	8.59	3.73	8.93
Worst Month %	-15.26	-2.36	-17.49

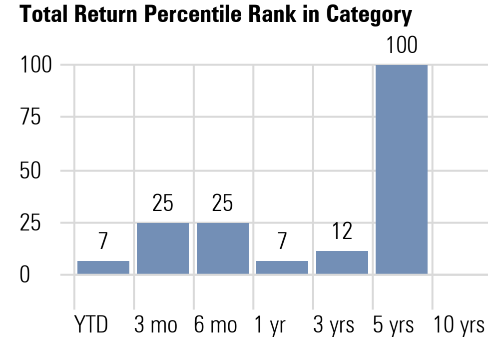
Trailing Returns Relative to Peer Group %

Peer Group (5-95%): Exchange Traded Funds - U.S. - Emerging Markets Bond



	YTD	3 mo	6 mo	1 yr	3 yrs	5 yrs	10 yrs
iShares JPMorgan USD Emerg Markets Bond	8.50	0.83	2.11	7.97	5.48	7.44	—
Barclays US Agg Bond TR USD	5.20	0.95	2.05	4.46	2.59	4.27	4.70
US ETF Emerging Markets Bond	3.03	-1.42	-0.39	2.45	3.33	5.83	—

Total Return Percentile Rank in Category



iShares JPMorgan USD Emerg Markets Bond EMB

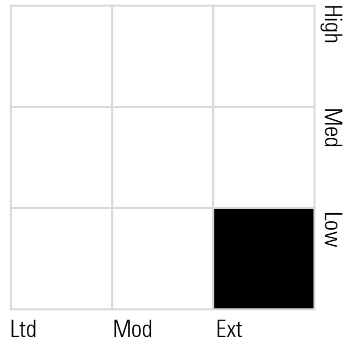
Morningstar Rating™
★★★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Emerging Markets Bond	Barclays US Agg Bond TR USD	JPM EMBI Global Core TR USD

Portfolio Construction

This fund tracks the J.P. Morgan Emerging Market Bond Index Global Core Index. This index reflects the total return of U.S. dollar-denominated bonds issued by emerging-markets countries, subject to certain liquidity requirements. At this time, there are 28 countries in the index. Eligible securities must be denominated in U.S. dollars, issued by sovereign entities, have a current face amount of $1 billion or more, and have at least two and a half years remaining until maturity. The index is market-capitalization-weighted, so countries with higher levels of debt outstanding receive correspondingly larger allocations in the fund. However, the index does employ country constraints to ensure diversification and to moderate exposure to the most heavily indebted countries. Unlike market-cap-weighted emerging-markets equity indexes, hard-currency emerging-markets bond indexes do not have very large country concentration. The five largest countries represented in the portfolio account for 25% of its assets (which each country accounting for about 5%), while the top 10 countries account for half. The index, and hence the fund, are rebalanced monthly. Distributions are paid monthly.

Morningstar Fixed Income Style Box™

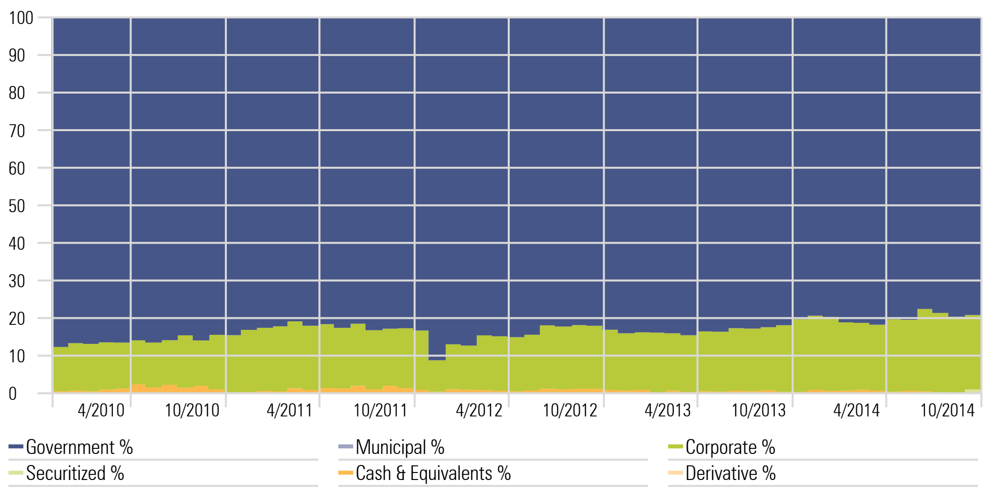


Fixed Income Portfolio Statistics

	ETF	Cat Avg
Average Eff Duration (yrs)	7.14	5.90
Average Eff Maturity (yrs)	—	9.28
Average Coupon %	6.15	6.46
Average Price	—	—
Average Credit Quality	BB	BB

	ETF	Cat Avg		ETF	Cat Avg
Yield to Maturity %	4.77	5.67	Turnover Ratio %	32.00	33.42
12 Month Yield %	4.24	5.34	% Asset in Top 10	10.50	12.19
SEC Yield %	4.60	—	# of Holdings	273	845

Fixed Income Super Sector Breakdown History



Current Fixed Income Sub Sector Breakdown

	ETF	Cat Avg
Government %	—	—
Government Related %	—	—
Municipal Taxable %	—	—
Municipal Tax-Exempt %	—	—
Bank Loan %	—	—
Convertible %	—	—
Corporate Bond %	—	—
Preferred Stock %	—	—
Agency Mortgage-Backed %	—	—
Non-Agency Residential MBS %	—	—
Commercial Mortgage-Backed %	—	—
Covered Bond %	—	—
Asset-Backed %	—	—
Cash & Equivalents %	—	—

Top 10 Holdings

Portfolio Date: 11/10/2014

	Maturity Date	Portfolio Weighting %
Russian Federation 7.5%	3/31/2030	1.75
Poland Rep 6.375%	7/15/2019	1.24
Republic Of Argentina Sr Unsecured 12/33 8.28	12/31/2033	1.11
Peru Rep 8.75%	11/21/2033	1.05
Romania Medium Term Nts Reg S 6.75%	2/7/2022	0.98
Petronas Cap 5.25%	8/12/2019	0.96
State Treas Republic Poland 5%	3/23/2022	0.91
Peru Rep 7.35%	7/21/2025	0.85
Ivory Coast Sr Unsecured Regs 12/32 Var	12/31/2032	0.82
Lithuania T. Bond Sr Unsecured Regs 0	2/11/2020	0.82

Bond Maturity Breakdown

	ETF	Cat Avg
1 to 3 Years %	—	—
3 to 5 Years %	—	—
5 to 7 Years %	—	—
7 to 10 Years %	—	—
10 to 15 Years %	—	—
15 to 20 Years %	—	—
20 to 30 Years %	—	—
30+ Years %	—	—

iShares JPMorgan USD Emerg Markets Bond EMB

Morningstar Rating™
★★★★

Morningstar Category	Category Index	Prospectus Benchmark
US ETF Emerging Markets Bond	Barclays US Agg Bond TR USD	JPM EMBI Global Core TR USD

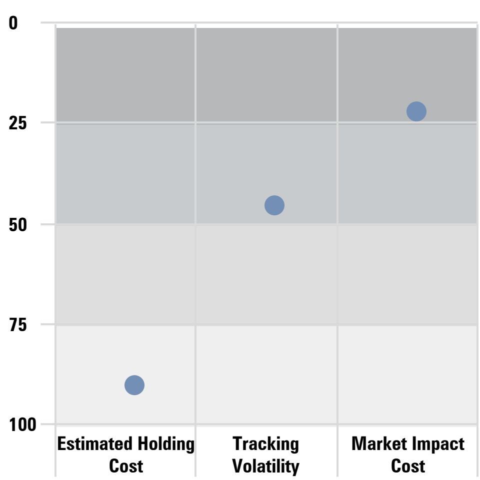
Fees

This fund levies an annual expense ratio of 0.60%, which is slightly higher than its closest competitor. With assets above $4 billion and average daily trading volume of around $90 million, EMB offers substantial liquidity.

Expenses

	ETF	Cat Avg
Net Expense Ratio %	0.60	0.52
Expense Waiver	—	—
Expense Waiver Expiration Date	—	—
Expense Waiver Type	—	—
Prospectus Date	10/10/2014	—

Percentile Rank Relative to ETF Universe



Total Cost Analysis Data Points

Estimated Holding Cost %	0.94
Tracking Volatility %	0.17
Market Impact Cost %	0.00

Estimated Holding Cost is essentially the difference between the ETF return and the benchmark return and represents the realized cost of replicating the benchmark. Lower or even negative costs indicate that the ETF is doing a better job of matching its benchmark while minimizing costs.

Tracking Volatility measures the uncertainty with which an ETF tracks a benchmark. A higher tracking error indicates a wider confidence interval for expected performance around the benchmark. Lower numbers and ranks are better.

Market Impact Cost represents the liquidity of the ETF and is based on the average market price movement in percent caused by a $100,000 trade in the ETF. Calculated as the residual volatility unexplained by movements in NAV and the previous day's premium or discount, scaled by average dollar volume traded. Lower numbers and ranks are better.

Alternatives

EMB's chief rival is PowerShares Emerging Markets Sovereign Debt PCY, which charges an annual expense ratio of 0.50%. This fund tracks an enhanced index, which seeks to select up to three liquid bonds from each emerging-markets country that are likely to generate excess return relative to bonds with similar attributes. Overall, EMB and PCY tend to have similar yields and durations, and during the past five years, their correlation in returns was 98%.

The three largest ETFs offering exposure to local-currency-denominated emerging-markets debt are WisdomTree Emerging Markets Local Debt ELD, Market Vectors Emerging Market Local Currency Bond EMLC, and iShares Emerging Markets Local Currency Bond LEMB. These funds charge respective annual expense ratios of 0.55%, 0.47%, and 0.60%. These funds have somewhat different country weightings, as each employs its own set of portfolio construction rules. The iShares fund has a relatively concentrated portfolio, with South Korean and Brazilian securities accounting for 22% and 17% of the portfolio, respectively.

Management

Longest Tenured Manager	Scott Radell
Manager Tenure (Longest)	4.33
Manager Tenure (Average)	3.83
Exchange	NYSE ARCA
Web Address	www.ishares.com

Passive Strategies
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