WisdomTree

THE LINK BETWEEN WARREN BUFFETT'S QUALITY INVESTING PHILOSOPHY & WISDOMTREE'S QUALITY DIVIDEND GROWTH APPROACH

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WISDOMTREE®

Warren Buffett's widely-read annual letters to Berkshire Hathaway shareholders offer a fascinating insight into Buffett's investment philosophy. Often, these shareholder letters contain information that is particularly valuable in understanding how Buffett has managed to deliver such incredible long-term returns for his investors. Analysing his letters, we believe the following extract is of note:

Berkshire Hathaway Inc. Acquisition Criteria[1]

- Demonstrated consistent earning power
- Businesses earning good return on equity while employing little or no debt

The key phrase here is *"businesses earning good return on equity while employing little or no debt."* In our view, high return on equity (ROE) and low debt are two fundamental "quality" investing attributes that are worth focusing on.

As such, we have created a series of strategies—the WisdomTree Quality Dividend Growth Indices—that are built with this framework in mind. Not only do these focus on companies with high return on equity, but they also avoid companies with high debt levels due to an analysis of return on assets (ROA) in the stock selection process.

Warren Buffett has always been a master stock picker, and he is also able to make special acquisitions due to the terms he can offer. For the rest of us, diversified exposure to a portfolio of stocks that have the characteristics above via an index-based fund is a compelling investment strategy.

In this paper, we review several proponents of quality investing before looking at WisdomTree's approach to quality investing in greater detail.

QUALITY INVESTING HAS A LONG HISTORY

While it's well known that Buffett favours high-quality stocks, his teacher, Benjamin Graham, also had a rigorous focus on quality attributes. While many investors associate Graham with value investing, a closer analysis of his purchase criteria reveals that five of his seven purchase criteria were actually focused on quality attributes.

BENJAMIN GRAHAM'S QUALITY ATTRIBUTES[2]

- Adequate enterprise size, as insulation against the vicissitudes of the economy
- Strong financial condition, measured by current ratios that exceed 2.0 and net current assets that exceed long-term debt
- Earnings stability, measured by 10 consecutive years of positive earnings
- A dividend record of uninterrupted payments for at least 20 years
- Earnings-per-share growth of at least one-third over the last 10 years

Examining these criteria, it's clear that there is a strong focus on quality. Only Graham's final two criteria, which involve price-to-earnings (P/E) ratios and price-to-book (P/B) ratios are focused on value. This suggests that quality investing is not a new concept.

[1] Buffett, Warren. "Berkshire Hathaway Annual Shareholder Letter." 27 February 2015.
[2] Novy-Marx, Robert. "Quality Investing." University of Rochester. December 2012 (Significantly Revised May 2014).

JEREMY GRANTHAM ON HIGH-QUALITY STOCKS[3]

Another well-known proponent of quality investing is Jeremy Grantham's firm, GMO. In a paper written in 2004, GMO wrote:

> "…even though many of these corporations tend to generate high profits year after year, they are systematically under-priced because they lack volatility. Instead of overpaying for these companies, as finance theory would suggest—given their low risk profile—shareholders in fact do just the opposite: they underpay. The result is that investors in high-quality companies get to forge ahead with 15%+ returns year after year without overpaying. Of course, in any given year, low quality stocks can and do stage rallies and high-quality stocks can underperform. But the high-quality stocks have always won over longer holding periods. No matter what metric is used to identify quality stocks—leverage, profitability, earnings volatility or beta—high quality stocks have beaten out low quality stocks."

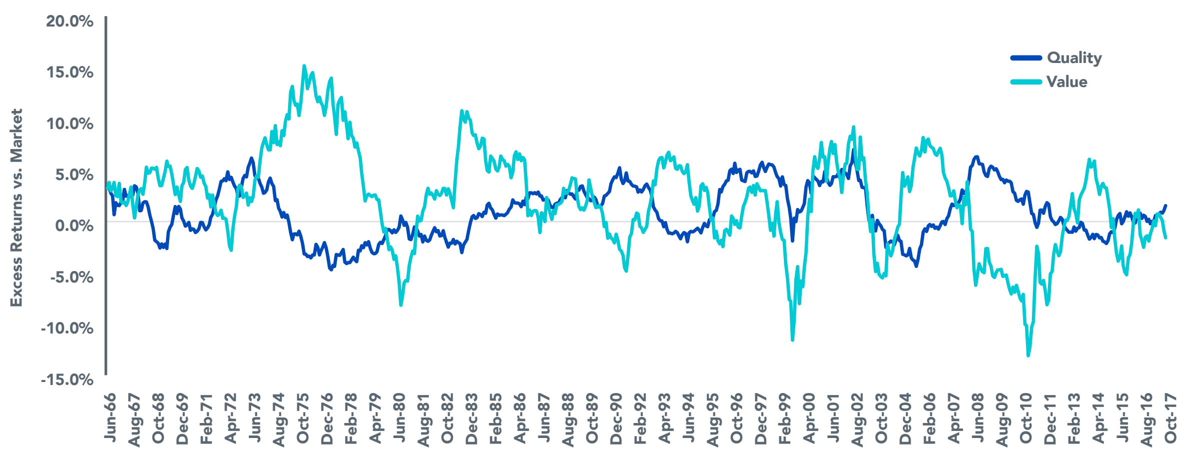
ROBERT NOVY-MARX ON PROFITABILITY

More recent academic research has supported these ideas. In his 2012 paper entitled "The Other Side of Value: The Gross Profitability Premium," economist Robert Novy-Marx wrote[4]:

> "Profitability, as measured by the ratio of the firm's gross profits (revenues minus cost of goods sold) to its assets, has roughly the same power as book-to-market at predicting the cross-section of average returns…
>
> Strategies based on gross profitability generate value-like average excess returns, even though they are growth strategies that provide an excellent hedge for value. The two strategies share much in common philosophically, however, despite being highly dissimilar in both characteristics and covariances…
>
> Because the value and profitability strategies' returns are negatively correlated, the two strategies work extremely well together. In fact, a value investor can capture the full profitability premium without taking on any additional risk."

This last point by Novy-Marx, in our view, deserves special attention. Figure 1 below shows average annual 3-year returns in excess of the market for growth and value strategies, going back to June 1963. There does tend to be some evidence that quality and value strategies delivered positive excess returns at somewhat opposing points in time.

FIGURE 1: Quality as a hedge for value: 30 June 1963 to 30 June 2018s



Sources: WisdomTree, Kenneth French Data Library. Quality refers to top 30% of US large cap listed stocks on basis of operating profitability. Value refers to top 30% of US large cap listed stocks on basis of book-to-market value ratio. ***Historical performance is not an indication of future performance and any investments may go down in value.***

[3] "The Case for Quality—The Danger of Junk." GMO Whitepaper. March 2004.
[4] Novy-Marx, Robert. "The Other Side of Value: The Gross Profitability Premium." June 2012.

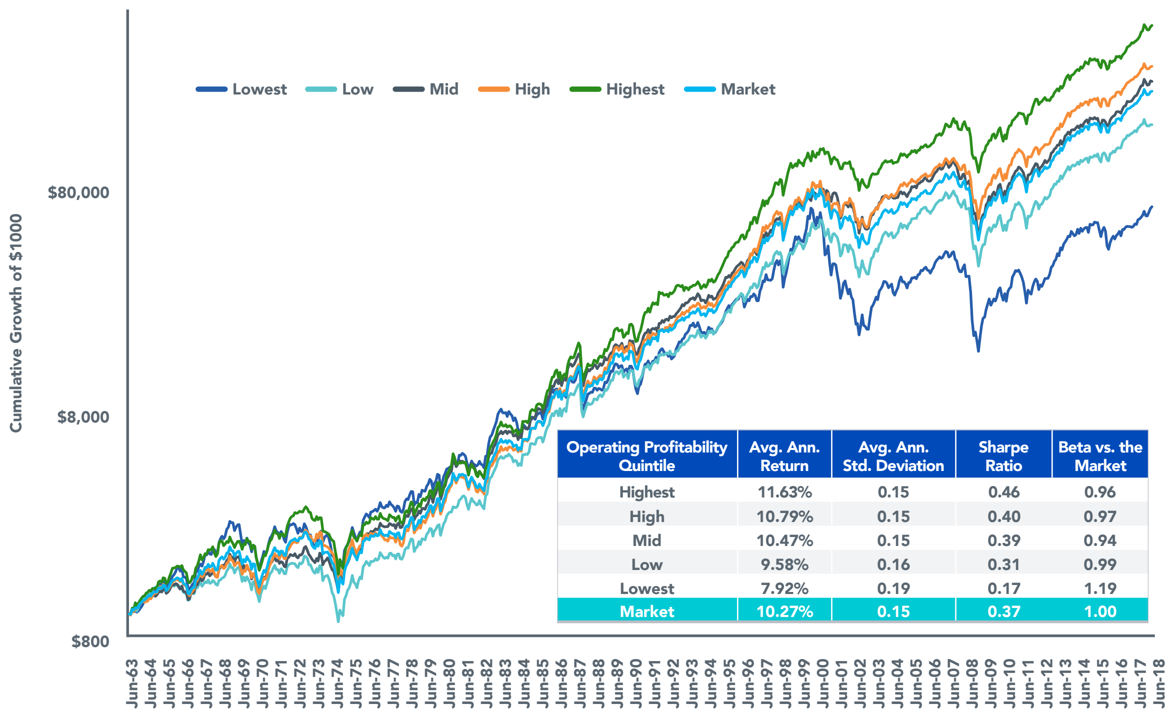
FAMA AND FRENCH ON OPERATING PROFITABILITY

Research by Eugene Fama and Kenneth French arrived at a similar conclusion. In their draft of "A Five-Factor Asset Pricing Model" from September 2014[5], Fama and French cite operating profitability, defined as annual revenues minus cost of goods sold, interest expense and SG&A, all divided by the book value of equity, as a source of investment returns. Note, this is similar to Buffett's criteria of a company earning a good return on its equity—in other words, a high ROE.

Arranging the US market into quintiles based on operating profitability further emphasizes that high-quality stocks have won over longer holding periods, as shown in Figure 2 below.

The market delivered 10.27% average annual returns, leading to a Sharpe ratio of 0.37. The high, the highest and the mid quintiles delivered both higher average annual returns and higher Sharpe ratios over the time period analysed.

FIGURE 2: Higher operating profitability has outpaced lower operating profitability



Operating Profitability Quintile	Avg. Ann. Return	Avg. Ann. Std. Deviation	Sharpe Ratio	Beta vs. the Market
Highest	11.63%	0.15	0.46	0.96
High	10.79%	0.15	0.40	0.97
Mid	10.47%	0.15	0.39	0.94
Low	9.58%	0.16	0.31	0.99
Lowest	7.92%	0.19	0.17	1.19
Market	10.27%	0.15	0.37	1.00

Sources: WisdomTree, Kenneth French Data Library, with data from 30 Jun. 1963 to 30 June 2018. US listed equities are ranked annually on the basis of their operating profitability and placed into quintiles—the highest being those with the highest operating profitability and the lowest being those with the lowest. The market is all US listed equities. ***Historical performance is not an indication of future performance and any investments may go down in value.***

[5] Fama, Eugene F. & Kenneth R. French. "A Five-Factor Asset Pricing Model." SSRN. September 2014.

RETURN ON EQUITY: THE CRITICAL LINK CONNECTING QUALITY TO DIVIDEND GROWTH POTENTIAL

In finance literature, return on equity is critically linked to dividend growth and the intrinsic value of companies through the dividend discount model (DDM)[6]. The DDM states:

The value of a stock = DPS (1) / (R-G)

Where:

+ DPS (1) = Dividends per share expected in one year
+ R = The required rate of return for the investment
+ G = Growth rate in dividends = ROE x earnings retention (or 1 minus dividend payout ratio)

The growth rate equals the return on equity multiplied by the reinvestment rate; simply stated, the dividend growth is determined by what fraction of earnings is reinvested back into the firm and how profitable those earnings are in their subsequent use. A sustainable dividend growth rate is thus critically linked in finance theory to ROE.

MARKET CYCLES: WHEN DOES QUALITY PERFORM THE BEST?

Before moving on to WisdomTree's approach to quality, we wanted to analyse market cycles and look at when different factor tilts delivered their greatest outperformance.

While it's impossible to predict a market correction in advance, we would argue that many market participants tend to have an intuitive feel for when it is late in the cycle, and this is something we have been hearing frequently of late as we write this article in September 2018. So, it's worth looking back at history to determine which factors delivered outperformance prior to, during, and after market corrections.

Looking at Figure 3 below, which analyses past S&P 500 market corrections, three patterns stand out:

+ Before market corrections, it's clear that momentum had the greatest chance of delivering outperformance, with quality not far behind. Value and size lagged, for the most part, during these periods.
+ During market corrections, quality was the factor that was most often associated with a capability to outperform the S&P 500. We should note that outperform does not mean that the strategy necessarily delivered positive returns, but rather, it mitigated downside risk. It's important to remember that a smaller decline in a market drawdown allows for a faster recovery when the tide turns.
+ After market corrections, it's clear that size, followed closely by value, were the factors most often associated with above-market performance. That's not to say that quality and momentum delivered negative returns—just that they didn't deliver as consistent outperformance over the S&P 500 during these recovery periods.

[6] Farrell, James L. Jr. "The Dividend Discount Model: A Primer." Financial Analysts Journal. November-December 1985.

FIGURE 3: Factor performance before, during and after S&P 500 corrections

US Equity Drawdown		Returns 12 Months Before Drawdown					Returns During Drawdown					Returns 12 Months After Drawdown				
Start Date	End Date	Size	Value	Quality	Mom.	S&P 500 Index	Size	Value	Quality	Mom.	S&P 500 Index	Size	Value	Quality	Mom.	S&P 500 Index
10/7/1997	10/27/1997	35.91%	44.33%	43.49%	42.14%	42.39%	-8.41%	-7.61%	-10.36%	-11.70%	-10.75%	-17.45%	20.70%	26.37%	25.06%	23.35%
7/17/1998	8/31/1998	17.51%	36.60%	31.28%	34.34%	29.36%	-27.69%	-17.24%	-19.04%	-20.48%	-19.19%	31.92%	21.08%	39.03%	42.68%	39.82%
7/16/1999	10/15/1999	3.32%	8.04%	20.77%	21.77%	21.49%	-10.65%	-13.87%	-11.51%	-8.89%	-11.80%	25.99%	12.07%	13.87%	21.77%	11.45%
3/24/2000	10/9/2002	79.76%	1.62%	22.00%	49.78%	21.90%	-33.31%	-31.21%	-35.25%	-40.27%	-47.38%	80.52%	38.54%	25.40%	29.26%	36.14%
11/27/2002	3/11/2003	-2.64%	-23.55%	-15.29%	-7.90%	-17.00%	-13.25%	-21.66%	-11.73%	-7.49%	-14.24%	84.79%	55.87%	33.04%	34.67%	40.69%
10/9/2007	3/9/2009	13.46%	16.50%	21.72%	25.15%	18.04%	-62.06%	-67.76%	-44.65%	-49.60%	-55.22%	114.18%	118.58%	62.05%	52.32%	72.26%
4/23/2010	7/2/2010	73.56%	54.97%	42.40%	51.25%	45.89%	-19.66%	-20.26%	-14.90%	-18.64%	-15.63%	38.02%	22.30%	35.79%	40.76%	33.63%
4/29/2011	10/3/2011	15.74%	2.04%	16.86%	18.12%	15.26%	-30.83%	-27.32%	-15.49%	-20.35%	-18.64%	40.23%	42.68%	33.12%	36.17%	35.00%
5/21/2015	8/25/2015	14.50%	10.63%	16.11%	18.07%	15.18%	-11.89%	-14.69%	-12.40%	-9.01%	-11.89%	12.32%	13.78%	17.67%	12.71%	18.92%
11/3/2015	2/11/2016	3.01%	-1.60%	5.95%	8.75%	6.75%	-20.66%	-19.22%	-12.69%	-13.27%	-12.71%	52.01%	52.89%	28.53%	22.61%	29.34%
1/26/2018	2/8/2018	21.11%	24.03%	33.23%	30.99%	27.59%	-8.72%	-10.36%	-9.35%	-9.89%	-10.10%	?	?	?	?	?

Sources: WisdomTree, Bloomberg, Yardeni Research Inc., Kenneth French Data Library. ***Historical performance is not an indication of future performance and any investments may go down in value. You cannot invest directly in an Index.*** Values shaded in green indicate outperformance vs. the S&P 500 during that time frame. ***Size*** *refers to the Lo 30 portfolio of all listed stocks in the bottom 30% of the total US market capitalization.* ***Value*** *refers to the BIG HiBM portfolio of large-cap companies with high book/market ratios.* ***Quality*** *refers to the BIG HiOP portfolio of large-cap companies with high operating profitability.* ***Momentum*** *refers to the BIG HIPRIOR portfolio of large-cap companies with positive trailing price momentum.*

To the extent possible, we wanted to test the US market cycle results observed in Figure 3 to see if a similar pattern held for Eurozone equities. As a result, we looked at the five commonly discussed factors for which the MSCI EMU parent index had a proper variant before, during and after the broad MSCI EMU parent index had a drawdown of more than 10%[7]. Figure 4 shows that:

+ 12 months before a drawdown, the MSCI EMU Momentum Index typically delivered the strongest performance during this period.
+ During a drawdown, the MSCI EMU Minimum Volatility, Momentum and Quality Indices delivered the strongest returns during these periods, and it really depended on which specific correction was being observed to determine which performed best.
+ After a drawdown, the MSCI EMU Enhanced Value Index delivered a clear advantage.

[7] An important aspect of period selection was limited due to being able to go 12-months prior to a correction and 12-months after without overlapping with another correction (as well as 12-months before and after THAT correction).

FIGURE 4: Testing factor performance on Eurozone equities

Eurozone Equity Drawdown		Returns 12 Months Before Drawdown						Returns During Drawdown						Returns 12 Months After Drawdown					
Start Date	End Date	Value	Low Vol.	Mom.	Quality	Size	Market	Value	Low Vol.	Mom.	Quality	Size	Market	Value	Low Vol.	Mom.	Quality	Size	Market
6/30/1998	9/30/1998			47.87%		45.24%	47.20%	-27.72%		-20.53%		-21.46%	-21.35%	30.83%		23.97%		17.79%	26.97%
2/29/2000	2/28/2003	55.93%		78.66%	34.32%	15.75%	44.98%	-37.06%		-56.58%	-44.94%	-35.39%	-57.27%	58.13%	28.00%	18.82%	26.24%	38.12%	35.75%
5/31/2007	2/28/2009	33.85%	28.41%	41.66%	25.66%	31.61%	27.81%	-59.54%	-51.06%	-52.66%	-48.31%	-58.40%	-57.99%	50.56%	31.16%	18.79%	34.11%	40.00%	38.83%
4/30/2011	11/30/2011	8.25%	7.89%	16.74%	9.61%	8.91%	8.65%	-25.72%	-14.27%	-16.52%	-15.15%	-20.28%	-22.45%	9.23%	9.24%	21.42%	13.25%	11.18%	12.39%
3/31/2015	1/31/2016	16.37%	22.89%	19.14%	22.00%	19.10%	18.07%	-16.24%	-5.25%	-5.61%	-8.75%	-10.23%	-14.94%	13.06%	0.14%	5.19%	9.33%	6.19%	7.62%

Sources: MSCI, Bloomberg. Period is from 30 June 1997 to 30 June 2018. Performance includes backtested results. ***Value*** *refers to the MSCI EMU Enhanced Value Index, with inception 23 September 2014.* ***Low Volatility*** *refers to the MSCI EMU Minimum Volatility Index, with inception 28 June 2011.* ***Momentum*** *refers to the MSCI EMU Momentum Index, with inception 11 December 2013.* ***Quality*** *refers to the MSCI EMU Quality Index, with inception 12 July 2013.* ***Size*** *refers to the MSCI EMU Risk-Weighted Index, with inception 5 May 2011. Due to data availability price level data is used and data frequency is monthly, meaning that periods can only start and finish on end-of-month dates.* ***You cannot invest directly within an Index. Historical performance is not an indication of future performance and any investments may go down in value.***

So, for Eurozone equities, momentum has generally performed well late in the cycle, quality has outperformed during corrections, and value has often outperformed during recoveries, although we should mention that we did not have the same number of data for this analysis as we had for US equities. Of course, the circumstances of specific market corrections could influence these results.

WISDOMTREE'S APPROACH TO QUALITY INVESTING: METHODOLOGY AND RATIONALE

Turning to our approach to quality investing, we believe that it's important to not dilute the potential power of quality by trying to apply too many stock selection rules or complex weighting schemes. In our view, the key is to be as simple and broad-based as possible, while still focusing on companies with high return on equity and low debt – attributes that are commonly considered to be fundamental in quality investing.

WISDOMTREE'S QUALITY DIVIDEND GROWTH SELECTION CRITERIA AND RATIONALE

The following general principles are used in creating our Quality Dividend Growth indices:

+ **Companies must have dividend coverage ratios greater than 1.0x:** Companies that are paying out more dividends than they have earnings are less likely to be dividend growth leaders, in our opinion
+ The Indices comprise of companies with the best combined rank of **growth and quality** factors from this universe
    - **Growth ranking 50%:** This is derived from analysts' long-term earnings growth expectations, which ultimately encompass the estimated growth in operating earnings per share over the company's next full business cycle – typically three to five years
    - **Quality ranking 50%:** This is split evenly between three-year average return on assets (ROA) and three-year average return on equity (ROE)
+ **Weighting:** The Indices are "dividend stream" weighted to reflect the proportionate share of the aggregate cash dividends. This gives larger weight to companies growing their dividends, which means more potential to increase the trailing 12-month dividend yield of the total portfolio. This dividend stream weighting methodology also brings a value tilt to the quality and growth selection
- **Rebalancing:** Our strategies also feature an annual rebalancing process, so if equity markets become more expensive, index weights are tilted towards qualifying firms whose dividends have become less expensive compared to their prices

NOTES ON SELECTION FACTORS

We believe the combined ranking of earnings growth and quality factors identifies stocks with the highest potential to increase dividends.

In relation to earnings growth expectations, we believe that companies that can grow their earnings have the greatest potential to raise their dividends, which is why long-term earnings growth expectations as a factor make up 50% of our selection criteria. Other index providers also look at earnings growth expectations as part of their classification of growth companies: FTSE Russell Indices includes a similar e-term growth expectation forecast variable in its model to determine whether constituent stocks qualify for the Russell Growth Indices or the Russell Value Indices[8]. MSCI indices also includes earnings per share growth rates—on both a long-term and a short-term basis[9]. We recognize that these are only estimates and that, with an increasing time horizon, estimates becomes less accurate. However, while the specific growth estimates per company may be hard to forecast, the relative direction and trends tend to be more accurate in general.

With regard to quality factor rankings, we believe that higher quality companies are those that have displayed above-average historical returns on equity and return on assets. We have used these criteria as part of our selection methodology, because we believe companies with better profitability metrics are better able to fund growing dividends. We are certainly not the first to suggest that there is a link between dividend growth and ROE or to use ROE as a stock selection criterion.

ROE: THE BUFFETT FACTOR

As we mentioned earlier, Warren Buffett often says that he looks for "businesses earning good returns on equity while employing little or no debt." Since high leverage involves the use of debt, our use of a quality ranking that incorporates both return on equity and return on assets enables us to mitigate the use of leverage as a sole driver of what may superficially appear to be a high ROE figure. The following quote from Charlie Munger at USC Business School in 1995 nicely summarises why Buffett likes ROE as a factor[10]:

> "We've really made the money out of high quality businesses… If the business earnings 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result."

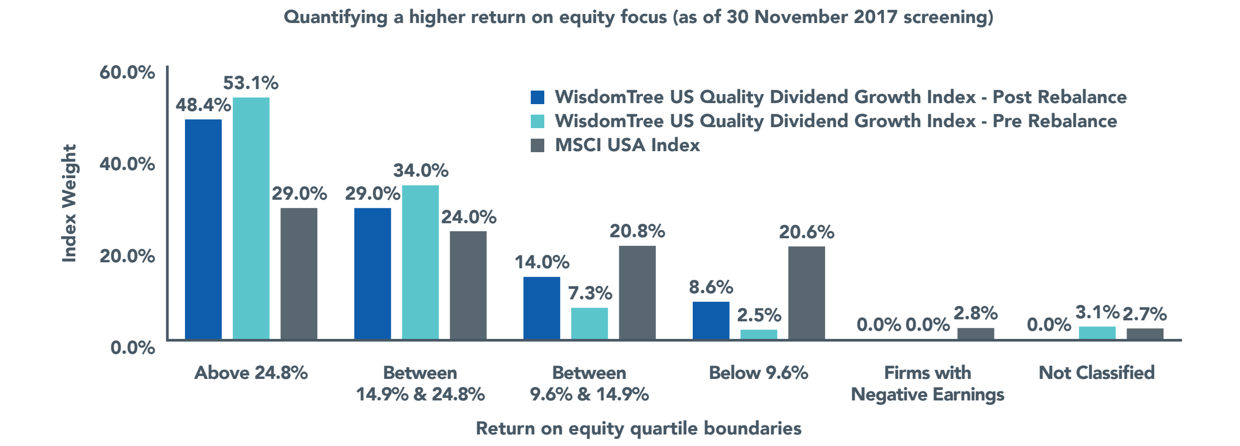
MEASURING THE TILT TOWARDS QUALITY COMPANIES WITHIN OUR INDICES

To quantify the tilt toward quality, we use each of the market capitalization-weighted benchmarks as baselines to determine three-year average ROE quartiles and show the exposure of various indices in each quartile.

Notably, the US equity market is weighted toward the higher end of the overall return on equity spectrum, but WisdomTree's approach still pushes almost 50% of its overall weight into the top quartile—nearly 20% more than the S&P 500. Also, while many focus more toward the higher end of the spectrum with statistics like this, the real advantage could actually be the tilt away from the lower return on equity end of the spectrum.

[8] "Russell US Equity Indices: Construction & Methodology." FTSE Russell. August 2018.
[9] "MSCI Global Investable Market Value & Growth Index Methodology." MSCI. September 2017.
[10] Munger, Charlie. "A Lesson on Elementary, Worldly Wisdom as it Relates to Investment Management & Business." 5th May 1995.

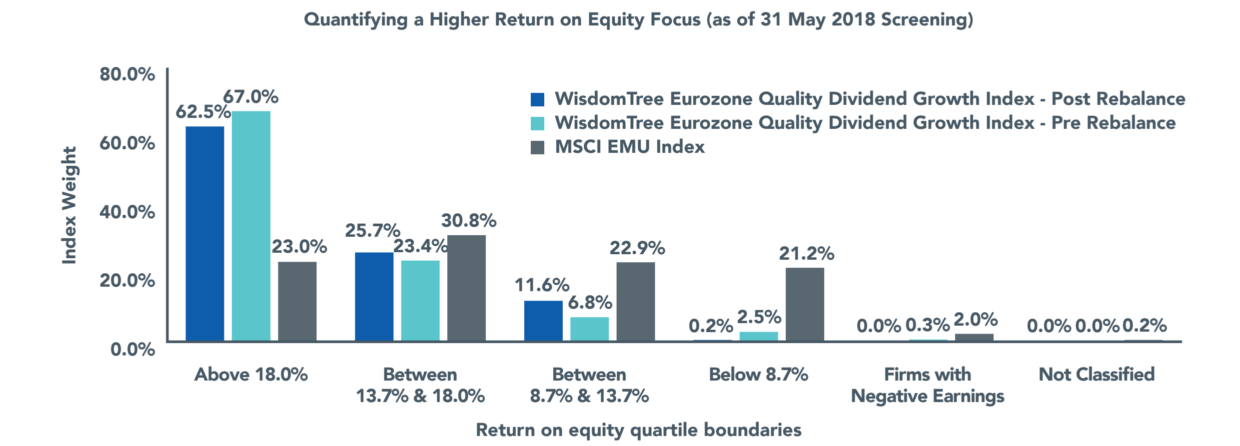
Figure 5a: Measuring the quality tilt WisdomTree's approach brought to US equities (30 November 2017 index screening)



Source: Factset, with data as of 30 November 2017 Index Screening You cannot invest directly within an Index. Firms with negative earnings refer to trailing 12-month earnings per share. Not classified refers to firms with either negative equity or lack of data availability. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Within the Eurozone, both the tilts toward high return on equity and away from low return on equity are even more pronounced than in the US. Almost three-quarters of the weight of the WisdomTree Eurozone Quality Dividend Growth Index was in firms within the highest return on equity quartile.

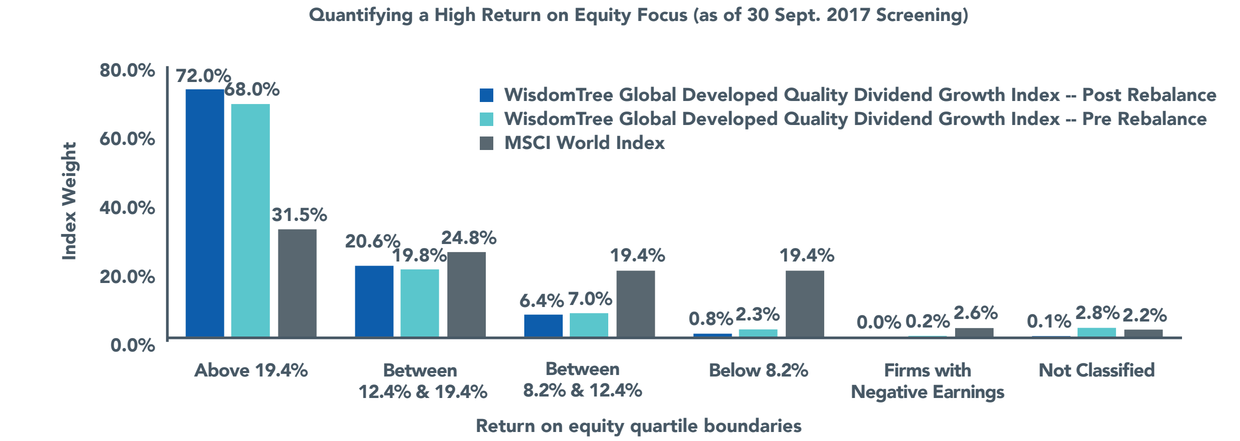
Figure 5b: Measuring the quality tilt WisdomTree's approach brought to Eurozone equities (31 May 2018)



Source: Factset, with data as of 31 May 2018. You cannot invest directly within an Index. Firms with negative earnings refer to trailing 12-month earnings per share. Not classified refers to firms with either negative equity or lack of data availability. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Since the global developed universe includes big chunks represented by both the US and the Eurozone, it's no surprise that the global developed market picture looks quite similar to both the US and Eurozone pictures.

Figure 5c: Measuring the quality tilt WisdomTree's approach brought to developed market global equities (30 September 2017 index screening)



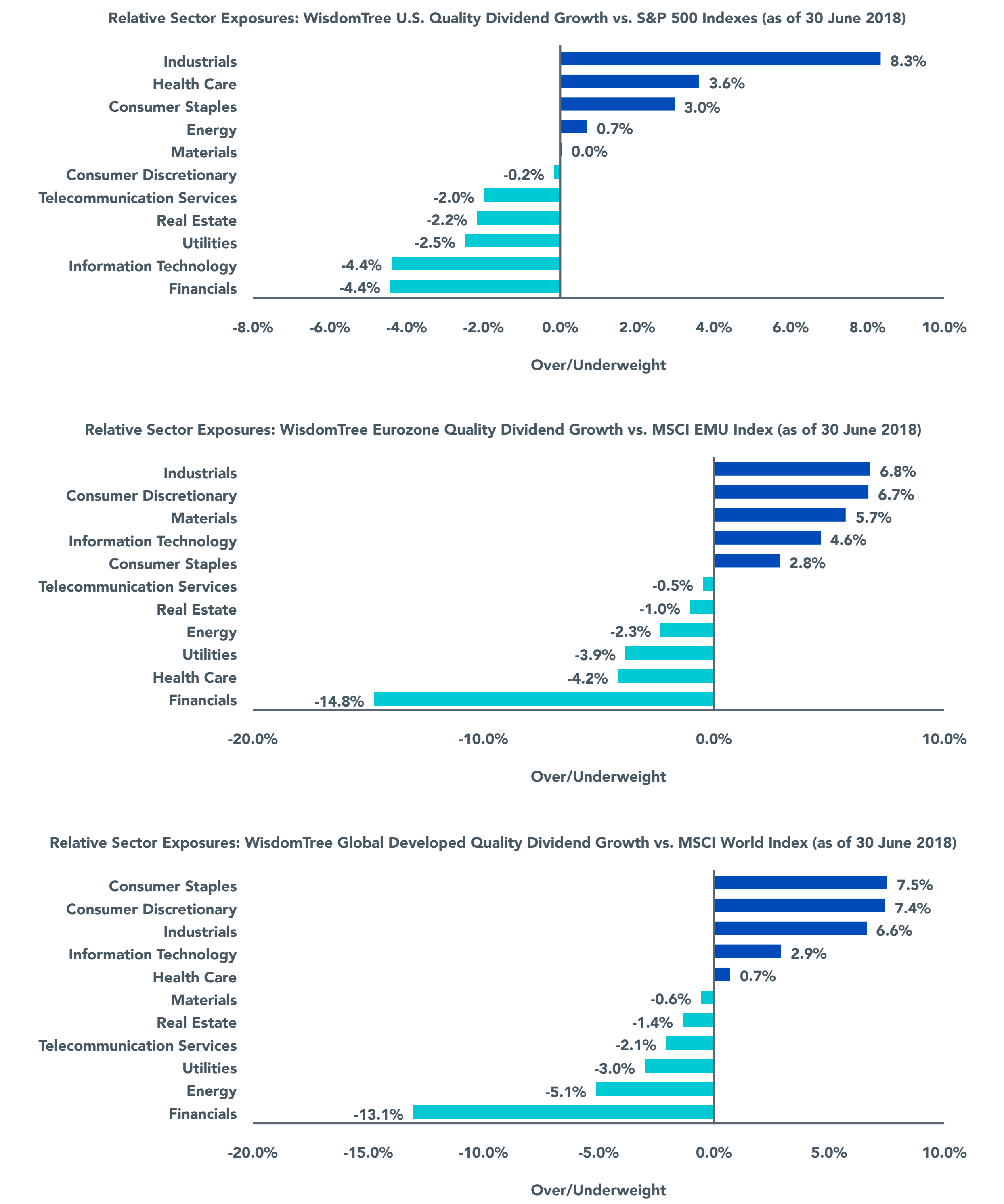
Source: Factset, with data as of 30 September 2017 Index Screening. You cannot invest directly within an Index. Firms with negative earnings refer to trailing 12-month earnings per share. Not classified refers to firms with either negative equity or lack of data availability. ***Historical performance is not an indication of future performance and any investments may go down in value.***

SECTOR EXPOSURES TILT AWAY FROM FINANCIALS

In applying WisdomTree's Quality Dividend Growth methodology around the world, the focus on low leverage led to another very interesting observation: our indices exhibit a bias away from the financial sector. After the Global Financial Crisis of 2008-09, the words "financials" and "leverage" became closely intertwined. Even though the picture has improved from the crisis levels, WisdomTree's Quality Dividend Growth Indices still underweight the sector.

In the US, which has deleveraged significantly since the crisis, from a period of September 2008 to the present period under analysis ending June 2018, the tilt shows up as a 4.4% underweight relative to the S&P 500. In the Eurozone, this tilt becomes a 14.8% underweight. In global developed markets, this tilt is a 13.1% underweight.

Figure 6a, 6b and 6c: Sector exposures of WisdomTree's Quality Dividend Growth approach vs. market capitalization-weighted benchmark indices



Sources: WisdomTree, Bloomberg, with data as of 30 June 2018.

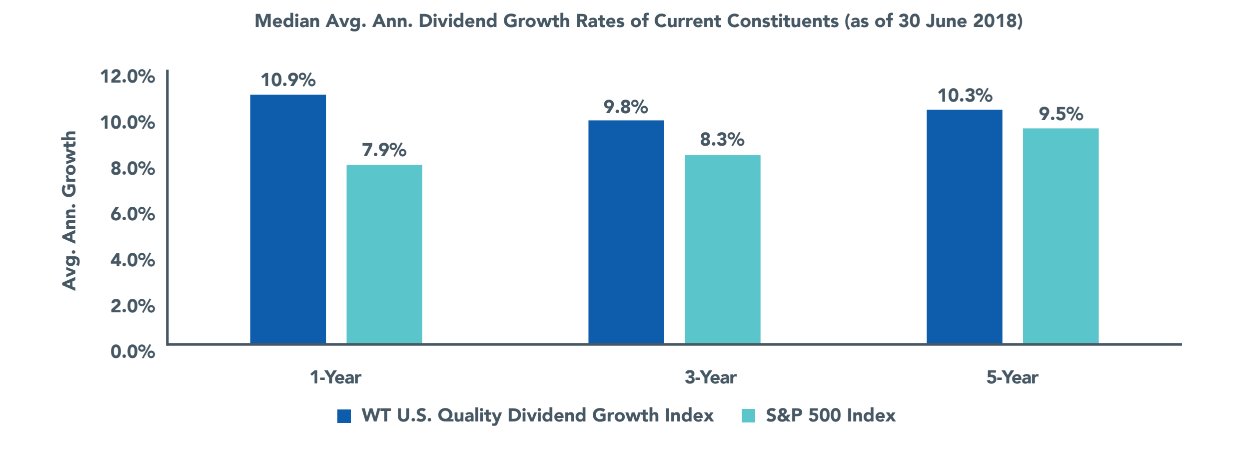
MEASURING THE DIVIDEND GROWTH OF OUR INDICES

It's important to look beyond the theoretical underpinnings of the indices and note the types of exposures and other characteristics that are resulting from an index's application.

One important attribute is the dividend growth of the current constituents of each index, measured against a market capitalization-weighted benchmark. The broad market capitalization-weighted benchmark represents the market in question, and the true question is whether the constituents selected by our methodology have been growing their dividends faster than the established benchmarks. Here's what we can tell from figures 7a to 7c:

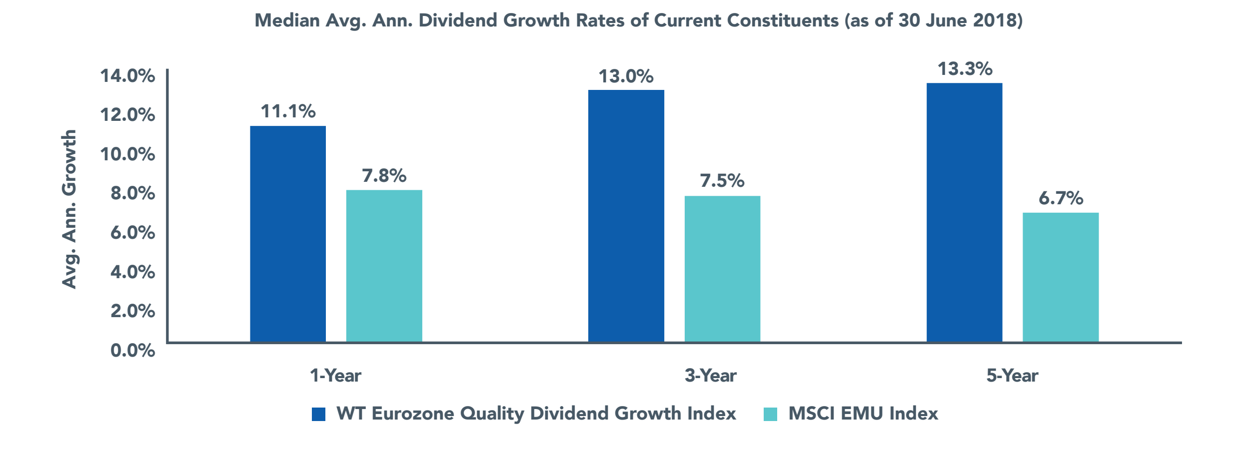
+ Each WisdomTree Quality Dividend Growth strategy exhibited a median level of dividend growth that outpaced that of the appropriate market capitalization-weighted benchmark over the respective time periods.
+ We saw earlier that the US version of the strategy had lower sector deviations relative to the others against the market capitalization-weighted benchmark. We'd note that this could be a contributing factor—greater overall active weights—that leads to what we observe in figure 7b and 7c where the WisdomTree strategy exhibited much different (and higher) median dividend growth over the periods shown.

Figure 7a: US Quality Dividend Growth: dividend growth of current constituents



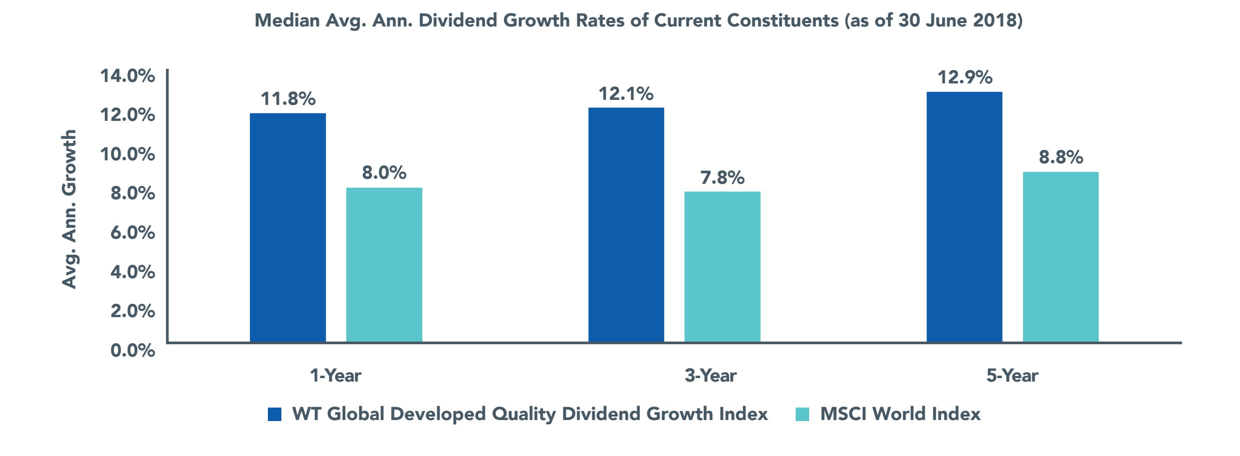
Source: Bloomberg, with data measured as of 30 June 2018. Growth rates are median so as to not be biased by extreme observations to either the high or low side. Data looks back at current constituent dividend growth behaviour over the specified horizons (i.e. 1-Year means dividend growth behaviour from 30 June 2017 to 30 June 2018). You cannot invest directly within an Index. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Figure 7b: Eurozone Quality Dividend Growth: dividend growth of current constituents



Source: Bloomberg, with data measured as of 30 June 2018. Growth rates are median so as to not be biased by extreme observations to either the high or low side. Data looks back at current constituent dividend growth behaviour over the specified horizons (i.e. 1-Year means dividend growth behaviour from 30 June 2017 to 30 June 2018). You cannot invest directly within an Index. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Figure 7c: Global Developed Quality Dividend Growth: dividend growth of current constituents



Source: Bloomberg, with data measured as of 30 June 2018. Growth rates are median so as to not be biased by extreme observations to either the high or low side. Data looks back at current constituent dividend growth behaviour over the specified horizons (i.e. 1-Year means dividend growth behaviour from 30 June 2017 to 30 June 2018). You cannot invest directly within an Index. ***Historical performance is not an indication of future performance and any investments may go down in value.***

CONCLUSION

Over the long run, focusing on quality has generated outperformance over different periods. While quality can be measured in a variety of ways, it appears that earnings consistency or growth, high return on equity and low debt are common attributes that are sought after by the majority of those focused on quality stocks. A focus on these attributes is no doubt one of the keys to Warren Buffett's investing success.

WisdomTree's Quality Dividend Growth strategies are built with this framework in mind. Our indices focus on long-term earnings growth expectations as well as on three-year average return on equity and return on assets metrics in an attempt to identify high-quality companies that offer significant outperformance potential.

With indices rebalanced annually, these strategies have the potential to capture quality while maintaining a reasonable overall valuation if markets move higher.

Appendix: Specified methodology details of each WisdomTree Index

Indexes	WisdomTree U.S. Quality Dividend Growth Index	WisdomTree Eurozone Quality Dividend Growth Index	WisdomTree Developed World Quality Dividend Growth Index
Tickers (Price/ Total Return)	WTDGI / WTDGNTRU	WTEZG / WTEZGET	WTDDG / WTDDGTR
Primary Selection Focus	Top 300 U.S. Companies from the WisdomTree U.S. Dividend Index with the best combined ranking of growth & quality factors	Top 100 European companies from within the WisdomTree International Equity Index with the best combined rank of growth & quality factors.	Top 600 companies from within the WisdomTree Global Dividend Index with the best combined rank of growth & quality factors.
Weighting Methodology	Indicated regular dividends per share as of the Annual Screening date, multiplied by the number of shares outstanding.	Regular dividends per share paid over annual cycle prior to the Annual Screening Date, converted to U.S. dollars and multiplied by the number of shares outstanding.	Regular dividends per share paid over annual cycle prior to the Annual Screening Date, converted to U.S. dollars and multiplied by the number of shares outstanding.
Capping Rules	Single positions capped at 5%, single sectors capped at 20%. Between annual rebalances, weights may fluctuate above these caps due to market movement.	Single positions capped at 5%, single countries capped at 25% and single sectors capped at 20%. Between annual rebalances, weights may fluctuate above these caps due to market movement.	Single positions capped at 5%, single countries capped at 25% except for the USA, which is capped at 50%, and single sectors are capped at 20%. Between annual rebalances, weights may fluctuate above these caps due to market movement.
Rebalance Frequency & Timing	Annual Rebalance, Screens 11/30	Annual Rebalance, Screens 5/31	Annual Rebalance, Screens 9/30

Source: "WisdomTree Rules-Based Methodology." WisdomTree. Last Updated July 2018.

Index Definitions

WisdomTree US Quality Dividend Growth Index: A fundamentally-weighted index designed to track the performance of dividend-paying companies in the US that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by indicated cash dividends.

WisdomTree Eurozone Quality Dividend Growth Index: A fundamentally-weighted index designed to track the performance of dividend-paying companies in the Eurozone that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by indicated cash dividends.

WisdomTree Global Developed Quality Dividend Growth Index: A fundamentally-weighted index designed to track the performance of dividend-paying companies in global developed markets that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by indicated cash dividends.

MSCI USA Index: This index is designed to measure the performance of large and mid-cap segments of the US market.

S&P 500: A market capitalization-weighted benchmark of 500 stocks selected by Standard and Poor's Index Committee and designed to represent the performance of the leading industries in the United States economy.

MSCI USA Quality Index: The MSCI USA Quality Index is a large and mid-cap US equity index that aims to capture the performance of quality growth stocks. The Index screens its parent index, the MSCI USA Index for ROE, stable year-over-year earnings growth, and low financial leverage.

MSCI USA Value Index: A large and mid-cap US equity index that aims to securities exhibiting overall value style characteristics. The Index screens for book value to price, 12-month forward earnings to price, and dividend yield as value characteristics.

S&P High Yield Dividend Aristocrats Index: This index is designed to track the performance of dividend-paying companies in the US that have increased their annual dividend payments for the last 20 or more consecutive years.

Dow Jones US Select Dividend Index: The index is a modified market capitalization approach and is weighted by dividend yield. Stocks are selected for fundamental strength relative to their peers, subject to various screens such as dividend quality and liquidity.

MSCI EMU Index: A free float-adjusted market capitalization-weighted index designed to measure the performance of the markets in the European Monetary Union.

MSCI EMU Quality Index: The MSCI EMU Quality Index is a large and mid-cap Eurozone equity index that aims to capture the performance of quality growth stocks. The Index screens its parent index, the MSCI EMU Index for ROE, stable year-over-year earnings growth, and low financial leverage.

MSCI EMU Risk-Weighted Index: An index of Eurozone stocks that tilts exposure from predominantly large cap and mid cap stocks downward toward the mid cap/small cap space. This index is frequently utilized to exemplify the "size" factor.

MSCI EMU Enhanced Value Index: An index that screens the MSCI EMU Index constituents to find those that best exemplify the value classification style by evaluating an array of fundamental characteristics

MSCI EMU Momentum Index: An index that screens the MSCI EMU Index constituents to find those that best exemplify trends of rising price behaviour.

MSCI EMU Minimum Volatility Index: This index optimises the MSCI EMU universe for the lowest absolute risk using a given set of constraints aimed to guard against exposure becoming too concentrated in either single stocks, sectors or countries.

Index Definitions

MSCI EMU Value Index: A large and mid-cap Eurozone equity index that aims to capture securities exhibiting overall value style characteristics. The Index screens for book value to price, 12-month forward earnings to price, and dividend yield as value characteristics.

Euro STOXX Select Dividend 30 Index: This index is designed to measure the performance of the highest dividend-paying stocks relative to the Eurozone market. Components are weighted on the basis of dividend yield and are required to have 5 years of non-negative dividend growth.

S&P Euro High Yield Dividend Aristocrats Index: This index measures the performance of the highest dividend yielding Eurozone companies. Stocks must have increased or maintained stable dividends for at least 10 consecutive years. Weighting is by dividend yield.

MSCI World Index: The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

MSCI World Quality Index: The MSCI World Quality Index is a large and mid-cap US equity index aiming to capture the performance of quality growth stocks. The Index screens its parent index, the MSCI World Index for ROE, stable year-over-year earnings growth, and low financial leverage.

MSCI World Value Index: A large and mid-cap world equity index aiming to capture securities exhibiting overall value style characteristics. The Index screens for book value to price, 12-month forward earnings to price, and dividend yield as value characteristics.

STOXX Global Select Dividend Index: This index is designed to measure the performance of the highest dividend-paying stocks relative to the global market. Components are weighted on the basis of dividend yield and are required to have 5 years of non-negative dividend growth.

S&P Global Dividend Aristocrats Index: This index measures the performance of the highest dividend-yielding global companies. Stocks must have increased or maintained stable dividends for at least 10 consecutive years. Weighting is by dividend yield.

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