

# The Case for EMERGING CURRENCIES

Investing in emerging markets presents both opportunities and risks. The potential for favorable returns is counter-balanced by the uncertainty of developing economies, markets and regulatory standards. Investing across multiple countries within the emerging market universe can help modify some of the volatility inherent in concentrated investments, whether it is in stocks, bonds or, in this case, short-term investments. Investments providing exposure to emerging money market rates offer investors return potential through income as well as currency appreciation.

## Why invest in a basket of emerging market currencies?

+ **Diversify your portfolio holdings with lower correlating assets.** Emerging market currencies often move independently of domestic stock, bond and money market investments, resulting, historically, in modest correlations between such currencies and other asset classes. In addition, emerging currencies exhibit low correlations to other alternative asset classes, such as commodities and gold. The correlation chart below showcases the return correlation between a broad-based basket of currencies and traditional asset classes over the last ten years. Incorporating a small amount of exposure to emerging money market instruments may reduce the overall dollar volatility of a portfolio and potentially enhance overall return.

## Why invest in a basket of emerging market currencies?

- + Diversify your portfolio holdings with lower correlating assets.
- + Temper the volatility of investing in individual currencies.
- + Gain broad-based exposure to money market rates across emerging markets.
- + Tap the long-term economic potential of emerging markets.
- + Position portfolios to potentially benefit from declines in the U.S. dollar.

## Correlations between Emerging Money Markets and Other Assets

(April 1, 1999–March 31, 2009)

	U.S. Stocks**	U.S. Bonds**	One-Month U.S. Bank Deposits**	International Stocks**	International Bonds**	Broad-Based Commodities**	Gold**
Equally-Weighted Basket of Emerging Currencies*	0.68	0.20	-0.02	0.80	0.37	0.43	0.27

Sources: JP Morgan, Zephyr StyleADVISOR, Bloomberg

Correlation is a statistical measure of how an investment moves in relation to another investment. A correlation ranges from 1 to -1. A correlation of -1 means the two investments have moved in exactly opposite directions, while a correlation of 1 means the two investments have moved in the same direction.

\* To construct a proxy for emerging market currencies, an equally weighted basket of 11 currencies was tracked and rebalanced to equivalent weights every quarter. The currencies utilized were those of Brazil, Chile, Mexico, Poland, Israel, South Africa, Turkey, India, China, South Korea and Taiwan. Returns for these individual currencies are represented by the total returns of the respective country subindices of the JP Morgan Emerging Local Markets Index Plus (ELMI+). The JP Morgan Emerging Local Markets Index Plus and its underlying country and regional subindices track the total returns for local-currency denominated money market instruments in emerging market countries. Each subindex uses a weighted basket of 1-mo, 2-mo, and 3-mo months currency forwards (deliverable or non-deliverable) collateralized with US money market rates to proxy the total returns of an investment in local-currency money market instruments. The returns are reported in US dollar terms. A deliverable forward currency contract is an agreement by two parties to transact in currencies at a specific rate on a future date upon which each party delivers the promised currency. A non-deliverable forward currency contract is an agreement by two parties to transact in currencies at a specific rate on a future date and then cash settle the agreement with a simple exchange of the market value difference between the current market rate and the initial agreed-upon rate.

\*\* U.S. stocks, U.S. bonds, one-month U.S. bank deposits, international stocks, international bonds, broad-based commodities and gold are represented by the S&P 500 Index, Barclays Capital Aggregate Index, Merrill Lynch U.S. Dollar, One-Month, LIBID Constant Maturity Index, Morgan Stanley Capital International MSCI EAFE (Europe, Australasia and the Far East) Index, Citigroup Non-USD World Government Bond Index, Dow Jones-AIG Commodity Total Return Index and the London PM Fix, respectively.

Diversification does not eliminate the risk of experiencing investment losses.

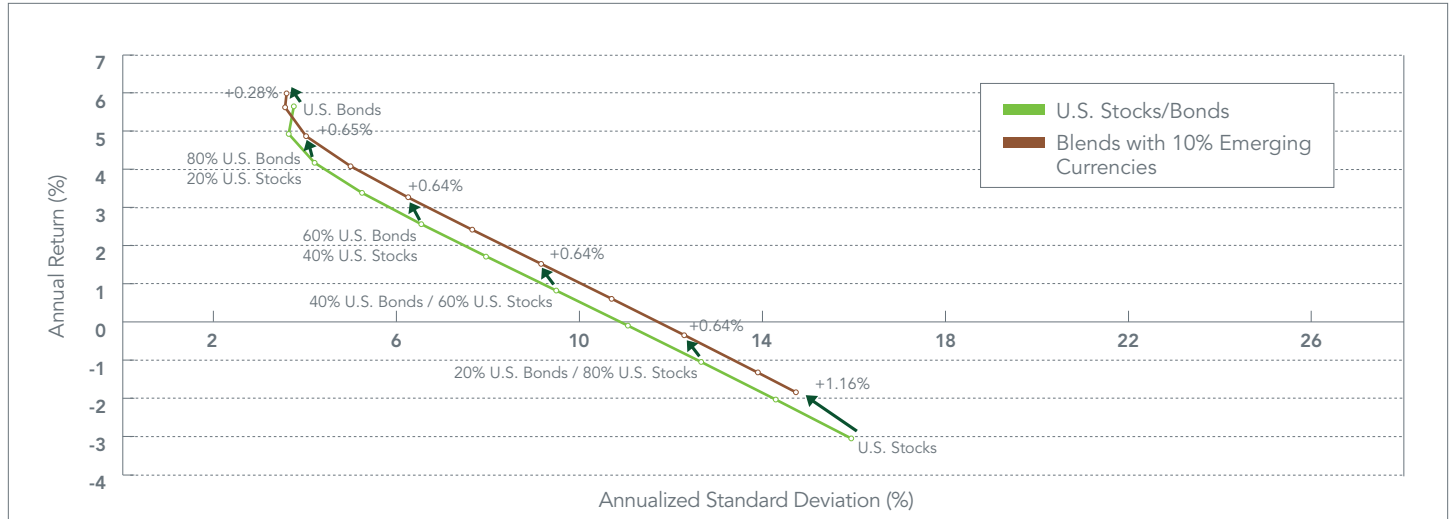
Although WisdomTree Currency Funds invest in very short-term, investment grade instruments, the funds are not "money market" funds and it is not the objective of any of the funds to maintain a constant share price.

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The risk-return chart illustrates the impact of incorporating a 10% allocation of emerging currency into balanced portfolio mixes of the domestic stocks and domestic bonds over the last ten years. For the targeted mixes, adding the emerging currency component raised annual returns by an average of 0.66%, while lowering overall portfolio volatility.

**Risk-Return of Balanced Portfolio Blends** (April 1, 1999–March 31, 2009)

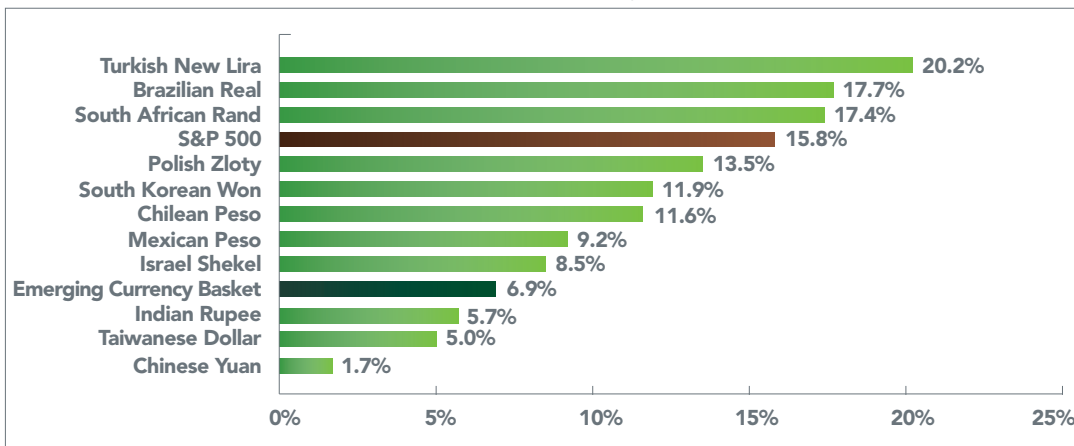


Sources: JP Morgan, Zephyr StyleADVISOR, Bloomberg

The risk-return profiles of ten portfolio mixes composed of domestic bonds and stocks were analyzed over the last ten years (April 1, 1999 – March 31, 2009) and compared to similar mixes incorporating a 10% allocation to emerging currencies at the expense of 10% of the original assets. For example, a 60%/40% equity- bond mix was compared against a mix of 55% equities / 35% bonds / 10% emerging currencies. Returns for US equities and US bonds were represented by the S&P 500 and the Barclays Capital Aggregate indices, respectively. Our proxy basket of 11 emerging market currencies described on the preceding page was used to represent an investment in emerging currencies. Each portfolio mix was rebalanced to its original target allocation each quarter. Past performance does not guarantee future results. You can not invest directly in an index.

**+ Temper the volatility of investing in individual currencies.** Returns from individual currencies are often driven by factors unique to the respective countries and move independently of other currencies. Consequently, assembling a portfolio of multiple currencies is likely to offer diversification benefits relative to investments in individual currencies. As evidenced in the graph below, holding a diverse basket of currencies helped stabilize returns relative to investments in individual currencies.

**Annualized Standard Deviation of Total Returns** (April 1, 1999–March 31, 2009)



Sources: Zephyr StyleADVISOR, JP Morgan

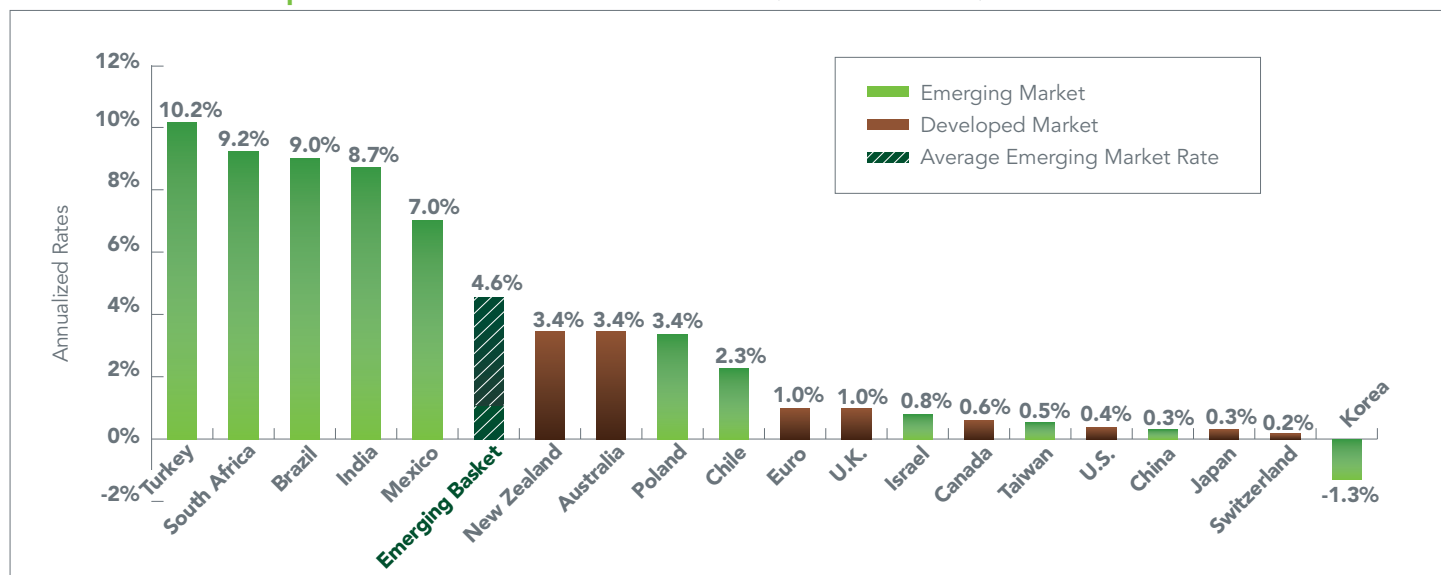
Standard deviation of return measures the average deviations of a return series from its mean and is often used as a measure of risk or volatility. A higher standard deviation implies that there have been large swings in the annual returns of an investment.

Total returns for individual currencies are represented by the total returns of the respective country subindex of the JP Morgan Emerging Local Markets Index Plus (ELMI+).

Using returns from these indexes, an equally weighted "Emerging Basket" of the 11 currencies was tracked and rebalanced to equivalent weights every quarter. The currencies utilized were those of Brazil, Chile, Mexico, Poland, Israel, South Africa, Turkey, India, China, South Korea and Taiwan.

**+ Gain broad-based exposure to money market rates across emerging markets.** The path to economic and capital market development is rarely a straight line for emerging economies. Emerging economies often offer higher yields to compensate investors for these risks. The chart below uses global one-month deposit rates to present a range of yield opportunities available to U.S. investors in certain emerging and developed markets. The bar labeled “Emerging Basket” shows an average of the emerging market currencies shown. As of March 31, 2009, the average rate on the Emerging Basket was 3.6 percentage points higher than deposit rates on the euro and 4.2 percentage points higher than similar short-term rates in the U.S.

**Global One-Month Deposit Rates Available to U.S. Investors** (as of March 31, 2009)



Past performance does not guarantee future results.

Source: Bloomberg, 2009

The rates are historical and do not reflect the returns of any WT currency Fund.

U.S., Euro, Japan, U.K., Australia, Canada, New Zealand, and Switzerland use the London Interbank Bid Rate (LIBID) for one-month deposits. LIBID rates are the daily reference rate at which a consortium of British banks are prepared to accept deposits. It is typically calculated as 0.125% less than the more popular LIBOR Rate or the rate at which banks offer to lend unsecured funds. Rates for Australia, Canada and New Zealand were calculated using the LIBOR Rate and subtracting the traditional 0.125% spread. South Africa used a similar constructed one-month interbank offer rate.

For Brazil, Taiwan, India, Chile, South Korea and China, the implied yields for one-month non-deliverable forward contracts were used to represent the rates available to U.S. investors. For Turkey, the implied yields for one-month deliverable forwards were used to represent the rates available. For Mexico, Israel, and Poland, representative 1-mo. interbank deposit and offer rates were used. The yield on the Emerging Basket is simply an average of the yields on the 11 emerging currencies in the graph—Brazil, Chile, Mexico, Turkey, Poland, South Africa, Israel, India, Taiwan, South Korea and China.

A deliverable forward currency contract is an agreement by two parties to transact in currencies at a specific rate on a future date upon which each party delivers the promised currency. A non-deliverable forward currency contract is an agreement by two parties to transact in currencies at a specific rate on a future date and then cash settle the agreement with a simple exchange of the market value difference between the current market rate and the initial agreed-upon rate.

**+ Tap the long-term economic potential of emerging markets.<sup>1</sup>** Exposure to emerging currencies and money market instruments provides access to the economic potential offered by emerging market countries. Emerging market economies have served as a principal engine of global GDP growth since 2000 and the gap between emerging market and developed market economy output is shrinking. The emerging markets are likely to play a pivotal role in lifting the global economy out of its current downturn.

The value of the currency and the level of short-term interest rates are the most obvious reflection of the differing economic and political fundamentals of a country and the market expectations regarding them. While sensitive to these fundamentals, investments in emerging market stocks also expose the investor to additional risks, which could cause returns to deviate from those specified by the currency alone. Emerging market equities react to factors independent of those factors that drive currency returns, often contributing to significantly higher volatility. Over the last 10 years, an equally weighted basket of emerging currencies had an annualized volatility<sup>2</sup> of 6.9%, while an equally weighted basket of emerging market stocks from the same countries had a volatility of 25.2%.

<sup>1</sup> Both emerging currencies and emerging stocks in this example are proxied by a basket which tracks the total return of an equally weighted basket of the following currencies: Brazil, Chile, Mexico, Poland, Israel, South Africa, Turkey, China, India, Taiwan and South Korea. Returns for the individual currencies are represented by sub-indexes of the JP Morgan Emerging Local Markets Index Plus (ELMI+) for each individual country. Returns for the equities are represented by MSCI emerging market sub-indexes for the individual countries. The equal weighting for the static basket is reset every quarter.

<sup>2</sup> Annualized volatility is the degree to which a fund's returns have fluctuated above or below its means. A higher number indicates higher volatility.

**+ Position portfolios to potentially benefit from declines in the U.S. Dollar.** In the second half of 2008, the dollar appreciated sharply against many currencies on the flight to safety and repatriation of capital triggered by the liquidity crisis. This gain interrupted a steady decline of the dollar over the previous seven years. The scale of fiscal and monetary stimulus employed to combat the financial crisis has raised potential concerns about long-term inflation and the sustainability of the dollar's current level. Investors can preserve or increase the dollar value of their assets yet still lose ground with a declining dollar. Incorporating a small allocation to a broad-based basket of emerging money markets can be a risk-conscious approach to diversifying currency exposure.

#### Federal Reserve Trade-Weighted Dollar Index (April 1, 1999–March 31, 2009)



Source: Federal Reserve, 2009

Federal Reserve Trade-Weighted Exchange Index: Broad index is defined as a weighted average of the foreign exchange value of the U.S. dollar against its major trading partners.

Past performance does not guarantee future results. You can not invest directly in an index.

*There are risks associated with investing, including possible loss of principal. In addition to the normal risks of investing, foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Securities that focus their investments in specific regions or countries increase the impact of events and developments associated with the region or country, which can adversely affect performance. Investments in emerging markets are generally less liquid and less efficient than developed markets. Investments in currency involve additional special risks, such as credit risk, interest-rate fluctuations, derivative investment risk and the effect of varied economic conditions. As these investment types can have a high concentration in some issuers, these investments can be adversely impacted by changes affecting issuers. Unlike typical exchange-traded funds, there are no indexes that the Currency Funds attempt to track or replicate. Thus, the ability of the Funds to achieve its objectives will depend on the effectiveness of the portfolio manager. Please read the funds prospectus for specific details regarding the fund's risk profile.*

**Investors should consider the investment objective, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other important information, please call 866.909.WISE (9473) or visit [wisdomtree.com](http://wisdomtree.com). Investors should read the prospectus carefully before investing.**

Barclays Capital Aggregate Index is an index used by bond funds as a benchmark to measure their relative performance. The index comprises government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The S&P 500 Index is a capitalization-weighted index of 500 stocks selected by the Standard & Poor's Index Committee, designed to represent the performance of the leading industries in the United States economy. The MSCI EAFE Index is a market cap-weighted equity index composed of companies representative of the developed market structure of 21 developed countries in Europe, Australasia and Japan. The returns are presented in two formats: denominated in U.S. dollars as well as the local currency versions. The MSCI Emerging Markets Index is a market cap-weighted equity index composed of companies representative of 26 emerging market countries. The sub-indexes for the individual countries track the performance of the constituent companies representative of the specific country. The Merrill Lynch U.S. Dollar, One-Month, Constant Maturity LIBID Index tracks a consistent investment in one-month U.S. bank deposits. LIBID is the London Interbank Bid Rate, or the rate at which banks are willing to borrow. It is the bid side of the more well-known London Interbank Offer Rate (LIBOR). The Dow Jones-AIG Commodity Total Return Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The index reflects the return of fully collateralized positions in futures contracts on 19 physical commodities. London PM Fix is the widely followed 3:00 p.m. London fixing of the price of an ounce of gold in U.S. dollar by the London Gold Market Ltd., which includes Barclays Capital, ScotiaMocatta, Deutsche Bank, Société Générale and HSBC Investment Banking Group. The Citigroup Non-USD World Government Bond Index is an unmanaged index composed of investment grade non-US government bonds which satisfy specific size and barriers-to-entry requirements, and is generally considered to be representative of broad non-US government bond market activity. The JP Morgan Emerging Local Market Index Plus and its component subindices are designed to be investable benchmark indexes for a series of tradable emerging market currencies. The total return indexes typically track the performance of a combination of U.S. cash with an equally weighted basket of one-month, two-month and three-month forward contracts, providing exposure to the specified currency or currencies.

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