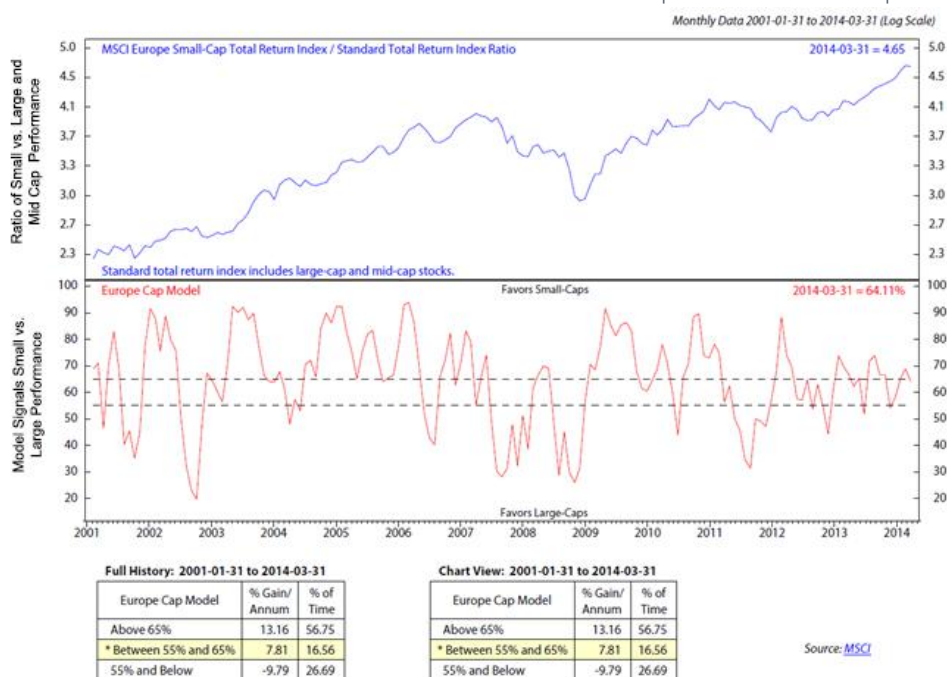


# POSITIVE SIGNALS FOR EUROPEAN SMALL CAPS

Tripp Zimmerman — Director, Research  
04/14/2014

The stabilization of the European economy last year was encouraging for global markets, and in the second half of 2013 many investors quickly acted on these green shoots by allocating more than \$20 billion to European-focused exchange-traded funds (ETFs) in their search for investment opportunities.<sup>1</sup> With continued positive economic growth readings at the end of last year and leading indicators signaling further expansion during 2014, sentiment among investors continues to build positive momentum. **Positioning for Earnings Recovery** One reason to have a continued positive view of European equities is that the current stage of the economic cycle—being very early in the economic recovery—may imply that the earnings cycle is about to ramp up to a higher gear. For investors who share this view, it may be beneficial to increase their allocations to [small caps](#), which had higher growth expectations than their [large-caps](#) peers<sup>2</sup> and typically provide more exposure to the economically sensitive sectors. Ned Davis Research (NDR) has created a model to help determine the relative attractiveness of European small caps compared to large caps. The model calculates a composite score by looking at a combination of [fundamentals](#), economic indicators and technical indicators<sup>3</sup> to determine the relative attractiveness of European small caps.

**Europe Cap Model**



Copyright 2014 Ned Davis Research, Inc. Published with the permission of Ned Davis Research, Inc. Further distribution prohibited without prior permission. All rights reserved. See NDR Disclaimer at [www.ndr.com/copyright.html](http://www.ndr.com/copyright.html). For data vendor disclaimers, refer to [www.ndr.com/vendorinfo/](http://www.ndr.com/vendorinfo/). Past performance is not indicative of future results. You cannot invest directly in an index.

## • Small Caps Displayed

**Strong Momentum** – The top chart compares the performance of European small caps as represented by the MSCI Europe Small Cap Index against large caps and [mid-caps](#) as represented by the [MSCI Europe Large Cap Index](#) and [MSCI Europe Mid Cap Index](#). The chart moving higher means small caps are exhibiting stronger relative performance. This relative strength of small caps, visible through the line's upward trend, is typically a positive technical signal. •

**Composite Model Positive for Small Caps** – As of March 31, 2014, the composite model is between the 55% and 65%

threshold, which is a level that is favorable to small caps. I find it impressive that when the composite reading is within this threshold, small caps *outperformed* large caps by more than 7.8%, and when the reading is below 55%, small caps *underperformed* by more than 9.7%. This model would suggest it's a good time to favor small caps and that following past periods when the model looked like this, small caps enjoyed a performance differential over large caps. We will keep tabs on this NDR model and let readers of our research know when it falls below 55%, which is when the model would favor large caps. Of course, it is important to remember that past performance can't predict future results.

**Potential Implementation** The European economic recovery is far from risk free, but the accommodative monetary policies seem to be favorable to continuing the momentum and could even provide a backstop if growth does not materialize. For example, the European Central Bank (ECB) has reaffirmed its commitment to keeping [interest rates](#) low by stating, "We firmly reiterate that we continue to expect the key ECB interest rates to remain at present or lower levels for an extended period of time."<sup>4</sup> Given this accommodative monetary policy, positive economic growth outlook and my belief that we are potentially still in the early innings of the earnings cycle, I remain positive on Europe and small caps in particular. I also want to emphasize the importance of diversifying and believe there are different ways to play the European recovery theme, depending on one's conviction. To read our full valuation and growth update for Europe, please click [here](#).

<sup>1</sup>Sources: WisdomTree, Bloomberg. <sup>2</sup>Source: Ned Davis Research (12/31/13). <sup>3</sup>Technical indicators attempt to predict the future price levels, or simply the general price direction, of a security by looking at past patterns.

<sup>4</sup>Mario Draghi, European Central Bank Press Release (04/03/14).

#### Important Risks Related to this Article

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments focused in Europe may be impacted by events and developments associated with the region, which can adversely affect performance. Investments focusing on certain sectors and/or smaller companies may be vulnerable to any single economic or regulatory development. This may result in greater share price volatility. Diversification does not eliminate the risk of experiencing investment losses.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## **DEFINITIONS**

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

**Large-Capitalization (Large-Cap)** : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

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

**Mid-Cap** : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

**MSCI Europe Large Cap Index** : captures large cap representation across the 15 Developed Markets (DM) countries in Europe.

**MSCI Europe Mid Cap Index** : captures mid cap representation across the 15 Developed Markets (DM) countries in Europe.

**Interest rates** : The rate at which interest is paid by a borrower for the use of money.