

FINDING EUROPEAN EXPOSURE LESS SENSITIVE TO THE CHINESE CURRENCY DEVALUATION

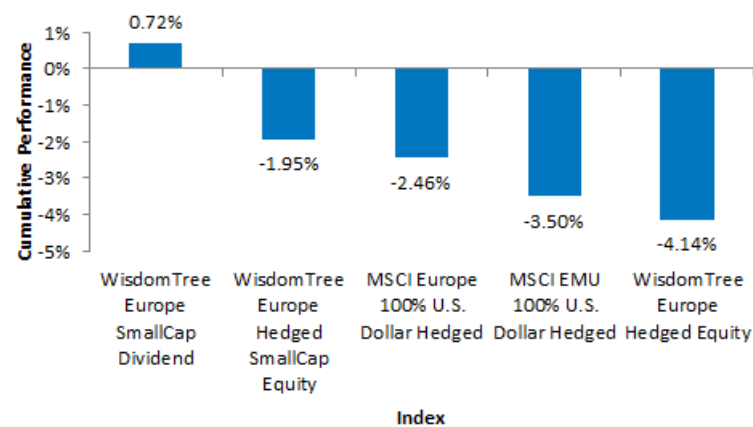
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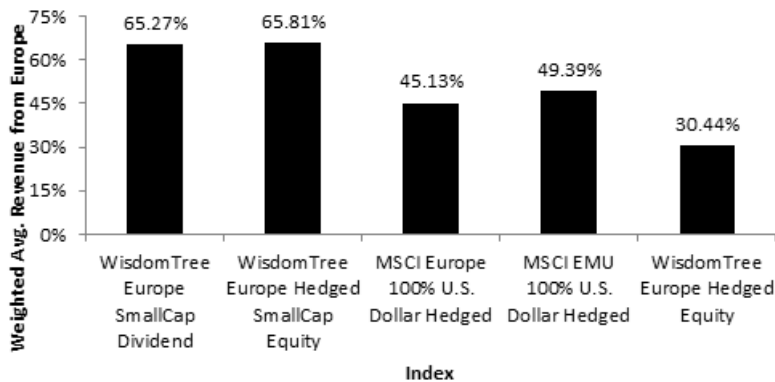
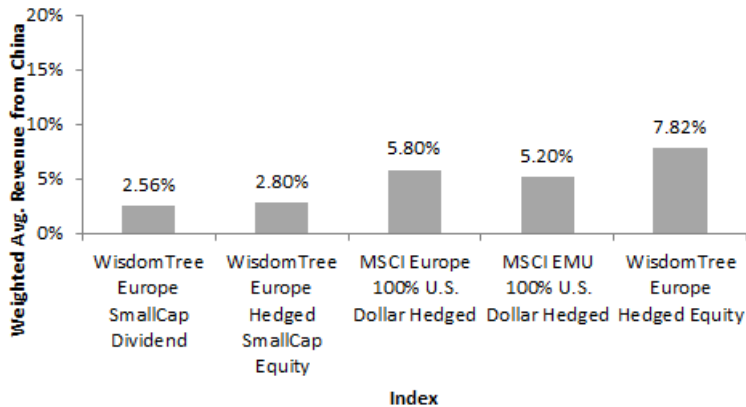
Of late, concerns about China have been widespread, spurred on by stimulus measures, currency adjustments and an overall sense of a general lack of transparency. China is a big market for many European exporters and luxury goods companies. Due to [quantitative easing](#) from the European Central Bank (ECB) and generally strong performance, large investment flows have found European equities to be attractive so far in 2015. If people believe in European equities but worry about the ramifications of the Chinese currency [devaluation](#) —where can they turn? **European Small Caps Emphasize Europe’s Potential** In short: European small caps draw a much greater share of their revenues from within Europe rather than from exports outside Europe. During the week of August 10, 2015, when the People’s Bank of China (PBoC) took action to weaken China’s currency, European small caps performed better than their large-cap exporters.

For instance¹:

- The [WisdomTree Europe SmallCap Dividend Index](#) delivered a 0.72% positive return. European equities were broadly negative during this period, but this Index also includes exposure to European currencies, which appreciated against the U.S. dollar over the period. The four largest exposures are to the euro (+1.29%), British pound (+0.97%), Norwegian krone (+0.56%) and Swedish krona (+3.04%).
- The [WisdomTree Europe Hedged SmallCap Equity Index](#) delivered a -1.95% return over the period. Being hedged, it was not helped by the positive return of the euro against the U.S. dollar.
- The [WisdomTree Europe Hedged Equity Index](#), on the other hand, specifically focuses on companies within the euro area that generate at least 50% of their revenues from outside Europe. It delivered a -4.14% return over the period, underperforming the two Indexes of European small caps. The [MSCI EMU 100% Hedged to USD](#) and [MSCI Europe US Dollar Hedged](#) Indexes also underperformed European small caps with returns of -3.50% and -2.46%, respectively. None of these indexes, due to being hedged, was helped by European currencies appreciating against the U.S. dollar. While there is no way to know whether the focus on China will continue in the coming weeks, but whether this devaluation was a one-off move or the start of a new trend it does illustrate the potential for European small caps to react differently to global events than European large caps.

Believe in Europe with Less Focus on China





Sources: Bloomberg for cumulative index performance, Factset for weighted average revenue. Past performance is not indicative of future results. You cannot invest directly in any index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends, but does not reflect any management fees, transaction costs or other expenses that would be incurred by a fund or portfolio, or brokerage commissions on transactions in fund shares. Such fees, expenses and commission could reduce returns.

• **Small Caps Had Significantly Less**

Revenue from China: For the WisdomTree Europe SmallCap Dividend and WisdomTree Europe Hedged SmallCap Equity Indexes we estimate that 2.6%–2.8% of their weighted average revenues came from China as of July 31, 2015. This is approximately half of what we saw for the MSCI Europe US Dollar Hedged and MSCI EMU 100% Hedged to USD Indexes, and significantly less than the 7.8% weighted average revenue from China that we estimate for the WisdomTree Europe Hedged Equity Index. It’s worth noting that for the WisdomTree Europe Hedged Equity Index, this means that we estimate 92.2% of weighted average revenues not coming from China.

• **Small Caps Generate Two-Thirds of**

Their Revenues from Within Europe: The WisdomTree Europe SmallCap Dividend and WisdomTree Europe Hedged SmallCap Equity Indexes saw approximately two-thirds (over 65%) of their weighted average revenues coming from within Europe. Not one of the three indexes focused on large caps that we showed cracked the 50% mark.

European Completion The week of August 7 to August 14, 2015, was just that—a one-week period. Yet it is illustrative of a bigger concept: European completion, namely by taking small caps into consideration, one can diversify the markets where companies receive revenue. Large caps tend to be more sensitive to the global economy and could face pressure if there are continued worries about an Asian currency war breaking out, while small caps are one way to position for an improving European economy. ¹Source for bullet points: Bloomberg, for period 8/7/15–8/14/15.

Important Risks Related to this Article

Investments focused in Europe increase the impact of events and developments associated with the region, which can adversely affect performance.

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adversely affect performance.

Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations.

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Quantitative Easing (QE) : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

Devaluation : deliberate downward adjustment to the value of a country's currency, relative to another currenc.

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