

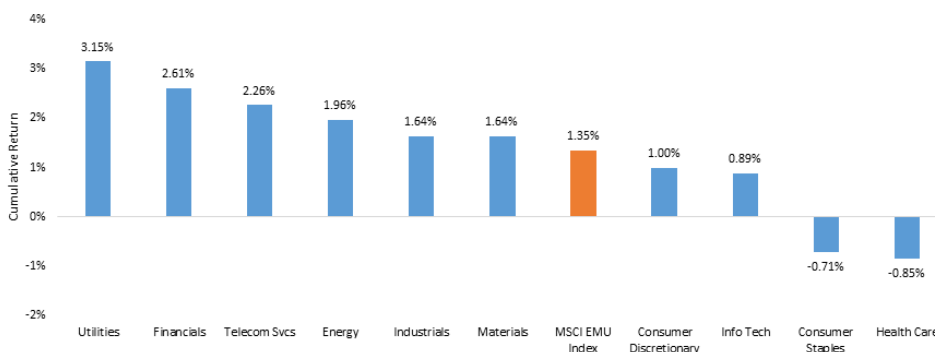
THE WISDOMTREE TOOLKIT FOR INVESTING IN EUROPE

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Central bank activity has become one of the most important and influential factors driving markets today. As the [U.S. Federal Reserve \(Fed\)](#) moves toward a [policy rate normalization](#), both the Bank of Japan (BOJ) and the European Central Bank (ECB) are pushing the boundaries with policies that many wouldn't have considered merely a few years ago. [Quantitative Easing \(QE\)](#) Will Have Important Impacts while it is clear to us that one desired impact of quantitative easing (QE) is rising equity markets, the impact across the different sectors may not be equal.

- **QE May Stimulate Financials:** ECB president Mario Draghi is focused on stimulating the credit channel in Europe's economy, and that could ultimately prove to be a positive for Financials. The sector has been [volatile](#) thus far in 2016—over some time frames, it's been the worst-performing sector and at other times the best.
- **Lower-Quality Sectors Performed Well Immediately Following the ECB's March 10, 2016, Announcement:** During the first week after the announcement, the three top-performing sectors in the [MSCI EMU Index](#) were Utilities, Financials and Telecommunication Services. These sectors are among the most heavily indebted, but if the ECB is positioning itself as a buyer of corporate and government debt, thereby encouraging lower [interest rates](#), it stands to reason that these sectors may experience a bit of an initial tailwind.
- **Exporters or European Companies Tilted More toward Domestic Demand?** While we believe that the thesis underpinning a weaker euro compared to the U.S. dollar is intact, the shorter-term behavior of the euro has not tended to cooperate. For export-oriented firms, it is important to recall that levels between \$1.10 and \$1.15—while not necessarily as beneficial as \$1.00 to \$1.05—are still significantly lower than the levels closer to \$1.40 that we saw in early May 2014. While we believe the euro could weaken further over the medium to long term, stimulating the competitiveness of exporters, there are other opportunities, be it in more domestic-demand-oriented European companies or even in European small-cap stocks.

European Sector Performance One Week after the March 10, 2016, ECB Announcement



Source: Bloomberg, with data from closing prices on 3/9/16 to closing prices on 3/17/16. Sectors represented by respective stocks from within the MSCI EMU Index. Returns are measured in euros. Past performance is not indicative of future results. You cannot invest directly in an index.

How to Think About Different Tools, Given the March 10, 2016, ECB Announcement while no one knows exactly how European equities will perform going forward, there is no shortage of

opinions. Thinking through some of the potential scenarios, we see these four possibilities:

- 1. The ECB's Policy Announcement May Encourage European Banks to Lend:** If this happens, the pickup in loan growth in Europe could create a desire for greater exposure to European Financials. One interesting tool to generate that exposure could be the [WisdomTree Europe Local Recovery Fund \(EZR\)](#), which had greater than 30% exposure to Financials as of March 17, 2016.
- 2. The ECB's Policy Announcement May Lead to a Weaker Euro:** Even though the first week after the announcement hasn't seen this occur, that doesn't mean that over a more medium- to long-term time frame it won't—especially if the Fed raises the [Fed Funds interest rate](#) in June 2016 or beyond. Here, the [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#) could be a feasible strategy, as it tracks the returns (after fees) of the [WisdomTree Europe Hedged Equity Index](#), which has a requirement of all constituents to generate at least 50% of their revenues from outside Europe.
- 3. European Consumers May Increase Their Aggregate Demand:** The importance of this outcome cannot be overstated. In addition to EZR, which tracks (after fees) the performance of the [WisdomTree Europe Local Recovery Index](#)—an Index that requires eligible constituents to derive at least 50% of their revenues from *inside* Europe—the focus would be on small-cap stocks, via either the [WisdomTree Europe Hedged SmallCap Equity Fund \(EUSC\)](#) or the [WisdomTree Europe SmallCap Dividend Fund \(DFE\)](#).
- 4. Uncertainty as to Exactly How the ECB Announcement Will Impact European Equities or the Euro:** The prior three thoughts represent different tilts that correspond to different viewpoints, but they're not the only answers. The [WisdomTree Dynamic Currency Hedged Europe Equity Fund \(DDEZ\)](#) owns dividend-paying stocks of Europe, weighted by the [dividends](#) paid. Additionally, DDEZ tracks (after fees) the returns of [an Index](#) that implements a [dynamic hedge](#) for the movements of the euro versus the U.S. dollar, which will adjust monthly based on changes in market conditions.

Central Bank Actions Are Here to Stay What we saw on March 10 from the ECB and earlier this year from the BOJ is that global central banks are doing whatever they can to influence markets. It is truly amazing to see that both are employing [negative deposit rates](#). Over time, we will have to see how market dynamics are influenced, and we hope that the fiscal side of the equation can ultimately make its appropriate contribution, taking some of the pressure off monetary policies to carry the full load.

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DEFINITIONS

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Policy Rate Normalization: steps to raise/lower the federal funds rate and other short-term interest rates to more normal level.

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.

Volatility: A measure of the dispersion of actual returns around a particular average level.

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

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

Federal Funds Rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Dividend: A portion of corporate profits paid out to shareholders.

Dynamic Hedge: Strategy in which a currency hedge can be varied (as opposed to targeting a constant level) and change over the course of time.

Negative deposit rates: A new European Central Bank policy measure aimed at charging banks for parking their excess cash with the central banks.