
DOES IT REALLY MATTER WHERE THE EURO GOES?

Joseph Tenaglia — Director, Model Portfolios

06/22/2017

Nowadays, everyone has an opinion. Especially when it comes to the euro.

Going into 2017, market consensus was that the U.S. dollar would strengthen over the course of the year, and the euro stood at 1.04 per U.S. dollar. [Bearish](#) euro positioning has largely unwound since then and the currency has rallied, standing at 1.12 at the end of May.

[Value](#) investors contend that even after the rally, the euro is still undervalued compared to the dollar. Technical signals show that the euro has reached “overbought” levels and is primed to fall. [Momentum](#) indicators hint that the euro should continue to rise. [Interest rate differentials](#) still suggest that the euro should fall. And at the end of May, net speculative positioning in the euro reached its most [bullish](#) level since 2011¹—and no doubt, both euro bulls and bears would view this last data point as evidence in their favor.

Where Will the Euro Go Next?

In short, currencies are notoriously difficult to predict. WisdomTree has worked with Record Currency Management to develop a rules-based approach that aims to add value over the long run using three currency indicators—and even these indicators are showing conflicting signals. The point of this blog post is not to provide an outlook on the euro.

The point is, for investors buying European equities right now, does it matter where the euro goes?

Case for Europe Equities Strengthening

Before talking about the currency, we should discuss European stocks themselves. To be sure, the fundamental case and outlook for European equities has improved significantly in recent months:

- Corporate earnings revisions have soared²
- Economic surprises have been positive.³
- [Valuations](#) compared to U.S. equities are attractive.
- Elections have been won by market-friendly candidates.
- Continued easy [monetary policy](#) has come from the European Central Bank (ECB).

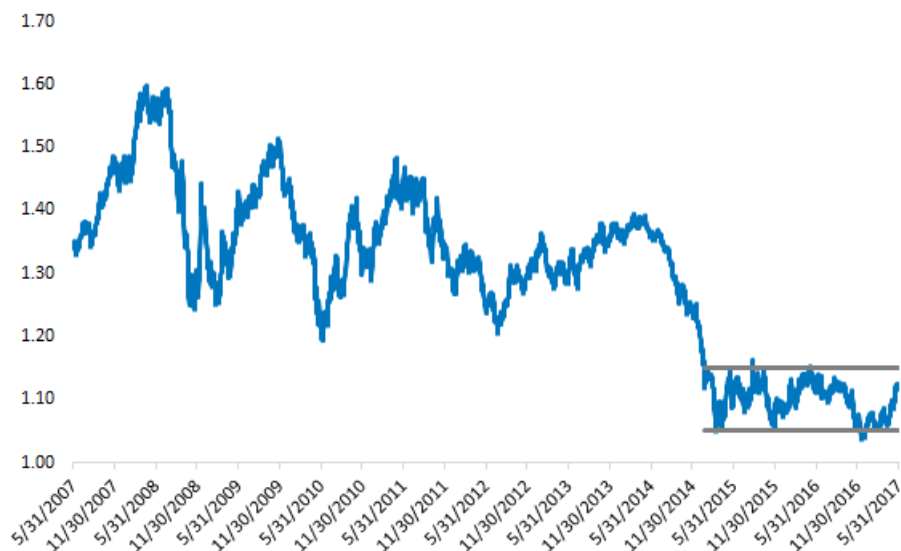
As a result of these positive developments, flows have returned in a big way, with \$10.5 billion in flows into broad-based

European ETFs since the end of February⁴—a sharp contrast to the \$23 billion in outflows in 2016. Clearly, investors are paying attention to Europe once again.

Euro's Moves Have Been Relatively Tame

Back to the euro. After significantly weakening during the ECB [QE](#) program, the euro has almost exclusively been range bound between 1.05 and 1.15 since January 2015. There have been intermittent periods of strength and weakness, but in total, the currency has not moved in a significant way over the last two-plus years.

Price of 1 Euro in U.S. Dollars



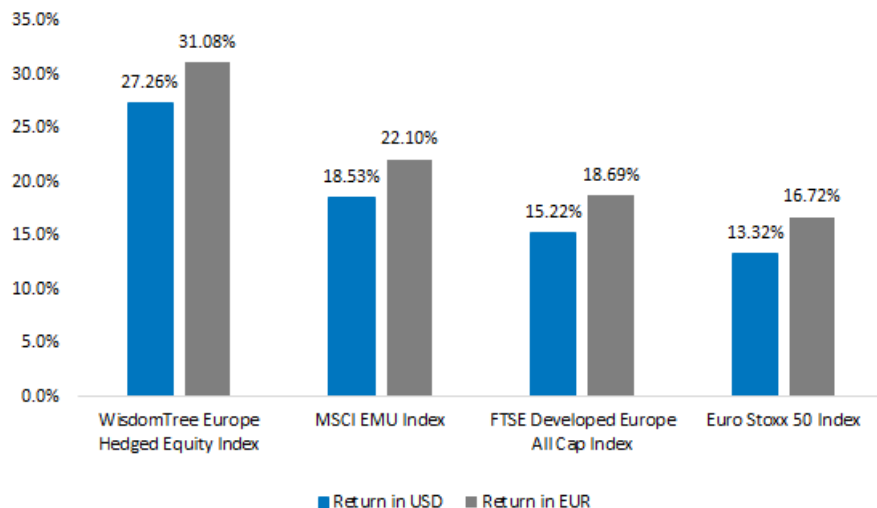
Source: Bloomberg, as of 5/31/17. Past performance is not indicative of future results.

Conversations about the euro inevitably prompt questions from investors about whether they should [hedge](#) their investments there. Our research has shown that over the long run, hedging euro exposure has reduced [volatility](#) and enhanced returns.⁵ But because many investors don't hold positions for 20 years, and since the euro is experiencing arguably its longest period of relative stability, the last few years provide an interesting case study.

With the euro not having shown sustained strength or weakness since January 21, 2015 (the day the euro first crossed below 1.15), would investors have been better off being hedged or unhedged?

To be blunt, it did not matter.

Index Returns from 1/21/2015–5/31/2017



Source: Bloomberg, as of 5/31/17. Past performance is not indicative of future results. You cannot invest directly in an 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 portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

For definitions of indexes in the chart, visit our [glossary](#).

Regardless of whether performance was measured in dollars or euros, the [WisdomTree Europe Hedged Equity Index](#) handily outperformed some of the most commonly followed [cap-weighted](#) European equity indexes. That the hedged WisdomTree Index could do so in a nondirectional currency environment implies that it was more than just the currency aspect that drove returns. Why?

Don't Miss the Forest for the Trees: Stocks!

WisdomTree launched its first ETFs in 2006, based on the idea that there was a better way to invest than in cap-weighted strategies. To point, several factors differentiate the WisdomTree Europe Hedged Equity Index from its comparable cap-weighted equity indexes:

- **Dividend-Paying Stocks:** Companies must pay at least \$5 million in annual cash dividends to be included in the Index, which places a focus on companies that regularly reward shareholders via dividends.
- **Exporters:** Companies must derive at least 50% of their revenues from outside Europe, giving the Index a global reach.
- **Dividend Weighted:** WisdomTree's [Dividend Stream®](#) process magnifies the impact of the largest dividend-paying stocks on the overall Index.
- **Annual Rebalance:** Every year, the WisdomTree Index will rebalance back toward the relative value of dividends, which acts as a disciplined value mechanism that typically results in selling the previous year's winners and buying the losers.

Sometimes conversations about international investing can be overshadowed by the impact of currencies. Perhaps the question investors should be asking right now is not "Where will the euro go?" or "Should I be hedged or unhedged?" Instead, perhaps the question should be "If I'm investing in Europe, what stocks do I want to own?"

Investors looking toward European equities can invest in the ETF that tracks the WisdomTree Europe Hedged Equity

Index, the [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#).

¹Source: Bloomberg, 6/5/17.

²Source: Merrill Lynch, 6/6/17.

³Source: Bloomberg, as of 5/31/17.

⁴Source: Bloomberg, as of 6/8/17.

⁵Sources: Bloomberg, MSCI. From 4/30/1998 to 3/31/2017.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

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)

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

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Momentum Factor : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

Interest Rate Differentials : The Difference between the 2 Year interest rate swaps of the United Kingdom vs. the United States.

Bullish : a position that benefits when asset prices rise.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

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.

Hedge : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

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

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

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

Dividend Stream : Refers to the regular dividends per share multiplied by the number of shares outstanding.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.