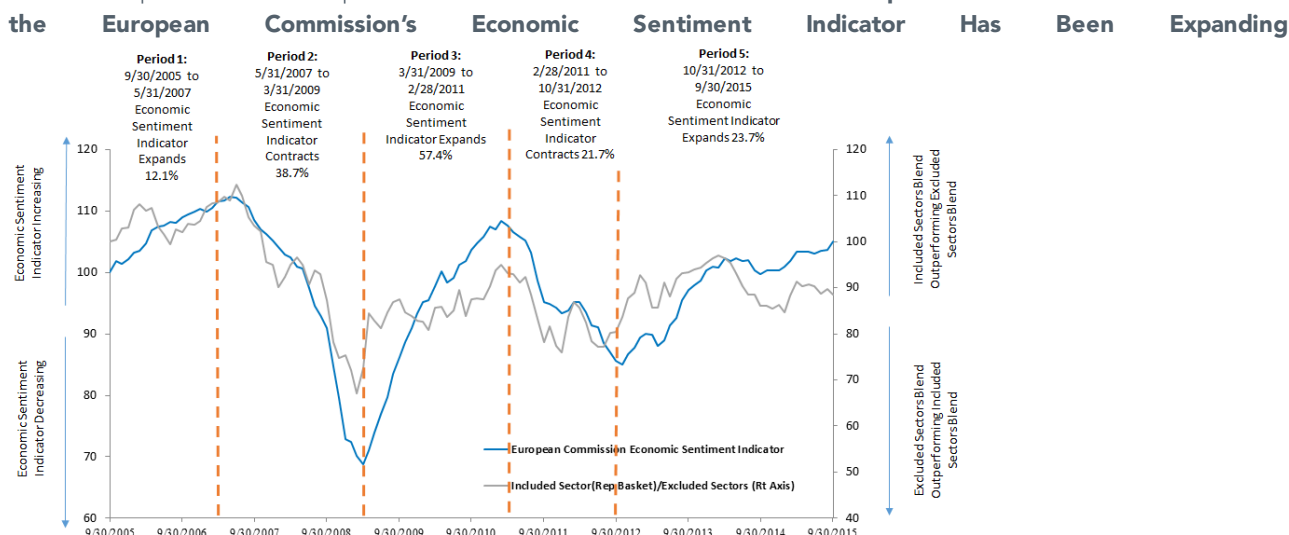


# HOW EUROPEAN COMPANIES RESPOND TO CHANGING GROWTH PROSPECTS

Jeremy Schwartz — Global Chief Investment Officer  
12/03/2015

WisdomTree recently introduced the new [WisdomTree Europe Local Recovery Index](#), which is designed to provide exposure to the more local side of the European economy by excluding companies whose business is dominated overseas as well as the more [defensive sectors](#) of the market. The Index construction process for this new Index is designed to favor more [cyclical sectors](#) and those that are more responsive to changes in the economic growth environment, using one of our favorite leading indicators of the economy: the [European Commission's Economic Sentiment Indicator](#). **Sector Mix That Has Responded to the Economic Sentiment Indicator** While it's clear that the sectors we've included have tended toward both higher [correlations](#) to the Economic Sentiment Indicator and [higher responsiveness to equity market movements when viewed in isolation](#), below we further our case by illustrating how our sector screens for this Index have corresponded to changes in the leading economic indicator used in the Index weighting methodology. To approach this question, we looked at two subsets of Index blends. • **Included Sectors:** The WisdomTree Europe Local Recovery Index includes stocks from the Consumer Discretionary, Energy, Financials, Industrials, Information Technology and Materials sectors. We created a blend of these sectors while maintaining sensitivity to the country exposures of the WisdomTree Europe Local Recovery Index as of September 30, 2015.<sup>1</sup> •

**Excluded Sectors<sup>2</sup>:** The WisdomTree Europe Local Recovery Index excludes stocks from the Consumer Staples, Health Care, Telecommunication Services and Utilities sectors, and we created an equally weighted blend to represent a more defensively oriented positioning.<sup>3</sup> **Bottom Line:** If the blend of *included* sectors tends to outperform the blend of *excluded* sectors during periods when the European Commission's Economic Sentiment Indicator is increasing, it shows an effective positive relationship between the two. **Included Sectors Have Outperformed Excluded Sectors When**



| Expansion by Economic Indicator (More than 10% Upward) |            |           |                                |                                   |                           |                                   |
|--------------------------------------------------------|------------|-----------|--------------------------------|-----------------------------------|---------------------------|-----------------------------------|
|                                                        | Start Date | End Date  | % Change in Economic Indicator | Returns Given by Included Sectors | Returns Given by MSCI EMU | Returns Given by Excluded Sectors |
| Period 1                                               | 9/30/2005  | 5/31/2007 | 12.1%                          | 50.3%                             | 45.7%                     | 37.9%                             |
| Period 2                                               | 3/31/2009  | 2/28/2011 | 57.4%                          | 85.2%                             | 63.9%                     | 42.4%                             |
| Period 3                                               | 10/31/2012 | 9/30/2015 | 23.7%                          | 55.7%                             | 44.1%                     | 47.8%                             |

| Contraction by Economic Indicator (More than 10% Downward) |            |            |                                |                                   |                           |                                   |
|------------------------------------------------------------|------------|------------|--------------------------------|-----------------------------------|---------------------------|-----------------------------------|
|                                                            | Start Date | End Date   | % Change in Economic Indicator | Returns Given by Included Sectors | Returns Given by MSCI EMU | Returns Given by Excluded Sectors |
| Period 1                                                   | 5/31/2007  | 3/31/2009  | -38.7%                         | -57.8%                            | -53.9%                    | -36.1%                            |
| Period 2                                                   | 2/28/2011  | 10/31/2012 | -21.7%                         | -11.8%                            | -7.7%                     | 1.1%                              |

Source: Bloomberg, with data covering the 10-year period ending 9/30/15. Past performance is not indicative of future results. You cannot invest directly in an index.

For definition of indexes in the chart, visit our [glossary](#). • **Performance during Expansions:** Here we define expansions as periods in which the European Commission's Economic Sentiment Indicator increased by 10% or more over the previous 10 years. There were three such periods, and in each case, the blend of included sectors outperformed both the [MSCI EMU Index](#) and the blend of excluded sectors. • **Performance during Contractions:** Conversely, we define contractions as periods in which the European Commission's Economic Sentiment Indicator decreased by 10% or more over the previous 10 years. There were two such periods, and in each case, the returns of the included sectors underperformed those of both the MSCI EMU Index and the blend of excluded sectors. These were also challenging environments for the market in general, with the big decline in the sentiment indicator occurring during the global financial crisis, when the MSCI EMU Index fell by more than 50%. These results align with what we think are natural expectations—cyclical sectors had a tendency to outperform as perceptions of economic growth improved, whereas defensive sectors had a tendency to do the same as those perceptions declined. Much of the macroeconomic work suggests that the eurozone's local economic recovery is in its early stages.<sup>4</sup> We believe the WisdomTree Europe Local Recovery Index is well positioned for such a growth outlook.

<sup>1</sup>Blend of included sectors: The blend of included sectors relates to the mixture of sectors allowable for inclusion within the WisdomTree Europe Local Recovery Index, adjusted proportionately for the country exposures of this Index as of 9/30/15. Blend comprises solely MSCI Indexes as follows: [MSCI France Consumer Discretionary Index](#), 9.66%; [MSCI France Industrials Index](#), 9.66%; [MSCI France Financials Index](#), 9.66%; [MSCI France Information Technology Index](#), 4.83%; [MSCI France Energy Index](#), 2.76%; [MSCI Germany Financials Index](#), 8.97%; [MSCI Germany Industrials Index](#), 8.97%; [MSCI Germany Consumer Discretionary Index](#), 8.28%; [MSCI Germany Materials Index](#), 4.14%; [MSCI Germany Information Technology Index](#), 2.76%; [MSCI Italy Financials Index](#), 11.72%; [MSCI Italy Consumer Discretionary Index](#), 4.14%; [MSCI Italy Industrials Index](#), 2.76%; [MSCI Spain Financials Index](#), 4.83%; [MSCI Spain Consumer Discretionary Index](#), 4.14%; and [MSCI Spain Industrials Index](#), 2.76%. <sup>2</sup>Subsequent to Index screening, it is possible that a current constituent may spin off a subsidiary company that may be classified as a Consumer Staples, Health Care, Telecommunication Services or Utilities sector firm. Spun off firms that remain in the Index do not get removed between Index rebalances due to their sector classification. <sup>3</sup>Blend of excluded sectors: The blend of excluded sectors is equally weighted between the [MSCI EMU Consumer Staples Index](#), [MSCI EMU Health Care](#), [Telecommunication Services and Utilities Indexes](#). <sup>4</sup>Source: Bloomberg, as of 9/30/15.

#### 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.

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

**Defensive sectors** : Consumer Staples, Health Care, Telecommunication Services and Utilities.

**Cyclical sectors** : Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.

**European Commission Economic Sentiment Indicator** : refers to a composite indicator made up of five sectoral confidence indicators with different weights: Industrial confidence indicator, Services confidence indicator, Consumer confidence indicator, Construction confidence indicator Retail trade confidence indicator.

**Correlation** : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

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

**MSCI France Consumer Discretionary Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Consumer Discretionary sector. in France.

**MSCI France Industrials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Industrials sector in France.

**MSCI France Financials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Financials sector in France.

**MSCI France Information Technology Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Information Technology sector in France.

**MSCI France Energy Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Energy sector in France.

**MSCI Germany Financials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Financials sector in Germany.

**MSCI Germany Industrials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Industrials sector in Germany.

**MSCI Germany Consumer Discretionary Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Consumer Discretionary sector in Germany.

**MSCI Germany Materials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Materials sector in Germany.

**MSCI Germany Information Technology Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Information Technology sector in Germany.

**MSCI Italy Financials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Financials sector in Italy.

**MSCI Italy Consumer Discretionary Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Consumer Discretionary sector in Italy.

**MSCI Italy Industrials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Industrials sector in Italy.

**MSCI Spain Financials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Financials sector in Spain.

**MSCI Spain Consumer Discretionary Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Consumer Discretionary sector in Spain.

**MSCI Spain Industrials Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Industrials sector in Spain.

**MSCI EMU Consumer Staples Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Consumer Staples sector in the European Monetary Union.

**MSCI EMU Health Care Index** : A free float-adjusted market capitalization-weighted index designed to measure the performance of stocks within the Health Care sector in the European Monetary Union.