

WHY EARNINGS TRENDS SUPPORT EUROPEAN EQUITIES

Jeremy Schwartz — Global Chief Investment Officer

10/04/2016

European markets trade at a discount to the U.S. Does that make them attractive despite the uncertainty that plagues the European economy and the political risk associated with [Brexit](#) and the possibility of it spreading to other countries that might vote for anti-[eurozone](#) politicians? I believe European equities are relatively attractive compared to the U.S., but one might retort—as one of my fellow market strategists did recently during a global investing panel discussion—that European markets always trade at a discount to the U.S. What makes the discount particularly attractive today? For starters, while we say in the U.S. that stocks look expensive on a raw [price-to-earnings \(P/E\)](#) multiple basis, a proper fair value model incorporates the discount rate to value future cash flows. Historically low [interest rates](#) in the U.S. suggest that U.S. equities are perhaps reasonably valued given the low discount rates that are central to market [valuations](#). In Europe, the earnings multiples are even lower—and the resulting earnings [yields](#) higher—and the bond yields are even lower than those in the United States. For example, the U.S. earnings yield based on current-year earnings is roughly 5.4% (1/PE ratio of 18.5), while our [10-Year bond yield](#) is 1.56%, giving an earnings yield premium (difference of earnings yield and bond yield) of under 4%. For Germany, this premium is nearly double that of the U.S., as the earnings yield is 7.4% and the bond yield is -0.15%. If one believes the TINA (that stands for “there is no alternative”) narrative for the income and asset allocation supports the case for equities in the U.S., then this particularly applies to European assets, especially German equities. This is just further valuation support showing Europe sells at a greater discount. But a second and maybe stronger point is that European sales and earnings—particularly for the exporters of Europe—are showing signs of more robust growth than earnings and sales in the U.S. The table below shows the median sales growth and earnings growth for the [S&P 500 Index](#) and the [WisdomTree Europe Hedged Equity Index](#), which focuses on multinationals from Europe with revenue diversified across the globe. **Sales and Earnings Growth of S&P 500 versus**

	Sales Growth: 1-Year	Earnings Per Share Growth: 1-Year	Sales Growth: 3-Years	Earnings Per Share Growth: 3-Year
S&P 500 Index	1.1%	5.8%	3.5%	11.2%
Europe Exporters	10.1%	14.8%	4.7%	10.3%

Source: Bloomberg as of 9/28/16. Based on median levels of constituents of S&P 500 and WisdomTree Europe Hedged Equity Index (“Europe Exporters”). Past performance is not indicative of future results. You cannot invest directly in an index.

European Multinationals

Stronger Sales, Earnings Growth in Europe The median sales growth for these European companies, year over year, was 10%, while the median sales growth in the U.S. was just 1%. And I think there is potential for this trend to continue. In 2015, reported [GAAP](#) U.S. earnings on the S&P 500 declined 15% on a reported earnings basis, and I believe roughly half of that decline came from the U.S. dollar’s strength (the other half was the decline in oil prices and collapse of earnings in the Energy sector). While the U.S. dollar move was a one-time translation impact of earnings coming in at stronger U.S. dollar prices (weaker foreign translation of earnings), we have shown that it can take as long as three years before U.S. export competitiveness is fully affected. Similarly, we have seen that a weaker euro can translate into a more robust export environment after a lag. I think we are seeing benefits in this stronger sales growth and earnings growth currently, but the question remains whether European multinationals can continue to make progress, realize even greater sales and take global market share from competitors as a result of being priced more competitively at a weaker euro value. I think they could. If the U.S. has this headwind that can continue to be a relative drag on earnings going forward and European markets have a bit of a tailwind for earnings, this could make the valuation argument even stronger and help make a case to look more positively on European equities. *Unless otherwise noted, data source is Bloomberg as of 9/28/16.*

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)

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

Brexit : an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

Eurozone (EZ) : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

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

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.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

10-year government bond yield : Yields on the 10 year government debt security.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.