TIME TO TAKE THE EURO OUT OF GERMANY?

Jeremy Schwartz — Global Chief Investment Officer
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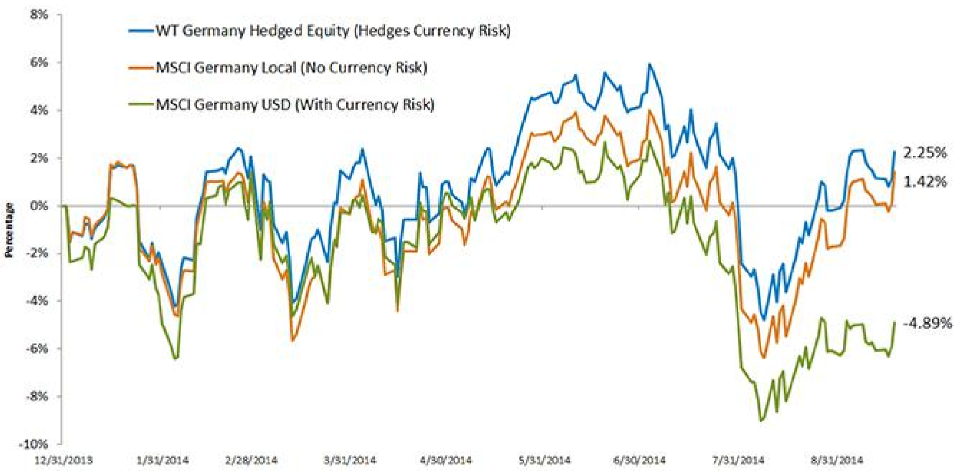
In most cases, when investors think about international equities, they consider the fact that they are gaining exposure to the performance of the equities. However, that's not the only investment they are making, they are also investing in the currency of the local market. And with this investment, investors face more than simply the volatility of the securities they choose; they also face the volatility of the local currency. What we tend to find is that most people investing internationally don't have an opinion on the underlying currency, but take the extra exposure because they believe it's their only option. And for a long time, it was. But today things are different, and investors have the option to invest internationally without layering on currency exposure, or the "currency bet." One market for which this concept may be timely? Germany. **Time to Take the Euro Out of Germany** Given the recent central bank policy divergences and potential for a stronger dollar, we think hedging the impact of the euro in Germany will be especially vital. As the Federal Reserve (Fed) is scheduled to end its asset purchase program next month, the European Central Bank (ECB) recently took further accommodative action and plans to expand its balance sheet by 1 trillion euros.[1] An expanding balance sheet has traditionally led to a weaker local currency, in this case the euro. Year-to-date the euro has depreciated against the dollar by almost 6%, and the ECB's balance sheet hasn't even expanded yet.[2] The weakness in the euro does not mean the case for investing in Europe should be weakened; on the contrary, our research has shown that stocks have historically performed better during periods of currency weakness.[3] The weakness in the euro just highlights the need to adopt currency-hedged equity strategies in obtaining exposure to European stocks. To help illustrate this point, I will chart the year-to-date performance of the WisdomTree Germany Hedged Equity Index against its market cap-weighted benchmark index, the MSCI Germany Index. To clarify the impact of currency, I will chart the returns of the MSCI Germany Index in both dollar terms (which is exposed to currency risk) and local currency terms (which is not exposed to currency risk). **Year-to-Date Performance**



Sources: WisdomTree, Bloomberg, 12/31/13–9/18/14. Past performance is not indicative of future results. You cannot invest directly in an index.

• **Currency Detracting from Unhedged German Returns –** The MSCI Germany Local Index (no currency risk) outperformed the MSCI Germany USD Index, (exposed to currency risk) by more than 6% year-to-date. Since these Indexes are otherwise identical, the entire performance differential is attributed to the impact of the currency. This negative currency impact is even more alarming when you consider added volatility. Over the past three years, the volatility of the currency was an annualized 8.9%.[4] •

The WisdomTree Difference – The WisdomTree Germany Hedged Equity Index (WTGEH), which hedges its currency risk in seeking to mitigate any exchange rate fluctuations from impacting returns, was able to outperform the local German market by an additional 83 basis points. WTGEH is a fundamentally weighted Index that screens and weights companies based on their cash dividends and then repeats this process annually. WTGEH also focuses on exporters, by screening out companies that generate more than 80% of their revenue from within Germany. Exporters have the potential to benefit from global growth even if domestic growth slows and are able to profit from the currency translation adjustment as their home currency weakens against currencies where they sell their goods. We've been writing about currency hedging for some time, and we continue to advocate that, unless you have a strong opinion about the future of a foreign currency—in this case the euro—the baseline exposure should not be in a 100% unhedged approach. We've seen strong interest in currency hedging within the broader eurozone region but believe it is still early in the adoption for the hedged concept when applied to German equities. Given European Central Bank policy and the trend of the euro, we believe it could be time to think about currency hedging of both broad, eurozone-related equities and German equities. [1]Sources: European Central Bank, Bloomberg, as of 9/4/14. [2]Source: Bloomberg, 12/31/13–09/18/14. [3]Sources: WisdomTree, MSCI, 12/31/87–6/30/14. [4]Sources: WisdomTree, Bloomberg, 8/31/11–8/31/14.

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You cannot invest directly in an index.

DEFINITIONS

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

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

Asset purchases : The Fed purchases longer-term securities issued by the U.S. government and longer-term securities issued or guaranteed by government-sponsored agencies such as Fannie Mae or Freddie Mac.

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.

MSCI Germany Index : Index weighted by float-adjusted market capitalization designed to measure the performance of the German equity market.

Basis point : 1/100th of 1 percent.

Fundamental weighting : A type of equity index in which components are chosen based on fundamental criteria as opposed to market capitalization. Fundamentally weighted indexes may be based on fundamental metrics such as revenue, dividend rates, earnings or book value.

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