

# HAVE YOU MISSED THE STRENGTH IN EUROPEAN SMALL CAPS?

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Small-cap stocks can deliver some of the greatest sensitivity to changes in sentiment across global asset classes. European small caps were a great example of this. When Mario Draghi delivered his “whatever it takes” speech in defense of the euro on July 26, 2012, European small caps delivered a sustained rally that continued pretty much unabated until June 6, 2014<sup>1</sup>. During this period of almost two full years, these were the average annual returns, for context:<sup>2</sup> • European small caps: 47.7% • European large caps: 27.8% • U.S. small caps: 26.0% • U.S. large caps: 24.0%

**Quantitative Easing as a New Policy Catalyst** While the “whatever it takes” speech was an important buttress to the continued existence of the euro, we believe that the new quantitative easing program—officially announced by the European Central Bank (ECB) on January 22, 2015—could be the policy catalyst that helps the euro area stave off the risk of [deflation](#). Since this announcement through April 10, 2015, we’ve seen:<sup>3</sup> • European small caps up 10.5% • European large caps up 6.2% • U.S. small caps up 6.6% • U.S. large caps up 2.4%

**European Small Caps Were Already Exhibiting Strength Compared to European Large Caps** The interesting thing is that you didn’t need to wait for the official announcement of quantitative easing for European small caps to start outperforming their large-cap counterparts—the shift in relative performance actually occurred closer to the September 4, 2014, ECB press conference. This was the meeting where the [Asset-Backed Securities Purchase Program](#) and the [Covered Bond Purchase Program](#) were announced. It’s possible that this outperformance of small caps over large caps in Europe was reflecting increased chances of full-scale QE more than four months before it happened. **European Small Caps Respond to Increased**



Sources: WisdomTree, Bloomberg, with period from 3/31/13 to 4/10/15. Europe Small Cap vs. Large Cap refers to the ratio of the performance of the WisdomTree Europe SmallCap Dividend Index to the performance of the FTSE Developed Europe Index, with an upward slope indicating outperformance of the WisdomTree Index over the FTSE Index. U.S. Small Cap vs. Large Cap refers to the ratio of the performance of the Russell 2000 Index to the performance of the S&P 500 Index, with an upward slope indicating outperformance of the Russell Index over the S&P Index. Past performance is not indicative of future results. You cannot invest directly in an index.

**Potential for Full-Scale QE**

For definitions of indexes and terms in the chart, please visit our [glossary](#). **Connecting Relative Performance to Absolute Performance (as of March 31, 2015)**

	WT Index Inception Date	Year-to-Date	1-Year	3-Year	5-Year	Since WT Index Inception
WisdomTree Europe SmallCap Dividend Index	6/1/2006	6.68%	-6.74%	18.24%	12.84%	5.93%
FTSE Developed Europe Index		3.52%	-4.73%	9.76%	6.61%	3.46%
Russell 2000 Index		4.32%	8.21%	16.27%	14.57%	7.91%
S&P 500 Index		0.95%	12.73%	16.11%	14.47%	7.94%

Source: Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index.

• **Upward Slope = Strength**

**in Small Caps:** In both cases, Europe and the U.S., an upward slope signifies [relative strength](#) in small caps measured against large caps. • **European Small Caps Have Delivered vs. European Large Caps:** What’s clear is that the ratios built to depict the relative strength of small caps vs. large caps in the European and U.S. equity markets start at the same place—1.00. As of April 10, 2015, the line showing the relative strength of European small caps vs. large caps was closing in on 1.20, whereas the same line for the U.S. was below 1.00. While there is no way to predict the future, this does show that dipping down in the [market capitalization](#) spectrum in Europe has delivered a greater reward than doing so in the U.S. over this particular period. **Bottom Line: Don’t Forget About European Small Caps** After it became clear that June 6, 2014, was the top of a nearly two-year upward trend in European small caps, the asset class shifted out of focus on the way to an ultimate peak-to-trough decline of almost 21%<sup>4</sup>. What has gotten much less attention is the fact that, as of April 10, 2015, European small caps had only about 6% further to appreciate to regain their June 6, 2014, level. Don’t forget that the last sustained rally in European small caps lasted almost two years—and that was while we were still debating whether or not a QE program could even happen. The [WisdomTree Europe SmallCap Dividend Index](#) (referred to within this piece as European small caps) is designed for a broad exposure to small-cap European equities. It includes exposure to European currencies like the euro, British pound and Swiss franc, as well as exposure to the equities.

*Unless otherwise noted, data source is Bloomberg.* Throughout this piece, “European small caps” refers to the [WisdomTree SmallCap Dividend Index](#) universe, “European large caps” refers to the [FTSE Developed Europe Index](#), “U.S. small caps” refers to the [Russell 2000 Index](#) and “U.S. large caps” refers to the [S&P 500 Index](#). <sup>1</sup>Source:

Bloomberg. <sup>2</sup>Source for all bullets: Bloomberg, from 7/26/12 to 6/6/14. Past performance is not indicative of future results. <sup>3</sup>Source for all bullets: Bloomberg, from 1/22/15 to 4/10/15. Past performance is not indicative of future results.

<sup>4</sup>Source: Bloomberg.

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You cannot invest directly in an index.

## DEFINITIONS

**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.

**Deflation** : The opposite of inflation, characterized by falling price levels.

**Asset-Backed Securities Purchase Program** : Program initiated by the European Central Bank aimed at increasing the availability of credit within the euro area by purchasing qualifying asset-backed securities.

**Relative strength** : A momentum investing technique that compares the performance of a stock, exchange-traded fund or mutual fund to that of the overall market.

**Market Capitalization** : 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.

**WisdomTree Europe SmallCap Dividend Index** : A fundamentally weighted index meant to measure the performance of small-cap European dividend-paying equities weighted by cash dividends paid.

**FTSE Developed Europe Index** : Measure of the performance of developed European companies, weighted by market capitalization.

**Russell 2000 Index** : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

**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.