EUROPEAN EARNINGS RECOVERY COULD MAKE EQUITY MARKETS ATTRACTIVELY PRICED

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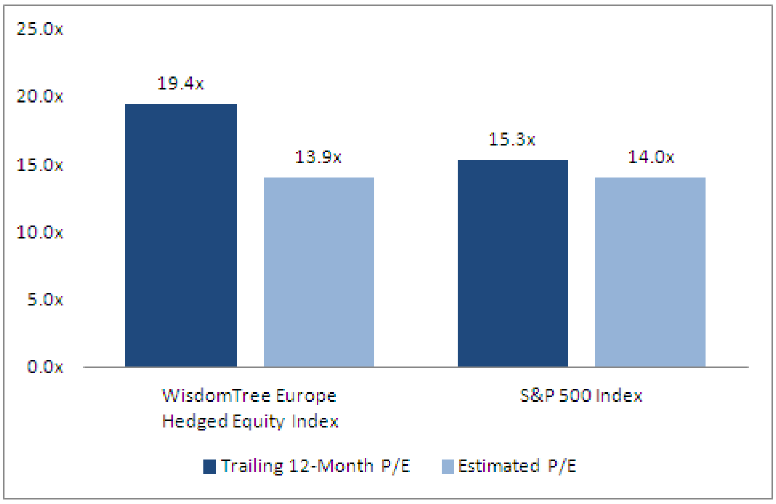
One of the equity markets that many investors are questioning today is Europe, given all the uncertainty surrounding its debt situations—highlighted by recent events in Cyprus. I can understand why some fear the risk levels of this region, but a simplistic dismissal of European exposure is not the right answer, in my view. • First, the prices of European equities may already reflect these troubles, and European equities can still be good investments while the market's economies slowly deal with the debt overhang. • Second, many companies have a global revenue base that is not just reliant on European economic growth. WisdomTree has focused on European exporters in its Europe Hedged Equity Index. These companies are selected only if more than 50% of their revenues come from outside Europe. Most of them have a true global revenue base, with the growth for many coming from emerging markets. When I look at the relative prices of these stocks, I see a fairly attractive price point for many of them. Here's why. **Earnings Recovery Translates to Improved Price-to-Earnings Ratio** Some point to the trailing 12-month price-to-earnings ratio of the WisdomTree Europe Hedged Equity Index as an indication that these stocks are actually quite expensive, with the P/E ratio of the Europe Hedged Equity Index almost 20 and a significant premium to U.S. markets (S&P 500 Index). However, utilizing what is referred to as an estimated P/E ratio can lead to a completely different picture. The two major P/E ratio statistics used in reference to the value of equities relative to their earnings are identical except for one element: The trailing 12-month P/E ratio utilizes the prior 12-months of earnings whereas the estimated P/E ratio utilizes what an array of analysts estimate the coming 12-months of earnings will bring. This by no means implies that these earnings will in fact materialize, and actual earnings might in fact be quite different. Instead, the estimated P/E ratio merely gives us a way to encapsulate the current price level and relate it to analyst expectations. Since in both P/E ratios the current price is the same, the true insight given if an estimated P/E ratio is lower than a trailing 12-month P/E ratio is that analysts largely expect earnings to increase over the coming 12-months.

Price-to-Earnings Ratio



Sources: Bloomberg, WisdomTree (03/19/2013)

• **Earnings Improvement:** Using estimated earnings, the WisdomTree Europe Hedged Equity Index had a lower price-to-earnings ratio than the S&P 500 Index. This illustrates that analysts believe that an earnings recovery has the potential to take place in Europe in a number of stocks. Of course, it may not actually materialize and this P/E ratio in no way implies a certain outlook for the future. In essence, we believe that the larger reason for the difference between these two P/E ratios is closely related to just how low earnings were over the prior 12-month period for these stocks. The sectors most responsible for the recovery in earnings over this period were Financials and Materials, which had very low cyclical earnings for a number of the large European holdings. While we cannot state whether the estimated earnings growth will in fact occur or whether stock prices will respond positively, we do believe that the expectations of earnings growth coming out of a period characterized by significant turmoil are worthy of mention. With all the talk of the various debt-related issues, it is easy to forget that many global companies within Europe are still doing business. **Long-Term Earnings Estimates[1]: Higher Than the S&P 500** Although the macroeconomic headwinds create uncertainty over Europe's growth, we have to remember that exporters compete in many global markets. Thus many of these companies are not as severely impacted by Europe's woes. One very interesting comparison of the current long-term growth estimates for Europe and the U.S. is as follows: • WisdomTree Europe Hedged Equity Index: 11.17% • S&P 500 Index: 10.67% This estimate shows that many companies domiciled in the European Union are still operating, making products and selling goods to people around the world. And their growth opportunities are just as promising as those for the companies in the S&P 500 Index, if not a little better. Again, the main point is not to emphasize that these are the exact levels of earnings growth that will be seen over the coming 12-months, but rather to point out that European firms are seen as having opportunities to grow their earnings. **Hedge Your Currency Risk** European peripheral debt concerns have increased the volatility of the euro. This is not all bad news—the euro's dropping value can increase the attractiveness of European-made products for consumers abroad. A weakening euro is also good for companies that derive a majority of their revenue from abroad, because when the company brings the overseas sales profit back to Europe, it can convert its foreign currency at a higher exchange rate. On the other hand, a weakening euro is not good for U.S. investors in European equities—unless they hedge the currency. Currency-hedged strategies allow investors to focus on European equities without the worry over currency declines. **Conclusion** In my opinion, many dismiss Europe due to the uncertain economic situation. But Europe is a big region of the world—and investors may be concentrating too much of their allocations on the United States even though many European companies have a strong global revenue base. European equities also show attractive price-to-earnings ratios and, surprisingly, higher long-term growth estimates than U.S. equities—a combination that makes them potentially attractive opportunities. [1]Source: Bloomberg (03/19/2013)

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Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

WisdomTree Europe Hedged Equity Index : Index designed to provide exposure to European equities while at the same time neutralizing exposure to fluctuations between the Euro and the U.S. dollar. Constituents are European dividend-paying firms with a least 50% of their revenues from outside of Europe. Weighting is by cash dividends paid.

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.

Long-Term Earnings Estimates : Estimated compounded annual growth rate of the operating earnings per share (EPS) over the company's next full business cycle (typically 3-5 years).

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

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.

Currency : Currency in which the underlying index returns are calculated. Euros: The returns are calculated, and there is no currency conversion; resulting statistics result purely from the returns of the equities. U.S. dollars: The returns are calculated and then converted into U.S. dollars; resulting statistics are the result of a combination of the euro's performance against the U.S. dollar and the returns of the underlying equities.

Currency hedging : Strategies designed to mitigate the impact of currency performance on investment returns.