GERMANY: ENGINE OF EUROPEAN GROWTH

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Germany remains the driver of European growth and has proven to be a resilient force throughout the crisis. With (i) the eurozone exiting recession in the second quarter of this year, and (ii) developed market growth now charting an upward trajectory, Germany stands to benefit significantly via its export channel. Below we outline the case for hedged German equity exposure and briefly discuss its macroeconomic backdrop: • Germany is the largest economy in the European Monetary Union (EMU), representing 31% of total EMU GDP in the first half of 2013[1] • German exports constitute over 30%[2] of the EMU's total exports, and its exports have doubled from 49.9 billion euros in August 2003 to 93.4 billion euros in July 2013[3] • Forward-looking sentiment and activity indicators point toward improving economic activity in Germany[4] • Germany's gross domestic product (GDP) growth has been resilient, despite the eurozone crisis, dipping briefly into negative territory in the fourth quarter of 2012, but quickly recovering in the first half of 2013 Having experienced a narrow contraction in the fourth quarter of 2012, Germany successfully returned to positive growth territory, recording a strong 0.7% (quarter over quarter, QoQ, annualized) growth in the second quarter of 2013. Unlike many of the core and peripheral economies in the eurozone, Germany did not record a recession in the wake of the European crisis.[5] Furthermore, Germany's forward-looking indicators on manufacturing activity, measured by the manufacturing Purchasing Managers' Index (PMI), troughed in July of 2012 at 43 and have since recorded an 8.3 point increase to 51.3 in September of 2013. This is well above the 50-point threshold that is indicative of "expansion." Additionally, sentiment indexes have also been on the rise. In particular, the IFO sentiment indexes are signaling a potential for further acceleration in the economy's underlying momentum. The IFO surveys on Germany's business climate and business expectations bottomed out in October of 2012 and have since been on an uptick.[6] This signals that assessments on business conditions in Germany have experienced sustained improvements in 2013. German exports constitute a large portion of Germany's economic growth profile, with over 50% of Germany's gross domestic product (GDP) driven by exports. The importance of these exports has increased over the last decade. Despite a rising euro, which provides a headwind, Germany's exports increased 1.7 times from 2000 to 2008, illustrating Germany's competitiveness in the face of a rising currency, which made the country's exports more expensive to foreigners. However, since the euro started declining in 2008, Germany's exports as a percent of GDP grew from 42% to 52%, illustrating how a weaker euro can provide support to the German export machine.

German Exports % GDP vs Euro Currency, January 1, 2000-September 30, 2013

Sources: WisdomTree, Eurostat, Bloomberg. Data as of 09/30/13. Past performance is not indicative of future results.

Conclusion In summary, the macroeconomic environment in Germany has displayed signs of stabilization and potential for stronger growth in the months ahead. The improvement in global growth, led by stronger data out of China and most other developed market countries, continues to provide tailwind for sustained improvements on the German economic front. Barring any major policy missteps by the European central Bank (ECB) and peripheral growth faltering, we believe that Germany is on track to continued economic improvement. For U.S. investors, one of the primary questions surrounding investments in Germany is not the strength of its economy but whether one has an optimistic outlook on the direction of the euro. The euro does not just represent Germany but the 17 separate nations that are part of the eurozone. There are a number of reasons why the U.S. dollar might gain ground against the euro over time—and we will explore these in future blog posts. An environment of a weakening euro (or U.S. dollar strength) could be very supportive of German exports, given Germany's export prowess. The importance of hedging the euro could thus become of prime importance for capitalizing on the best opportunities of German equities if the dollar rises (or the euro falls) in value. WisdomTree has created the Germany Hedged Equity Index to focus on a broad basket of German exporters while hedging out the euro's fluctuations against the dollar to serve as a broad benchmark for this theme. We will be writing more about the case for this strategy over the coming days. [1]Source: Eurostat, June 2013. [2]Source: Eurostat, June 2013. [3]Source: German Federal Statistical Office, July 3013. [4]Sources: Information and Forschung Institute (IFO), Bloomberg, September 2013. [5]Source: German Federal Statistical Office, July 3013. [6]Sources: Information and Forschung Institute (IFO), Bloomberg, September 2013.

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DEFINITIONS

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).

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Purchasing Managers' Index (PMI) : An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 indicates an expansion of the manufacturing sector compared to the previous month; below 50 represents a contraction while 50 indicates no change.

IFO sentiment indexes : Prepared by the IFO Institute for Economic Research in Munich. The Ifo Business Climate Index is based on ca. 7,000 monthly survey responses of firms in manufacturing, construction, wholesaling and retailing. The firms are asked to give their assessments of the current business situation and their expectations for the next six months.