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# BOLD IS BEAUTIFUL: ECB AND INVESTMENT TAKEAWAYS

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President Mario Draghi took a bold stance at the European Central Bank (ECB) press conference last Thursday. Not only did Draghi announce the timeframe for ending the asset purchase program in 2018, but he also provided forward guidance on the unlikelihood of an interest [rate hike](#) until the summer of next year, subject to incoming data. Considering the meeting came just weeks after the Italian political turmoil, it is likely that Draghi was trying to project the most politically unbiased stance of the ECB to the markets.

This was contrary to most analyst expectations, as forward guidance language on rates was expected only at the December meeting. In addition, the projected timeframe for the next rate hike is longer than investors had originally expected. It appears that Draghi has found the perfect balance for the [hawks](#) (ending an era of easy money) and [doves](#) (strengthened forward rate guidance). The timing of the end of the stimulus is viewed as a trigger for speculation on when the ECB will raise rates. According to the [Fonia-dated contracts](#), it now appears more likely that the first rate hike won't take place until September 2019, provided inflation is sustainable. This is close to the time that Draghi will retire from his position—October 2019. The market looks as if it is becoming convinced that this is a slightly dovish set of policy changes.

As the ECB's mandate remains focused on price stability, it shrugged off a series of downbeat macroeconomic data in the euro area and contagion spreading from Italian political risks, drawing attention to the sustained adjustment in the path of inflation as the reason for ending its bond-buying program. According to the latest staff projections for [gross domestic product \(GDP\)](#), growth was revised lower for this year, while the outlook for 2019 and 2020 remains upbeat. The [inflation](#) outlook was lifted to 1.7% from 1.4% each year until 2020. It seemed contradictory that the ECB remained optimistic on the forward growth projections despite central bank staff projections for 2018 being lowered to 2.1% from 2.4%. It is also worth noting that the decision to change forward guidance was unanimous, and Draghi confirmed there was a desire to retain optionality should conditions deteriorate.

The dovish undertone, coupled with greater clarity from the ECB on the path ahead, seemed to resonate across the markets: The euro dipped more than 1%, while European equity markets closed higher and bond yields in Germany, Italy and Spain declined. European equity exporters, namely the automakers, caught a tailwind from the declining euro, leading the gains on European equity markets after being caught in the crossfire of trade wars.<sup>1</sup>

WisdomTree has long been advocating that U.S.-based investors could [reduce the risk profile of their international investments](#) by focusing on equity allocations in a currency-hedged manner—and not take uncompensated [currency risk](#) by always being long the euro. The moves in the euro this year remind investors that the currency is not always a one-way trade higher. We still believe investors could be better served by being more hedged than they are today.

For European region allocations, consider our euro-hedged ETF, the [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#).

For broad-based international allocations, we have been writing on the benefits of taking a dynamic currency approach, and our latest piece on these strategies can be found [here](#).

<sup>1</sup>Source: Bloomberg, as of 6/14/18, post-ECB meeting.

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## **DEFINITIONS**

**Rate Hike** : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

**Hawkish** : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

**Dovish** : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

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

**Inflation** : Characterized by rising price levels.

**Currency risk** : the risk that an investment will decline in value due to a change in foreign exchange rates.