

TAKING THE EURO OUT OF SMALL CAP EUROPE

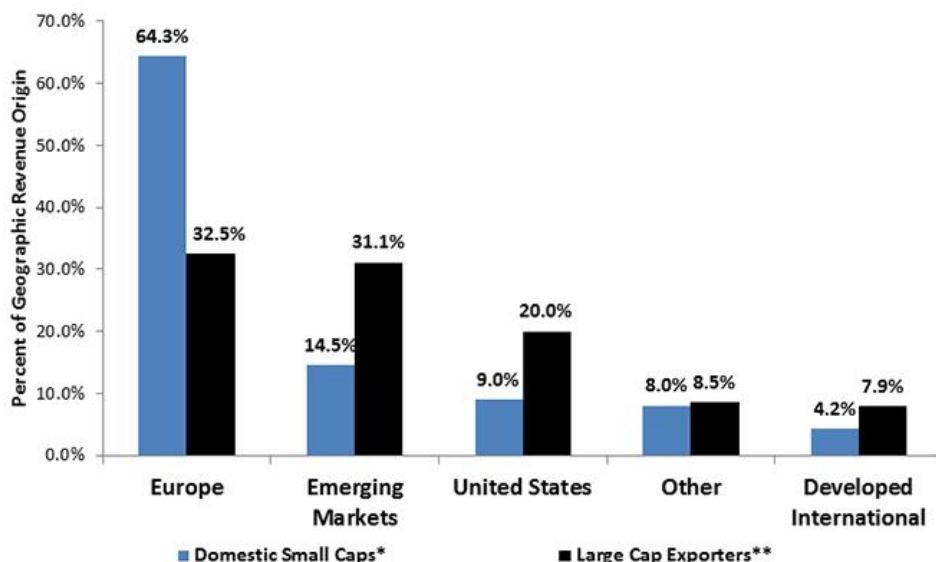
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European equities have been one of the best performing regional equity markets thus far in 2015,¹ and a primary catalyst has been the blockbuster January 22 announcement by Mario Draghi, president of the European Central Bank, of an open-ended plan of quantitative easing. An immediate impact was seen through a weaker euro compared to the U.S. dollar, which should help make large-cap euro-area exporters more competitive in global markets—especially for the exporting powerhouse from Germany. But large-cap multinationals are not the only way to invest in euro-area stocks. **A New Way to Invest in Euro-Area Small Caps Without Investing in the Euro** The divergence between the European Central Bank (ECB) and the U.S. Federal Reserve (which may raise [short-term interest rates](#) at some point in 2015) makes it very difficult to argue for a stronger euro versus the U.S. dollar. As a result, for those looking to get exposure to the euro region, we believe currency hedging is of prime importance. For those who want exposure beyond the exporters, we believe small-cap euro-area stocks also offer an interesting opportunity set that is tied to improvements felt in the local economies. **The [WisdomTree Europe Hedged SmallCap Equity Index](#) represents:**

- The performance of small-cap euro-area stocks without the additional layer of euro [risk](#).
- A [dividend-weighted](#) approach that may further mitigate small-cap equity [volatility](#).
- The Index is created by selecting the bottom 10% of the total [market capitalization](#) of euro-area countries within WisdomTree's broad developed international dividend Index (the [WisdomTree DEFA Index](#)). The Index has approximately 260 constituents, with an average market capitalization of about \$2.2 billion and a total market capitalization of about \$580 billion.

Euro-Area Small Caps Contrasted with Euro-Area Exporters So, why should people think about euro-area small caps? We think a primary reason is that they offer a geographic revenue exposure that is distinctly different from euro-area large-cap multinationals³. **Geographic Revenue Distribution as of December 31, 2014**



*Domestic Small Caps: Refers to the WisdomTree Europe Hedged SmallCap Equity Index universe.

**Large-Cap Exporters: Refers to the WisdomTree Europe Hedged Equity Index universe.

Sources: WisdomTree, FactSet, with Index constituent weights calculated as of 2/6/15, the date of initial index screening for the WisdomTree Europe Hedged SmallCap Equity Index. Company geographic revenue distribution data is as of the 12/31/14 quarterly reporting cycle, the most recently available.

• Approximately Twice the

European Revenue Exposure: Euro-area small caps tend to have approximately twice the European revenue exposure as euro-area exporters, thereby offering significant complementarity and more direct exposure to any improvements or sensitivity to local economic conditions.

• **Improved Economic Expectations:** If an initial result of the ECB's quantitative easing announcement is a weaker euro and more competitive exporters, a secondary reaction could be an inflection point in improving economic expectations, which could impact small-cap stocks. Large-cap exporters typically are more than twice as exposed to emerging markets as the more domestic small caps.

Underlying Exposures A key driver of performance in any broadly diversified strategy is the country and sector exposures. When looking at the WisdomTree Europe Hedged SmallCap Equity Index, it is clear this Index represents a more cyclical segment of European equity exposures. For example:

• On a country basis, Italy represents more than 18% of the Index, and Spain represents 8.8%. These exposures are considered part of the peripheral European⁴ countries that need the types of additional lending and credit programs that the European stimulus measures are directed toward.

• On a sector basis, the three greatest sector exposures are also all to the sectors most leveraged⁵ to economic growth: Industrials (23%), Consumer Discretionary (15.5%) and Financials (18%).

If the ECB monetary stimulus does increase euro-area growth and lending, these sectors could stand to benefit.

An Important New Tool in the European Equity Toolkit The

[WisdomTree Europe Hedged SmallCap Equity Fund \(EUSC\)](#) was designed to track the performance of the WisdomTree

Europe Hedged SmallCap Equity Index after costs, fees and expenses. For those thinking about European equities, EUSC

represents the first available option for investors to invest in euro-area small caps without layering on the additional euro

currency risk. In future blog posts, we'll look at the [valuations](#) of euro-area small caps and how they compare to the U.S.

small caps. In short, as of February 10, 2015, higher [dividends](#) are available in the euro area, and the stocks are selling at

lower valuation multiples.⁶ We believe that by hedging the euro and focusing on dividend payers in the euro area,

investors can find an attractive risk and return profile in euro-area small caps.

¹Refers to the [MSCI EMU Local Currency Index](#) universe, which returned 8.61% over the period from 12/31/14 to 2/10/15, as compared to the S&P 500

Index, which returned 0.67%, and the [MSCI Emerging Markets Index](#), which returned 1.19%.

²Sources: WisdomTree, Standard & Poor's, with data as of 2/10/15.

³Refers to the [WisdomTree Europe Hedged Equity Index](#) universe, which, as part of its selection criteria, requires that every constituent generate at least 50% of revenue from outside of Europe.

⁴Peripheral European countries: Portugal, Ireland, Italy, Greece and Spain

⁵Leveraged: In this context, leverage does not refer to the level of debt but rather the potential sensitivity to reacting to a change in economic conditions.

⁶Source: Bloomberg, with data as of 2/10/15. Universe of euro-area small caps is [MSCI EMU Small Cap Index](#). Universe of U.S.

small caps is Russell 2000 Index.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. This Fund focuses its investments in Europe, thereby increasing the impact of events and developments associated with the region, which can adversely affect performance. The securities of small-capitalization companies generally trade in lower volumes and are subject to greater and more unpredictable price changes than larger-capitalization stocks or the stock market as a whole. The Fund uses various strategies to attempt to minimize the impact of changes in the value of the euro against the U.S. dollar, and these strategies may not be successful. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile. Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.

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You cannot invest directly in an index.

DEFINITIONS

Short-term rates : the rate of interest on a debt instrument maturing in two years or less.

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.

Dividend weighted : Constituent securities represented within the Index in proportion to their contribution to the dividend stream of the Index.

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

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.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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

MSCI EMU Local Currency Index : captures large- and mid-cap representation across the 11 developed market countries in the EMU and provides local currency returns, which are not translated back to U.S. dollars.

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

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.

MSCI EMU Small Cap Index : captures the small cap representation across countries in the European Economic and Monetary Union.