

EUROPEAN BANKS: THE ECB'S CONDUIT FOR KICKING THE CAN

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We're fielding a lot of inquiries about how the [WisdomTree International Hedged Quality Dividend Growth Fund \(IHDG\)](#) has held up better than the [MSCI EAFE Index](#) during the COVID-19 panic.

Much of it can be explained by the post-global financial crisis setup: when you screen for high-quality companies by using [return on equity \(ROE\)](#), the result is often very light exposure to the beleaguered Financials sector.

Skewing away from [value](#) in the direction of growth has proven fortuitous for international developed economy stocks in the COVID-19 crash. Figure 1 shows standardized performance, which is reported on a quarterly basis.

Figure 1: Average Annual Total Returns to 3/31/20

Name	YTD	1 Year	3 Year	5 Year	10 Year	Since Fund Inception (5/7/2014)
IHDG NAV Returns	-15.40%	-2.66%	3.60%	4.35%	N/A	5.81%
IHDG Market Returns	-16.54%	-3.95%	3.16%	4.09%	N/A	5.48%
WisdomTree International Hedged Quality Dividend Growth Index	-15.33%	-2.07%	4.35%	5.01%	N/A	6.48%
MSCI EAFE Local Currency Index	-20.55%	-12.58%	-1.80%	-0.15%	4.35%	2.64%
MSCI EAFE Index	-22.83%	-14.38%	-1.82%	-0.62%	2.81%	-0.90%

Sources: Bloomberg, WisdomTree. You cannot invest directly in an index.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at [wisdomtree.com](#).

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. ET net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

The Banks

Pay the [dividends](#) before the workers take notice and go on strike. That's the European way.

Last year, companies in the [MSCI Europe Index](#) made sure to follow the rulebook, so much so that 71 cents of every dollar earned by its underlying companies was returned as dividends, a fundamentally different picture than the 38% of earnings paid out by [S&P 500](#) companies.

Industrial actions, CEO kidnappings, stopped trains, maybe a Molotov cocktail or three. These are the headlines of European industry, of manufacturing, of airlines. With a little bit of bad luck, you can find this type of thing in a city like Paris at any given time.

But while labor strife is the threat for industrial companies, European banks have a bugbear of a different variety: European Central Bank (ECB) directives.

The ECB's March 27 decree was predictable:

The European Central Bank (ECB) today (recommends that banks)...should not pay dividends for the financial years 2019 and 2020 until at least 1 October 2020. Banks should also refrain from share buy-backs aimed at remunerating shareholders.

The ECB expects banks' shareholders to join this collective effort. In this vein, capital conserved by refraining from dividend distributions and share buy-backs can also be used to support households, small businesses and corporate borrowers and/or to absorb losses on existing exposures to such borrowers.

This raises two questions:

1. Are European banks really “for profit” or are they functioning as conduits for ECB policy?
2. Are there now parallels between European banks and China’s notorious state-owned financial institutions, where the state and the central bank is the boss?

We believe The MSCI EAFE Index—the oft-cited basket of non-U.S. developed economy stocks—has a problem. Its 166 Financials companies are one-sixth of the index’s weight, even after the crash. Granted, the eurozone is just part of “EAFE,” which stands for Europe, Australasia and the Far East. But no-dividend directives are going global:

New Zealand’s Central Bank Orders Lenders to Pay No Dividends or Redeem Capital Notes – Reuters, 4/1/20

Switzerland’s financial regulator urged dividend curbs last week, saying “acting to preserve strength is not a sign of weakness.” – Wall Street Journal, 3/31/20

Along with other UK banks, HSBC decided to scrap dividend payments after urging from UK regulators. – Singapore Straits Times, 3/31/20

Here are the 166 Financials firms in the MSCI EAFE.

Figure 2: MSCI EAFE Financial Sector Companies

Company	Index Weight	Company	Index Weight	Company	Index Weight
HSBC HOLDINGS PLC	1.02%	KBC GROUP NV	0.10%	JAPAN POST INSURANCE CO LTD	0.03%
AIA GROUP LTD	0.93%	SOMPO HOLDINGS INC	0.10%	KINNEVIK AB - B	0.03%
ALLIANZ SE-REG	0.63%	SWISS LIFE HOLDING AG-REG	0.10%	LUNDBERGS AB-B SHS	0.03%
COMMONWEALTH BANK OF AUSTRAL	0.61%	BOC HONG KONG HOLDINGS LTD	0.09%	M&G PLC	0.03%
ZURICH INSURANCE GROUP AG	0.46%	DNB ASA	0.09%	MAGELLAN FINANCIAL GROUP LTD	0.03%
MITSUBISHI UFJ FINANCIAL GRO	0.43%	SKANDINAVISKA ENSKILDA BAN-A	0.09%	MEDIOBANCA SPA	0.03%
BANCO SANTANDER SA	0.36%	SUMITOMO MITSUI TRUST HOLDIN	0.09%	NATIXIS	0.03%
UBS GROUP AG-REG	0.32%	SWEDBANK AB - A SHARES	0.09%	SBI HOLDINGS INC	0.03%
BNP PARIBAS	0.31%	3I GROUP PLC	0.08%	SCHROEDERS PLC	0.03%
HONG KONG EXCHANGES & CLEAR	0.31%	ASX LTD	0.08%	SCOR SE	0.03%
WESTPAC BANKING CORP	0.31%	HANNOVER RUECK SE	0.08%	SHIZUOKA BANK LTD/THE	0.03%
SUMITOMO MITSUI FINANCIAL GR	0.30%	INSURANCE AUSTRALIA GROUP	0.08%	TRYG A/S	0.03%
AXA SA	0.29%	JAPAN EXCHANGE GROUP INC	0.08%	AMP LTD	0.02%
PRUDENTIAL PLC	0.28%	BANK LEUMI LE-ISRAEL	0.07%	AOZORA BANK LTD	0.02%
AUST AND NZ BANKING GROUP	0.26%	CREDIT AGRICOLE SA	0.07%	BANCO DE SABADELL SA	0.02%
LLOYDS BANKING GROUP PLC	0.26%	JULIUS BAER GROUP LTD	0.07%	BANK OF EAST ASIA LTD	0.02%
MIZUHO FINANCIAL GROUP INC	0.26%	NN GROUP NV	0.07%	BANK OF IRELAND GROUP PLC	0.02%
TOKIO MARINE HOLDINGS INC	0.26%	AGEAS	0.06%	BANK OF KYOTO LTD/THE	0.02%
LONDON STOCK EXCHANGE GROUP	0.25%	BALOISE HOLDING AG - REG	0.06%	BANKINTER SA	0.02%
MUENCHENER RUECKVER AG-REG	0.25%	BANK HAPOALIM BM	0.06%	BENDIGO AND ADELAIDE BANK	0.02%
NATIONAL AUSTRALIA BANK LTD	0.25%	CAIXABANK SA	0.06%	CHIBA BANK LTD/THE	0.02%
DEUTSCHE BOERSE AG	0.23%	DANSKE BANK A/S	0.06%	CREDIT SAISON CO LTD	0.02%
INTESA SANPAOLO	0.21%	QBE INSURANCE GROUP LTD	0.06%	EURAZEO SE	0.02%
DBS GROUP HOLDINGS LTD	0.20%	RESONA HOLDINGS INC	0.06%	FUKUOKA FINANCIAL GROUP INC	0.02%
BANCO BILBAO VIZCAYA ARGENTA	0.19%	ROYAL BANK OF SCOTLAND GROUP	0.06%	MAPFRE SA	0.02%
CREDIT SUISSE GROUP AG-REG	0.19%	STANDARD LIFE ABERDEEN PLC	0.06%	MEBUKI FINANCIAL GROUP INC	0.02%
ING GROEP NV	0.19%	SUNCORP GROUP LTD	0.06%	MITSUBISHI UFJ LEASE & FINAN	0.02%
SWISS RE AG	0.19%	ADMIRAL GROUP PLC	0.05%	MIZRAHI TEFAHOT BANK LTD	0.02%
BARCLAYS PLC	0.18%	DAIWA SECURITIES GROUP INC	0.05%	PARGESA HOLDING SA-BR	0.02%
INVESTOR AB-B SHS	0.18%	ERSTE GROUP BANK AG	0.05%	RAIFFEISEN BANK INTERNATIONA	0.02%
OVERSEA-CHINESE BANKING CORP	0.17%	EXOR NV	0.05%	SHINSEI BANK LTD	0.02%
MACQUARIE GROUP LTD	0.15%	FINECOBANK SPA	0.05%	SONY FINANCIAL HOLDINGS INC	0.02%
NORDEA BANK ABP	0.15%	GROUPE BRUXELLES LAMBERT SA	0.05%	WENDEL	0.02%
ORIX CORP	0.15%	HARGREAVES LANSDOWN PLC	0.05%	ACOM CO LTD	0.01%
UNITED OVERSEAS BANK LTD	0.15%	RSA INSURANCE GROUP PLC	0.05%	AEON FINANCIAL SERVICE CO LT	0.01%
STANDARD CHARTERED PLC	0.14%	AEGON NV	0.04%	AIB GROUP PLC	0.01%
UNICREDIT SPA	0.14%	DIRECT LINE INSURANCE GROUP	0.04%	BANKIA SA	0.01%
ASSICURAZIONI GENERALI	0.13%	MEDIBANK PRIVATE LTD	0.04%	CHALLENGER LTD	0.01%
LEGAL & GENERAL GROUP PLC	0.13%	POSTE ITALIANE SPA	0.04%	CNP ASSURANCES	0.01%
NOMURA HOLDINGS INC	0.13%	SINGAPORE EXCHANGE LTD	0.04%	SEVEN BANK LTD	0.01%
MS&AD INSURANCE GROUP HOLDIN	0.12%	ST JAMES'S PLACE PLC	0.04%	TOKYO CENTURY CORP	0.01%
SOCIETE GENERALE SA	0.12%	T&D HOLDINGS INC	0.04%		
AVIVA PLC	0.11%	ABN AMRO BANK NV-CVA	0.03%		
DAI-ICHI LIFE HOLDINGS INC	0.11%	AMUNDI SA	0.03%		
DEUTSCHE BANK AG-REGISTERED	0.11%	COMMERZBANK AG	0.03%		
HANG SENG BANK LTD	0.11%	CONCORDIA FINANCIAL GROUP LT	0.03%		
JAPAN POST HOLDINGS CO LTD	0.11%	GJENSIDIGE FORSIKRING ASA	0.03%		
PARTNERS GROUP HOLDING AG	0.11%	INDUSTRIVARDEN AB-C SHS	0.03%		
SAMPO OYJ-A SHS	0.11%	ISRAEL DISCOUNT BANK-A	0.03%		
SVENSKA HANDELSBANKEN-A SHS	0.11%	JAPAN POST BANK CO LTD	0.03%		
		Sector Total			16.48%

Sources: Bloomberg, WisdomTree, as of 3/31/20. Weights subject to change.

In contrast, the [WisdomTree International Hedged Quality Dividend Growth Index \(WTIDGH\)](#)¹ has just 2% in Financials right now. No Deutsche Bank, no BNP Paribas, no Banco Santander, no tiny font needed to show them all (figure 3).

Figure 3: Financials Components, WisdomTree International Hedged Quality Dividend Growth Index

Company	Index Weight
PARTNERS GROUP HOLDING AG	0.95%
MAGELLAN FINANCIAL GROUP LTD	0.26%
EURONEXT NV	0.21%
HARGREAVES LANSDOWN PLC	0.20%
ASHMORE GROUP PLC	0.12%
PENDAL GROUP LTD	0.10%
NIB HOLDINGS LTD	0.07%
BREWIN DOLPHIN HOLDINGS PLC	0.05%
TBC BANK GROUP PLC	0.02%
Sector Total	1.98%

Source: WisdomTree, 12/31/213–03/31/220. Past performance is not indicative of future results.

The MSCI EAFE Financials Index's ROE is 7.6%, so its large weight pulls the ROE of the broader index down to less than half that of WTIDGH (figure 3). If rocky markets continue, it may be wise to focus away from stocks that score poorly on profitability.

Figure 4: Return on Equity ROE



Source: WisdomTree, 12/31/213–03/31/220. Past performance is not indicative of future results.

Unless otherwise stated, all performance is Bloomberg as of 4/7/20.

¹IHDG seeks to track the price and yield performance of the WisdomTree International Hedged Quality Dividend Growth Index (WTIDGH) before fees and expenses.

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You cannot invest directly in an index.

DEFINITIONS

MSCI EAFE Index : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

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

MSCI Europe Index : A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe.

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.