

# Why European investors are allocating to growth strategies

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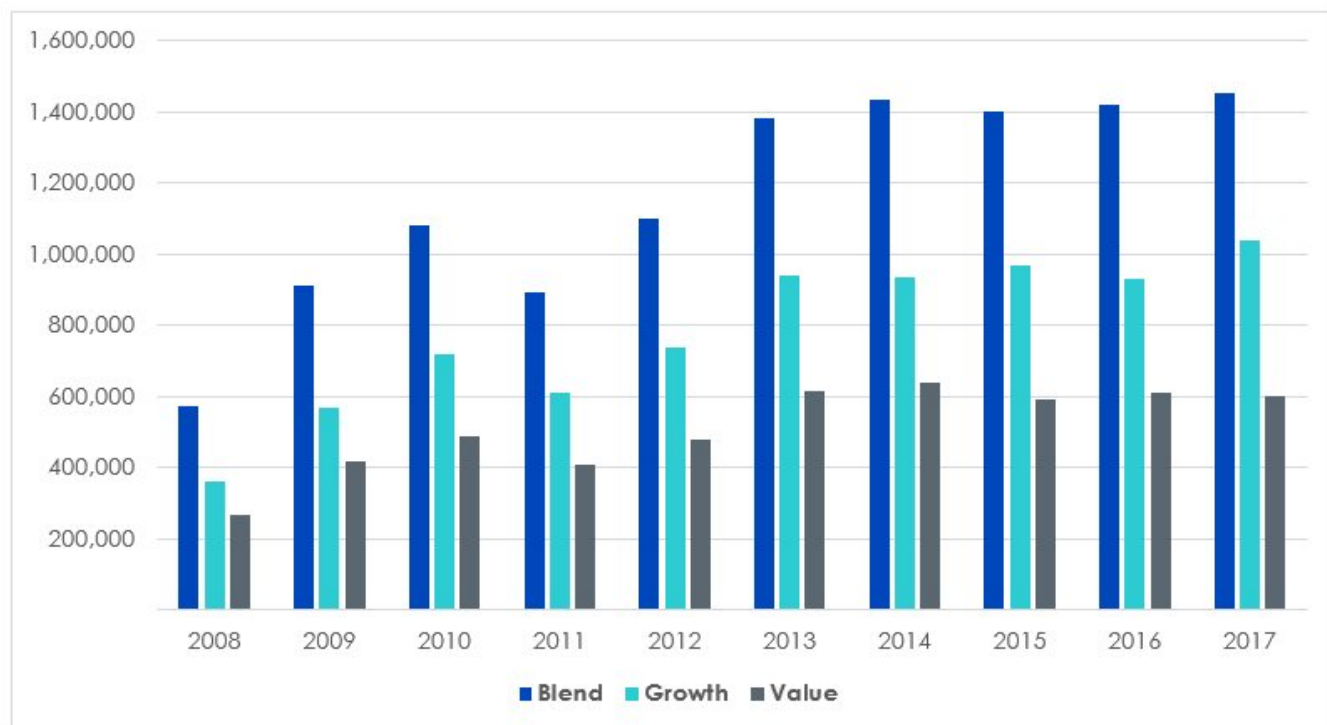
## WisdomTree

Contributor

European investors are increasingly allocating to growth as a style, and these strategies currently account for over €1trn of mutual fund assets. Over the past nine years, equity assets in the growth category increased by close to 12.5% per annum, outstripping both value and blended/market capitalisation categories. Growth as a style now accounts for 34% of all European mutual fund assets. The current strength of Eurozone economic fundamentals, with higher expected rates of growth, combined with the end to quantitative easing which is likely to be a prelude to rising rates, sets the scene for a continued focus on growth strategies.

The challenge for investors when allocating to mutual fund strategies, whether it is in broad equities, growth or value, is the consistency of performance by active managers. One way to avoid such vagaries is to use a transparent systematic strategy designed to target growth companies. This trend has helped ETF AUM in the growth category increase by close to 27% per annum over the past nine years, ahead of both value and market capitalisation ETFs.

### Figure 1: Growth strategies gather Mutual Fund assets

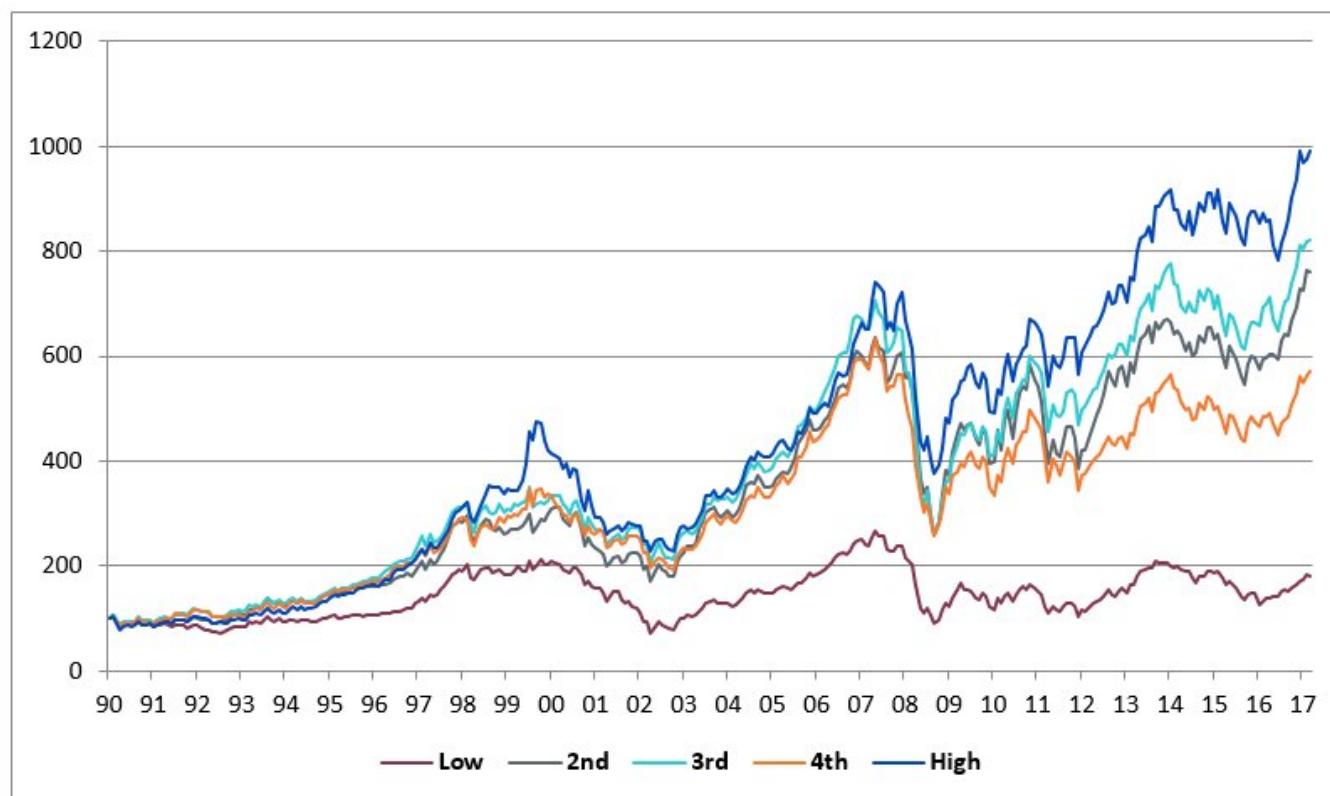


Source: WisdomTree

One great advantage of ETFs is that the strategies tend to be systematic and offer transparency and clarity surrounding the stock selection process, weighting and rebalancing methodology. This allows investors a better opportunity to assess the risks and merits between different strategies within the same style grouping such as growth.

Here at WisdomTree we have created a unique combination of screening factors, ranking and weighting methodologies to focus on Quality Dividend Growth companies. The aim of the strategy is to capture systematically companies that exhibit strength in terms of operating profitability. Fame/French data has shown the superior returns from companies categorised by different rankings of profitability. This effect was originally shown to be effective for US equities but has been shown to be equally applicable to European and global equities. In the case of European equities, the performance difference between the top and bottom quintiles in terms of operating profitability has been over 10.4% per annum since 1990.

**Figure 2: High operating profitability delivers outperformance**



Source: WisdomTree

The WisdomTree Eurozone Quality Dividend Growth Index has a more nuanced approach to selecting companies, by introducing a focus on both growth and quality and only selecting from a universe of dividend stocks with a market capitalisation \$1bn. In terms of the quality ranking, companies are ranked based on both the three-year average return on equity and return on assets. The growth aspect is addressed by considering long-term earnings growth expectations and represents a forward-looking aspect to the selection criteria. Overall, this combination of selection processes helps identify companies that are likely to produce strong future dividend growth and therefore deliver above average total returns. The companies in the index are weighted by total cash dividends paid as opposed to market capitalisation.

Since launch, the WisdomTree Eurozone Quality Dividend Growth Index has risen by over 35%. This is compared to 31% for MSCI EMU and 25% by the S&P Euro Dividend Aristocrats. As one would expect, the selection process delivers materially stronger fundamental metrics compared to the benchmark MSCI EMU index with return on assets of 6.2% (1.28% for MSCI EMU), return on equity over 19% (v 10.35%) and estimated long term earnings growth at close to 13% (versus 11.4). In terms of valuations it is noteworthy that it is possible to access these quality stocks at only a modest premium to MSCI EMU with a PE of 21.91x, which compares favourably to 20.89x for the benchmark. The selection process also delivers substantial differences in sector exposures with our strategy being significantly overweight the technology, consumer discretionary and industrials sectors. The focus on fundamentals also means that the strategy is considerably underweight financials, and regulated sectors such as telecoms and utilities.

**Figure 3: Quality Dividend Growth delivers outperformance**

Source: WisdomTree

As the Eurozone's macro backdrop shifts to a more growth oriented outlook we anticipate investors will seek to increase their exposure to quality strategies. The recent and long-term performance of our WisdomTree Eurozone Quality Dividend Growth Index suggests that the selection process both adds value, with factor loading that has enhanced returns relative to the market, and lower risk.

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