

Have You Missed the Strength in European Small Caps?

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Small-cap stocks can deliver some of the greatest sensitivity to changes in sentiment across global asset classes. European small caps were a great example of this. When Mario Draghi delivered his “whatever it takes” speech in defense of the euro on July 26, 2012, European small caps delivered a sustained rally that continued pretty much unabated until June 6, 2014¹. During this period of almost two full years, these were the average annual returns, for context:² • European small caps: 47.7% • European large caps: 27.8% • U.S. small caps: 26.0% • U.S. large caps: 24.0% **Quantitative Easing as a New Policy Catalyst** While the “whatever it takes” speech was an important buttress to the continued existence of the euro, we believe that the new quantitative easing program—officially announced by the European Central Bank (ECB) on January 22, 2015—could be the policy catalyst that helps the euro area stave off the risk of deflation. Since this announcement through April 10, 2015, we’ve seen:³ • European small caps up 10.5% • European large caps up 6.2% • U.S. small caps up 6.6% • U.S. large caps up 2.4% **European Small Caps Were Already Exhibiting Strength Compared to European Large Caps** The interesting thing is that you didn’t need to wait for the official announcement of quantitative easing for European small caps to start outperforming their large-cap counterparts—the shift in relative performance actually occurred closer to the September 4, 2014, ECB press conference. This was the meeting where the Asset-Backed Securities Purchase Program and the Covered Bond Purchase Program were announced. It’s possible that this outperformance of small caps over large caps in Europe was reflecting increased chances of full-scale QE more than four months before it happened. **European Small Caps Respond to Increased Potential for Full-Scale QE**



Sources: WisdomTree, Bloomberg, with period from 3/31/13 to 4/10/15. Europe Small Cap vs. Large Cap refers to the ratio of the performance of the WisdomTree Europe SmallCap Dividend Index to the performance of the FTSE Developed Europe Index, with an upward slope indicating outperformance of the WisdomTree Index over the FTSE Index. U.S. Small Cap vs. Large Cap refers to the ratio of the performance of the Russell 2000 Index to the performance of the S&P 500 Index, with an upward slope indicating outperformance of the Russell Index over the S&P Index. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes and terms in the chart, please visit our [glossary](#). **Connecting Relative Performance to Absolute Performance (as of March 31, 2015)**

	WT Index Inception Date	Year-to-Date	1-Year	3-Year	5-Year	Since WT Index Inception
WisdomTree Europe SmallCap Dividend Index	6/1/2006	6.68%	-6.74%	18.24%	12.84%	5.93%
FTSE Developed Europe Index		3.52%	-4.73%	9.76%	6.61%	3.46%
Russell 2000 Index		4.32%	8.21%	16.27%	14.57%	7.91%
S&P 500 Index		0.95%	12.73%	16.11%	14.47%	7.94%

Source: Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index.

• **Upward Slope = Strength in Small Caps:** In both cases, Europe and the U.S., an upward slope signifies relative strength in small caps measured against large caps. • **European Small Caps Have Delivered vs. European Large Caps:** What's clear is that the ratios built to depict the relative strength of small caps vs. large caps in the European and U.S. equity markets start at the same place—1.00. As of April 10, 2015, the line showing the relative strength of European small caps vs. large caps was closing in on 1.20, whereas the same line for the U.S. was below 1.00. While there is no way to predict the future, this does show that dipping down in the market capitalization spectrum in Europe has delivered a greater reward than doing so in the U.S. over this particular period. **Bottom Line: Don't Forget About European Small Caps** After it became clear that June 6, 2014, was the top of a nearly two-year upward trend in European small caps,

the asset class shifted out of focus on the way to an ultimate peak-to-trough decline of almost 21%⁴. What has gotten much less attention is the fact that, as of April 10, 2015, European small caps had only about 6% further to appreciate to regain their June 6, 2014, level. Don't forget that the last sustained rally in European small caps lasted almost two years—and that was while we were still debating whether or not a QE program could even happen. The WisdomTree Europe SmallCap Dividend Index (referred to within this piece as European small caps) is designed for a broad exposure to small-cap European equities. It includes exposure to European currencies like the euro, British pound and Swiss franc, as well as exposure to the equities. ***Unless otherwise noted, data source is Bloomberg.*** Throughout this piece, “European small caps” refers to the WisdomTree SmallCap Dividend Index universe, “European large caps” refers to the FTSE Developed Europe Index, “U.S. small caps” refers to the Russell 2000 Index and “U.S. large caps” refers to the [S&P 500 Index](#). 1Source: Bloomberg. 2Source for all bullets: Bloomberg, from 7/26/12 to 6/6/14. Past performance is not indicative of future results. 3Source for all bullets: Bloomberg, from 1/22/15 to 4/10/15. Past performance is not indicative of future results. 4Source: Bloomberg.

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