

On Europe's QE & Seven Year Rallies in the U.S. Market

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Two events occurred almost simultaneously last week: the U.S. stock market celebrated the seventh anniversary of the rally that began in March of 2009, and the European Central Bank (ECB) injected another dose of monetary stimulus into global financial markets by expanding its quantitative easing (QE) policy. Let me comment on the former before coming back to the latter. **U.S. Market Celebrates Seven-Year Rally** The financial press was abuzz last week, trumpeting the 194% run-up in U.S. stock market prices since March 9, 2009, when the [S&P 500](#) closed at 676. Through March 9, 2016, the total return of the S&P 500 Index, compounded at an annualized rate of 19% over that period. Those impressive returns are a reminder of why we believe investors should remain permanently invested in broad equity markets if they have the ability to invest for decades, rather than months or days. But the return stocks have generated from panic lows is probably not all that meaningful, as few have the ability to time generational market bottoms. A more salient number may be the return of the S&P 500 Index over the last 10 years, a period that encompasses the bull market *and* the financial panic that preceded it. Measuring market returns over full market cycles is not just more realistic, it is also relevant for what we may see over the next 10 years. Over the decade since March 9, 2006, the S&P 500 returned 6.8% on an annualized basis. This is materially lower than the 10% equity markets have returned in the U.S. back to 1800. But 6.8% may be more reflective of the world we live in now, given aging populations, stalled productivity growth and subdued global inflation. Another important number in that 10-year return is 2.2%, which is the portion of the S&P 500's total return attributable to dividends reinvested in the market. Put another way, about 32% of the stock market's return over the last decade was generated by the dividends companies in the S&P 500 paid you to "own the market." The lesson I take from the current market rally is not to wait for once-in-a-decade opportunities to buy low, but to get paid to own equity markets—and not just with U.S. large caps. In today's low Treasury yield environment, you should be getting paid for owning mid-cap stocks, small-cap stocks, developed world and emerging market stocks. And for stock investors, one form that payment takes is cash dividends. Interestingly, if we value the stock market based solely on what it currently pays you to own it, the dividend yield on the S&P 500 Index recently stood at 2.3%. For those interested in owning only the dividend portion of the U.S. market, as measured by the [WisdomTree Dividend Index](#), its dividend yield was 3.3%, as of March 10. **ECB Expands QE** On March 10, the ECB announced it would expand its QE program from approximately €60 billion a month to €80 billion a month beginning in April. Speaking at a news conference that morning, ECB President Mario Draghi said that the QE purchases would be extended into March of 2017 or beyond, if necessary. The expansion of the QE program will also include euro-denominated investment-grade corporate debt (excluding banks). Moreover, the ECB cut three key

interest rates, including the rate it charges member banks for keeping reserves on deposit with the central bank. It lowered that deposit rate further into negative territory by ten basis points (bps) to -.4%. Finally, the ECB announced it would launch the second iteration of its bank lending program, targeted longer-term refinancing operations (TLTRO II), which will start in June of 2016. Stocks across Europe initially rallied on the news, but then closed that day, down 1.5% measured in euro. Likewise, the euro initially lost about 1.6% of its value, before sharply reversing course, and ending that day up 1.6% on news reports that Mario Draghi and the ECB may not do anything more on monetary policy going forward. It remains to be seen whether future data points prompt additional ECB action, but it will be interesting to see how investors digest the additional dose of QE [and what it means for markets](#), once it goes into effect in April. Many are debating whether these central bank QE policies are good or bad for the global economy. A better question is whether they are necessary, given how little governments and corporations in aggregate are doing to spur new public and private investment. In Europe, tepid economic growth, high unemployment, large sovereign debt and the specter of deflation require policies that spur lending, private sector job growth, gross domestic product (GDP) growth and, ultimately, higher inflation. In Europe, Mario Draghi and the ECB evidently believe such monetary measures *are* necessary. For investors looking for a way to play Europe, WisdomTree continues to believe the [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#) is an attractive option. It neutralizes the impact of the euro and tilts the portfolio toward companies that derive revenue from outside Europe. Because of this exporter tilt, HEDJ is currently under-weight the financial sector by about 11 percentage points compared to some of the “beta” exposures for Europe.¹ This may be a meaningful distinction for some investors, as negative interest rates could put pressure on the profit margins of European banks. Thus far in 2016, Financials has been the worst-performing sector in Europe. ***Unless otherwise noted, data source is Bloomberg, as of 3/10/2016.*** ¹Comparison drawn using MSCI EMU 100% Hedged to USD as of 3/8/16.

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