# The Short- and Long-Term Case for European Small Caps

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There's revitalized interest in Europe, as investors look away from stretched valuations in the U.S. to lower valuations across the world.

Many focus on U.S. large caps as being an expensive market, but perhaps this is even more true for small-cap indexes.

Here's a table that looks at trailing 12-month valuations across U.S. and European indexes:

| Index Name | Trailing 12m P/E Ratio | Estimated P/E Ratio |
|---|---|---|
| Russell 2000 | 44.6x | 28.6x |
| S&P 600 | 26.4x | 22.0x |
| WT Small-Cap Dividend (U.S.) | 23.4x | 20.3x |
| S&P 500 | 21.6x | 18.7x |
| MSCI Europe | 24.6x | 15.9x |
| WT Europe SmallCap Dividend | 18.2x | 15.5x |

Source: Bloomberg, 6/2/17. Estimated P/E ratio based on current year estimated earnings. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance.

*For definitions of indexes in the chart, visit our glossary.*

**Where in the Economic Recovery Cycle Is Europe?**

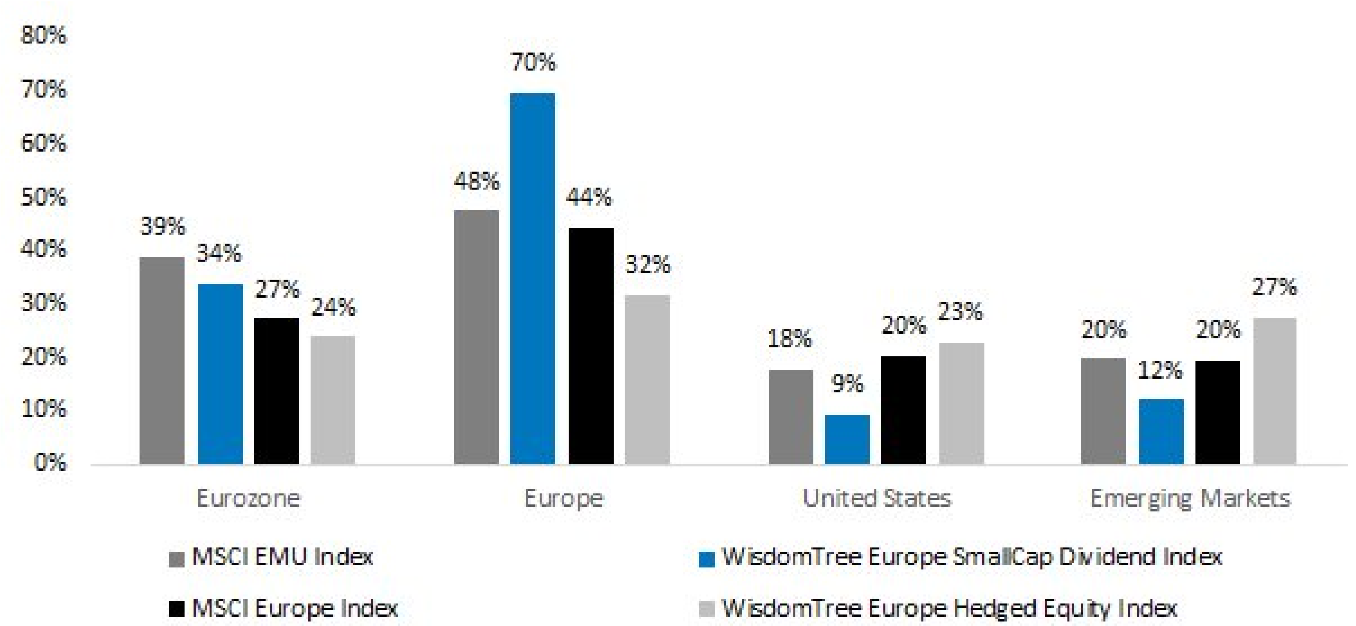
Josh Brown made a comment on Twitter about current European investment prospects: "Screaming buy. It's 2012 there."1

If it is truly 2012 in Europe with more catch up in the economy to come, one should optimize exposure to the European economic growth cycle.

When thinking about geographic revenue exposures, the chart below provides some color on the different sources of revenue for large caps and small caps, a consideration for investors that have a certain macroeconomic view.

Large-cap Europe often tilts exposure to more global, growth oriented companies and the global business cycle prospects. Conversely, small-cap Europe derives more of its revenue and profits from the local European economies.

**Geographic Revenue Exposure as of 4/30/17**




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

**The Longer-Term Case for Small Caps?**

A continued economic recovery could support the short-term case for European small caps, but what about the long-term case?

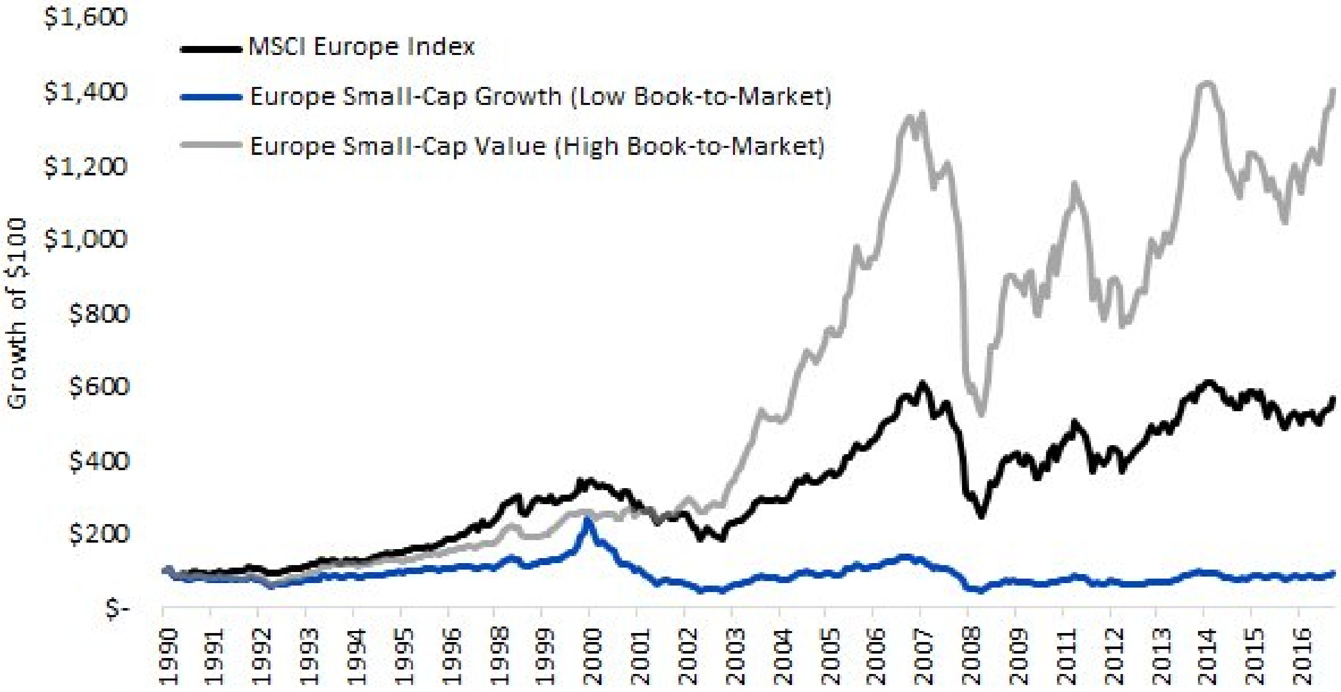
We've long heard the research that there is a small-cap value premium. Was this true for Europe?

Absolutely.

Data from Fama-French shows the long-term compounding of European small-cap value versus small-cap growth to be dramatic.

European small-cap growth had negative returns over the last 30 years, while small-cap value compounded over 10.4% per year.

**Cumulative Returns to Europe Small-Cap Growth vs. Value**




Source: Fama-French Factor Library, data from 6/30/1990 to 3/31/2017. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance.

The 5x5 matrix for size x valuations that Fama-French produces for Europe supports a clear long-term case for European small caps.

**Long-Term Returns of European Factor Portfolios**

| Size Segment | Book to Market: Lowest | Low | Mid | High | Highest |
|---|---|---|---|---|---|
| Smallest | -0.37% | 4.98% | 6.26% | 8.06% | 10.38% |
| Small | 3.48% | 6.26% | 7.42% | 9.34% | 10.05% |
| Mid | 4.05% | 7.20% | 7.29% | 7.47% | 9.56% |
| Large | 6.21% | 6.98% | 8.02% | 7.38% | 8.13% |
| Largest | 5.27% | 7.51% | 7.49% | 8.43% | 6.37% |

Source: Fama-French Factor Library, data from 6/30/1990 to 3/31/2017.

Even over the last decade, which saw a growth-driven market particularly for large caps, European small caps performed well.

**10-Year Returns of European Factor Portfolios**

| | | Book to Market | | | | |
|---|---|---|---|---|---|---|
| | | Lowest | Low | Mid | High | Highest |
| Size Segment | Smallest | -3.55% | 1.07% | 1.86% | 1.22% | 1.68% |
| | Small | 3.36% | 4.45% | 2.75% | 2.41% | 0.63% |
| | Mid | 2.39% | 3.61% | 2.62% | 1.48% | -0.64% |
| | Large | 5.92% | 3.39% | 3.19% | 1.53% | -3.13% |
| | Largest | 4.37% | 3.63% | 0.43% | -0.69% | -2.49% |

Source: Fama-French Factor Library, data from 3/31/2007 to 3/31/2017.

The WisdomTree Europe SmallCap Dividend Index (WTESC) tilts exposure to these European small-cap value stocks.

The Index launched in 2006 and has a strong 10-year track record compared to traditional large-cap market cap benchmarks.

| Index | Cumulative Returns | Avg. Annual Returns |
|---|---|---|
| MSCI Europe | 42.9% | 3.3% |
| WTESC | 113.5% | 7.1% |

Source: Bloomberg, 5/31/2006–5/31/2017. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

1https://twitter.com/ReformedBroker/status/867319485363081219.

## Important Risks Related to this Article

Investments focused in Europe increase the impact of events and developments associated with the region, which can adversely affect performance.