HOW TO ADD EMPHASIS TO THE CYCLICAL SECTORS OF EUROPE

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Recent bouts of rather extreme <u>volatility</u> notwithstanding, as U.S. equities have performed strongly over the past few years, more and more investors have been asking, "Where might I invest new money coming in?"

What they were really saying: With U.S. equities at elevated levels, it is harder and harder to continue to make allocations.

International equities, and Europe in particular, might be poised for a run of outperformance.

European Economy Showing Signs of Strength

Europe has been enjoying increased economic growth and aggregate demand. At a recent monetary policy conference in Frankfurt, Dr. Jens Weidmann, president of the Bundesbank, described the state of the European economy in the following manner:

As Mario Draghi pointed out recently, what started out as a recovery is now a fully fledged <u>expansion</u>. It is robust and broad-based, with most countries and sectors posting positive growth figures. As a result, the <u>euro area</u> grew even faster than the U.S. economy last year. After years of challenges, the euro area is now driving global growth, not dragging it down. And indicators show no sign of growth abating anytime soon. In many respects, the euro-area economy might be further along now than the U.S. economy at the time the Fed ended its <u>net asset purchases</u>.

Currency Appreciation: What We Were Not Expecting One Year Ago

One year ago, we were aligned with many in thinking that the euro was more likely to tilt toward depreciation than appreciation. The approximate 15% appreciation against the U.S. dollar from February 9, 2017, to February 9, 2018, showed us all just how tricky trying to predict currency markets can be.

Even the British pound has been appreciating while we all wait for a little more than a year to figure out just what "Brexit" may entail.

Two Opposite Ways of Looking at European Equities

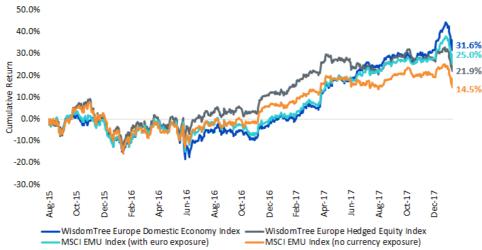
The revival of growth in Europe has led to a dramatic performance differential breaking out between local economy European stocks and those that are more global in nature. WisdomTree has two distinct Indexes designed to represent opposing market environments.



Many investors are familiar with the <u>currency-hedged</u> exporters basket that was in favor during periods of euro weakness. They may be less aware of the <u>cyclical</u> recovery basket that has exposure to both the euro and the more local economy sectors and stocks that are benefiting from this economic growth momentum.

- WisdomTree's exporter basket is represented by the <u>WisdomTree Europe Hedged Equity Index</u>, which also hedges exposure to the euro and does not benefit when the euro rises but does not get hurt when euro falls.
- The <u>WisdomTree Europe Domestic Economy Index</u> began its live calculation on September 1, 2015. It has exposure to companies with more than 50% of their revenue from within the local economy and excludes more defensive sectors (Telecom, Utilities, Health Care, Consumer Staples) to represent the more cyclical elements of the European economy. We designed this Index two years ago in anticipation that there could be a cyclical recovery under way for which investors would want more optimized exposure.





Sources: WisdomTree, Bloomberg. Past performance is not indicative of future results. You cannot invest directly in an index. Performance is shown from September 1, 2015, to February 9, 2018. Period corresponds to the live calculation history of the WisdomTree Europe Domestic Economy Index.

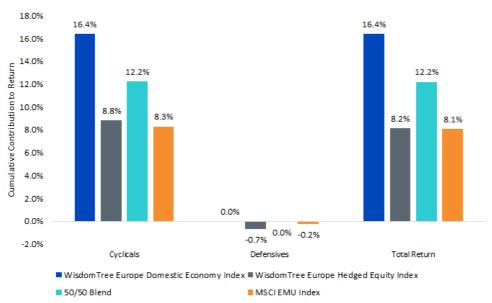
• This period is interesting for a few reasons. First, from about mid-2016 to mid-2017, the WisdomTree Europe Hedged Equity Index performed quite strongly as the euro depreciated in value against the dollar. Then, when the euro's performance shifted toward appreciation, the WisdomTree Europe Domestic Economy Index saw a very strong performance jump, as it is designed to both tap into the European domestic recovery that has been at the forefront of many conversations as well as have exposure to the euro's appreciation.

Cyclical Sectors Have Led European Equities Higher over the Past Year

This concept of cyclical sectors has been an important one given the revival of domestic demand and positive growth impulses coming from the European economy. With a shifting growth environment, cyclical equity exposures are outperforming defensive equity exposures, and this trend may still be in early phases.

Domestic Recovery Theme Will Start to Trump **Quantitative Easing**Raising Cyclical Exposure Tapped into the Recent Trend (February 9, 2017, to February 9, 2018)





Sources: WisdomTree, Bloomberg. Currency is in euros and has no impact of fluctuating exchange rates. Past performance is not indicative of future results. You cannot invest directly in an index. Cyclicals: Consumer Discretionary, Energy, Financials, Industrials, Information Technology, Materials and Real Estate. Defensives: Consumer Staples, Health Care, Telecommunication Services and Utilities.

The WisdomTree Europe Domestic Economy Index, by design, derives all of its return from the cyclical sectors of Europe's equity market. Over the past year, there has been no question that these are the sectors that have been driving performance. Whether looking at the WisdomTree Europe Domestic Economy Index or the WisdomTree Europe Hedged Equity Index, it is apparent that nearly all of the contribution to total returns—measured in euros so as to negate the impact of the difference in currency exposure—came from the cyclical sectors. If one had blended these two strategies together over this period, the return of the export-oriented equities would have been raised by about 4%.

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.

For standardized performance and the most recent month-end performance click <u>here</u> NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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You cannot invest directly in an index.



DEFINITIONS

Volatility: A measure of the dispersion of actual returns around a particular average level. & nbsp.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Monetary Expansion: Actions undertaken by a central bank with the ultimate desired effect of lowering interest rates and stimulating the economy.

Euro Area: refers to the Member States of the European Union that have adopted the euro as their currency.

Net Asset Purchases: The net total of central bank purchases of government bonds and other financial assets and its maturing securities.

Brexit: an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.

Currency hedging: Strategies designed to mitigate the impact of currency performance on investment returns.

Cyclical sectors: Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.

Quantitative Easing (QE): A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

