

EUROPEAN EQUITIES SELLING AT A DISCOUNT TO HISTORICAL AVERAGES

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With the various issues plaguing Europe over the past few years, it isn't surprising that equity market [valuations](#) have been depressed. Yet given the general feeling that the worst of the European crisis may be behind us, allocations to Europe have been increasing and certain markets have experienced strong gains in 2013. Some may feel they missed the rally or that valuations are stretched. Yet if the earnings cycle is just starting to turn up, there could still be opportunities for growth in earnings as I discussed in a previous [blog post](#). To provide context for the current valuations, we compare both the [trailing](#) and estimated [price-to-earnings \(P/E\) ratio](#) for the 10 largest developed European countries to other regional indexes and their historical medians. **Figure 1: Regional and Country Price-to-Earnings Ratios**

Price-to-Earnings Ratio [1/31/1997-10/31/2013]				
Index	Historical Median	Current		Current Estimated Discount to Median
		Trailing	Estimated	
MSCI Emerging Markets	13.2x	12.2x	11.7x	-11.6%
MSCI Europe	18.3x	19.6x	14.6x	-20.1%
S&P 500	17.9x	16.7x	15.9x	-11.4%
Top 10 Countries of Europe				
MSCI Germany	14.7x	15.4x	13.3x	-9.5%
MSCI United Kingdom	18.5x	20.5x	13.4x	-27.5%
MSCI France	19.9x	22.2x	14.5x	-27.0%
MSCI Italy	18.6x	78.7x	15.0x	-19.2%
MSCI Netherlands	16.7x	21.8x	15.7x	-6.3%
MSCI Switzerland	19.6x	18.6x	16.3x	-16.8%
MSCI Spain	14.4x	62.2x	16.5x	14.5%
MSCI Sweden	16.7x	16.4x	17.0x	1.6%
MSCI Denmark	19.1x	19.0x	17.1x	-10.7%
MSCI Belgium	14.7x	13.5x	17.4x	18.2%

Sources: WisdomTree, Bloomberg (01/31/1997-10/31/13).
You cannot invest directly in an index. Subject to change. Past performance is not indicative of future results.

For definitions of indexes in

the chart, please visit our [Glossary](#).

- **Estimated Earnings Improvement Strong for Europe** – Of the major regional indexes, the [MSCI Europe Index](#) showed the largest improvement in the estimated P/E ratio, thus signaling the greatest expectations for earnings growth compared to the [S&P 500](#) and [MSCI Emerging Markets indexes](#).
- Within Europe, the best improvements in expected earnings look to be in Italy and Spain, which have elevated P/E ratios on a trailing 12-month basis but see more normalized earnings and valuations in line with the rest of Europe. It is important for these two countries to begin normalizing, because they have provided some of the greatest headwinds for the European economy over the past six quarters.
- **Europe Region with the Largest Discount to Its Own History** – Europe's estimated P/E ratio compared to its historical median showed a discount of 20%, greater than both the S&P 500 Index and the MSCI Emerging Markets Index. To be fair, the emerging markets have the lowest absolute valuation, but they have historically sold at a lower valuation compared to such developed markets as Europe or the United States.
- **United Kingdom, Germany, France Lowest-Priced Markets** – Looking within the individual country markets we notice the United Kingdom and Germany leading the way with the lowest estimated P/E ratios—just above 13x earnings and about 10% lower than Europe's valuation as a whole. Both countries being among the region's top economies, it is interesting that they also have the lowest current valuations. If one looked for the highest discount to its historical median, France takes the second spot after the United Kingdom. France also happens to have the third-lowest estimated P/E ratio.

Implementation Europe has been one of the primary risks for the global economy—with sluggish growth, over-leveraged countries and banks being a prime concern for many investors. With these concerns and risks, it may be no

surprise that Europe looks attractive from a price-to-earnings perspective, compared to other regions and even its own history. If Europe's economy can expand upon its recent growth, it could be very supportive for future earnings growth and the regional equity markets. We feel there are different ways to play the European recovery theme, depending on one's conviction, and WisdomTree has designed many different Indexes to provide exposure: • [WisdomTree Europe SmallCap Dividend Index](#) – designed to provide exposure to the [small-capitalization](#) segment of the European dividend-paying market • [WisdomTree Europe Hedged Equity Index](#) – designed to provide exposure to [large-capitalization](#) European exporters while at the same time neutralizing the currency exposure • [WisdomTree United Kingdom Hedged Equity Index](#) – designed to provide exposure to global exporters listed in the United Kingdom while at the same time neutralizing the currency exposure • [WisdomTree Germany Hedged Equity Index](#) – designed to provide exposure to German exporters while at the same time neutralizing the currency exposure *Read the full research [here](#).*

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You cannot invest directly in an index.

DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

MSCI Europe Index : A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

WisdomTree Europe SmallCap Dividend Index : A fundamentally weighted index meant to measure the performance of small-cap European dividend-paying equities weighted by cash dividends paid.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

WisdomTree Europe Hedged Equity Index : Index designed to provide exposure to European equities while at the same time neutralizing exposure to fluctuations between the Euro and the U.S. dollar. Constituents are European dividend-paying firms with a least 50% of their revenues from outside of Europe. Weighting is by cash dividends paid.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

WisdomTree United Kingdom Hedged Equity Index : Designed to provide exposure to United Kingdom equities while at the same time neutralizing exposure to fluctuations between the British pound and the U.S. dollar. The Index is based on dividend-paying companies in the WisdomTree DEFA Index that are domiciled in the UK and are traded in British pounds, have at least \$1 billion market capitalization and derive at least 80% of their revenue in the latest fiscal year from countries outside the UK. The component securities are weighted in the Index based on annual cash dividends paid with the following caps: maximum individual position capped at 5%, maximum sector weight capped at 25.

WisdomTree Germany Hedged Equity : broadly focused measure of the equity performance of dividend-paying equities within Germany, with specific methodology focusing on hedging the performance of the euro against the U.S. dollar. Weighting is by cash dividends paid.