A RECOVERING EUROZONE ECONOMY: WHERE SHOULD YOU POSITION?

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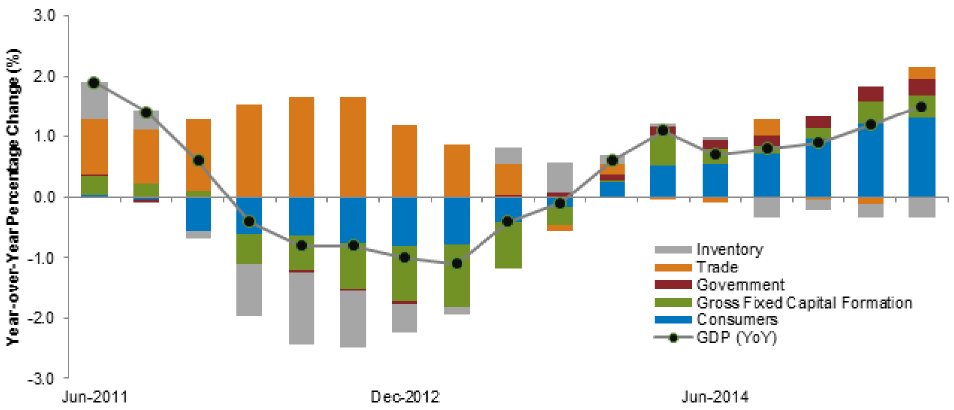
10/29/2015

Amid the recent global financial market turmoil, both the European Central Bank (ECB) and the International Monetary Fund (IMF) have downplayed the near-term economic recovery in the euro area.[1] This downward revision was no doubt a serious hit to investors' confidence in the region's growth prospects, especially in the wake of the accommodative monetary policies being implemented by the ECB, which was expected to pull the struggling area out of the mud and get its growth back on track. What went wrong? Both agencies cited deteriorating external factors that were dragging down their projections.[2] Global trade has lost significant momentum in recent years, and the gloomy growth outlook of major emerging market economies has dampened foreign demand further. Export growth in the euro area—despite a weakening euro—has yet to contribute meaningfully to gross domestic product (GDP) growth. The trade component of GDP growth has become almost a non-factor, as compared to the major impact it had in the second quarter of 2011.

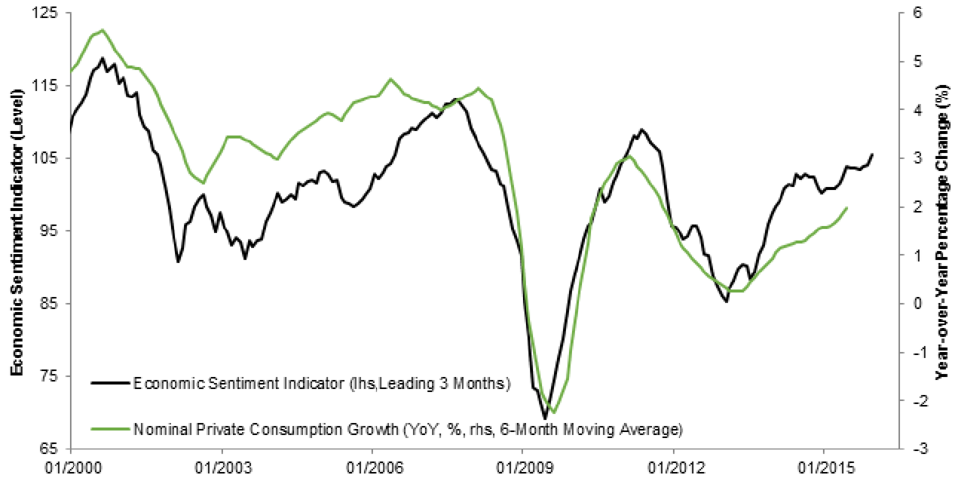
Euro Area GDP Growth: Private Consumption Playing a Leading Role Recently Eurozone GDP Growth Contribution Breakdown By Major Components (Year-over-Year, %)



Sources: Bloomberg, Eurostat and WisdomTree. Period is from 6/30/11 to 6/30/15, quarterly data.
Inventory: Measure of production that has not yet been sold but still must indicate a component of economic activity. Trade: A measure of a market's exports minus a measure of a market's imports.
Government: More specifically, government spending geared toward contributing to the productive capacity of a market. Gross fixed capital formation: Includes spending on land improvements, plant, machinery and equipment purchases as well as construction of roads, railways, private residential dwellings and commercial/industrials buildings.Consumers: Measure of spending by consumers contributing to economic activity.

On the other hand, private consumption expenditures have been making up for the slack in the trade component and are largely responsible for keeping the euro area's economic recovery alive. Yet it may not be wise to dismiss the strength of domestic consumption growth altogether and thus ignore the embedded investment opportunities, as we expect favorable domestic dynamics to continue.

Domestic Growth Is Expected to Strengthen Further Confidence is a key to economic growth. At WisdomTree, we closely watch the European Commission Economic Sentiment Indicator, which is a timely composite measure of business and consumer confidence in the region. Historically, it has been a reliable leading indicator for the region's economic activities. As illustrated in the figure below, it leads the eurozone nominal private consumption expenditure growth quite well. The increased confidence has been a tailwind to the consumption growth, and the latest readings suggest the trend might continue. This growth is further supported by the monetary easing provided by the ECB. Some of the monetary indicators we watch, such as M1, imply continued support for this trend. **Economic Sentiment Indicator Leads Private Consumption Growth Europe Nominal Private Consumption Growth vs. Economic Sentiment Indicator**



Sources: Bloomberg, Eurostat, European Commission and WisdomTree. Period is from 1/31/1998 to 9/30/2015. Past performance is not indicative of future results.
Nominal private consumption growth: Measure of the consumption activity of households, not businesses, that is not adjusted for any impact of inflation.

Unique European Toolkit

WisdomTree has been creating tools to position for various scenarios in the eurozone economy. Many investors have become familiar with the WisdomTree Europe Hedged Equity Fund (HEDJ), which tracks the performance before fees of European exporters while at the same time neutralizing the impact of the euro's performance against the dollar. HEDJ is well positioned to access global growth and a more competitive dynamic from the weak euro. But there is also this local recovery side of the European equation, and there is now more than one option for getting this exposure. **Small Caps:** Among our first exposures to the European markets have been European small-cap companies. In particular, the WisdomTree Europe SmallCap Dividend Fund (DFE) has been leading the broader and large-cap European markets higher in 2015,[3] and one of the reasons for this is the earlier economic discussion: small caps typically are much more local to the European economy than large caps. If one believes in the local growth, small caps should continue to be in favor. But not everyone wants to have full exposure to European small caps as they would to large caps. This led WisdomTree to create a new strategy geared to the local demand dynamics in the eurozone but that narrows from the total market universe. **Unhedged Local Recovery:** EZR, the WisdomTree Europe Local Recovery Fund, expands WisdomTree's European toolkit to include a broader-based, all-cap-inclusive strategy positioned for a local economic recovery in the eurozone. In a series of upcoming blog posts, we will discuss the Index methodology that drives EZR and how it can complement existing European strategies quite well for a more finely tuned exposure to this local growth story.

[1]Sources: "ECB Staff Macroeconomic Projections for the Euro Area," ECB, 9/15; and "World Economic Outlook: Adjusting to Lower Commodity Prices," International Monetary Fund, 10/15. [2]Sources: "ECB Staff Macroeconomic Projections for the Euro Area," ECB, 9/15; and "World Economic Outlook: Adjusting to Lower Commodity Prices," International Monetary Fund, 10/15. [3]Sources: WisdomTree, Bloomberg; refers to the period from 12/31/14 to 9/30/15, where the WisdomTree Europe SmallCap Dividend Fund outperformed the MSCI Europe Index, a broad market cap measure of European securities.

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DEFINITIONS

International Monetary Fund : international organization for global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth around the world.

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.

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

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Private Consumption Expenditures : refers to actual and imputed expenditures of households pertaining to durables, non-durables, and services.

Eurozone (EZ) : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

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

M1 : refers to the M1 money supply that includes physical money, such as coins and currency, as well as demand deposits, checking accounts, and Negotiable Order of Withdrawal accounts.

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