EUROPE: FROM GREAT CHALLENGES COME GREAT INVESTMENT OPPORTUNITIES

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Lately it has seemed easy to find reasons to *avoid* investing in European assets:

- There have been many important dates in the Brexit process. The dates seem to come and go, and no one has any clarity on exactly what will happen.
- Last year, a populist government was formed in Italy—a country that has issued so much debt that actually paying it back seems dubious.
- Various political events—whether elections in Germany or riots in France—have showcased an undercurrent of tension and potential for future instability.

While this list isn't exhaustive, it hints at factors that affect investors when they initially think about Europe.

Context Point One: Performance

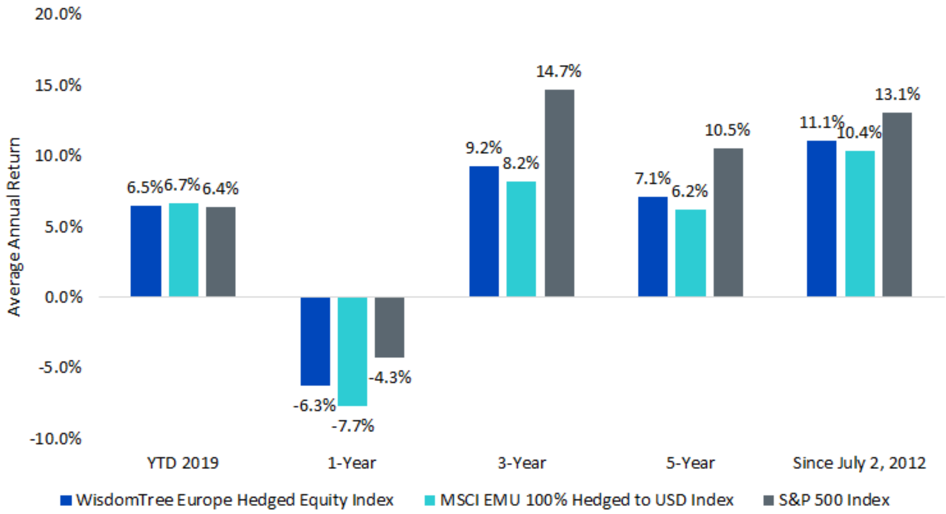
Before my hands hit the keyboard, I know U.S. equities have outperformed European and most global equities for a significant period of time.

However, within European equities, we have seen a divergence between European exporters and the broader market. If investors succumb to thinking about these and other risks, it may lead to less demand for the euro against other currencies, encouraging depreciation. That could encourage further outperformance of these exporters.

For example:

- European equities have started 2019 with outperformance over U.S. equities.
- 2018 was a rough period for risky assets globally, but European exporters outperformed the broad market by more than 1.0%.
- Since the launch of our Europe Hedged Equity strategy in July 2012, we'd bet that many investors wouldn't realize how close the performance of European exporters was to U.S. equities.

Figure 1: European Exporters Have Outperformed over the Longer Term



Source: Bloomberg, with periods measured as of 1/25/19. The WisdomTree Europe Hedged Equity Index began its live performance history on 7/2/12. Past performance is not indicative of future results. You cannot invest directly in an index.

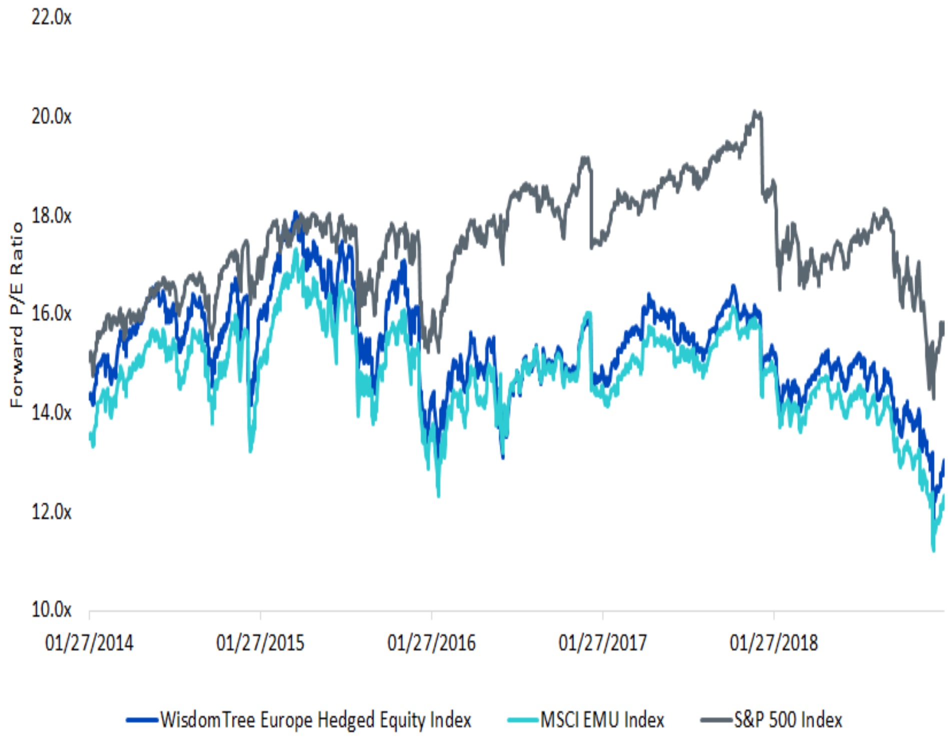
Context Point Two: Valuation

Looking at performance alone (and forgetting about things like the U.S. government shutdown), it's easy to make the case to invest in U.S. equities and harder to make a case to invest in European equities. Of course, this would tend to mean that European equities would be trading at far less expensive valuations than U.S. equities.

Bottom line: The most critical question to consider is whether the discounted valuation of European equities eases concerns over the aforementioned risks.

- After the last quarter of 2018, forward P/E ratios of the S&P 500 Index, the WisdomTree Europe Hedged Equity Index and the MSCI EMU Index have all come down. After a bit of recovery in January 2019, we see a range from 12.3x to 15.0x.
- The difference between the forward P/E ratios of the MSCI EMU Index (12.3x) and the WisdomTree Europe Hedged Equity Index (13.0x) comes down to the export tilt, which leads to an under-weight in the Financials and Energy sectors. The Financials sector within Europe is actually a single-digit forward P/E ratio sector as of this writing.

Figure 2: Valuation Gap for European Equities Has Widened Relative to U.S. Equities



Source: Bloomberg, for the five-year period 1/25/14–1/25/19. Past performance is not indicative of future results. You cannot invest directly in an index.

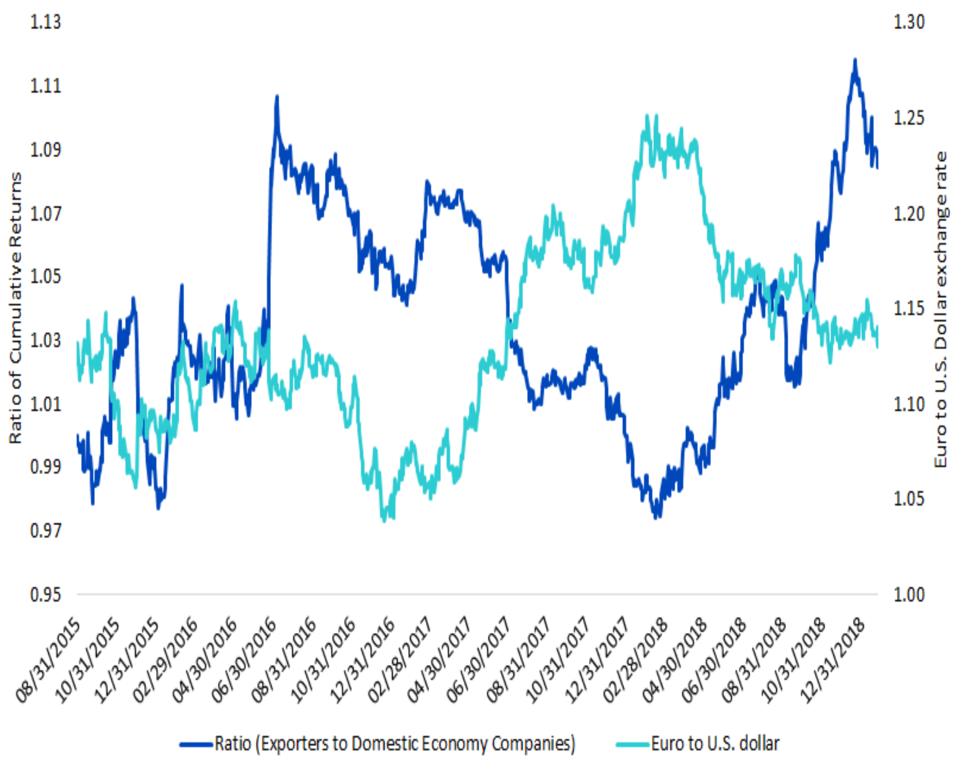
Context Point Three: Exporters vs. Domestically Focused Firms

Memories are short. People may not remember the details of what happened in 2017. We can settle for reminding investors that economic data in Europe was strong—and growing—and the euro appreciated by 14% against the U.S. dollar.

The irony: At a time when everyone was demanding European investments and demanding euros, it would actually have been more challenging than at present to make a case for the outperformance of European exporters that are high-quality, global businesses domiciled in Europe.

- 2018 was a transition in the euro-to-U.S. dollar exchange rate from the 1.23 to 1.25 range to the 1.13 to 1.15 range, where we remain today.
- We can see from figure 3 that the export-oriented approach delivers outperformance over the domestic company-focused approach to European equities when the euro is trending toward weakness rather than strength. In 2017, a year of euro strength, exporters were up 27.5% and the domestic companies were up 34.8%. In 2018, a year of euro weakness (and, admittedly, risk-off sentiment), exporters were down 16%, whereas the domestically oriented companies were down 24.2%.[1]

Figure 3: A Weaker Euro Has Catalyzed Exporter Outperformance



Source: Bloomberg, for the period 8/31/15–1/25/19, which corresponds to the live calculation history of the WisdomTree Europe Domestic Economy Index. Past performance is not indicative of future results. You cannot invest directly in an index.

Conclusion: From Great Challenge Comes Great Opportunity

It's easy to find flaws when making the case for European equities over U.S. equities today. There is political risk in the U.S. and in Europe, but economic and earnings growth in the U.S. tends to be enough (at least at present) to paper over some of the risk. In Europe, there is currently nothing that can do that. At the same time, these risks create valuation opportunities. If investors have time horizons extending three, five or seven years into the future, it could make sense to be thinking of Europe from a global allocation perspective.

[1]Returns represent the WisdomTree Europe Hedged Equity Index and the WisdomTree Europe Domestic Economy Index, measured in US dollars, due to a lack of the WisdomTree Europe Domestic Economy Index calculated in hedged terms.

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DEFINITIONS

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

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.

Forward P/E ratio : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

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 EMU Index : A free float-adjusted market capitalization-weighted index designed to measure the performance of the markets in the European Monetary Union.