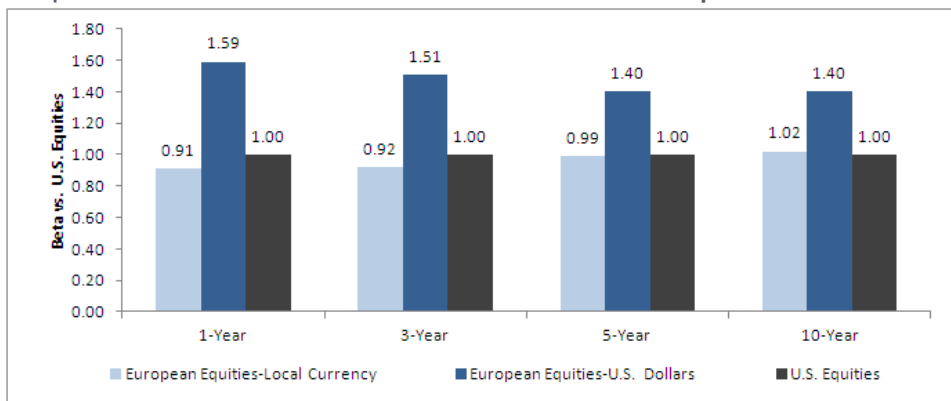


A BENEFIT TO HEDGING THE EURO FROM A DIFFERENT PERSPECTIVE

Jeremy Schwartz – Global Chief Investment Officer
04/03/2013

I recently wrote a [blog](#) about how currency exposure—specifically to the euro—impacted [volatility](#) of European equities (the [MSCI EMU Index](#) over the last 10 years¹). The central analytics of that blog measured the “beta” of European equities in local currency terms against European equities in U.S. dollars. The index measured in U.S. dollars includes the fluctuations of the euro against the U.S. dollar, which tends to increase its volatility. I make a similar point in this blog but from a different perspective, specifically by measuring the beta of these European equities against the [S&P 500 Index](#). This analysis highlights how sensitive European equities are to moves in the S&P 500—a common framework for evaluating investment strategies. Indexes with a beta greater than 1.0 relative to the S&P 500 Index have tended to be more sensitive, with the potential to magnify movements of this benchmark during the periods studied, while strategies with a beta below 1.0 have tended to exhibit lower sensitivity to those same movements. **Two Sources of Risk** For U.S. investors in international equities, there are traditionally two sources of volatility: 1) volatility of equity prices 2) volatility of the currency relative to the U.S. dollar Oftentimes, U.S. equities appear less volatile than international equities—not because of volatility in their actual equity price movements, but rather because of the respective currency’s movements against the U.S. dollar. The chart below illustrates how much higher the beta (measured against the S&P 500 Index) of European equities is *with* euro exposure (meaning the incremental volatility from movements of the euro against the U.S. dollar) than *without* euro exposure.

How Euro Exposure Increased volatility



Period: 10 years ended 2/28/2013. Sources: MSCI, Zephyr StyleADVISOR
European Equities-Local Currency is represented by MSCI EMU Local Currency Index.
European Equities-U.S. Dollars is represented by MSCI EMU Index.
U.S. Equities is represented by S&P 500 Index.

(For definitions of terms in this chart, please see our [Glossary](#).)

- **Risk Reduction:** Removing the euro risk from the equation significantly lowered the beta of European equities compared to U.S. equities. In fact, over the one-, three- and five-year periods, this index had a beta of less than 1, and the beta was approximately equal to 1 over the 10-year period.
- **Incremental Risk of Euro Exposure:** It is worth noting that for the 10-year period ending February 28, 2013, exposure to the euro increased the beta of European Equities

by nearly 40%. Over shorter periods, this additional risk was even more pronounced. **Why Be 100% Unhedged?** When it comes to a currency such as the euro, I believe there will be cycles of both appreciation and depreciation against the U.S. dollar. Given the difficulty in predicting exactly when these cycles will turn, we question why typical allocations should always fully assume this currency risk. To me, an allocation that is 50% hedged and 50% unhedged—especially for someone without a strong view as to a currency’s future performance—would seem a better baseline to dial up or down from, depending on one’s conviction regarding the direction of any future currency trend. **Take the euro out of Europe [\(Video\)](#)** 12/28/2003–2/28/2013.

Important Risks Related to this Article

Past performance does not guarantee future results.

For standardized performance and the most recent month-end performance click [here](#) 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.

For more investing insights, check out our [Economic & Market Outlook](#)

view the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

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

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

Beta: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

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.