

# POSITIONING FOR A EUROPEAN RECOVERY WITH SMALL CAPS

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Is Europe’s economy starting to turn the corner? It seems hard to fathom. Over the past few years, the news and predictions on the region at times didn’t just seem to signal *whether* the [eurozone](#) would break up—the underlying tone seemed to only question *when*. Questions would repeatedly abound as to how 17 disparate governments, each with its own agenda, could come together in a functioning [currency union](#). Being bearish on Europe was the easy view to take. However, looking at the data coming out of Europe now, the proverbial phoenix rising from these dire expectations has been the European consumer. Measures such as retail sales, consumer confidence and auto registrations seem to point to stabilization –an important first step on the path to recovery. **European Equities Also on an Upturn** with the various issues plaguing Europe, it isn’t surprising that equity market [valuations](#) have been depressed. With some investors believing that the worst of the European crisis is behind us, many are starting to position for a potential recovery in Europe, and the performance of some pockets of European equities is starting to turn very positive. In this blog post, I will contrast two different approaches one can take to participate in a European recovery. WisdomTree has developed two Indexes specifically focused on Europe, and each provides a unique exposure to the European market and economy– depending on the types of companies one desires. • [WisdomTree Europe Hedged Equity Index](#) (European Exporters): Constituents of this Index must demonstrate each year at the Index screening date that they derive at least 50% of their revenues from outside Europe, thereby focusing the Index on global revenue generators. Additionally, the Index hedges exposure to fluctuations in the euro/U.S. dollar exchange rate. • [WisdomTree Europe SmallCap Dividend Index](#) (European Small Caps): Constituents of this Index must have paid the U.S. dollar equivalent of at least \$5 million in cash dividends over the year prior to the Index screening and be in the bottom 25% of the [WisdomTree Europe Dividend Index](#) after removal of the 300 largest companies. In other words, the focus is on dividend-paying small caps within Europe. This Index does not hedge the performance of its constituent currencies vs. the U.S. dollar. **Illustrating Geographic Revenue Differences with the Top 10 Index Holdings**

Top 10 Index Holdings (as of 7/31/2013)

WisdomTree Europe SmallCap Dividend Index			
Ticker	Name	Weight	% Revenue from Europe
LOGN SW	Logitech International SA	2.23%	37%
DRI GY	Drillisch AG	1.91%	100%
ATEA NO	Atea ASA	1.85%	100%
UNI IM	Unipol Gruppo Finanziarie SpA Ord	1.78%	100%
HOLMB SS	Holmen AB B	1.75%	88%
ISPR IM	Intesa Sanpaolo SpA Rnc	1.60%	97%
CSM NA	CSM NV	1.33%	38%
LSG NO	Leroy Seafood Group ASA	1.26%	81%
LEO GY	LEONI AG	1.24%	63%
BSLN SW	Besilea Pharmaceuticals	1.06%	72%
Weighted Average:			78%

WisdomTree Europe Hedged Equity Index			
Ticker	Name	Weight	% Revenue from Europe
SAN SM	Banco Santander SA	6.16%	42%
BBVA SM	Banco Bilbao Vizcaya Argentaria	6.03%	80%
ABI BB	Anheuser Busch Inbev NV	5.93%	13%
SAN FP	Sanofi-Aventis	4.60%	24%
DAI GY	Deimier AG	4.35%	34%
UNA NA	Unilever NV	4.34%	27%
SIE GY	Siemens AG	4.02%	49%
EOAN GY	E.ON SE	3.75%	49%
MC FP	LVMH-Moet Vuitton	3.27%	80%
OR FP	L’Oreal	2.86%	33%
Weighted Average:			32%

Sources: WisdomTree, Bloomberg. Subject to change.

Small Caps Are

**More Local to Europe** Small-cap stocks of a particular region are often more domestically sensitive, deriving more of their revenues from that region than their large-cap compatriots. To illustrate the point, the above table takes the top 10 holdings of our two European indexes, highlighting the percentage of revenues coming from Europe for each company.

- **Weighted Average Revenues:** The top 10 constituents of European Small Caps had weighted average revenues of 78% from Europe, as compared to only 32% for European Exporters. The exporter screen of the Europe Hedged Equity Index results in the more global focus for these top holdings. We believe that this points to an interesting potential opportunity for revenue diversification across Indexes, or for thinking along the lines of either over-weighting the revenues from Europe or over-weighting blue-chip, multinational revenue generators.

**Further Points of Diversification** European Exporters share very few common constituents with European Small Caps—12 as of July 31, 2013, to be precise. They comprise:

- Less than 1% of the weight of European Exporters
- 7.2% of the weight of European Small Caps

**Considering a Blended Currency Approach** Blending exposure to stocks with a [currency hedge](#) with exposure to those that do not have a currency hedge could have the potential to minimize the risk of being on the wrong side of the euro's performance against the U.S. dollar. Thus far in 2013, the euro has exhibited significant [volatility](#) that hasn't resulted in a sustained trend of either weakness or strength against the U.S. dollar. For those unsure of which direction the euro may move in the near term, considering a blend that is 50% long and 50% hedged against euro declines would yield positions that could benefit no matter which way the currency may go.

**Conclusion** with potential economic green shoots perking up in the European landscape, [\(as detailed in yesterday's blog by Jeremy Schwartz\)](#), the time could be ripe to consider the tools and options available across European equity indexes. European small-cap stocks may be some of the best positioned to benefit from a rebound in Europe's economy and deserve some special consideration.

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## DEFINITIONS

**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).

**Currency union**: Group of different markets or countries committed to using the same currency.

**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.

**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.

**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.

**WisdomTree Europe Dividend Index**: Index designed to measure the performance of dividend-paying companies within Europe.

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

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