

WHY EUROPEAN DIVIDEND GROWTH COMPANIES LOOK ATTRACTIVELY PRICED

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Investors anticipate a continued economic recovery in Europe and are flocking toward European investments. European markets still trade at a slight discount to their peers in the U.S.,¹ but there is a particular segment that we believe looks attractively priced: high-quality companies. **Valuation Analytics in European Equities** Usually higher-quality companies command premium market multiples and [valuations](#) because they are viewed as having more potential to quickly and sustainably grow their earnings and dividends. I introduced the new WisdomTree Europe Dividend Growth Index in our last [blog post](#), in which I discussed [return on equity \(ROE\)](#) and [return on assets \(ROA\)](#). WisdomTree uses these quality factors to help select the companies we believe have the best prospects for sustainable long-term dividend growth. The valuation of the [WisdomTree Europe Dividend Growth Index](#), on a [price-to-earnings \(P/E\) ratio](#) basis, is only slightly higher than the broader European market indexes shown in the table below. Its [dividend yield](#), another important valuation metric, is broadly in line with, if actually a little higher than, that of the [MSCI EMU Index](#). This low valuation [spread](#) for a high-quality basket, in my opinion, makes this a particularly attractive time to consider these stocks to represent European equity exposures. **Why a Focus on Growth and Quality**

European Equity Index							
	WT Europe Dividend Growth	WT Europe Hedged Equity	WT Europe SmallCap Dividend	FTSE Developed Europe	MSCI EMU	Euro Stoxx 50	S&P Europe 350
Price-to-Earnings (P/E) Ratio	14.9x	14.8x	15.0x	14.0x	13.9x	13.1x	13.9x
Median Long-Term Earnings Growth	8.5%	11.1%	12.7%	9.4%	11.2%	10.4%	9.5%
Dividend Yield	3.1%	3.3%	3.5%	3.4%	3.0%	3.3%	3.4%
Earnings Yield	6.7%	6.8%	6.7%	7.1%	7.2%	7.6%	7.2%
Earnings Retention	53.6%	51.1%	47.1%	52.6%	58.1%	57.2%	52.5%
Return on Equity (ROE)	25.3%	14.2%	15.4%	15.2%	12.4%	11.5%	15.6%
Return on Assets (ROA)	10.1%	5.1%	5.9%	5.4%	4.2%	3.9%	5.3%
Leverage	2.5x	2.8x	2.6x	2.8x	3.0x	3.0x	3.0x
ROE x Earnings Retention	13.6%	7.2%	7.2%	8.0%	7.2%	6.6%	8.2%

Sources: WisdomTree, Bloomberg, with data as of 3/31/2014. You cannot invest directly in an index. Past performance is not indicative of future results. Subject to change.

May Be Attractive Today

For definitions of terms and indexes in the chart, please visit our [Glossary](#).

Drivers of Dividend Growth: The [dividend discount model](#) suggests that dividend growth is critically linked to earnings retention and return on equity. Simply stated, the

potential future growth of dividends is determined by the fraction of earnings put back into the firm and how profitable those earnings are in their subsequent use. While there is no way to know what any firm's actual future dividend growth will be, I believe this metric is important when attempting to gauge a firm's future dividend growth potential.

• **WisdomTree Europe Dividend Growth:** The Index's ROE x earnings retention was 13.6%. None of the other European indexes score above 10% by this metric. This wasn't attributable to earnings retention—that was broadly similar across each index. ROE for the WisdomTree Europe Dividend Growth Index was—by virtue of its selection methodology—nearly 26%, which was at least 9% above the ROE of the next highest index shown. This illustrates how one of the great differentiators of the current constituent list is a focus on quality companies, with quality being approximated by ROE. **Blending WisdomTree's Indexes to Fine-Tune European Equity Exposure** The WisdomTree Europe Dividend Growth Index is actually the third broadly focused European Index in our current lineup. Below are two crucial discussions regarding how it fits in with the [WisdomTree Europe Hedged Equity Index](#) and the [WisdomTree Europe SmallCap Dividend Index](#).

Discussion 1: Currency Exposure [Currency hedging](#) developed international equities is a theme that WisdomTree has written about [extensively](#), as we believe it is one of the most significant issues to think about when considering this segment of today's equity landscape. The cost to hedge the euro is minimal, yet we face the distinct possibility that the European Central Bank (ECB) could act to support its economy, which could lead to a weaker euro against the U.S. dollar. I believe there is a chance that exposure to the euro could lead to the potential for unrewarded [volatility](#). To mitigate this risk, I advocate consideration of blends of the [WisdomTree Europe Hedged Equity Index](#), weighted equally, with either our [Europe Dividend Growth Index](#) or our [Europe SmallCap Dividend Index](#). Such equally weighted blends reflect the reality that very few people have a strong conviction which way the euro will move, especially over the short term. Combining some currency-hedged strategies with the new Europe Dividend Growth Index, as well as or in addition to the Europe SmallCap Dividend Index, can take some of that [risk](#) off the table.

Discussion 2: European Completion The WisdomTree Europe SmallCap Dividend Index has relatively low overlap with either the WisdomTree Europe Hedged Equity Index or the Europe Dividend Growth Indexes and thus blends well with both of those Indexes from a completion standpoint.² European small caps are often more sensitive to the local economy than large-cap companies, many of which are global exporters. Small caps also make a good potential complement in sectors and types of stocks. **Conclusion** I believe the European variant of our dividend growth methodology provides a valuable addition to the universe of indexes tracking that region's stocks. For people who historically have appreciated a higher quality bias in their approach to U.S. equities, I believe the existence of a new option in Europe could be of particular interest. For those who think the European recovery is just getting under way, I believe this new Index should be well positioned to capitalize on the dividend growth opportunities in Europe. ¹Refers to the price-to-earnings (P/E) ratio of the [MSCI Europe Index](#) measured against the P/E ratio of the S&P500 Index, with values as of 3/31/2014. ²Based on the constituents of the WisdomTree Europe Dividend Growth, Europe Hedged Equity and Europe SmallCap Dividend Indexes as of 3/31/2014.

Important Risks Related to this Article

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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.

Return on Equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA): Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

WisdomTree Europe Dividend Growth Index: A fundamentally weighted index that measures the performance of dividend-paying common stocks with growth characteristics selected from the WisdomTree DEFA Index. The Index comprises companies from the eligible universe based on their combined ranking of growth and quality.

Dividend yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

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

Spread: Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

Dividend discount model (DDM): Method of determining whether a company's share price is currently above or below where it could be if future dividend payments were the key determinant, as opposed to other factors.

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.

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.

Risk: Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

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