
FRENCH ELECTION ROUND 1: HOW DID EUROPEAN EQUITIES RESPOND?

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It has been difficult to turn on any investment media in 2017 without hearing at least something about European elections—particularly the French presidential election. Going into April 23, the first round of the process, we as an industry waited with baited breath, given the apparent tightening of polls.

Few (If Any) Were Allocating to European Equities Prior to This Event

In speaking to industry professionals over the course of the first four months of 2017, a common conversational framework tended to ensue:

1. **Broad Agreement That U.S. Equities¹ Were Either Close to [Fairly Valued](#) or Even Expensive:** The only logical argument we tended to hear supporting U.S. [valuations](#) was that interest rates² remain near historic lows, and therefore bonds are still quite expensive compared to stocks.
2. **Awakening to Emerging Market Equities³, which Have Been Performing Strongly for More Than 12 Months:** We remember trying to discuss emerging market equities at the end of 2015 (largely to no avail), but now that the benchmark index is more than 25%⁴ above those levels, there seems to be greater interest.
3. **Disconnected Reality of European Equity Performance vs. European Equity Sentiment:** Growth and [inflation](#) dynamics in Europe, not to mention corporate earnings, were far from a disaster scenario. While the [S&P 500 Index](#) and the [Russell 2000 Index](#) delivered 6.07% and 2.47%, respectively, European large caps and small caps⁵ outperformed.

Home country bias—even in the face of many saying outwardly that they didn't love the current levels of the U.S. equity markets—remained the majority action, we think predominantly due to the feeling of being “burned” by 1) the [Brexit](#) referendum surprise and 2) Donald Trump's surprise election victory.

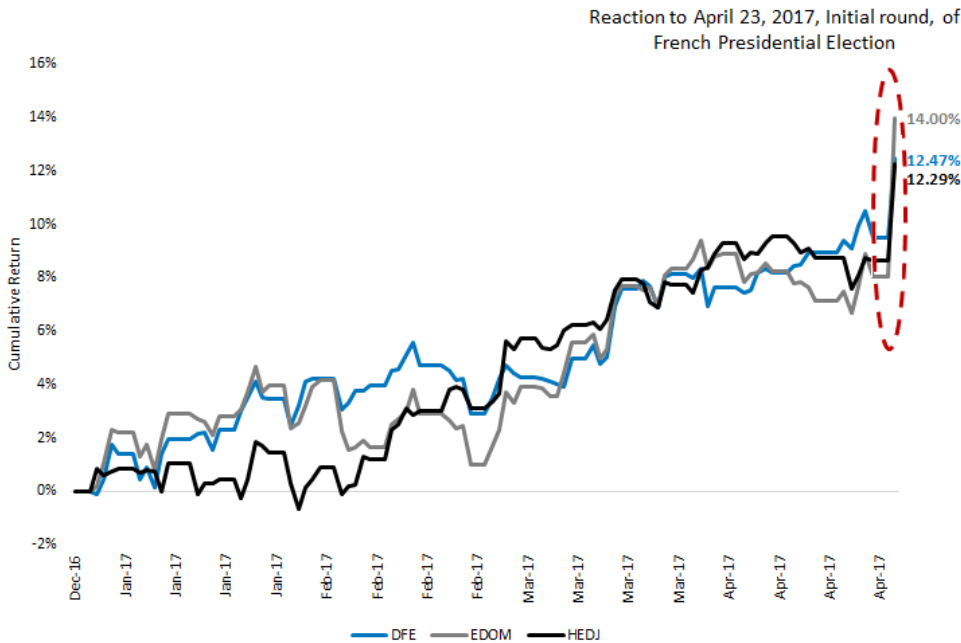
The European Equity Opportunity Became a Coiled Spring

Europe is a major world market—if one includes the UK and the eurozone, the exposure in the [MSCI ACWI](#) is approximately 17%.⁶ With the election concerns, a divide occurred among sentiment, [fundamentals](#), and ultimate allocations. Any catalysts for shifts in sentiment (such as more positive election results than expected) could therefore lead to significant rebalancing or reallocation back into the region.

Average Annual Returns

Fund Name	Fund Information			NAV Returns (%)						Market Price Returns (%)					
	Ticker	Exp. Ratio	Inception Date	YTD	1-Year	3-Year	5-Year	10-Year	Since Fund Inception	YTD	1-Year	3-Year	5-Year	10-Year	Since Fund Inception
WisdomTree Europe Domestic Economy Fund	EDOM	0.48%	10/29/2015	8.92%	9.90%	N/A	N/A	N/A	4.08%	9.11%	10.41%	N/A	N/A	N/A	3.76%
WisdomTree Europe SmallCap Dividend Fund	DFE	0.58%	6/16/2006	7.66%	7.97%	1.40%	12.78%	3.04%	6.08%	8.26%	8.24%	1.32%	12.59%	2.99%	5.96%
WisdomTree Europe Hedged Equity Fund	HEDJ	0.58%	12/31/2009	9.28%	24.20%	9.89%	12.25%	N/A	8.40%	9.65%	24.75%	9.80%	11.86%	N/A	8.42%

Broad-Based Measures of European Equities Responded Strongly in Initial Reaction



Source: WisdomTree, with data from 12/31/16 to 4/24/17. Returns reflect NAV total returns.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

Summarizing some of the critical takeaways, in our view:⁷

- **EDOM:** The [WisdomTree Europe Domestic Economy Fund](#), built to track the price and yield performance of the [WisdomTree Europe Domestic Economy Index](#) before fees and expenses, reacted very strongly to the initial results from the first round of the French presidential election. In looking at underlying drivers, what stands out is that EDOM had slightly more than 30% of its exposure in the Financials sector. This sector responded very strongly on April 24, 2017, with French and Italian banks delivering in many cases double-digit returns. Looking beyond the single-day reaction, we find it instructive to consider the fact that the European Financials sector may have among the highest [betas](#) to shifts in European sentiment, so if things continue to “surprise to the positive,” this strategy may be particularly sensitive.

- DFE: The [WisdomTree Europe SmallCap Dividend Fund](#), built to track the price and yield performance of the [WisdomTree Europe SmallCap Dividend Index](#) before fees and expenses, also responded strongly. We wrote about this Index on April 5, 2017, as a way to think about [expressing a view that the election results might not conform to the most dire of predicted scenarios](#). While EDOM is tracking an Index that requires constituents to derive at least 50% of their revenues from *inside* Europe, DFE is tracking an Index that merely focuses on small caps to get a similar exposure to locally driven revenues of Europe. While Financials in DFE also led the way in the April 24 market reaction, we'd make an important distinction: EDOM's constituents include some of the largest, most well-known (for better or worse) banks throughout Europe. DFE's constituents are small caps, lending the potential to gain exposure to a completely different, lesser-followed slice of Europe's equities.
- HEDJ: The [WisdomTree Europe Hedged Equity Fund](#), built to track the price and yield performance of the [WisdomTree Europe Hedged Equity Index](#) before fees and expenses, also responded strongly. It's important for investors to see the completely different positioning compared to EDOM and DFE, since the case can be made that both of those strategies tap into improvements in Europe's local picture and rising domestic demand. HEDJ's Index requires constituents to derive at least 50% of their revenues from outside Europe, so the Fund is really generating exposure to the performance of global companies. It's also important to note that HEDJ's Index is [hedging](#) the exposure to the movements of the euro versus the U.S. dollar. The euro appreciated by approximately 1.30% on April 24 (benefitting the returns of EDOM and DFE, which do not track the returns of hedged indexes and do include euro exposure), but as we look forward, we question how much euro appreciation may make sense, given the not-realized divergence in monetary policy between the European Central Bank (ECB) and the U.S. Federal Reserve.

Ready for the Next Chapter of the Story

While the market seems to be thinking Emmanuel Macron will be victorious (at least as of this writing), the past few years have led us to remember that it ain't over till it's over. We'll continue to monitor how different types of European equity strategies respond to new developments.

¹Refers to S&P 500 Index universe, as of 4/24/17.

²Refers to both short-term interest rates, like the U.S. [Federal Funds Rate](#), and more long-term rates, like the [U.S. 10-Year Treasury](#) note interest rate, as of 4/24/17.

³Refers to the [MSCI Emerging Markets Index](#) universe, with performance from 12/31/15 to 4/24/17.

⁴Refers to the [MSCI Emerging Markets Index](#) universe, with performance from 12/31/15 to 4/24/17.

⁵Refers to the [Euro Stoxx 50 Index](#) and the [MSCI EMU Small Cap Index](#) from 12/31/16 to 4/24/17.

⁶Source: Bloomberg, with data as of 4/24/17.

⁷Sources for all bullets: WisdomTree, Bloomberg.

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DEFINITIONS

Fairly priced: Implies that market prices are thought to be aligned with the underlying fundamentals of the firms in question, not appearing expensive and not appearing inexpensive.

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.

Inflation: Characterized by rising price levels.

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.

Russell 2000 Index: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

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

MSCI ACWI Index: A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

Fundamentals: Attributes related to a company's actual operations and production as opposed to changes in share price.

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.

Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Federal Funds Rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

U.S. 10 Year Treasury Note: A debt obligation issued by the United States government that matures in 10 years.

MSCI Emerging Markets Index: a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

Euro Stoxx: Refers to the Euro Stoxx 50 Index, a market capitalization-weighted stock index of 50 large, blue-chip European companies operating in Eurozone nations.

MSCI EMU Small Cap Index: captures the small cap representation across countries in the European Economic and Monetary Union.