

# (NOT) OVER THE HEDGE

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It’s been a turbulent year for European markets.

The aftershocks of the Russian invasion of Ukraine further inflamed economic conditions already strained by [inflationary](#) pressures and rising [interest rates](#).

The euro and the U.S. dollar hit [parity](#) for the first time in two decades in July. The last time markets had seen such a phenomenon was in December 2002, just three years after the euro made its debut. As of October 24, one U.S. dollar could buy 1.01 euros.

Despite worldwide inflation, Americans are flying across the pond in record numbers, eager to participate in what almost feels like a fire sale across the entire region. Holiday-goers aside, exporters are also poised to take advantage of a tumultuous [FX](#) landscape that has made euro-denominated goods more attractive for overseas buyers.

In a sign of potential FX tailwinds for exporters, we have begun to see a modest performance gap materializing between the [MSCI EMU \(European Economic and Monetary Union\) Automobiles Index](#) and the broader MSCI EMU Index in the past few months.

## Year-to-Date Performance, MSCI EMU vs. MSCI EMU Automobiles



Sources: WisdomTree, MSCI, 12/31/21–10/24/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

For definitions of indices in the chart above, please visit the [glossary](#).

## WisdomTree Europe Hedged Equity Index Rebalance

The [WisdomTree Europe Hedged Equity Index \(WTEHIP\)](#) conducted its annual rebalance at the beginning of November.

The Index seeks to provide exposure to European equities while mitigating exposure to fluctuations of the euro relative to the U.S. dollar. The Index is based on dividend-paying companies in the WisdomTree International Equity Index that are domiciled in Europe and are traded in euros, have at least \$1 billion market capitalization and

derive at least 50% of their revenue in the latest fiscal year from countries outside of Europe, essentially tilting holdings toward exporters.

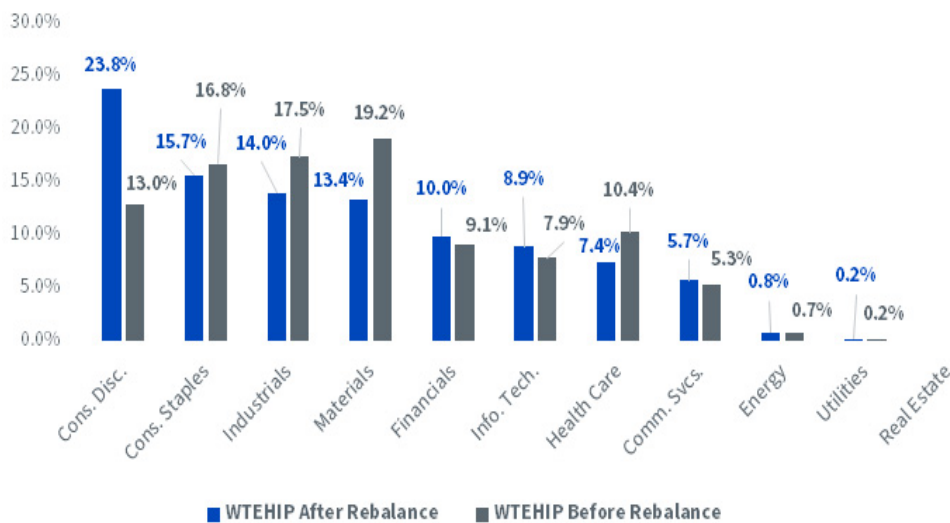
**Year-to-Date, WisdomTree Europe Hedged Equity vs. MSCI EMU**



Sources: WisdomTree, MSCI, 12/31/21-10/24/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The rebalance saw the Index make major additions in the [Consumer Discretionary sector](#) and drop significant allocations in the Industrials and Materials sectors.

**Rebalance Changes, Sector Weights**



Sources: WisdomTree, FactSet, as of 10/21/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

These sector weight changes were largely due to the performance of exporters of luxury goods, such as automobiles, that increased their distributions over the past few months. The rebalance bumped two names into the Index’s top 10 holdings: Mercedes-Benz Group AG and Bayerische Motoren Werke AG (BMW)—both German automakers.

Looking at the effect of the rebalance on portfolio fundamentals, WTEHIP modestly improved its return on assets and return on equity. It also reduced its price-to-earnings ratio from 10.42x to 7.03x and improved its dividend yield from 3.56% to 4.22%. Index constituents were roughly unchanged, decreasing from 130 securities to 126 securities after the rebalance.

### Rebalance Changes, Index Characteristics

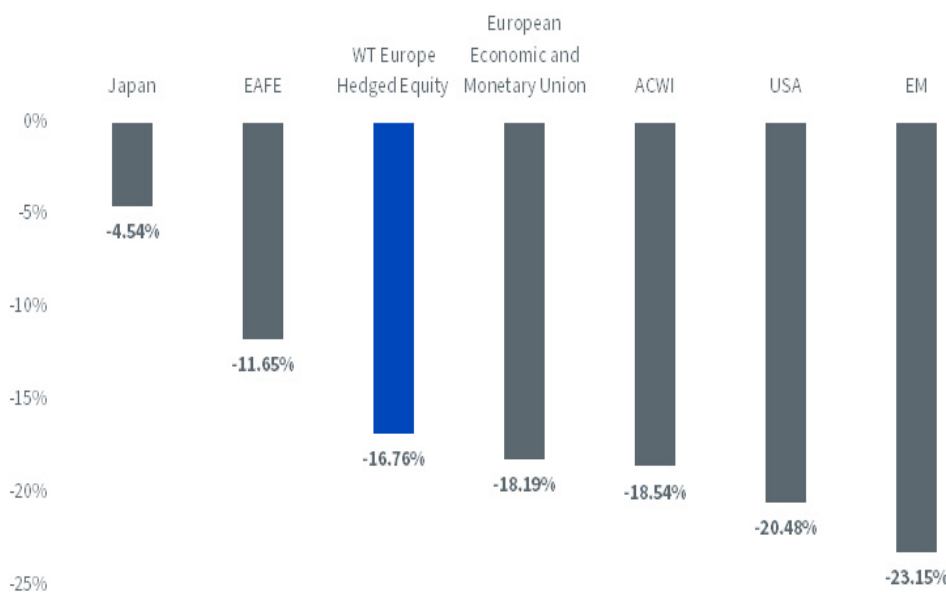
	Company Count	P/E	Div. Yield	ROA	ROE	Large Cap	Mid Cap	Small Cap
WTEHIP After Rebalance	126	7.0x	4.2%	3.0%	18.7%	82.0%	16.3%	1.6%
WTEHIP Before Rebalance	130	10.4x	3.6%	2.5%	15.1%	84.4%	13.4%	2.2%

Sources: WisdomTree, FactSet, as of 10/21/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

What may be surprising to some investors is that European equities—despite all the geopolitical and economic turmoil of 2022—have slightly edged U.S. equities in local currency terms.

European exporters (as measured by the WisdomTree Europe Hedged Equity Index) have fared even better, benefiting from a more competitive euro, and were able to mitigate exposure to the global sell-off in high-growth stocks.

### Year-to-Date Index Performance, WisdomTree Europe Hedged Equity vs. MSCI Indexes

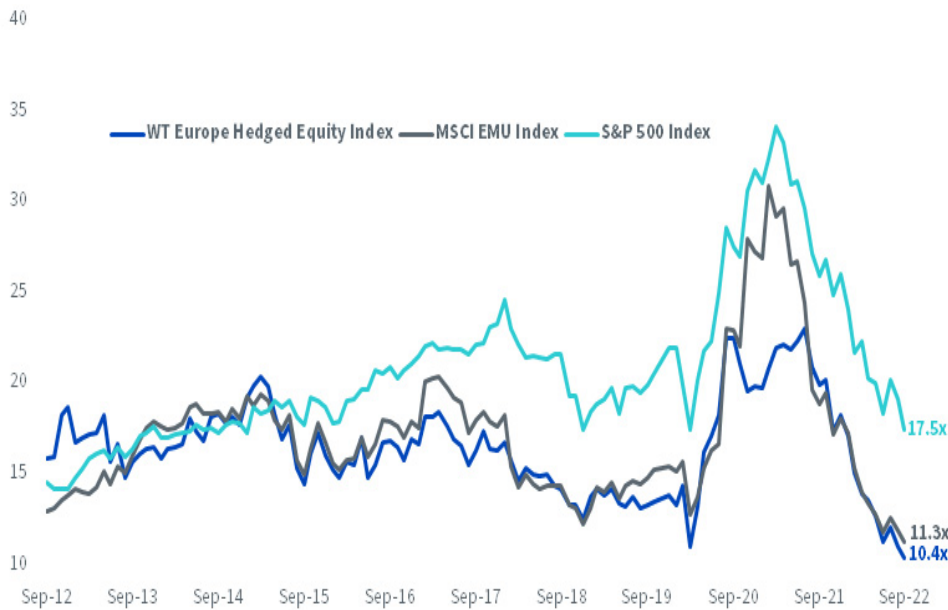


Sources: WisdomTree, MSCI, 12/31/21–10/24/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

As the popular saying goes, “Things get worse before they get better.” On the economic front, valuations of European equities certainly look discounted to reflect that sentiment.

The trailing 12-month price-to-earnings ratio of around 10x for European equities is as depressed as we have seen for the market over the past 10 years—a decade that included myriad challenges to the existence of the euro altogether.

### Lowest P/E Ratio Since Index Launch



Sources: WisdomTree, MSCI, 9/28/12-9/30/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

The gap between the [price-to-earnings ratios](#) of the [S&P 500](#) and the MSCI EMU Index has been widening since an initial convergence in 2020.

For perspective, the median absolute difference between the S&P 500’s price-to-earnings ratio and that of the MSCI EMU Index from September 2002 to September 2012 was 2.6 multiple turns.

That median difference from September 2012 to today is now 3.8 multiple turns—almost 50% wider.

As of November 11, 2022, WTEHIP held 3.80% and 3.10% in Mercedes-Benz AG (MBG GY) and Bayerische Motoren Werke Ag (BMW GR), respectively. Click [here](#) for a full list of holdings. Holdings are subject to change.

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.

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

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You cannot invest directly in an index.

## DEFINITIONS

**Inflation**: Characterized by rising price levels.

**Interest rates**: The rate at which interest is paid by a borrower for the use of money.

**Parity**: Euro at parity means the euro would be trading at rate of \$1 equals €1.

**Foreign Exchange (FOREX, FX)**: The exchange of one currency for another, or the conversion of one currency into another currency.

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

**Consumer Discretionary**: A term for classifying goods and services that are considered non-essential by consumers, but desirable if their available income is sufficient to purchase them.

**Price-to-earnings (P/E) ratio**: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**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.