

# WisdomTree Emerging Markets ex-State-Owned Enterprises ETF XSOE

Fund Analysis | Daniel Sotiroff

Assets (\$Mil)	Expense Ratio %	12-Mo. Yield %	Turnover %	Inception
3,420	0.32	1.02	19.00	12/10/14

## Total Return %



Source: Morningstar Direct. Data from Dec. 10, 2014, to Dec. 31, 2020

Returns	1-Year	3-Year	5-Year	SI
XSOE	29.49	9.38	15.54	10.24
iShares Core MSCI Emrg. Mkts ETF IEMG	18.18	5.81	12.25	7.19

Source: Morningstar Direct. Data as of Dec. 31, 2020. Returns data for periods longer than one year is annualized.

Top Holdings	Wtg (%)	Fundamentals	XSOE	IEMG
Alibaba Group Holding Ltd Ordinary Shares	6.92	ROIC (%)	10.43	9.48
Tencent Holdings Ltd	6.00	P/E Fwd.	18.15	15.08
Samsung Electronics Co Ltd	5.67	P/B	2.33	1.75
Taiwan Semiconductor Manufacturing Co Ltd	5.62	P/CF	11.34	8.72
Meituan	1.91			
Naspers Ltd Class N	1.39	Moat (%)		
Reliance Industries Ltd ADR	1.39	Wide	44.6	39.72
JD.com Inc ADR	1.34	Narrow	28.48	29.93
Ping An Insurance (Group) Co. of China Ltd Class H	1.17	None	26.92	30.35
Baidu Inc ADR	1.05			

Source: Morningstar Direct. Data as of Dec. 31, 2020

WisdomTree Emerging Markets ex-State-Owned Enterprises ETF **XSOE** is a great option for investors looking for a broad emerging-markets fund with considerably less exposure to state-owned enterprises and the political risks they bear. This is the only strategy in the diversified emerging-markets Morningstar Category that explicitly tries to eliminate state-owned enterprises from its portfolio. Few other rules-based strategies in the category, including broad market index funds, strategic-beta funds, and ESG-oriented funds, provide effective shelter from the potential political fallout associated with these firms.

## Process

The construction of this portfolio starts with a broad collection of stocks listed in 17 emerging markets, including the 50 largest Chinese firms listed in mainland China on the Shanghai or Shenzhen exchanges. Researching, compiling, and maintaining the list of government-owned firms is the heart of this strategy. This is no simple task as there aren't universally accepted criteria that qualify companies as "state-owned." Any insight is further obscured by the variety of avenues that state ownership can occur through, including government agencies and sovereign wealth funds.

WisdomTree's research team draws some boundaries around the qualification standards in a way that effectively identifies government-owned stocks. Government ownership typically occurs through sovereign governments, their agencies, local governments, and sovereign wealth funds as they all enable political influence. WisdomTree further defines state-owned enterprises as firms with more than 20% of their outstanding shares held by those same institutions. Subsidiaries of SOEs are eligible for exclusion, as are stocks listed in one emerging market that are owned by the government of another emerging economy.

The strategy initially weights constituents by their float-adjusted market capitalization, but certain market segments harbor more of these firms than others. Many SOEs are closely tied to their country's natural resources and banking system, so they tend to be more prevalent in the materials, energy, and financials sectors. And some countries, like China and Russia, are home to more of these firms than others.

Removing these stocks from the portfolio tends to push it away from these market segments, introducing biases that may not be compensated. The strategy uses market-cap multipliers to correct these biases and more closely align its sector and country weights with their weights in the parent universe. However, it still tends to favor countries and sectors with fewer SOEs.

### Portfolio

WisdomTree's emerging-markets universe contains a little more than 800 names, and the state-owned enterprise exclusion culls about 220 from that roster. That amounts to a sizable chunk of the market—just over 20% of the starting universe by market cap. Major SOEs like China Construction Bank, China Mobile, and Gazprom are notably absent. This includes many of the firms with ties to the Chinese military that the recent White House executive order prohibits U.S. citizens from owning. Removing more than a fourth of the names from the starting universe contributes to the fund's active risk. Relative to the MSCI Emerging Markets Index, its tracking error over the trailing three years through December 2020 landed at about 3%, meaning it doesn't move in lock step with the index.

Removing China's large state-owned banks from this portfolio has influenced its composition. As of Dec. 31, 2020, it had a 10% smaller stake in Chinese stocks than the MSCI Emerging Markets Index, and it was underweight in the financials sector as well. The portfolio compensates for those differences by leaning toward technology and consumer stocks listed in Taiwan and South Korea, which contribute to its modest growth orientation. The fund's valuation ratios and profitability have consistently been higher than the index's.

WisdomTree's emerging-markets universe doesn't include some of the smaller countries found in MSCI or FTSE's emerging-markets indexes, including Saudi Arabia, Qatar, and the United Arab Emirates. Omitting stocks from these countries has a negligible effect on its diversification. These nations represent a small fraction of those benchmarks, and many of the largest firms in these countries, such as Saudi Basic Industries and Qatar National Bank, would likely qualify as state-owned and thus be excluded from the portfolio.

### People

WisdomTree's research team compiles the list of state-owned companies excluded from the portfolio and builds the WisdomTree Emerging Markets ex-State-Owned Enterprises Index. The team compiles information from multiple sources, including corporate financial statements and government publications (among others), to identify state-owned companies.

Responsibility for tracking the index is handed over to a portfolio management team at Mellon—WisdomTree's exchange-traded funds subadvisor—led by Thomas Durante and Marlene Walker-Smith. Durante and Walker-Smith are supported by analysts who help prepare for index changes and assist with corporate actions. This is a small team with less specialization than larger index fund managers, but Mellon's team is still well-equipped to deliver solid index-tracking performance.

### Performance

To date, removing SOEs has not damped volatility. The fund's standard deviation over the trailing five years through December 2020 was roughly equal to that of the MSCI Emerging Markets Index. But forgoing government-owned firms does appear to have aided XSOF's returns. Favorable stock selection in the financials, communications, and energy sectors—those with considerable exposure to SOEs—helped it beat the MSCI Emerging Markets Index by 2.7 percentage points annually over those five years. Smaller stakes in the financials and utilities sectors also contributed to its strong performance, but the impact wasn't as large as the boost it got from superior stock selection.

The strategy's outperformance occurred over three periods since it was launched in late 2014. It briefly beat the index in mid-2015 and again through most of 2017. Its longest and strongest streak occurred between January 2019 and December 2020. Stock selection in sectors with heavy exposure to SOEs, including financials, energy, and communication services, provided a substantial benefit in each period. ■■■

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**Definitions**

Turnover: a measure of how quickly securities in a fund are either bought or sold by the fund's managers, over a given period of time

ROIC %: Return on invested capital (ROIC) is a calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments.

P/E Fwd: Forward price-to-earnings is a version of the ratio of price-to-earnings (P/E) that uses forecasted earnings for the P/E calculation.

P/B: Price to book ratio compares a firm's market capitalization to its book value. It's calculated by dividing the company's stock price per share by its book value per share

P/CF: Price-to-cash flow (P/CF) ratio is a stock valuation indicator or multiple that measures the value of a stock's price relative to its operating cash flow per share.

Moat %: The Morningstar Economic Moat Rating represents a company's sustainable competitive advantage. A company with an economic moat can fend off competition and earn high returns on capital for many years to come. A company whose competitive advantages Morningstar expects to last more than 20 years has a WIDE moat. A company whose competitive advantages Morningstar expects to last more than 10 years has a NARROW moat. While a firm with no advantage or one that could quickly dissipate has NO moat.

**Important Information:**

The purpose of this material is to provide investors with a means to evaluate the investment methodology of XSOE compared to IEMG. It is the opinion of WisdomTree, the Fund's investment adviser, that all funds are managed differently and do not react the same to economic or market events. The investment objectives, strategies, policies or restrictions of other funds may differ and more information can be found in their respective prospectuses. Therefore, we generally do not believe it is possible to make direct fund to fund comparisons in an effort to highlight the benefits of a fund versus another similarly managed fund. The information included in this material is based upon data obtained from a source which is believed to be accurate. This material is not considered as an offer to sell or a solicitation to buy shares of any other funds mentioned herein.

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging or offshore markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Funds focusing their investments on certain sectors and/or regions increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

[XSOE Fact Sheet](#) with standardized performance

[IEMG Fact Sheet](#) with standardized performance

Past performance is not indicative of 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 above. For the most recent month-end performance go to [wisdomtree.com](http://wisdomtree.com) or [ishares.com](http://ishares.com) respectively.

XSOE risk language:

**Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before investing. To obtain a prospectus containing this and other important information, please call 866.909.9473, or visit [WisdomTree.com](http://WisdomTree.com) to view or download a prospectus. Investors should read the prospectus carefully before investing.**

WisdomTree funds are distributed by Foreside Fund Services, LLC.

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging or offshore markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Funds focusing their investments on certain sectors and/or regions increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Investments in currency involve additional special risks, such as credit risk and interest rate fluctua-

tions. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

IEMG risk language:

**Carefully consider the fund's investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Fund's prospectus, and if available summary prospectus, which can be obtained by calling 1-800-iShares (1-800-474-2737) or by visiting [www.ishares.com](http://www.ishares.com) or [www.blackrock.com](http://www.blackrock.com). Read the prospectus carefully before investing.**

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Investing involved risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are often heightened for investments in emerging/developing markets or in concentrations of single countries.