

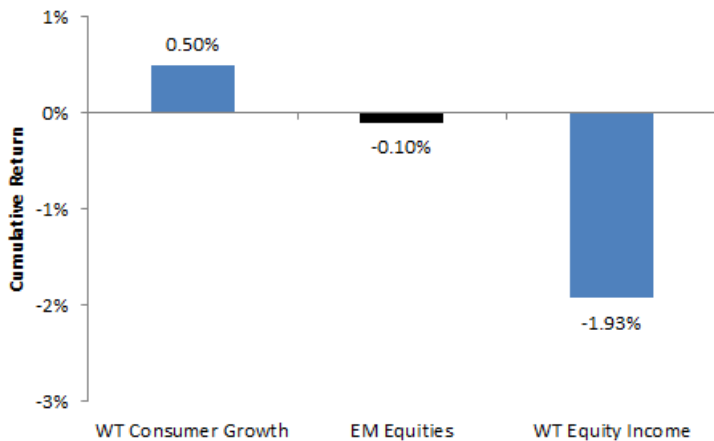
# POSITIONING FOR AN EMERGING MARKET REBOUND

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When investing, timing is ever important. On August 9, 2013, WisdomTree launched an [Index](#) designed to reflect a growing middle class spurring broad-based consumption in the emerging markets. Most recognize that emerging market consumers will be important drivers of long-term global economic growth. However, emerging markets experienced short-term pain last year, and the performance out of the gate for this Index was challenged in the second half of 2013.

**India and Indonesia Run into Summer 2013 Troubles** India and Indonesia comprise large weights, nearly 19%, within the [WisdomTree Emerging Markets Consumer Growth Index](#) (WT Consumer Growth), which is more than double the weight of a broad index such as the [MSCI Emerging Markets Index](#) (EM Equities).<sup>1</sup> Last August, investors were weighing the prospect of the U.S. Federal Reserve [tapering](#) its monthly bond purchases and the implications this had for countries such as India and Indonesia, which rely on foreign financing to fund their high [current account deficits](#). Both the Indian rupee and the Indonesian rupiah responded, dropping 7.4% and 8.2%, respectively, against the U.S. dollar from WT Consumer Growth's inception through the end of August 2013.<sup>2</sup> Overall, the Index was down nearly 7% in less than one month. **Refocusing on the Fundamentals: 2014 Could Be Turnaround Year** Broadly speaking, EM Equities have been out of favor over the past few years, but we are seeing signs of a potential turnaround in 2014, showing just how quickly the picture can change in these markets: • **Indonesia:** Through April 30, 2014, Indonesia was the top-performing country in EM Equities—over 20%!<sup>3</sup> The rupiah was up more than 5%, and it was also a top performer among other emerging market currencies.<sup>4</sup> • Indonesia's current account deficit eased to less than 2% of [gross domestic product](#) in the fourth quarter of 2013. Part of the reason for this was a ban on unprocessed minerals going into effect in January 2014, inducing miners to export what they could during December 2013. Expectations of Indonesia's inflation have also trended downward, with the Indonesian Central Bank expecting 2014 inflation in the range of 3.5% to 5.5%, a contrast to the 8.22% inflation seen in January 2014 year-over-year.<sup>5</sup> • **India:** During this same period, the rupee was up approximately 2%, and India was the top-performing country of the [BRIC](#) nations.<sup>6</sup> • India's current account deficit reduction was largely driven by decreasing gold imports (taxes on gold imports were increased three times in 2013) and decreasing commodity prices.<sup>7</sup> India's central bank has also garnered increased credibility as an "inflation fighter" with governor Raghuram Rajan at the helm. **WT Consumer Growth in 2014**



Source: Bloomberg, with data from 12/31/13 to 4/30/14. Past performance is not indicative of future results. EM Equities is proxied by the MSCI Emerging Market Index.

• **Consumer Focus Helping:** By design, WT Consumer Growth will have 60% of its weight split between the Consumer Discretionary and Consumer Staples sectors, thereby positioning with significant over-weights in these sectors compared to both EM Equities and WT EM Equity Income. Critically though, this WT Consumer Growth Index is not a “sector index”; it is broadly inclusive of companies from eight of ten sectors. It is just designed to remove companies that are most globally sensitive and not reflective of growth trends within emerging market economies.

- **Special Note on Valuation:** Despite focusing on a theme of growth and quality and reflecting growth trends within emerging market consumers, the WT Consumer Growth had a [price-to-earnings \(P/E\) ratio](#) of approximately 11.5x, compared with 10.8x for EM Equities. By contrast, the Consumer Staples in EM Equities has a P/E ratio over 20.0x.<sup>8</sup> This is a testament to WisdomTree’s proprietary methodology while mitigating the risk of an expensive valuation.
- **Complements WT Equity Income:** WT Equity Income’s strategy, focusing on stocks with high [dividend yields](#), has significant weights in state-owned enterprises—most notably Chinese financials and Russian energy firms. WT Consumer Growth, by virtue of its design, actually avoids these sectors:
  - **Energy Sector:** Since we believe the Energy sector to be more globally sensitive and less a play on a growing emerging market consumer, it is excluded from WT Consumer Growth—meaning no exposure to Russian or Brazilian Energy stocks. The Materials sector is excluded for much the same reason.
  - **Large Banks:** Large banks tend to be global economic actors rather than focusing on their local markets, and the largest Chinese banks are prime examples. WT Consumer excludes banks with more than \$10 billion in [market capitalization](#).

**Conclusion: An Interesting Portfolio Approach** The reality is that, as India and Indonesia have been recovering to start 2014, Russian Energy stocks and Chinese Financials may lead an emerging market rebound in the future. It is hard to envision EM Equities rebounding without China turning the corner and performing more positively. But we think it’s interesting to consider just how complementary WT Consumer Growth and WT EM Equity Income actually are. As of April 30:

- **Low Overlap in Common Constituents:** There were 53 common constituents, with an 11.6% weight in WT EM Equity Income and a 21.8% weight in WT Consumer Growth. That is approximately 80% of the WT Consumer Growth is uniquely positioned in different stocks and sectors.<sup>9</sup>
- **Energy & Materials:** WT EM Equity Income’s two largest sector over-weights compared to EM Equities were Energy and Materials. WT Consumer Growth avoids these sectors, making a good pair in obtaining exposure to EM generally.

The emerging markets have been among the most battered of asset classes over last three to four years, especially when compared with the performance in the United States. As investors begin to look for unique opportunities to position for a rebound in EM equities, the WT Consumer Growth Index is one such set of unique exposure. 2014 is off to a relatively good start, and this could be the year when emerging markets begin to shine among the regional counterparts.

<sup>1</sup>Source:Bloomberg, as of 4/30/14 <sup>2</sup>Specific period:8/9/13 to 8/30/13  
<sup>3</sup>Source:MSCI, with data from 12/31/13 to 4/30/14 <sup>4</sup>Source:Bloomberg, with data from 12/31/13 to 4/30/14 <sup>5</sup>Source: (whole bullet point): "Optimism about the Performance of the Indonesian Rupiah Rate in 2014," Indonesia Investments, 2/24/14 <sup>6</sup>Sources:Bloomberg for rupee's performance and MSCI for performance of India's equities. Period 12/31/13 to 4/30/14 <sup>7</sup>Source:Unni Krishnan, "India's Shrinking Current-Account Gap Reduces Risks to Rupee," Bloomberg, 12/3/13 <sup>8</sup>Source:for P/E ratio data: Bloomberg, as of 4/30/14 <sup>9</sup>Sources:WisdomTree, Standard & Poor's, as of 4/30/14

Important Risks Related to this Article

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or political developments. The recent growth in the stock market has helped to produce short-term returns for some asset classes that are not typical and may not continue in the future.

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## DEFINITIONS

**WisdomTree Emerging Markets Consumer Growth Index** : A fundamentally weighted index designed to measure the performance of emerging market equities that have a potential heightened sensitivity to increased emerging market consumption. Weighting is by earnings.

**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.

**Tapering** : A shift in monetary policy by which the Federal Reserve would begin decreasing the amount of bonds it purchases.

**Current account deficit** : Situation where a country has a greater level of imports than exports.

**Gross domestic product (GDP)** : The sum total of all goods and services produced across an economy.

**BRIC** : An acronym for Brazil, Russia, India and China.

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

**Market Capitalization** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.