

# WHY THIS EM STRATEGY REDUCED EXPOSURE TO BRAZIL AND TAIWAN

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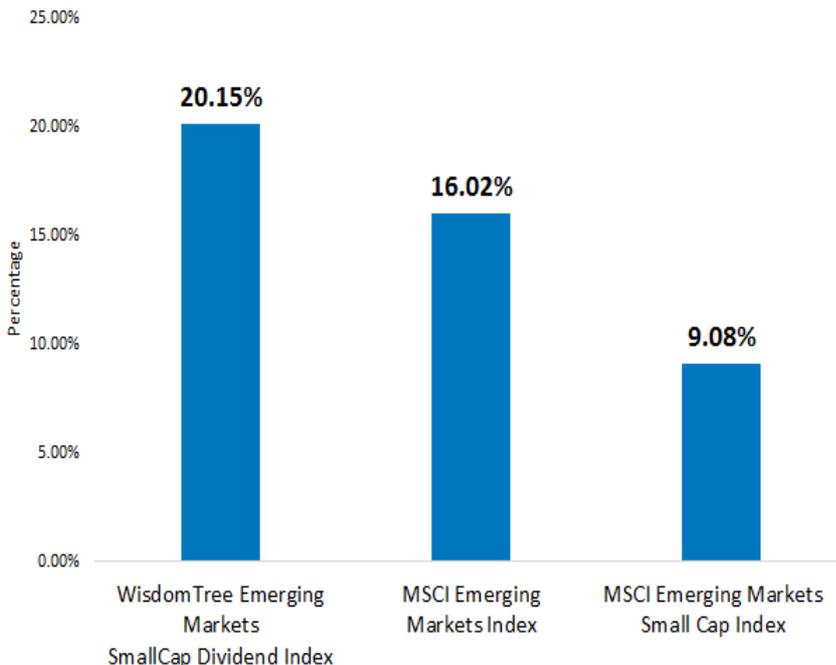
I often describe emerging market small caps as a surprisingly low-volatility way to access exposure to emerging markets. Investors think of small caps as high volatility, and that is particularly true for indexes such as the [Russell 2000 Index](#) compared to the [S&P 500 Index](#), but it may come as a surprise that for emerging market equities, large caps have been more volatile over the last nine years than dividend-paying [small caps](#).<sup>1</sup>

As an example, the [beta](#) of the WisdomTree Emerging Markets SmallCap Dividend Index to the MSCI Emerging Markets Index has been .92 since its inception.<sup>2</sup>

### Small Caps Usually Lag During a Commodity Rally

This year has been a year of strong commodity prices and commodity gains. Taken at face value and with no other information, I would say this should lead to small caps underperforming large caps, given their lower exposure. And this has been true for the [MSCI Emerging Markets Index](#) family—where small caps returned 9.08% year-to-date through 9/30, compared to large caps, which returned 16.02%, a 6.94% difference.<sup>3</sup>

### Year-to-Date Performance



Sources: WisdomTree, Bloomberg, 12/31/15–9/30/16. Past performance is not indicative of future results. You cannot invest directly in an index.

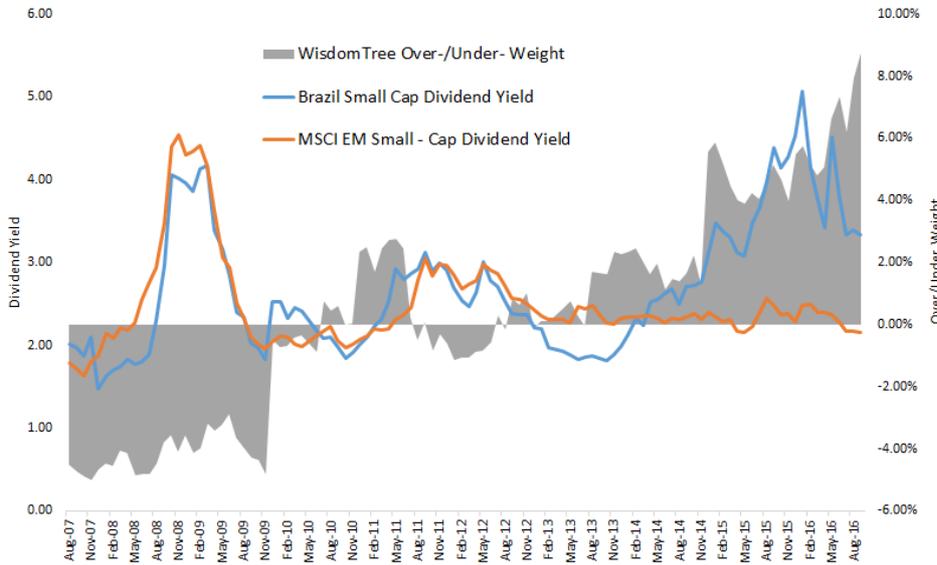
Yet the WisdomTree Emerging Markets SmallCap Dividend Index, again a lower-volatility strategy with a beta below 1 since its inception, had returns that were 4 percentage points ahead of the large-cap MSCI Emerging Markets Index and

11 percentage points ahead of the [MSCI Emerging Markets Small Cap Index](#). What could explain this?

**Country Allocations, but Now Taking Chips Off the Table**

On a country basis, the WisdomTree strategy has been over-weight Brazil by a significant margin, and Brazil has been the strongest-performing market in emerging markets. Brazil has been a country with remarkably high [dividend yields](#), and in our dividend-weighted approach, these companies have received an over-weight. After gains that averaged over 60% year-to-date, driven in part by a currency that was up over 21%, the Index is [rebalancing](#) and taking some chips off the table in these stocks, spreading them out to the other dividend payers in emerging market small caps.<sup>4</sup>

**Relative Brazil Weight**



Sources: WisdomTree, Bloomberg, 8/31/2007–9/30/16. Past performance is not indicative of future results. You cannot invest directly in an index. "WisdomTree Over-/Under-Weight" references the over-/under-weight for the WisdomTree Emerging Markets SmallCap Dividend Index relative to the MSCI Emerging Markets Small Cap Index. "Brazil Small Cap Dividend Yield" is a weighted average dividend yield for Brazilian companies with MSCI Emerging Markets Small Cap Index.

Another very strong performer this year have been Taiwan technology stocks. Tech stocks have generally been an area of growth, and Taiwan companies have participated strongly. Taiwan thus saw a weight reduction to rival Brazil's at this year's rebalance, and Technology was the sector that received the greatest reduction in weight across all countries. These stocks were up, on average, over 22% year-to-date.<sup>5</sup>

Notable additions this year include an approximately 3 percentage point increase to South Korea. South Korea has not been known for its [dividend](#) payments, and it had one of the lowest dividend [payout ratios](#) historically. But over recent years, the South Korean government has changed tax incentives, and we are seeing the kind of dividend growth that makes Korea's position in the Index less under-weighted than in years past.

Thailand has been a notable over-weight in the Index for years, and it is one of the recipients of higher allocation of weight away from Brazil and Taiwan, primarily on the back of higher dividend growth relative to others but with performance in line with others, thus improving the relationship between dividends and prices.

**Emerging Market Allocations**

WisdomTree has been an advocate for small-cap allocations within an emerging market portfolio. These types of companies are often relatively uncovered in traditional passive strategies that often target the large- and mid-cap segment of the markets. But this is a year when emerging markets are recovering, and the WisdomTree process focused on [valuations](#) and [fundamentals](#) has added value over traditional benchmarks. The key driver of this value-added approach is the annual rebalance, and with the rebalance now complete, we encourage investors to take a fresh look at the reconstituted Indexes.

<sup>1</sup>Sources: WisdomTree, Bloomberg, 8/1/07–9/30/16. For emerging markets, the statement references the WisdomTree Emerging Markets SmallCap Dividend Index's lower volatility compared to the MSCI Emerging Markets Index over the period.

<sup>2</sup>Sources: WisdomTree, Zephyr StyleADVISOR, 8/1/07–9/30/16.

<sup>3</sup>Sources: WisdomTree, Bloomberg, 12/31/15–9/30/16. Refers to the MSCI Emerging Markets Small Cap Index vs. the MSCI Emerging Markets Index.

<sup>4</sup>Sources: WisdomTree, Bloomberg, 12/31/15–9/30/16.

<sup>5</sup>Sources: WisdomTree, Bloomberg, 12/31/15–9/30/16. Refers to weighted average performance of the Information Technology sector within the WisdomTree Emerging Markets SmallCap Dividend Index. Taiwanese Information Technology stocks were up over 24% over that period.

#### Important Risks Related to this Article

Investments in emerging, offshore or frontier 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.

Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility.

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

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.

For more investing insights, check out our [Economic & Market Outlook](#)

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

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You cannot invest directly in an index.

## **DEFINITIONS**

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;

**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.

**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.

**Small caps** : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**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.

**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.

**Dividend yields** : Refers to the trailing 12-month dividend yield. Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

**Rebalance** : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

**Dividend** : A portion of corporate profits paid out to shareholders.

**Payout ratio** : The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.

**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.

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