

# BOOSTING THE ESG FOCUS OF OUR EX-STATE-OWNED ENTERPRISES STRATEGIES

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WisdomTree’s family of [ex-state-owned enterprises \(ex-SOE\)](#) Indexes was designed to represent the performance of emerging markets companies without significant government ownership—which we define as a 20% or more stock ownership stake.

As a result of this state-ownership screening, there were explicit tilts away from poor corporate governance companies and implicit tilts away from companies that score poorly on environmental considerations:

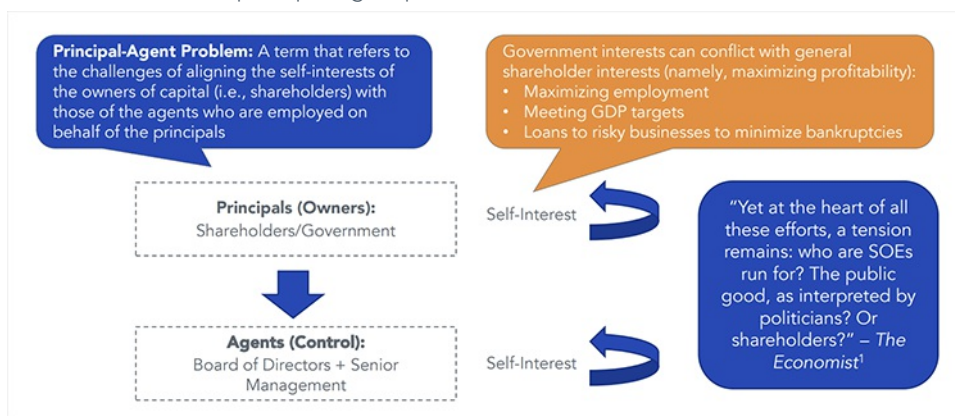
- **“G” in ESG** – Selecting only private enterprises explicitly mitigates exposure to the governance issues related to state-owned enterprises.
- **“E” in ESG** – These Indexes tended to reduce weight to sectors that score poorly on environmental concerns because of the high degree of state ownership in Energy and Materials businesses—this created an implicit environmental tilt.

Based on these tilts, the [WisdomTree Emerging Markets ex-State-Owned Enterprises Fund \(XSOE\)](#) was named the 2019 Mutual Fund Industry & ETF Awards’ ESG/Impact ETF of the Year.<sup>1</sup>

WisdomTree believes these Funds already represented best-in-class ESG solutions due to their performance-driven methodologies. But to further solidify their ESG credentials, we added some more considerations.

## Focus on Governance

Screening out state-owned enterprises (SOEs) from our starting universe explicitly improves aggregate governance, as it removes the inherent principal-agent problem detailed below.

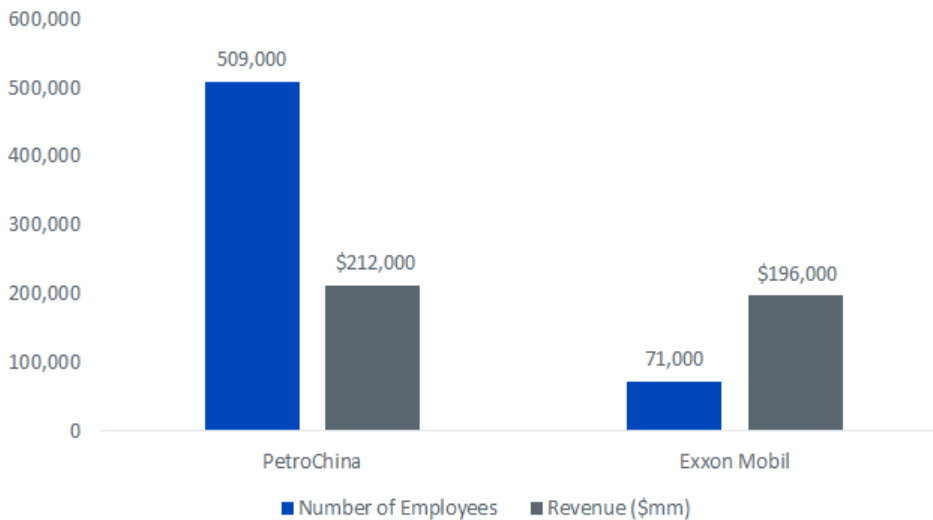


Source: WisdomTree. 1 “Government-controlled firms: State capitalism in the dock,” *The Economist*, 11/20/14.

A common criticism of SOEs is that political influences force them to employ too many people and pay above-market wages. A real-life example of the principal-agent problem can be seen by contrasting the per-employee revenue numbers of two comparable energy companies: state-owned PetroChina and privately held Exxon Mobil.

Over the past few years, the Chinese government has praised PetroChina for creating jobs despite falling oil prices and

the meltdown of the global economy due to the COVID-19 pandemic.<sup>2</sup> As seen below, Exxon Mobil generated roughly \$2.76 million in revenue per employee—almost seven times as much as the \$0.42 million generated by PetroChina in 2016.

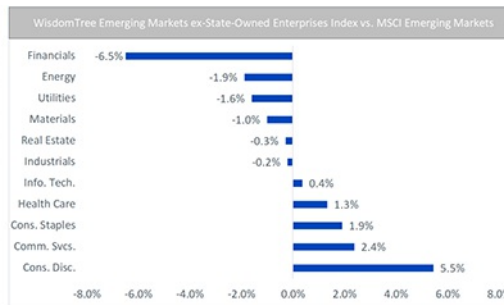


Source: Brian Spegele, “China Seeks More Private Money for Its Massive State-Owned Energy Companies,” The Wall Street Journal, 5/22/17. Chart on number of employees sourced from this article. Number of employees as of year-end 2016. 2016 revenues sourced from WisdomTree, FactSet.

### Implicitly Improving Environmental Exposures

State-owned enterprises tend to be clustered in Financials, Energy, Materials and Utilities. By screening out SOEs, WisdomTree’s ex-SOE Indexes implicitly screen on environmental considerations by removing exposure to Energy and Materials companies. Some of the largest SOEs in the MSCI Emerging Markets Index’s universe include Energy and Materials companies like Vale, Petroleo Brasileiro (i.e., Petrobras) and Gazprom.

| Top 10 MSCI Emerging Markets Weights Screened Out by SOE |        |               |         |
|--|--------|---------------|---------|
| Name   | Weight | Sector        | Country |
| China Construction Bank                                  | 0.93%  | Financials    | China   |
| Vale S.A.  | 0.79%  | Materials     | Brazil  |
| Petroleo Brasileiro                                      | 0.59%  | Energy        | Brazil  |
| ICBC   | 0.53%  | Financials    | China   |
| Sberbank Russia PJSC                                     | 0.50%  | Financials    | Russia  |
| China Mobile   | 0.44%  | Comm. Svcs.   | China   |
| Gazprom PJSC   | 0.43%  | Energy        | Russia  |
| China Merchants Bank                                     | 0.42%  | Financials    | China   |
| Bank of China Limited                                    | 0.36%  | Financials    | China   |
| Kweichow Moutai Co.                                      | 0.29%  | Cons. Staples | China   |



Sources: WisdomTree, FactSet. Top 10 MSCI Emerging Markets weights screened out by SOE based on 12/31/20. MSCI Emerging Markets Index weights of companies not eligible for the WisdomTree Emerging Markets ex-State-Owned Index based on state ownership criteria. Sector differentials based on differential of average year-end sector weights 2014–2020. You cannot invest directly in an index.

### Additional ESG Considerations

As additional ESG considerations to the current methodology of its ex-SOE Indexes, WisdomTree will exclude companies involved in controversial weapons, tobacco or thermal coal activities or that are noncompliant with the [Global Standards Screening \(GSS\)](#), as identified by third-party ESG data provider Sustainalytics, from the strategies’ eligible universes.

|   |  |
|---|--|
| <p><b>Activity-based exclusions:</b></p> <p><b>Controversial Weapons:</b> Companies with any involvement, or with significant ownership in such companies.</p> <p><b>Tobacco Products:</b> Any company involved in the production of tobacco products, or supplying tobacco-related products, or with significant ownership of such companies.</p> <p>Companies deriving more than 10% of their revenues from the distribution of tobacco products.</p> <p><b>Thermal Coal:</b> Companies deriving more than 25% of their revenues from thermal coal extraction, or generating more than 25% of their capacity from thermal coal.</p> | <p><b>Principle-based exclusions (using the United Nations Global Compact Principles):</b></p> <p>Companies found to be non-compliant with the following principles:</p> <ul style="list-style-type: none"> <li>❖ <b>Human Rights</b></li> <li><b>Principle 1:</b> Support and respect the protection of internationally proclaimed human rights</li> <li><b>Principle 2:</b> Make sure that they are not complicit in human rights abuses</li> <li>❖ <b>Labour</b></li> <li><b>Principle 3:</b> Uphold the freedom of association and the effective recognition of the right to collective bargaining</li> <li><b>Principle 4:</b> Elimination of all forms of forced and compulsory labour</li> <li><b>Principle 5:</b> Effective abolition of child labour</li> <li><b>Principle 6:</b> Elimination of discrimination in respect of employment and occupation</li> <li>❖ <b>Environment</b></li> <li><b>Principle 7:</b> Support a precautionary approach to environmental challenges</li> <li><b>Principle 8:</b> Undertake initiatives to promote greater environmental responsibility</li> <li><b>Principle 9:</b> Encourage the development and diffusion of environmentally friendly technologies</li> <li>❖ <b>Anti-Corruption</b></li> <li><b>Principle 10:</b> Businesses should work against corruption in all its forms, including extortion and bribery</li> </ul> |
|---|--|

Source: WisdomTree. Companies are excluded from the investable universe at the start of the screening process. Exclusions are done using industry-leading data provider Sustainalytics.

WisdomTree applied these changes to all its ex-SOE Indexes on January 25 of this year. The broad [Emerging Market ex-State-Owned Enterprises Index \(EMXSOE\)](#) dropped a total of 14 companies, representing 1.57% of its weight. The relatively modest additional impact of the new ESG screens was by design given the environmental and governance considerations already inherent in the strategy.

The [India ex-State-Owned Enterprises Index \(INXSOE\)](#) had five companies excluded, totaling 7.65% of Index weight. [China ex-State-Owned Enterprises Index \(CHXSOE\)](#) had no additional companies screened.

| Company                           | WisdomTree Ex-State Owned Index Weight |          |              | Country      | Sector        |
|-----------------------------------|--|----------|--------------|--------------|---------------|
|                                   | EMXSOE                                 | CHXSOE   | INXSOE       |              |               |
| Tata Consultancy Services Limited | 0.66%                                  | -        | 5.68%        | India        | Info. Tech.   |
| Grupo Mexico S.A.B. de C.V. Class | 0.19%                                  | -        | -            | Mexico       | Materials     |
| SK Holdings Co., Ltd.             | 0.14%                                  | -        | -            | Korea        | Industrials   |
| KT & G Corporation                | 0.13%                                  | -        | -            | Korea        | Cons. Staples |
| Adani Ports & Special Economic    | 0.08%                                  | -        | 0.71%        | India        | Industrials   |
| Hindalco Industries Limited       | 0.08%                                  | -        | 0.69%        | India        | Materials     |
| Klabin SA                         | 0.07%                                  | -        | -            | Brazil       | Materials     |
| Exxaro Resources Limited          | 0.04%                                  | -        | -            | South Africa | Energy        |
| Haci Omer Sabanci Holding A.S.    | 0.04%                                  | -        | -            | Turkey       | Financials    |
| Tata Power Company Limited        | 0.04%                                  | -        | 0.31%        | India        | Utilities     |
| PT Adaro Energy Tbk               | 0.03%                                  | -        | -            | Indonesia    | Energy        |
| Adani Enterprises Limited         | 0.03%                                  | -        | 0.26%        | India        | Industrials   |
| PT Gudang Garam Tbk               | 0.03%                                  | -        | -            | Indonesia    | Cons. Staples |
| Hanwha Corp                       | 0.02%                                  | -        | -            | Korea        | Industrials   |
| <b>Total</b>                      | <b>1.57%</b>                           | <b>-</b> | <b>7.65%</b> | <b>-</b>     | <b>-</b>      |

Source: WisdomTree. EMXSOE = WisdomTree Emerging Markets ex-State-Owned Enterprises Index. CHXSOE = WisdomTree China ex-State-Owned Enterprises Index. INXSOE = WisdomTree India ex-State-Owned Enterprises Index. Index weights as of 1/19/21. Index announcements made on 1/19/21 and 1/25/21. You cannot invest directly in an index.

**Conclusion**

At a time when many investors are concerned about the ESG characteristics of their portfolios, WisdomTree believes screening SOEs from a broad emerging market universe provides investors with a portfolio with strong governance and environmental characteristics. Adding more ESG screens on product involvement and noncompliance to GSS further enhances these portfolios.

For those investors looking to add emerging markets exposure to their portfolios, this family of ex-state-owned enterprises strategies can provide the right combination of long-term returns and sustainable exposures.

<sup>1</sup>This award is given to the most successful ETF focused on issues related to environmental, social and governance factors or specific ESG objectives. Success is determined by a combination of several factors, such as flows, performance and innovation. The finalists are comprised of individuals and firms who have submitted entries or been nominated via the online submission process, as well as through recommendations from leading market participants. Judges will use the submitted application material, as well as any uploaded supplemental information, to determine which firm, individual

or product they believe to be the most suitable and deserving winners for each category.

<sup>2</sup>“The new state capitalism: Xi Jinping is trying to remake the Chinese economy,” The Economist, 8/15/20.

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You cannot invest directly in an index.

## **DEFINITIONS**

**Ex-SOEs** : ex-state owned enterprises or companies that are neither wholly or partially owned and operated by a government.

**ESG** : An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible. &nbsp;

**Global Standards Screening (GSS)** : Assesses companies impact on stakeholders and the extent to which a company causes, contributes or is linked to violations of international norms and standards.