EXPOSURE TO EMERGING MARKETS WITH LOWER RISK? THINK ABOUT EUROPE

Christopher Gannatti – Global Head of Research
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In the past few years, emerging market equities[1] have begun to come back into favor after multiple years of underperformance. However, in our conversations, people remain concerned about certain risks:

- The price of oil dropped 46% during 2014 and another 30% during 2015.[2] While it seems to have settled around $50 per barrel, the potential for commodity price instability remains within the immediate consciousness of investors.
- The currency impact for the MSCI Emerging Markets Index was a headwind for 2013 (-5.8%), 2014 (-7.0%) and 2015 (-9.7%). While this situation seems to have reversed in 2016 and thus far in 2017, it cannot be ignored that the U.S. Federal Reserve has been raising interest rates.[3] Investors see the potential specter of dollar strength on the horizon.
- Geopolitics, particularly the situation in North Korea, also remains in people's minds. Any "risk-off" scenario could create difficulties for emerging market equities.

Many Companies Do Business beyond Their Home Markets

Even with the populist rhetoric of 2016–2017, today's world is extremely globalized. For investors, many of their investments may seem to be in companies domiciled within a particular region, but on closer analysis, the truth is that many of those firms are global multinationals.

This is one factor that has drawn investors to focus on the S&P 500 Index, which derives less than two-thirds of its weighted average revenues from inside the United States.[4] Some might argue that these firms are so globally exposed that international investments aren't needed.

We think that the risk of this approach is that there may be valuation opportunities existing beyond the U.S. market that could be missed. Emerging market equities, for example, remain one of the least expensive regional equity markets in the world.

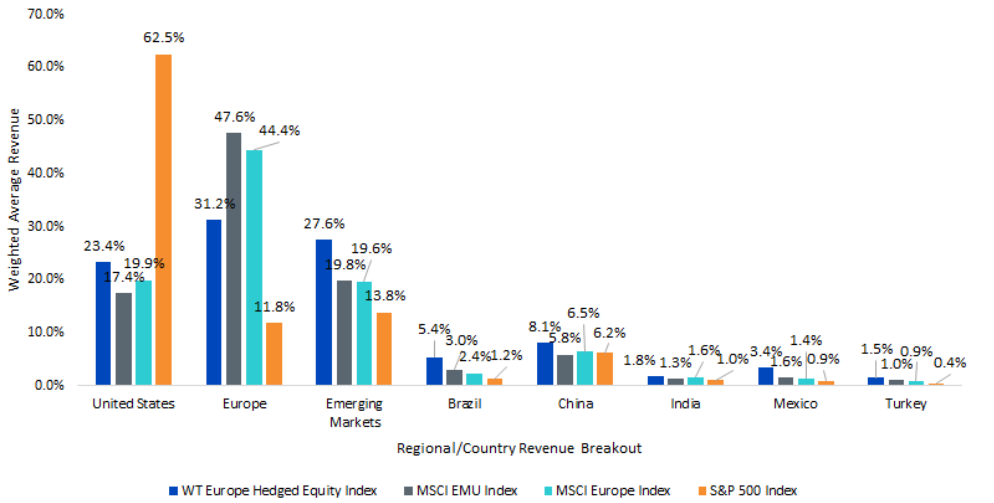
The Rise of Revenue-Based Investing

If there was a way to balance a business exposure to emerging markets with the equity market volatility of a more developed region, that could create an interesting compromise between risk and revenue exposure.

The WisdomTree Europe Hedged Equity Index requires that each qualifying constituent has more than 50% of its revenue from outside of Europe. In fact, this was WisdomTree's first Index to have exposure to a particular market (Europe) but also ensure that the constituents are exporters and very globally oriented. This is an example of how index construction has changed the game, lending a new level of transparency to where companies are doing business.

When we studied the data, we noticed that more than one-quarter of the WisdomTree Europe Hedged Equity Index's revenue was from emerging markets.

How WisdomTree's Export Tilt Led to Substantial Revenue Exposure to Emerging Markets



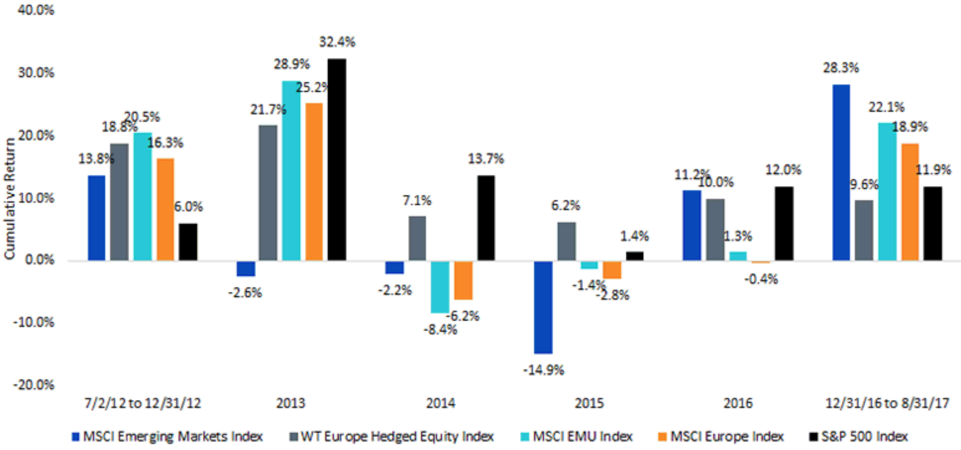
Sources: WisdomTree, FactSet, as of 7/31/17. You cannot invest directly in an index.

- One of the first things we hear is that the S&P 500 Index has revenues from all over the world. According to our data, 13.8% of its revenue was from emerging markets. The WisdomTree Europe Hedged Equity Index had approximately twice as much revenue exposure to emerging markets. It's notable how "balanced" the WisdomTree Europe Hedged Equity Index's weighted average revenues were regionally compared with the others—the S&P 500 Index had the bulk of its revenue from inside the U.S. while the MSCI EMU Index and the MSCI Europe Index had a large component of revenue from inside of Europe.
- According to our data, about half of the emerging market revenues for the WisdomTree Index shown here were from Brazil and China. It is also significant that the WisdomTree Index had greater weighted average revenue from Mexico than did the S&P 500 Index.

Managing the Perception of Risk

The fact is that those who invested in emerging markets prior to the 2016 and 2017 rally have been doing fairly well. Those looking for an entry point today are the ones with the concerns mentioned above. The calendar year return profile draws an interesting contrast between U.S. equities, the WisdomTree Europe Hedged Equity Index, a few European equity indexes and emerging market indexes.

2014, 2015 and 2016 Showcased the Consistency of the WisdomTree Europe Hedged Equity Index



Sources: WisdomTree, Bloomberg, with data from 7/2/12 (start of live calculation for the WisdomTree Europe Hedged Equity Index) to 8/31/17. You cannot invest directly in an index.

- In 2014 and 2015, emerging market equities delivered negative returns. European equities—particularly when unhedged and including currency exposure—also faced difficulties. The U.S. market and the WisdomTree Europe Hedged Equity Index were positive in each of these years, but the WisdomTree Index led in 2015, when returns were particularly tough to come by.
- The most important potential benefit, in our view, is how the WisdomTree Europe Hedged Equity Index neutralizes exposure between the euro and U.S. dollar—a currency exposure that can be quite volatile. This helps the consistency that we saw within the calendar year results.

Valuations Favor European Multinationals over U.S. Equities

While emerging markets represent one of the best valuation opportunities in global equity markets today, it's notable that the WisdomTree Europe Hedged Equity Index has an approximate discount of 20% on a forward P/E ratio basis versus U.S. equities.[5] That's a 20% discount valuation with twice the revenue exposure to emerging markets—something we think could be compelling for those who like emerging markets but may want to be more cognizant of certain risks.

[1]Refers to the MSCI Emerging Markets Index.

[2]Source: Bloomberg. 2014 refers to 12/31/13–12/31/14. 2015 refers to 12/31/14–12/31/15. Price of oil refers to price per barrel of West Texas Intermediate crude oil.

[3]Source for both sentences: Bloomberg. 2013 refers to 12/31/12–12/31/13. 2014 refers to 12/31/13–12/31/14. 2015 refers to 12/31/14– 12/31/15. 2016 refers to 12/31/15–12/31/16. 2017 refers to 12/31/16–8/31/17.

[4]Sources: WisdomTree, FactSet, as of 7/31/17.

[5]Source: Bloomberg, with data comparing the WisdomTree Europe Hedged Equity Index and S&P 500 Index as of 8/11/17.

Important Risks Related to this Article

Investments focused in Europe increase the impact of events and developments associated with the region, which can adversely affect performance.

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You cannot invest directly in an index.

DEFINITIONS

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.

Risk-on/risk-off : refers to changes in investment activity in response to perceived risk. During periods when risk is perceived as low, investors tend to engage in higher-risk investments. When risk is perceived as high, investors tend to gravitate toward lower-risk investments.

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.

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.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

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

MSCI Europe Index : A free float-adjusted market capitalization-weighted index designed to measure the performance of developed equity markets in Europe.

Unhedged : Strategy that includes the performance of both the underlying asset as well as the currency in which it is denominated. The performance of the currency can either help or hurt the total return experienced.

Forward P/E ratio : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.