COVERING THE "G" IN ESG WITH OUR EMERGING MARKETS EX-STATE-OWNED STRATEGY

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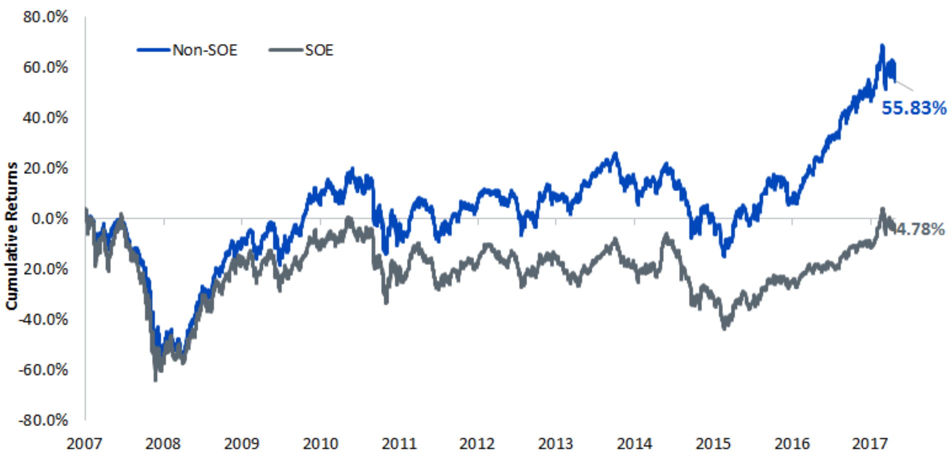
There is a phenomenon in emerging markets (EM) of government actors investing alongside other investors in publicly traded equities. We've previously made the case that state-owned enterprises (SOEs) in emerging markets are prone to conflicts between the interests of shareholders and government stakeholders. The key issue is to whom the company answers: shareholders or government stakeholders. In our view, companies with meaningful government ownership are often run as much for government benefit as for their shareholders. Problems arise for investors when these interests are not aligned and possibly affect their profitability and future returns. Companies that align management's and shareholders' interests are considered compliant with the "G" in ESG (environmental, social and governance) factors used to measure sustainability and responsibility.

Performance Difference

The first and probably most critical issue regards whether SOEs and ex-state-owned companies (non-SOEs) have performed differently. Intuition tells us that if shareholder returns and fundamentals such as return on equity (ROE) are not a company's top priority, this should be reflected in decreased returns and greater risk. To prove this theory, we built broad market capitalization-weighted portfolios of state-owned and non-state-owned EM companies. State ownership is defined as those firms that have more than 20% of their shares owned by government entities.

Performance of SOEs vs. Non-SOEs in Emerging Markets



Source: FactSet. Universe of securities is the MSCI Emerging Markets Index. Returns are calculated in U.S. dollars. Past performance is not indicative of future results. You cannot invest directly in an index.

The data shows us that over this period there was a cumulative difference of more than 60 percentage points between the performance of non-SOEs and SOEs, while also exhibiting lower volatility. Focusing on the most recent calendar year, we can see how non-SOEs outperformed and contributed 85% of the MSCI EM Index's return despite having a 75% weight.

MSCI EM Index: Contribution to Total Return Analysis			
2017	Avg. Weight	Segment Return	Contribution to Total Return
Non-State Owned	75.73%	42.02%	31.66%
State Owned	24.27%	23.80%	5.62%
MSCI EM Index	**100.00%**		**37.28%**

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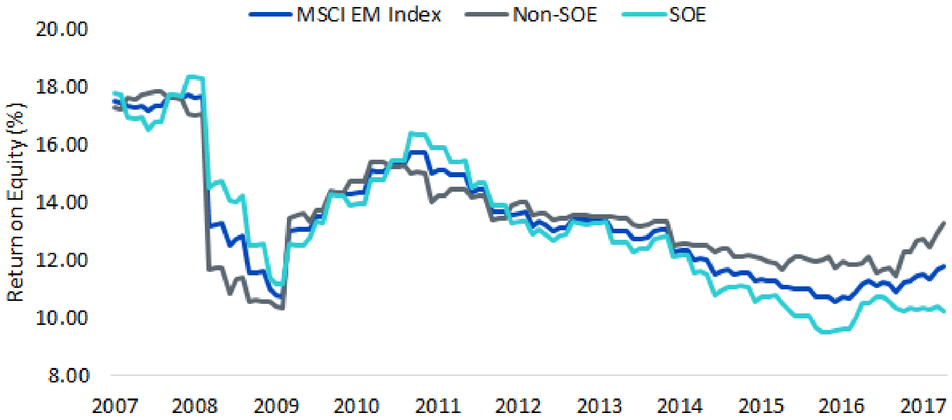
Fundamentally Different

Another area of consideration has to do with fundamentals. If, in fact, SOEs are managed in ways that do not favor shareholders' interests, this should show up in "lower quality" or "less efficient" fundamental metrics. Using ROE as a quality proxy, we can see how non-SOEs had a distinct advantage over this time period, with the difference relative to SOEs widening in the most recent periods.

Return on Equity over time (12/31/07–3/31/18)



Source: FactSet. Universe of securities is the MSCI Emerging Markets Index. Returns are calculated in U.S. dollars. Past performance is not indicative of future results. You cannot invest directly in an index.

Conclusion

The WisdomTree Emerging Markets ex-State-Owned Enterprises Index (EMXSOE) provides exposure to companies in which the government owns less than 20%. We believe that exposure to non-SOEs is a more efficient way to approach EM equity markets for investors that want to mitigate risks inherent in investing alongside governments. Investing in companies that have shareholder interests as a top priority has proven to be a way to tap into quality, which could lead to potentially higher expected returns. For a deeper look, check out our full white paper on the Emerging Markets ex-State-Owned Enterprises strategy.

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.

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DEFINITIONS

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

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

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Market capitalization-weighting : 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.

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

MSCI Emerging Market Index : The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over tim.