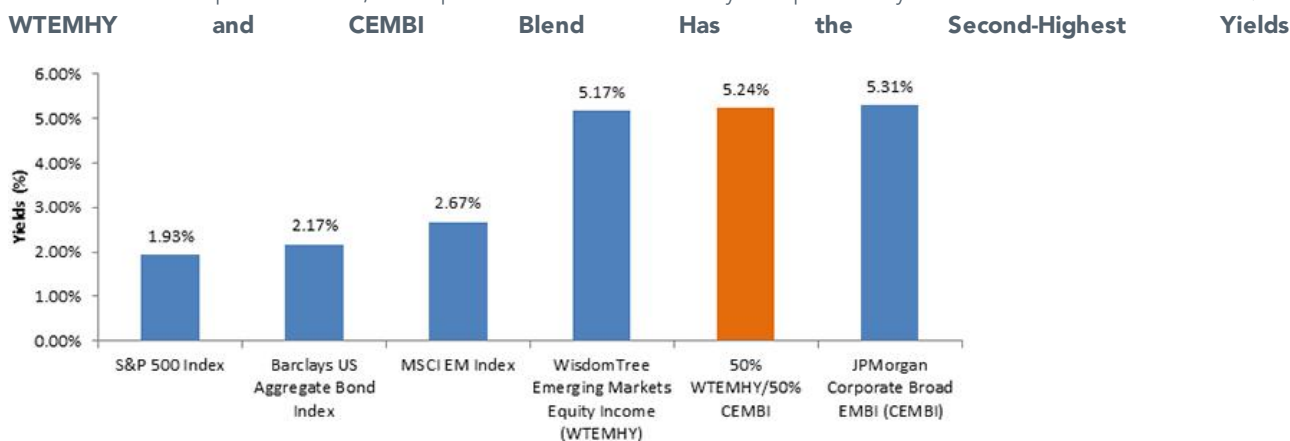


# THE EMERGING MARKETS 50/50: YIELDS & VOLATILITY

Jeremy Schwartz — Global Chief Investment Officer

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The emerging markets (EM) represent great valuation opportunities and some of the highest income levels, but they also represent significant volatility. One strategy that may help investors capture [yields](#) and mitigate [volatility](#) is to blend EM equities and EM corporate bonds. In this blog post, we will explore the strategy of blending the [WisdomTree Emerging Markets Equity Income Index \(WTEMHY\)](#) and the JP Morgan Corporate Broad EMBI Index (CEMBI), which zeroes in on the debt of EM corporate issuers, to help investors reduce volatility and potentially increase total returns. **The 50/50**



Sources: WisdomTree, Bloomberg, as of 5/31/14. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes in

the chart, visit our [Glossary](#). **The 50/50 blend offers the opportunity of:**

- **Yield Pickup:** Compared with an all-equity position in WTEMHY that yields 5.17%, the blend offers approximately a 10-basis-point pickup in yields (5.24%). Compared with the S&P 500 Index and the Barclays U.S. Aggregate Bond Index, the WTEMHY/CEMBI blend offers a 3.31% and 2.57% pickup in yields, respectively. It is also noteworthy that WTEMHY has a 2.50% yield advantage compared with the broad [MSCI EM Index](#). We believe that WisdomTree's yield advantage is largely a function of WTEMHY's [smart beta](#) methodology, which is focused on higher-dividend-yielding stocks.
- **Lower Volatility:** WTEMHY, has an annualized volatility of 22.07% since its inception on June 1, 2007. We contrast this with [CEMBI Index](#), which has an annualized volatility of 10.77% since inception. The 50/50 blend gives investors a midway total volatility number of 15.10% annually. To add further context, the [S&P 500](#) Index and the MSCI EM Index have annual volatility numbers of 17.06% and 26.22%, respectively. The blend's ability to help lessen volatility is especially powerful against a backdrop of higher yields, as discussed in the above bullet point.
- **Attractive Equity Valuations:** Since the inception of WTEMHY, the [price-to-earnings ratio](#) (as of May 31, 2014) is trading at a 20% discount to its average; the [price-to-book ratio](#) is trading at a 35% discount; the price-to-sales ratio<sup>1</sup> is trading at a 15% discount; and the price-to-cash-flow ratio is trading at a 5.8% discount. This offers a powerful rationale for considering emerging market equities in a portfolio.
- **Attractive Fixed Income Valuations:** EM corporates presently trade at a yield premium to B-rated U.S. corporates. CEMBI is 69% investment grade as of 5/31/2014, while B-rated corporates represent the middle tier of speculative credits in the U.S. Prior to last year's sell-off, yields for EM corporates have historically traded more in line with Ba-rated credits. Yields for Ba corporates as of 5/31/2014 are 4.16%, a full 115 [basis points](#) lower than CEMBI. The wider spreads are representative of more attractive valuations in EM corporates.

**Some of the notable characteristics of using this 50/50 blend of WTEMHY and CEMBI include:**

- **First, the blend maintains exposure to leading EM corporations while**

**reducing emerging markets foreign exchange (FX) exposure by half.** Through WTEMHY's methodology, investors gain exposure to some of the highest-yielding segments of emerging market equities and exposure to the pursuant currencies. As we have argued in the past, EM currencies can be very expensive to [hedge](#), given relatively higher local interest rates. CEMBI offers a solution for investors who want to take part in the EM story while dialing down exposure to EM FX. In particular, a 50% allocation to CEMBI can help reduce currency exposure by half without incurring the high cost of hedging local currencies; CEMBI invests in USD-denominated corporate bonds. • **Second, the blend scales the capital structure.** Going up in capital structure from equities to emerging market corporate bonds can translate into a reduction in asset volatility for the balanced portfolio. Further, a priority claim on assets is an important consideration in emerging markets. • **Third, it blends active and passive management:** WisdomTree's Emerging Markets Corporate Bond Fund is sub-advised by Western Asset Management, one of the premier active managers for emerging markets. Given that the role of fixed income in a portfolio is principally to deliver income and mitigate [risk](#) from equities alone, the active overlay, with history evaluating credits, may provide an extra level of comfort in accessing this asset class.

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You cannot invest directly in an index.

## **DEFINITIONS**

**Yield** : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

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

**WisdomTree Emerging Markets Equity Income Index** : A subset of the WisdomTree Emerging Markets Dividend Index measuring the performance of the higher-yielding stocks as measured by trailing 12-month dividend yields, weighted by cash dividends.

**Smart Beta** : A term for rules-based investment strategies that don't use conventional market-cap weightings.

**JP Morgan Corporate Emerging Markets Bond Index Broad (CEMBI Broad)** : The JPMorgan Corporate Emerging Markets Bond Index Broad (CEMBI Broad) is a market capitalization weighted index consisting of US dollar-denominated Emerging Market corporate bonds. The index serves as a global corporate benchmark representing Asia, Latin America, Europe and Middle East / Africa. US dollar-denominated corporate issues from index-eligible countries are narrowed further by only including issues with more than \$300m current face outstanding and at least five years to maturity (at the time of inclusion into the index).

**S&P 500 Quality Index** : Designed to track high quality stocks in the S&P 500 by quality score, which is calculated based on return on equity, accruals ratio and financial leverage ratio.

**Price-to-earnings (P/E) ratio** : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Basis point** : 1/100th of 1 percent.

**Hedge** : Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

**Risk** : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.