
INDIA: CAPTURE REGIONAL GROWTH VIA EX-STATE-OWNED COMPANIES

Gaurav Sinha — Associate Director, Asset Allocation and Modern Alpha

04/04/2019

Look at the irony of emerging market (EM) equities.

When the American economy stalls, they tend to take the heat since America is the largest market for EM products.¹

But when the American economy booms, EM equities can still suffer if the Federal Reserve (Fed) hikes rates too fast. Last year is the best example.

After [volatile](#) U.S. equity markets last year and low [inflation](#), many believe the Fed may take a softer course this year. This may come as good news to EM equities, which currently have attractive valuations after taking a hit in 2018.

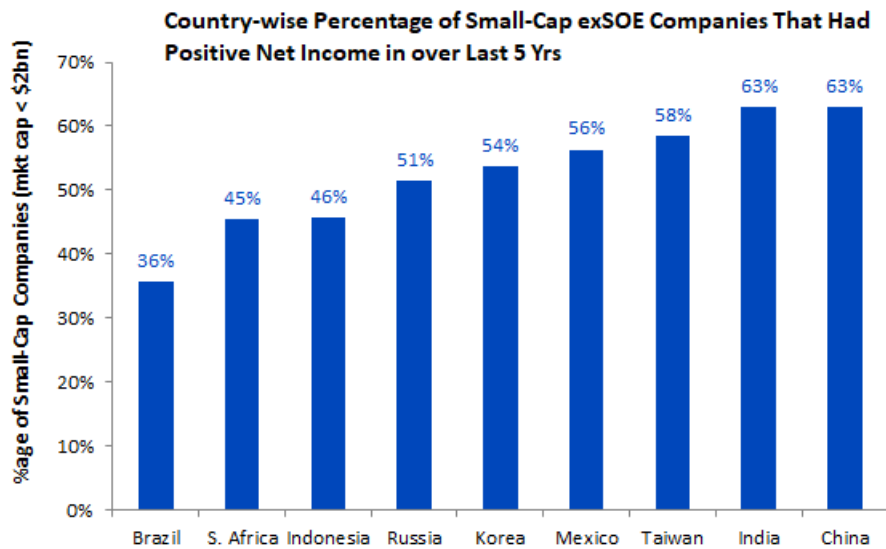
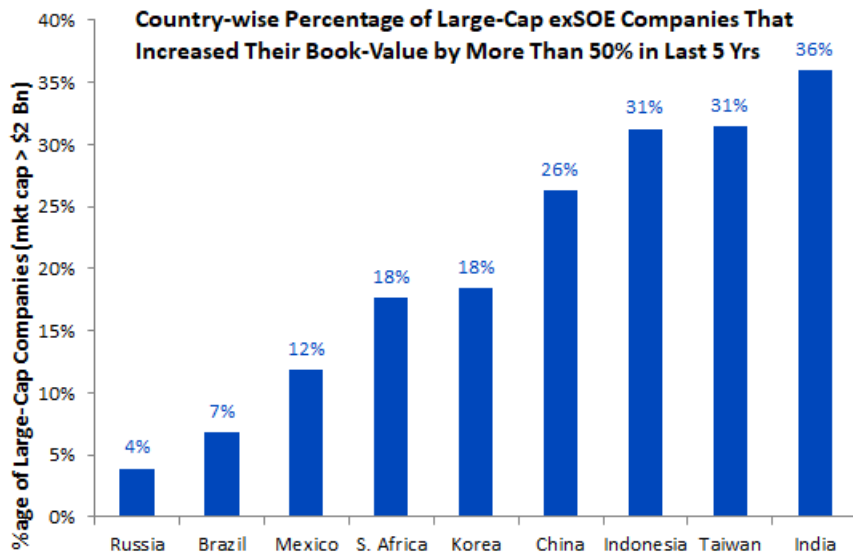
So, is this the right time to allocate to EM equities?

The answer is nuanced: when investing in EM, investors may want to focus on countries with higher economic growth and apply smart security selection to select stocks within those markets.

Fast Economies Lead to Faster Corporate Growth

Below, we look at ex-state-owned enterprises (ex-SOEs), both large and small caps, to identify places where maximum growth has happened. We define any company as ex-SOE where the state has less than 20% ownership. Our goal is to identify growth and profitability with minimal state interventions.

The first chart below is the proportion of large-cap ex-SOEs (market cap greater than \$2 billion) that show [book value](#) growth of more than 50% over the last five years. The second chart is the proportion of small caps (market cap less than \$2 billion) ex-SOEs with positive cash flows over the last five years.



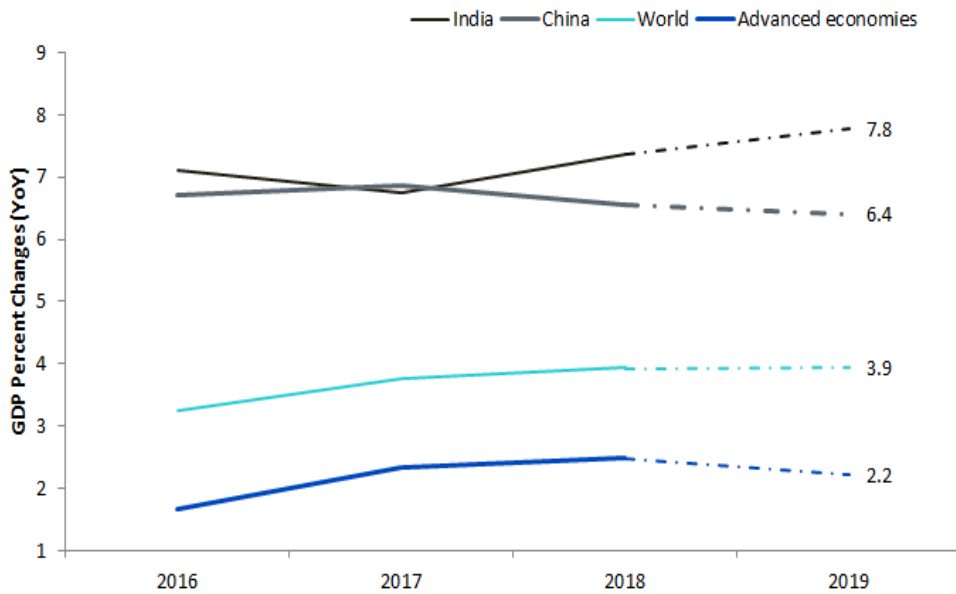
Sources: FactSet, Bloomberg, as of 12/31/18. Past performance is not indicative of future results.

A quick observation: *Indian, Chinese and Taiwanese companies consistently fared better across large and small caps.* Next, let's look at what may have helped these companies.

Economic Growth Feeding Corporate Growth

To explore one reason why certain countries did better than others, look at a simple chart of gross domestic product (GDP) growth trends projected by the International Monetary Fund.

GDP Growth Rates (Past and Projected)



Source: International Monetary Fund, as of 12/31/18. Past performance is not indicative of future results.

If you juxtapose this chart with the corporate profit growth above, there are two takeaways:

- Countries such as India and China, which grew nearly twice as fast as the rest of the world, provided a massive tailwind to their large-cap companies.
- As the economy picked up and growth percolated throughout the economy, small-cap companies, which are typically tied more strongly to local consumption, benefited and made more profits.

A few thoughts about all of this:

- Strategic investors may want to be over-weight in fast-growing countries, such as India and China.
- And while economic growth is a function of many factors, including government policy, ex-SOEs can benefit not just from the faster economic growth but from profit-centric policies of a lean management, promoting some of the biggest capture of economic tailwinds.

Investing in Ex-State-Owned Enterprises

While India can offer an excellent growth opportunity, EM institutions are often fragile. This poses the unique challenge of tapping into efficiently run firms but avoiding inefficient firms that could suffer more if sentiments were to change. To help solve for this problem, we just expanded our ex-state-owned EM suite, launching the [WisdomTree India ex-State-Owned Enterprises Fund \(IXSE\)](#), which tracks the [WisdomTree India ex-State-Owned Enterprises Index \(INXSOE\)](#).

INXSOE removes any company with greater than 20% government ownership and thus focuses more on the private and consumer economy, tapping into the real growth of India’s rising middle class and privately held sector.

Beyond just profits and book values as shown by exhibits above, the table below reflects how meaningfully different the stock performance of state and ex-state-owned companies could be.

Annualized Returns of ex-State-Owned vs. State Owned Entities in [MSCI India Index](#)

	1-Year	3-Year	5-Year	10-Year
Ex-state-owned enterprises	-5.86%	9%	9%	12%
State-owned enterprises	-12.12%	6%	6%	7%

Sources: FactSet, Bloomberg, MSCI, as of 12/31/18; period covered is 12/31/08 –12/31/18. State ownership is defined as more than 20% ownership by government. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

IXSE marks another milestone in our continual effort to offer investors enhanced exposures with unique stock selection methodology and expands our existing suite of ex-state-owned strategies within the emerging markets. We believe by allocating to IXSE, investors can potentially benefit from the exceptional growth that the private sector of India’s economy can offer.

¹Sources: World Bank, IMF, s of 12/31/18.

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

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

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

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

Inflation : Characterized by rising price levels.

Book Value : refers to the net asset value of a company determined by subtracting liabilities and intangible assets from Total assets.

MSCI India Index : A market capitalization-weighted index designed to measure the performance of the Indian equity market.