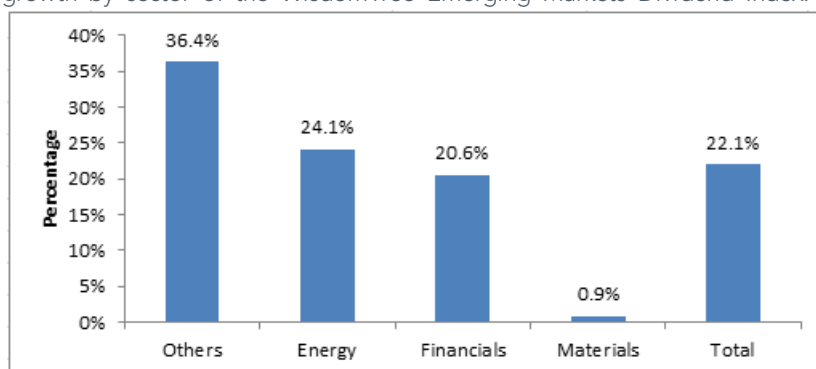


ARE THERE VALUATION IMPROVEMENTS IN RUSSIA?

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One of the most disappointing regional markets over the past year has been the emerging markets, and one country that is currently top of mind is Russia. Investing in emerging markets provides access to potentially faster-growing economies and potentially higher expected returns, but those benefits also come with higher [risks](#). Specific to Russia, recent tension with Ukraine and potential economic sanctions from the West have caused equity markets to underperform. As negative headlines come to the fore, the focus tends to be less on individual companies and their [fundamentals](#) and more on fears of a deteriorating macroeconomic environment. Below, I highlight some of the positive fundamental attributes we are seeing in the region—specifically [dividend](#) growth. **Russia Selling Below Historical Median** Depending on market sentiment and country-specific risks, individual countries within the emerging market landscape can trade at either lower or higher [valuations](#) compared to the broad market, which can help compensate investors for the perceived increase or decrease in risk, respectively. From a [price-to-earnings](#) perspective, Russian equities historically traded at a [median](#) discount of approximately 38% compared to the [MSCI Emerging Markets Index](#) and currently trade at close to a 64% discount, well below their historical median discount.¹ Another important fundamental measure to consider is dividends, which, unlike earnings, can't be manipulated or restated. I find it impressive that the trailing [dividend yield](#) for the [MSCI Russia Index](#) was 4.22%, compared to 2.74% for the MSCI Emerging Markets Index, almost 1.50% higher.² What is even more impressive is that Russia's current dividend yield is almost 2.5% higher than its 10-year historical median yield of 1.79%.³ A majority of Russian firms are annual payers, and many have announced their upcoming dividends. Within our broadest emerging market index, [WisdomTree Emerging Markets Dividend Index](#), **14 of the 22** firms have announced a dividend increase. • The aggregate [Dividend Stream®](#) growth for these 22 Russian firms was 22.1%, or an increase from \$19.1 billion to \$23.3 billion (680 billion to 830 billion rubles).⁴ • Over the most recent year, the ruble has depreciated 12.9% against the U.S. dollar, which would have lowered the dollar value of dividends received compared to a currency that is strengthening against the dollar.⁵ To help illustrate recent dividend trends, I will chart the Russian *Dividend Stream* growth by sector of the WisdomTree Emerging Markets Dividend Index. **Russian Sector Dividend Stream**



Sources: WisdomTree, Bloomberg, as of 4/30/14. Not all 10 sectors are represented in the Index. "Others" label includes the Financials, Telecommunication Services and Utilities sectors. Past performance is not indicative of future results.

Growth

• **Energy Is Largest Payer** – The sector is by far the largest in the Index, accounting for more than 60% of the total *Dividend Stream*. Dividend increases from Russia's largest Energy firms, including Rosneft and Gazprom, led the *Dividend Stream* growth with 60% and 20% growth, respectively. With these dividend increases, both Rosneft and Gazprom had an indicated dividend yield over 5%, higher than their estimated price-to-earnings ratios of 4.8x and 2.7x. Gazprom is targeting a dividend payout ratio of

between 17.5% and 35%, and Rosneft targets a payout ratio of 25%. The median dividend payout among all firms in the Index is 26%.⁶

- **Financials Are Another Important Payer** – The largest payer in the sector was Sberbank, which happens to be the largest bank in Russia.⁷ Sberbank was able to grow its dividend by an impressive 25%. I think it is important to see dividend growth among financial firms because future economic growth typically relies on the financing they provide.
- **Other Sectors Displayed Growth** – Although not all sectors are represented in the Index, it is quite impressive that we saw growth among the majority of sectors represented. One of the largest growers within the other category is from Consumer Staples firm Magnit OJSC, Russia's largest retailer by number of stores and revenue. It recently reported sales growth of 30%, which possibly signals strong underlying consumption trend growth.⁸ Given its broad exposure and penetration across Russia, I think this company is well-positioned to benefit from a growing emerging market consumer. Other large growers within the other category were Telecommunication Services firms Mobile TeleSystems and Sistema, with growth rates of 63% and 115%, respectively. Utilities were the only sector that didn't see growth, and this is because there is only one Utility firm in the Index and it hasn't announced its yearly dividend yet.

Outlook There remains a lively debate about the ongoing risks from investing in Russia during this time of conflict, but how much of the risks are already priced into these securities? These concerns have caused major Russian companies to trade at depressed valuations, whether looking at price-to-earnings ratios or dividend yields compared to their historical medians. Famed investment writer James Grant recently referred to Gazprom as being the opposite of Tesla Motors, pointing to the former's discounted valuations and high dividend yield as reasons to own the stock. During times of [volatility](#), the focus tends to be less on individual companies and their fundamentals and more on fears of a worsening situation. Recent dividend announcements from some of the largest companies in Russia are fundamentally positive, and if the situation improves in the region, these stocks may indeed represent significant investment opportunities. For current holdings of the WisdomTree Emerging Markets Dividend Index, click [here](#).

¹Sources: WisdomTree, Bloomberg, historical median calculated from 4/30/04–4/30/14 ²Source: Bloomberg, 4/30/14 ³Sources: WisdomTree, Bloomberg, historical median calculated from 4/30/04–4/30/14 ⁴Source: WisdomTree, Bloomberg, 4/30/14 ⁵Source: Bloomberg, 4/30/13–4/30/14 ⁶Source: Bloomberg, 4/30/14 ⁷Source: Bloomberg, 4/30/14 ⁸Source: Magnit Q1 2014 Investor Presentation, 4/30/14

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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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You cannot invest directly in an index.

DEFINITIONS

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.

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

Dividend : A portion of corporate profits paid out to shareholders.

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.

Median : The median is the value within a dataset at which 50% of all observations occur above and 50% occur below.

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.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

MSCI Russia Index : Index weighted by float-adjusted market capitalization designed to measure the performance of the Russian equity market.

WisdomTree Emerging Markets Dividend Index : A cash dividend-weighted Index measuring the performance of dividend-paying equities incorporated within emerging markets.

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