

EVERY RALLY STARTS SOMEWHERE

Christopher Gannatti — Global Head of Research

06/17/2014

Emerging market equities have not been much comfort to investors in 2014. We've had a number of detailed discussions on our blog about our [Emerging Markets Equity Income Fund \(DEM\)](#), which tracks the performance of our [Emerging Markets Equity Income Index](#)—an Index designed to locate some of the best [valuation](#) opportunities across [dividend-paying](#) emerging markets stocks. **Sometimes Value Investing Requires Patience** In many cases, finding what might look inexpensive in an equity market is only part of the battle. A bigger issue is being able to maintain the conviction in the face of how what is inexpensive may not appreciate in price immediately. We've had many of those discussions with regard to DEM, particularly about the Russian Energy and Chinese Financials sectors. These are some of the most inexpensive areas of emerging markets today, and they have been prominent holdings within DEM since June 2012. For current holdings of DEM click [here](#). A critical question from investors has not been whether these stocks may represent a buying opportunity from a valuation perspective; on that point we've seen wide agreement. Rather, a critical question—and one we could never answer with perfect certainty—is **when might there be a catalyst to shift sentiment that could potentially allow these sectors to rally?** **Case Study of the Past Two Months** Since every rally starts somewhere, we decided to take a look at Russian Energy and Chinese Financials stocks over the past two months—specifically March 21 to May 23, 2014. At the start of this period, concerns over Russia's actions in Ukraine were in full swing. Additionally, it seems like each year China comes into the news with the potential of an economic “hard-landing”—meaning in essence a quick transition from economic growth to economic recession. Central to this discussion in China's equity markets are large, state-owned financial institutions, as the feeling is that if China does run into economic problems, these companies may be at the center of the storm. Over the course of this period, each of DEM's top three holdings within the Russian Energy and Chinese Financials sectors announced a dividend increase.¹ The reason we mention this is simple: Each of these companies has committed to distribute more cash to its shareholders. Our viewpoint is that this may indicate that the situation—both within these Chinese Financials as well as these Russian Energy companies—may not be as dire as what was being reported in March 2014 when negative sentiment was widespread, and we've actually analyzed dividend increases broadly in [China](#) and [Russia](#) in prior blogs. Of course, these dividend announcements shouldn't be taken as an indication that these firms are risk-free—far from it, and we also recognize that this is a short-term period and there is no way to know with certainty whether it will continue. We just believe it may be time to take a second look at what we believe to be attractive valuation opportunities in emerging markets, as opposed to having a knee-jerk reaction to avoid these firms. Taking a step back for a moment, we set up a series of comparisons of performance back to the broad [MSCI Emerging Markets Index \(MSCI EM\)](#). Ultimately, this is the emerging markets benchmark that many look to when judging the performance of the asset class. To it, we compare the performance of Chinese Financials sector stocks within DEM, as well as the Russian Energy sector stocks. While we recognize that the MSCI EM is a broad emerging market benchmark, its ultimate performance is heavily related to people's feelings about emerging markets, and those feelings are presently tied to Russia's and China's activities. Within Russia's and China's equity markets, Energy and Financials are the dominant sectors, both if weighting by market capitalization, as the MSCI EM does, and if weighting by dividends, as the WisdomTree Emerging Markets Equity Income Index does. We also look at the performance of the top three individual holdings within each of these sectors, which are responsible for the majority of DEM's exposures within each. It's important to note that within the MSCI EM these are also larger positions that are influential in determining the overall performance generated by the MSCI EM's China and Russia exposure. • **Russian Energy Stocks within DEM:** As a sector, Russian Energy stocks within DEM outperformed the MSCI Emerging Markets Index (MSCI EM) by approximately 3% over this period. The bulk of this performance came from Gazprom (average weight of 5.27% for period). Lukoil (average weight of 2.18% for period) and Rosneft (average weight of 4.13% for period) clearly did not perform as well. We believe that the major catalyst for Gazprom's performance was the striking of an important natural gas supply deal with China—38 billion cubic meters per year for 30 years—which could have a value of approximately \$400 billion.² This deal had been under negotiations for 15 years and eliminates an important source of uncertainty hanging over the company's stock price. Still, after this positive

performance, each of these three stocks had price-to-earnings (P/E) ratios below 5.6x. As of the same time, the MSCI EM had a P/E ratio of 11.1x.³ • **Chinese Financials within DEM:** As a sector, Chinese Financials within DEM outperformed the MSCI EM by approximately 1.5% over this period. Relative to what we saw in the Russian Energy sector, the performance of DEM's top three holdings in the sector was clustered much more closely together. China Construction Bank (average weight of 4.38% for period) led the way, but Industrial & Commercial Bank of China (average weight of 3.13% for period) and Bank of China (average weight of 2.04% for period) also outperformed the MSCI EM. After this period of positive performance, each of these three stocks still had a P/E ratio below 5.0x.⁴ **Average Annual Returns**

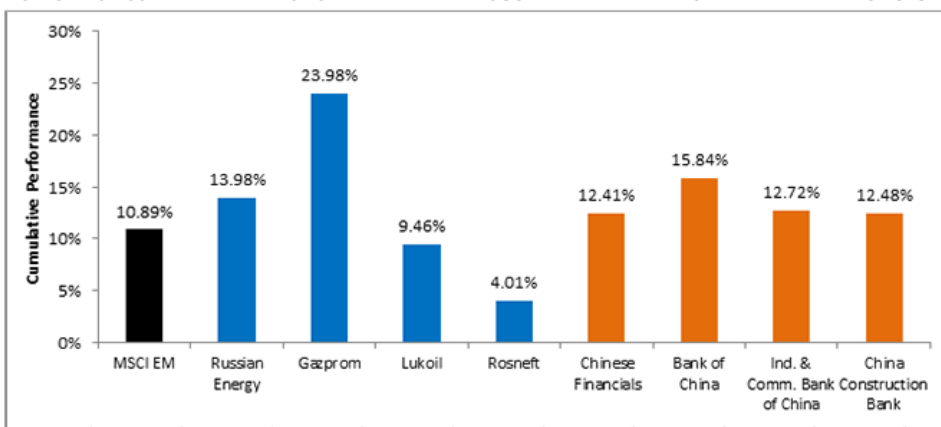
As of 3/31/2014	Fund Information			Total Return (NAV)					Market Price				
	Fund Ticker	Exp. Ratio	Fund Inception Date	YTD	1-Year	3-Year	5-Year	Since Fund Inception	YTD	1-Year	3-Year	5-Year	Since Fund Inception
WisdomTree Emerging Markets Equity	DEM	0.63%	7/13/2007	-2.62%	-6.22%	-2.80%	13.96%	3.57%	-3.39%	-6.98%	-3.22%	13.62%	3.07%
MSCI Emerging Markets Index				-0.43%	-1.43%	-2.86%	14.48%	0.21%	-0.43%	-1.43%	-2.86%	14.48%	0.21%

Sources: WisdomTree, Bloomberg.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

for DEM Performance over Last Two Months Cumulative (3/21/14–5/23/14)



Source: Bloomberg, with data from 3/21/14 to 5/23/14. High double-digit returns were achieved primarily during favorable market conditions. Investors should not expect that such favorable returns can be consistently achieved. Performance, especially for very short periods, should not be the sole factor in making your investment decision.

Gauging Sentiment: Dire to

Less Dire What we seem to see here is not that the risks to Russian Energy firms or Chinese Financials have completely abated—they've just receded a bit and seem less immediately dire. Sometimes in emerging markets, the movement in sentiment from dire to less dire could lead to positive performance, and we look forward to seeing if this two-month rally can continue. ¹Source: Bloomberg, as of 5/23/14. ²Source: Matthew Philips, "Is the Russia-China Gas Deal for Real—or Just Fumes?" Bloomberg Businessweek, 5/21/14. ³Source for P/E ratio data: Bloomberg, as of 5/23/14. ⁴Source: Bloomberg, as of 5/23/14.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing on a single sector generally experience greater price volatility. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention and political developments. Investments focused in Russia and China are impacted by events and developments associated with the regions, which can adversely affect performance. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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.

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

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.

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.

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

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.