

# EMERGING MARKETS: WHERE EARNINGS ARE HOLDING UP BEST

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Emerging market (EM) equities have been shrouded by years of underperformance. China's transition from an investment-led economy supporting commodity prices and the performance of many EM commodity producers like Brazil and Russia have been major disappointments. As one of my colleagues discussed recently, there has been a large dispersion in country performance, [with Asian importers of commodities like India](#), China and Taiwan leading the pack, and Russia and Brazil at the bottom. This macro theme has also played out in the underlying [fundamentals](#) and earnings growth of the various sectors in emerging market indexes. **EM Stuck in a Rut?** EM has experienced a contraction in earnings of more than 22% over a period of 43 months—the longest earnings recession since 1999. While earnings have edged higher since the bottom in 2014, EM earnings would have to grow almost 30% to reach their prior peak in 2012. Interestingly, not all emerging markets are built alike—there is a high degree of variability across countries and sectors in terms of their earnings strength and potential. This distinction becomes especially important for those who are considering investing in EM during turbulent market environments. **EM's Lackluster [Earnings per Share \(EPS\)](#) Closely Tied to Commodity Prices**

Sector Earnings per Share (EPS) USD	MSCI EM EPS Peak*	10/31/2015	EPS Growth / Contraction
MSCI EM Materials Index	48.10	7.41	-84.6%
MSCI EM Energy Index	106.02	31.52	-70.3%
MSCI EM Industrials Index	13.47	7.77	-42.3%
MSCI EM Telecom Services Index	18.95	11.62	-38.7%
MSCI Emerging Markets Index	88.53	68.25	-22.9%
MSCI EM Consumer Discretionary Index	52.50	42.89	-18.3%
MSCI EM Consumer Staples Index	21.24	17.62	-17.0%
MSCI EM Health Care Index	28.43	28.55	0.4%
MSCI EM Financials Index	33.73	35.28	4.6%
MSCI EM Utilities Index	14.37	20.62	43.5%
MSCI EM Information Technology Index	14.06	25.76	83.2%

Broad Index EPS (USD)	Since Nov 2013	10/31/2015	EPS Recession	Weight in Bottom 3 Underperforming Sectors
MSCI Emerging Markets Index	84.89	68.25	-19.6%	21.8%
WT EM Consumer Growth	16.17	15.93	-1.5%	3.2%

Source: Bloomberg, as of 10/31/15. Bottom three underperforming sectors are Materials, Energy and Industrials. Start date of November 2013 was chosen to coincide with data availability across all indexes.

## Sector Highlights—[New](#)

**Economy Sectors Show Promise:** Throughout this recessionary period in EM earnings, only four of the 10 sectors experienced positive earnings growth. Upon dissecting earnings at the sector level, we observed that old economy sectors in EM, namely Materials, Energy and Industrials, have experienced the most significant deterioration in earnings. One common thread among these sectors is their heavy reliance on commodity prices, which is in turn partly driven by global growth concerns. Given faltering global growth, as projected by the [International Monetary Fund](#), it may be prudent to look for sectors that are less commodity- or old economy-oriented. **Positioning in Areas of Earnings Strength:** We believe that exposure to EM Consumers, Information Technology and Health Care—driven by supportive population demographics, a

growing middle class and innovation—will help drive the earnings recovery in the years ahead. • The [WisdomTree Emerging Markets Consumer Growth Index \(WTEMCG\)](#) through its growth and quality tilts, offers access to the new economy sectors in EM. • While the MSCI Emerging Markets Index has experienced an earnings contraction of almost 23%, WTEMCG saw its earnings contract by only 1.5%. The ability to maintain its earnings growth while the MSCI EM Index experienced a large contraction in earnings is testimony to the strength of the consumer-related sectors in the EM block. • Further, WTEMCG is designed to exclude the Energy and Materials sectors, so there is zero weight to those two sectors. Industrials, which can be influenced by commodity price cycles, is also a small weight in WTEMCG. As a result, the three sectors with the biggest earnings declines are 21.8% weight in the MSCI EM Index but only 3.2% weight in WTEMCG. • It comes as no surprise that WTEMCG has been able to showcase relative strength in earnings growth. This index is designed to help investors gain access to areas of the markets that have strong:

- Growth characteristics, through three- to five-year forward-looking earnings growth estimates
- Quality characteristics, measured by [return on equity \(ROE\)](#) and [return on assets \(ROA\)](#)—which together give the investor an idea of leverage used in a company's operations

#### **Important Risks Related to this Article**

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## DEFINITIONS

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

**Earnings per share** : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

**New economy sectors** : High-growth industries that are on the cutting edge of technology and are the driving force of economic growth, such as Information Technology, Health Care and to some degree the consumer-oriented sectors.

**International Monetary Fund** : international organization for global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth around the world.

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

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.