

EMERGING MARKETS: AVOIDING DEMOGRAPHIC TIME BOMBS

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"If all the Chinese in the world were to march four abreast past a given point, they would never finish passing, though they marched forever and ever." —Ripley's Believe It or Not, 1910

The International Monetary Fund (IMF) says China's population will top 1.4 billion sometime in 2019, about four times that of the U.S. But for investment opportunities, what matters is not population *levels*, but population *growth*.

In sharp contrast to the graying U.S., many emerging market nations have youthful demographics, but that's not always the case. For example, Russia's population has dropped by 5 million since peaking at 148.4 million in 1993. You'll find a similar trend across the former Eastern bloc. For perspective, the U.S. population grew by 63 million during that time frame.¹

Demographic malaise typically happens when there is something structurally deficient inside a political or economic system that causes early deaths, a lack of births and emigration. It happens when young people find little opportunity at "home" and opt to try their luck in foreign cities. It happens when there is some sclerosis, likely stemming from a kleptocratic state, that crushes the confidence that young people need to enthusiastically bring babies into the world.

And it happens when investment prospects are crushed.

Population Growth: An Asset Allocation Metric

Using IMF data for China, South Korea, Taiwan, India, Brazil, South Africa, Russia, Mexico, Indonesia, Malaysia, Thailand and Poland, we assessed a country rotation strategy using a basket of nations that currently make up 89% of the [MSCI Emerging Markets Index \(MSCI EM\)](#).²

Figure 1 breaks out performance for three equally weighted investment baskets comprising stocks in countries that were ranked #1–4, #5–8 and #9–12 in the 12-nation study, hereafter referred to as the Lowest, Middle and Highest population growth groups.

Figure 1: Population Growth Rotation Study, 2/28/01 –3/31/17

	Return	Standard Deviation	Beta*	Sharpe Ratio	Information Ratio*	Tracking Error (%)*	Correlation*
Lowest Growth	7.43%	25.18%	1.06	0.24	-0.11	9.07%	0.93
Middle Growth	10.86%	22.83%	0.96	0.41	0.29	8.39%	0.93
Highest Growth	11.90%	22.51%	0.93	0.47	0.38	8.97%	0.92
EqualWeight 12	10.30%	22.07%	0.98	0.40	0.42	4.33%	0.98
MSCI Emerging Markets	8.47%	22.19%	1.00	0.32	0.00	0.00%	1.00

Sources: Zephyr StyleADVISOR, WisdomTree, as of 3/31/17. *Beta, Information Ratio, Tracking Error and Correlation are calculated relative to the index occupying the last row of each individual table. Country returns = MSCI indexes for each. Data is lagged to ensure availability at annual rebalance. For example, March 2017 population growth is based on compound growth in 2014 and 2015. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of terms in the chart, visit our [glossary](#).

In the 15 years that had full calendar year returns, Lowest Growth only outperformed the equally weighted MSCI EM in five of them, while both the Middle and Highest Growth strategies outperformed in nine calendar years. As with the performance data, it appears that the most important consideration is to avoid the demographic time bombs—the Lowest Growth group.

How do the 12 nations rank now, in spring 2017, and is there an exchange-traded fund (ETF) approach in the halls of WisdomTree Research for grabbing this population factor loading? Here are the standings:

Lowest Growth: Poland, Russia, Taiwan, Thailand

Middle Growth: South Korea, China, Brazil, Mexico

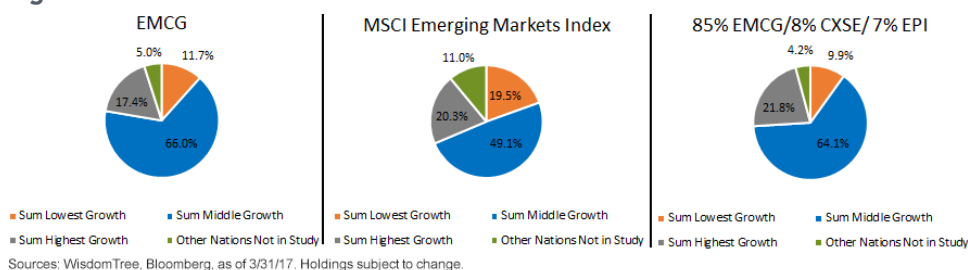
Highest Growth: Indonesia, India, Malaysia, South Africa

How can we obtain broad EM exposure while cutting down the Lowest Growth groups?

Action Plan: [WisdomTree Emerging Markets Consumer Growth Fund \(EMCG\)](#)

MSCI EM, a [market cap-weighted](#) index, has 19.5% of its exposure in the four Lowest Growth nations. Yet in contrast, we can help reduce that problem by using the WisdomTree Emerging Markets Consumer Growth Fund, which closed the first quarter with just 11.7% of its holdings in Poland, Russia, Taiwan and Thailand. Furthermore, while MSCI EM is stuck below 70% in the eight Middle and Highest Growth countries, EMCG clocks in at roughly 83% in those countries (see figure 2).

Figure 2



For investors who want to further reduce the Lowest Growth group, figure 2 shows a third possibility: combining EMCG with the [WisdomTree India Earnings Fund \(EPI\)](#) and the [WisdomTree China ex-State-Owned Enterprises Fund \(CXSE\)](#). The new portfolio has less than a tenth of its exposure in the population “dead zone” while still managing to hold China and India in weights that fall between those of MSCI and FTSE EM indexes.

We stopped there, but you get the point. You can go with the multiple ETF mix or keep it simple and stick with EMCG. Either way, “population-proofing” may be something to think about.

¹Source: IMF, as of March 2017.

²Using two-year annualized population growth, as of the previous year. All MSCI Emerging Markets Index data sourced from Bloomberg as of 3/31/17.

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DEFINITIONS

MSCI Emerging Market Index : The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.