

DRIVING OUTPERFORMANCE WITH A STATE-OWNERSHIP SCREEN

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The [value](#) factor has outperformed growth globally, including in emerging markets (EM), since the last half of 2020.

[Valuations](#) for growth companies in EM look “stretched” by traditional metrics —while many notable value investors believe EM value stocks represent one of the bright spots for forward-looking returns.

EM value multiples have remained stagnant and near single-digit numbers over the last six years—tough to find in the U.S.—while growth multiples have been rising.

Meanwhile, it encourages us to see how the [WisdomTree Emerging Markets ex-State-Owned Enterprises Index \(EMXSOE\)](#), which has elements of a growth-tilted core strategy, has managed to generate excess returns over this most recent period, we believe solidifying its state-owned enterprise (SOE) screen as a driver of outperformance.

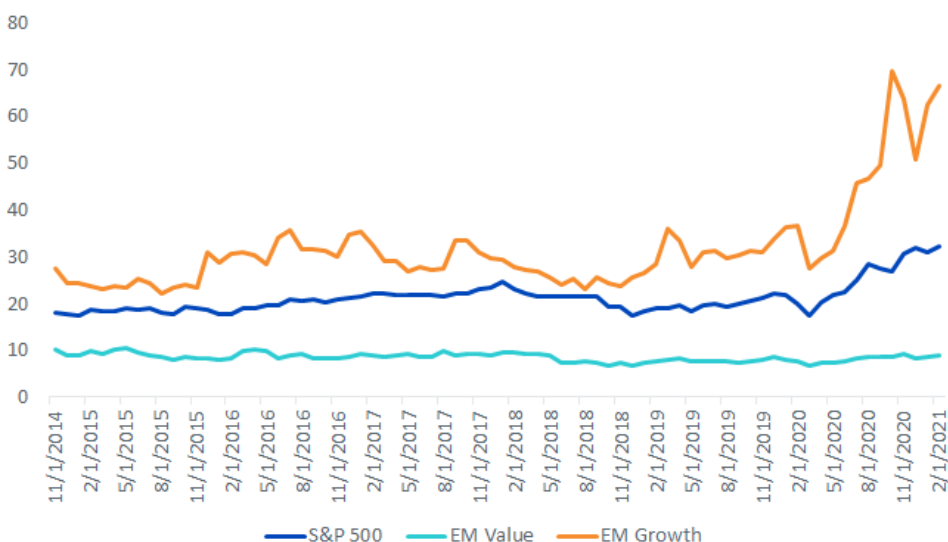
Valuations in EM

The rapid recovery in prices and sluggish earnings and sales we’ve experienced over the last 12 months have caused standard valuation metrics to spike in certain markets. EM is one.

As we can see in the chart below, [trailing price-to-earnings \(P/E\)](#) for companies in the most expensive valuation quartile (“EM Growth”) spiked in the middle of last year, deviating from its historical spread versus the lowest multiple stocks (“EM Value”) and the broad [MSCI EM Index](#). (These sorts are all done within industries, so they don’t represent sector bias of higher multiple sectors).

It is interesting to see how the [S&P 500 Index’s](#) P/E ratio has followed a similar path as the EM [growth](#) stocks, and the EM value basket is trading around the same 10 times earnings it has traded at over the last six years.

P/E Ratio



Sources: WisdomTree, FactSet, 11/30/14–2/26/21. Value measure incorporates current measures of sales-to-price, book-to-price, earnings-to-price, estimated-earnings-to-price, EBITDA-to-enterprise-value and operating-cash-flow-to-price. Past performance is not indicative of future results. You cannot invest directly in an index.

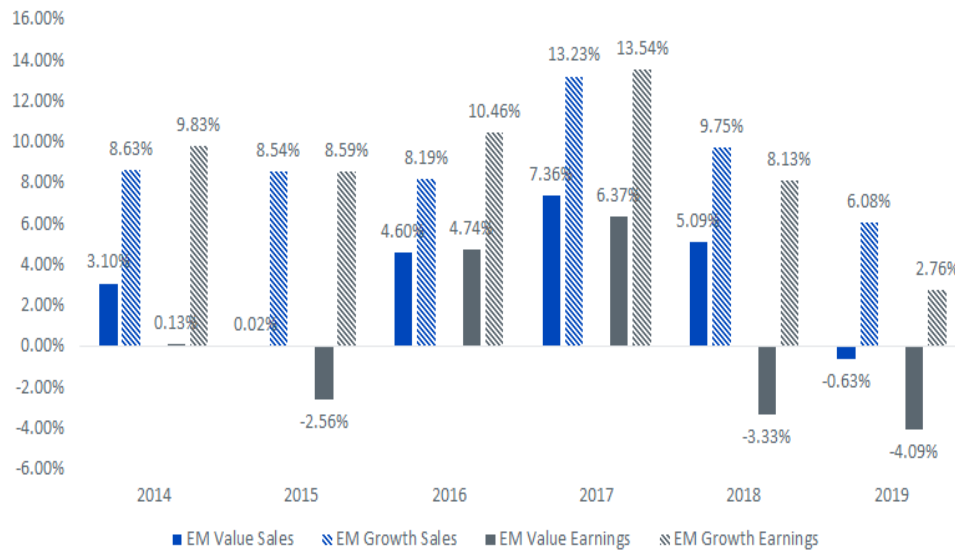
Premium Multiples for Premium Growth Rates

When profit and sales growth is scarce, investors may assign greater value—and higher multiples—to those companies that are consistently growing. Combining valuation with sales and earnings growth metrics can give investors greater insight into why they see significant valuation spreads in certain areas of the market.

The chart below compares the forward one-year growth rates of constituents in these EM baskets. Companies in the EM Growth portfolio at the end of 2019 saw a median sales growth of 6.08% during 2020, while companies in the EM Value portfolio saw their median sales decrease by 0.63%.

During the last six calendar years, the EM Growth basket has shown stronger sales and earnings growth, leading to higher multiples. The average differential in sales growth between these baskets was 5.81%, favoring the EM Growth basket. The strong sales growth together with higher margins and profitability caused the differential in earnings growth to be 8.67%.

1yr. Median Growth



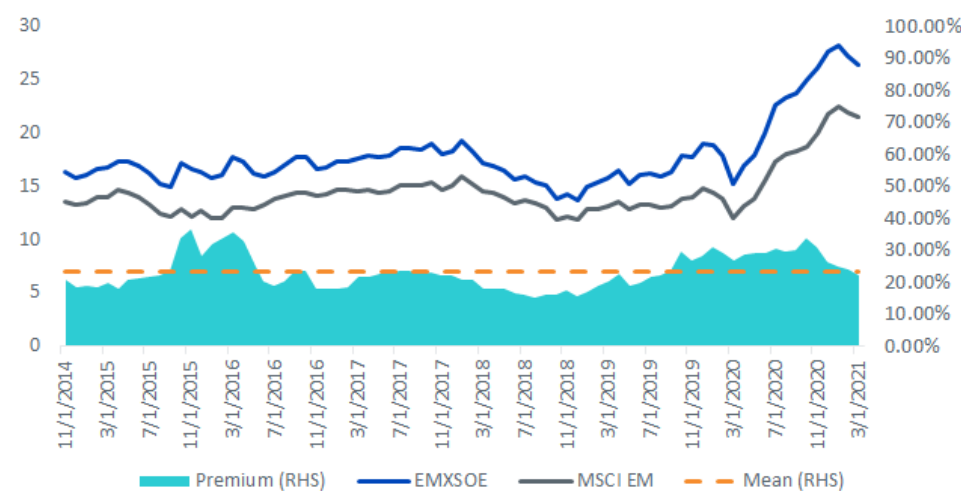
Sources: WisdomTree, FactSet, 11/30/14–11/30/20. Value measure incorporates current measures of sales-to-price, book-to-price, earnings-to-price, estimated earnings-to-price, EBITDA-to-enterprise value and operating cash flow-to-price. Baskets are reset on November 30 every calendar year. Past performance is not indicative of future results.

EMXSOE vs. MSCI EM

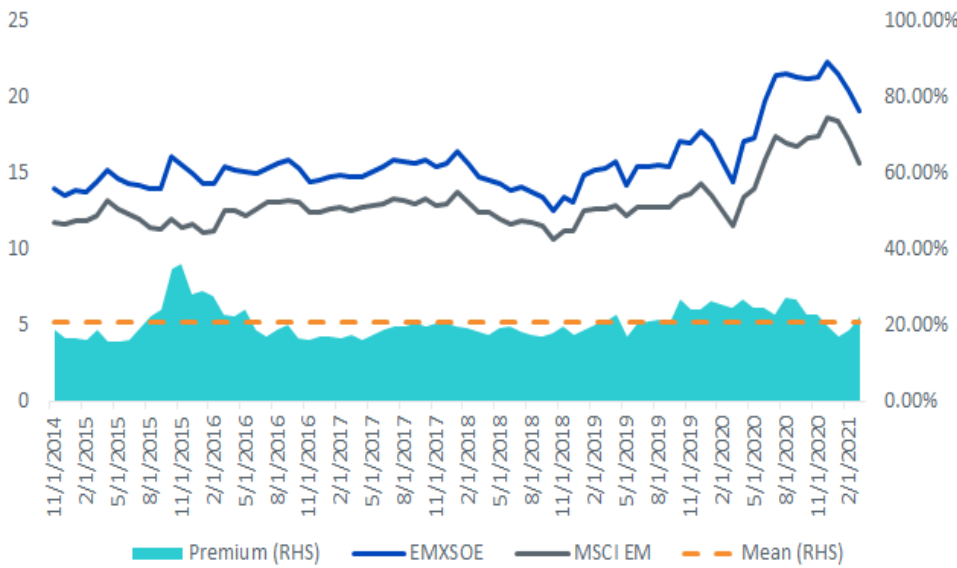
The WisdomTree EM ex-State-Owned Enterprises Index (EMXSOE) was created with the objective of improving investors’ exposure to the EM region. Through its SOE screen, EMXSOE removes companies with significant government ownership from its investment universe, resulting in a portfolio with constrained over-weights in sectors with a growth tilt.

Looking at the trailing P/E ratio, we can see that EMXSOE’s basket is not more expensive than usual compared to MSCI EM. It even looks slightly cheaper than its history when adjusting for forward earnings.

Trailing P/E Ratio



Forward P/E Ratio



Sources: WisdomTree, FactSet, 11/30/14–3/31/21. Past performance is not indicative of future results. You cannot invest directly in an index.

Similarly, EMXSOE’s sales and earnings growth rates have exceeded MSCI EM’s in the past 12- and 36- month periods.

Fundamental Growth Rates

Performance Drivers

Since its inception in 2014, EMXSOE has outperformed the MSCI EM by more than 3.5% annually. EMXSOE’s constrained tilts toward sectors with a higher growth profile have contributed to the outperformance, but the main driver has been the SOE screen along with the resulting over-/under-weights in high-/low-profitability companies in EM.

A testament to the SOE screen as a consistent driver of outperformance is the fact that EMXSOE has outperformed the MSCI EM in periods when growth has outperformed value—like 2017—and to a lesser extent, during the most recent value-led market cycle.

Growth of \$100

Figure 6_Growth of 100_UPDATED

Whether we’re seeing the start of a bull market of value or perhaps just a six-month outperformance, EMXSOE’s performance in growth and value markets reveals that it’s a strategy reliant on stock selection more than factor tilting.

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](#).

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You cannot invest directly in an index.

DEFINITIONS

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

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.

Trailing Price-to-earnings (P/E) ratio : Trailing Price-to-earnings (P/E) ratio: Share price divided by trailing 12-month earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

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.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.