

# EM CONSUMER GROWTH: CHEAPER VALUATIONS AND HIGHER QUALITY

Jeremy Schwartz — Global Chief Investment Officer

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The emerging market (EM) consumer has shown resilience despite the highly uncertain economic times in the region. It comes as no surprise that the [WisdomTree Emerging Markets Consumer Growth Index \(WTEMCG\)](#) has returned 10.4%<sup>1</sup> on a year-to-date basis. In an environment where the EM consumer has commanded a premium, we feel that it is important to caution investors that not all EM consumer indexes are built alike, and some potentially offer better diversification and [valuation](#) opportunities than others. Some emerging market equity indexes that are focused on the consumption theme ultimately deliver exposure to the basic EM consumer at the expense of valuation and concentration in a small number of holdings—as few as thirty. However, WTEMCG employs a methodology that seeks to deliver the EM consumer growth theme in a broad-based, diversified fashion at a more attractive valuation. This is achieved by employing a stock selection ranking system focused on growth, quality and valuation measures<sup>2</sup>.

**Who Says Cheaper Valuations and Higher Quality Can't Go Hand-in-Hand?**

As of 7/25/2014		WTEMCG Index	MSCI Emerging Markets Index	DJ EM Cons Titans 30 Index
Valuation Statistics	P/E Ratio	14.5x	13.8x	22.9x
	Long-Term Earnings Growth Estimates	12.6%	12.9%	24.7%
	Dividend Yield	2.7%	2.6%	1.7%
	Earnings Yield	6.9%	7.3%	4.4%
Quality Statistics	Return on Equity	27.1%	17.1%	21.8%
	Return on Assets	12.0%	6.8%	10.2%
	Leverage	2.3x	2.5x	2.1x
Sector Statistics	Energy Weight	0.0%	10.5%	0.0%
	Materials Weight	0.0%	8.7%	0.0%
	Financials Weight	19.8%	27.4%	0.0%
	Consumer Discretionary Weight	32.1%	9.0%	38.4%
	Consumer Staples Weight	26.9%	8.4%	61.6%

Sources: WisdomTree, Bloomberg

WTEMCG and the DJ EM Consumer Titans 30 index were chosen to represent the 2 key strategies in the EM Consumer Space. Additionally, the MSCI Emerging Market Index was added as a broad based benchmark. Past performance is not indicative of future results. You cannot invest directly in an index. Subject to change.

*For definitions of terms in the*

*chart, please visit our [glossary](#).* • **Attractive P/E Valuation:** WTEMCG has a 14.5x P/E, which trades at a 37% discount to the 22.9x P/E of the [Dow Jones Emerging Markets Consumer Titans 30 Index](#). The Dow Jones Index consists of thirty firms in the Consumer Discretionary and Consumer Staples sectors in EM, weighted by market capitalization. WTEMCG's large P/E discount speaks volumes about the benefits of both sector and security diversification in emerging markets<sup>3</sup>.

• **Explaining WTEMCG's Sector Exposure:** The [MSCI Emerging Markets Index](#) has more than 18% of its exposure in the Energy and Materials sectors<sup>4</sup>. WTEMCG, on the other hand, excludes the aforementioned sectors and instead has approximately 75% of its weight in domestic demand sectors. We believe that these sectors are consistent with the theme of growth in the emerging markets' middle class and are therefore supportive of domestic demand. WTEMCG's allocation away from Energy and into the domestic demand sectors partially contributes to the higher P/E when compared with the MSCI Emerging Markets Index. • **WTEMCG for Income Potential:** Even though WTEMCG weights according to net income, which results in a lower P/E tilt to construction, WTEMCG's 2.7% [dividend yield](#) offers an

important income buffer for those seeking exposure to the emerging markets. WTEMCG's dividend yield is a full 1% higher than that of the Dow Jones Emerging Markets Consumer Titans 30 Index and is slightly higher than the broad MSCI Emerging Markets Index.

- **An Emphasis on Quality:** WTEMCG's valuation story is incomplete without a discussion of quality. Its methodology rewards companies that show promise in terms of return on equity (ROE) and return on assets (ROA). This combination of ROE and ROA not only rewards companies that are highly efficient in utilizing their assets and equities to generate net income, it also penalizes companies that employ immense leverage in doing so. As a result, WTEMCG has the highest ROE and ROA of the Indexes listed above. WTEMCG has a broad focus on the emerging markets consumer growth theme. The Index identifies securities whose revenue is primarily based in emerging markets. Further, it has the benefit of being broadly focused on the EM domestic demand story, which is reflective of the growth in emerging markets' middle class. A key consideration in its methodology is sensitivity to valuation, employing a two-part process to enhance WTEMCG's valuation focus:
- **Stock Selection:** Index screening incorporates a one-third ranking to the earnings yield—in other words, a focus on stocks with lower prices relative to the earnings they have generated
- **Weighting:** Weighting by net income with an annual rebalance. This ultimately results in an Index that likely has a bias for less expensive valuation and higher quality<sup>5</sup> compared with its competitors.

<sup>1</sup>Source: Bloomberg, as of 7/25/14. Past performance is not indicative of future results. A fund's performance, especially for very short time periods, should not be the sole factor in making your investment decision. <sup>2</sup>Growth, quality and valuation measures: One-third weighted to the rank of long-term estimated earnings growth, one-third weighted to the rank of historical three-year average [return on equity](#) and historical three-year average [return on assets](#), and one-third weighted to the rank of the [earnings yield](#). <sup>3</sup>As of 7/25/14, WTEMCG has 248 constituents and seven sectors that have over a 1% weight. <sup>4</sup>Domestic demand sectors are Consumer Staples, Consumer Discretionary, Telecommunication Services, Utilities and Health Care. <sup>5</sup>Measures through higher ROE and ROA as well as lower leverage.

#### Important Risks Related to this Article

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## **DEFINITIONS**

**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.

**Dow Jones Emerging Markets Consumer Titans 30 Index** : Index designed to measure the performance of the 30 leading emerging market companies in the consumer goods and consumer services industries. Weighting is by float-adjusted market capitalization, subject to diversification requirements.

**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.

**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.

**Earnings yield** : The earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (which is the inverse of the P/E ratio) shows the percentage of each dollar invested in the stock that was earned by the company.