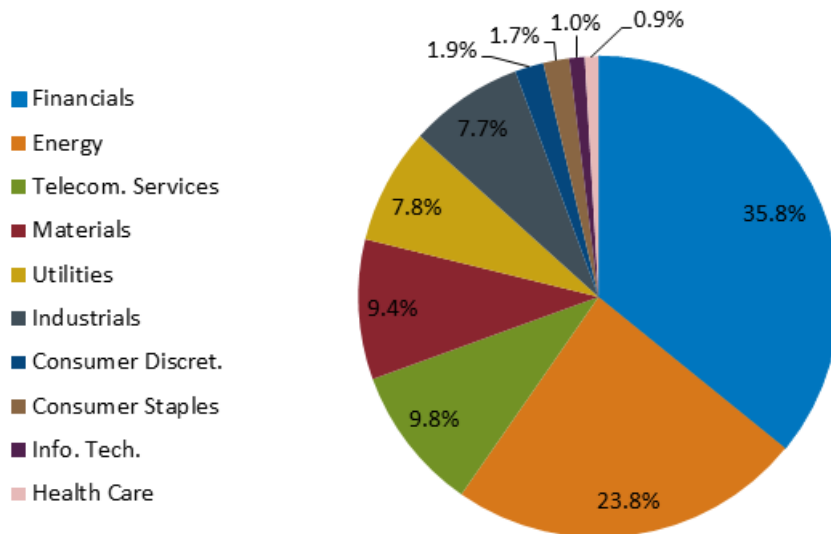


# EMERGING MARKETS AND STATE OWNED ENTERPRISES

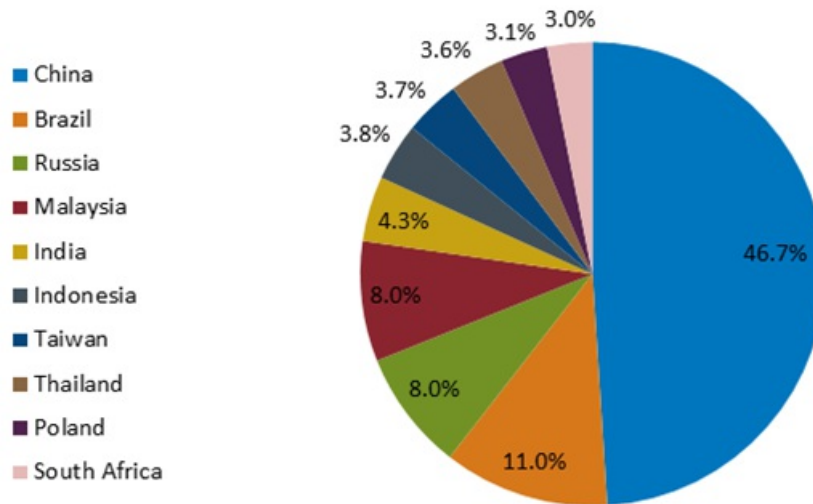
Jeremy Schwartz — Global Chief Investment Officer  
12/04/2014

When investors allocate to [emerging markets](#), they typically do so through broad-based [market cap-weighted](#) exposure. More recently, investors have shown interest in specific cuts or subsets of the broader emerging markets, such as country rotation, high-[dividend-yield](#) strategies, [small caps](#), low [volatility](#) and other investment strategies. We've seen growing interest in the degree of exposure to state-owned enterprises (SOE) in various investment strategies. State-owned enterprises are typically defined as companies that are either wholly or partially owned or operated by a government. Some investors believe that government ownership can negatively impact the operational aspects of a company because government-owned companies might be influenced by a broader set of interests, beyond generating profits for shareholders. **Characteristics of State-Owned Enterprises** State ownership levels can vary significantly among sectors and countries, depending both on a sector's significance for providing public goods or fostering economic growth and on the governmental structure. WisdomTree identified 424 companies out of an initial 3,000 companies in emerging markets as state-owned enterprises (SOE), with government owning more than 20% of shares. The SOEs had market cap of over \$1.31 trillion, about 26% of the original universe's market cap of approximately \$5.07 trillion.<sup>1</sup> Figures 1 and 2 illustrate the market cap profiles of the SOE universe by sectors and countries. **Figure 1: State-Owned Enterprises by**



Sources: WisdomTree, Standard and Poor's, as of 7/31/14; subject to change.

**Sector** **Ownership Concentrated among Public Good Sectors:** Given that the Financials, Energy, Telecom and Utilities sectors are among the most systemically important sectors to economic development, we are not surprised that governments tend to play a more active role in these sectors. **Less Ownership among Private Good Sectors:** Currently, governments are less involved in the Consumer Discretionary and Consumer Staples, Information Technology and Health Care sectors. Companies in many consumer-focused sectors tend to be less vital to the strategic economic development and welfare of emerging market governments. These sectors also are often the focus for growth investors who see a burgeoning opportunity as emerging market consumers develop and increase their income and standard of living. **Figure 2: State-Owned**



Sources: WisdomTree, Standard and Poor's, as of 7/31/14; for illustration purposes, only the top 10 countries by ownership are displayed; therefore, weights will not equal 100%; subject to change.

**Enterprises by Country**

**• China**

**Displayed the Largest Government Involvement:** Given China's communist background, it is not surprising that almost half of the SOE market cap companies are Chinese companies. A large percentage of the Chinese government's market cap ownership comes from the stakes it holds in the country's large financial institutions. These large state-owned banks are among the lowest-priced areas of the entire emerging markets, with average dividend yields over 6% and [price-to-earnings \(P/E\) ratios](#) below 5x.<sup>2</sup>

**• Russia Also Displayed Significant Government Involvement:** Russia's socialist and communist history has led to noteworthy government ownership in the Energy and Financials sectors. Although the recent Ukrainian conflicts have further depressed valuations, the Russian Energy sector had already displayed depressed [valuations](#) compared to the broader emerging markets before the crisis. For example, Gazprom and Rosneft, two of the largest state-owned energy companies, have dividend yields north of 5% and P/E ratios under 5x.<sup>3</sup>

**WisdomTree Emerging Markets ex-State-Owned Enterprises Index** WisdomTree created a broad-based Index to emerging market stocks that are not state-owned enterprises; this Index will help investors monitor the performance of this subset. In a future blog post, we will introduce this new Index, the WisdomTree Emerging Markets ex-State-Owned Enterprises (EMXSOE), designed to measure the performance of broad-based emerging market stocks that exclude state-owned companies.

<sup>1</sup>Sources: WisdomTree, Standard and Poor's, as of 7/31/14. <sup>2</sup>Sources: WisdomTree, Bloomberg; refers to the five largest dividend-paying Chinese banks as of 9/30/14. <sup>3</sup>Sources: WisdomTree, Bloomberg, as of 9/30/14. The WisdomTree Emerging Markets Ex State Owned Enterprises Index does not hold Gazprom or Rosneft.

**Important Risks Related to this Article**

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 or political developments.

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

**Emerging market** : Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

**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.

**Dividend yield** : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

**Small caps** : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;nbsp;.

**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.