

# WISDOMTREE CREATES AN EMERGING MARKETS EX STATE OWNED ENTERPRISES INDEX

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In a [previous blog post](#) we discussed the characteristics of [emerging market](#) state-owned enterprises and the growing interest that some investors have expressed in avoiding or limiting their exposures. 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. The *Economist* magazine ran an article that sums up the bottom-line concern for investors: “The performance of state-owned enterprises has been shockingly bad.”<sup>1</sup> In the words of the Economist article: *Ronald Reagan said the nine most terrifying words in the English language were “I’m from the government and I’m here to help.” For investors the scariest words may be, “I’m from a state-owned firm and I want your capital.” Across the world, big, listed state-owned enterprises (SOEs) that were floated, or raised mountains of equity, between 2000 and 2010 have had a dismal time. Their share of global market capitalisation has shrunk from a peak of 22% in 2007 to 13% today.* To be fair, there are certainly price levels at which these state-owned companies can become very cheap, and all the bad news can become reflected in the prices such that they perform very well going forward. But given the dominance of many emerging market indexes in state-run companies (as much as 25% to 30% of popular benchmarks), WisdomTree thought it prudent to offer an alternative view of the emerging markets—without state-run companies. Therefore, we introduce our new Index, the [WisdomTree Emerging Markets ex-State-Owned Enterprises \(EMXSOE\)](#), which is designed to measure the performance of broad-based emerging market stocks that exclude state-owned companies. To WisdomTree, state-owned enterprises are defined as those having government ownership of more than 20% of outstanding shares.

**Index Methodology** The Index employs a modified [float-adjusted market-capitalization](#) weighting process to target the weights of countries in the universe *prior to the removal of state-owned enterprises* while also limiting sector deviations to 3% of the starting universe float-adjusted market. The application of this rule is intended to provide a type of [beta](#) exposure that targets the initial universe from a country perspective, once the state-owned companies have been removed.

**Eligible Universes:** Must be incorporated or domiciled and have their shares listed on exchanges in one of the following countries: Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Philippines, Poland, Russia, South Africa, South Korea, Taiwan, Thailand or Turkey<sup>2</sup>

**State-Owned Enterprises:** Companies with more than 20% ownership by government body are excluded

**Minimum Market Capitalization:** \$1.0 billion

**Weighting:** Modified float-adjusted market capitalization

**Holding Caps and Weight Adjustments • Country Weights:** Target weight equal to float-adjusted market caps of universe prior to removal of SOEs<sup>3</sup>

**• Sector weights:** Constrain differentials to 3% differentials from starting universe, after country adjustment

**WisdomTree Emerging Markets ex-State-Owned Enterprises**      **Index:**      **Top**      **20**      **Index**      **Holdings**

Company	Country	Sector	Weight	Trailing 12M Dividend Yield	Price-to-Earnings Ratio
Tencent Holdings Ltd.	China	Info. Tech.	3.85%	0.21%	41.8x
Baidu.com	China	Info. Tech.	2.90%	N/A	37.0x
Samsung Electronics Co	South Korea	Info. Tech.	2.88%	1.21%	6.0x
Taiwan Semiconductor Manufacturing Co Ltd	Taiwan	Info. Tech.	1.66%	2.50%	13.6x
Lukoil OJSC	Russia	Energy	1.52%	5.96%	5.3x
Ambev S.A.	Brazil	Consumer Staples	1.43%	3.39%	23.8x
Naspers Ltd N	South Africa	Consumer Discret.	1.29%	0.34%	82.2x
America Movil SAB de CV L	Mexico	Telecom. Services	1.29%	1.36%	19.1x
Reliance Industries Ltd	India	Energy	1.08%	1.00%	12.3x
Ping An Insurance (Group) Co of China Ltd	China	Financials	1.07%	1.50%	11.5x
Hon Hai Precision Industry Co Ltd	Taiwan	Info. Tech.	0.89%	1.67%	12.7x
Housing Development Finance Corp	India	Financials	0.89%	1.33%	20.6x
MTN Group Ltd	South Africa	Telecom. Services	0.88%	4.66%	16.3x
Hyundai Motor Co	South Korea	Consumer Discret.	0.87%	1.02%	6.2x
Bank Central Asia Tbk PT	Indonesia	Financials	0.78%	0.92%	20.0x
POSCO	South Korea	Materials	0.75%	2.44%	17.6x
BRF S.A.	Brazil	Consumer Staples	0.74%	1.43%	35.9x
Genting Bhd	Malaysia	Consumer Discret.	0.72%	5.37%	19.8x
Infosys Ltd	India	Info. Tech.	0.71%	1.68%	18.1x
Astra International Tbk PT	Indonesia	Consumer Discret.	0.65%	3.06%	14.0x
	Sum/Average		26.84%	2.16%	21.7x

Sources: WisdomTree, Bloomberg, as of 9/30/14. Subject to change. Past performance is not indicative of future results.

For definitions of terms in the chart, please visit our [glossary](#). Information Technology Rises to the Top: Given emerging market governments' low involvement in the Information Technology sector, we are not surprised that the weights of some of the largest companies increase after the state-owned enterprises have been removed. Although the sector is well-represented among the top five holdings, the Index caps sector differentials to 3%, compared to the starting universe, at each annual rebalance, in an effort to remain diversified and not take large sector risks. As emerging market countries continue to grow and transform, investors will demand more ways to gain access to this unique asset class. Recently, some investors have expressed concern over state-owned enterprises, and they have sought tools to limit their exposure, even after understanding the [valuation](#) differences. These investors are interested in concentrating their exposure on the private sector and accessing higher growth potential. Although it is impossible to know which area will be more beneficial to focus on going forward, we think it is important to have different tools available, and the case for either exposure could be made, depending on an investor's goals and objectives. For full research on the Emerging Markets ex-State-Owned Enterprises Index [click here](#).<sup>1</sup>Source: The Economist, 11/22/14. <sup>2</sup>Companies domiciled or incorporated in those countries but trading primarily on a U.S. stock exchange are also eligible for inclusion. <sup>3</sup>The maximum country factor is set at 3.0, or no country's weight can be increased more than 3x after state-owned enterprises have been removed.

#### 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](#)

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## 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.

**Float-adjusted market capitalization**: Share price x number of shares outstanding, adjusted for the fact that in many emerging markets, not all of the shares outstanding regularly trade, which leads to a reduction in the number of shares outstanding used in the calculation.

**Market Capitalization**: 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.

**Beta**: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

**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.