

Diversifying your emerging market exposure using WisdomTree strategies

Publié le 14 août 2023

Alejandro Saltiel, CFA

Head of Indexes, U.S.

Allocating to emerging markets (EM) has been a tall task recently. Looking at the trailing five-, 10- and 15-year periods, the broad MSCI Emerging Markets Index (MSCI EM) lagged the S&P 500 by more than 11%, 10% and 9% annually, respectively¹. However, flows to EM from non-EM investors have started to pick up in June. With \$22 billion net² (\$12.3 in stocks and \$9.8 in debt securities), June has been the best month since January.

There have been pockets of companies within emerging markets that have experienced solid performance over these periods – usually driven by idiosyncratic considerations such as country, sector and factor exposures. As seen in the chart below, Value and Growth companies in emerging markets have had periods of outperformance over the past 5 years.

Figure 1: Historical performance of the MSCI Emerging Markets compared to the S&P 500

Source: WisdomTree, Bloomberg. Data from 29 June 2018 to 30 June 2023. Historical performance is not an indication of future performance and any investments may go down in value.

At WisdomTree, we believe in the long-term benefits of diversification and encourage investors to allocate across regions and asset classes.

Below, we lay out a capital efficient way to allocate to Emerging Markets using WisdomTree's strategies.

WisdomTree large cap emerging market strategies

WisdomTree has two strategies that provide exposure to emerging market³ companies: the [WisdomTree Emerging Markets ex-State-Owned Enterprises ESG Screened strategy](#) and the [WisdomTree Emerging Markets Equity Income UCITS strategy](#).

The Equity Income strategy was launched in 2007⁴ and provides exposure to the highest dividend-yielding companies in emerging markets. The strategy reconstitutes annually and holds the highest (top 30%) dividend-yielding companies in EM, screening out those with the highest risk according to our Composite Risk Screen measure. Following the most recent rebalance, it is overweight Energy, Materials and Financials and underweight Consumer and Health Care sectors compared to the MSCI EM. It is also

overweight Brazil and Taiwan and underweight China, India and South Korea with respect to MSCI EM.

The ex-State-Owned strategy was launched in August 2014 and its investment thesis is to identify State-Owned companies (SOE's) – defined as those with 20% or more local government ownership – and exclude them from the investable universe. The strategy, which also reconstitutes annually, weights non-State-Owned Enterprises using their market capitalisation and aims to maintain country neutrality and sectors within +/- 3% of the starting universe prior to removing SOE's. This results in a consistent overweight to Consumer Staples and Discretionary, Information Technology, and Health Care and underweights to Energy, Financials and Utilities.

By looking at each portfolio's fundamentals, one can see how these indices provide different factor exposures to investors. The ex-State-Owned strategy tends to have high profitability metrics (ROE, ROA) and growth estimates resulting in exposure to Quality and Growth factors. Meanwhile, the Equity Income strategy has a Value and Quality tilt with a high dividend yield, lower valuations and strong profitability metrics.

Figure 2: Aggregate Fundamentals (as of 30/06/2023)

Source: WisdomTree, FactSet. Data as of 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

Since their common inception almost 9 years ago, both strategies have each outperformed the MSCI EM by more than 80 bps annualised, almost doubling its risk-adjusted return.

We can see below how both indices achieved this with a different risk-return profile and driven by their underlying factor exposures.

The ex-State-Owned strategy outperformed during the years where Growth companies in EM outperformed and experienced its maximum drawdown when Value companies led as commodity prices rebounded in 2021 and 2022. The Equity Income strategy experienced its highest drawdown at the start of the period only to track closer to MSCI EM in the subsequent years and experience its stronger period of relative performance in the past 18 months, as dividend payers have outperformed.

Figure 3: Performance metrics (29/08/14 – 30/06/2023)

Source: WisdomTree, FactSet. Data from 29/08/2014 – 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

Figure 4: Performance of WisdomTree EM strategies compared to the MSCI EM

Source: WisdomTree, FactSet. Data from 29/08/2014 – 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

The power of diversification

It can be difficult to make an investment decision looking at the information presented above and without knowledge of how markets (and investment factors) will behave in the future.

Modern Portfolio Theory (MPT) – first introduced by Nobel Prize winner Harry Markowitz in 1952 – states that a portfolio's idiosyncratic risk can be reduced by investing in assets which are not perfectly correlated. Applying this theory to WisdomTree's two EM indexes, the portfolio's idiosyncratic risk is driven mainly by the Sector, Country and Factor exposures resulting from the index's methodology. The chart below shows the rolling 12-month correlation between our 2 strategies.

Figure 5: Rolling correlation: WisdomTree Emerging Markets ex-State-Owned Enterprises ESG Screened versus WisdomTree Emerging Markets Equity Income UCITS

Source: WisdomTree, FactSet. Data from 29/08/2014 – 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

The lower correlation between these indices could potentially allow investors to build a more efficient EM asset allocation. The efficient frontier below, shows the annualised return and volatility of portfolios built by combining the 2 strategies. The data used for this chart stems from 29/08/2014 to 30/06/2023 and assumes that the allocation is rebalanced quarterly at the end of February, May, August, and November. Each dot on the curve shows a 5% shift in allocation from one asset to the other.

Figure 6: Asset allocation: WisdomTree Emerging Markets ex-State-Owned Enterprises ESG Screened versus WisdomTree Emerging Markets Equity Income UCITS

Source: WisdomTree, FactSet. Data from 29/8/2014 – 30/6/2023. Historical performance is not an indication of future performance and any investments may go down in value.

As we can see, the combination of both strategies over the period, would've allowed investors to obtain comparable levels of return while reducing volatility. It is also interesting to see how most points on the curve have higher returns than the MSCI EM with lower volatility. The highlighted allocation (WT EM Allocation), which holds 75% in the WisdomTree Emerging Markets ex-State-Owned Enterprises ESG Screened strategy and 25% in the WisdomTree Emerging Markets Equity Income UCITS strategy, represents the point in the curve with greatest risk-adjusted returns. If we look at the performance metrics in the table below, we can see the power of diversification as the WT EM Allocation portfolio has increased risk-adjusted returns and lower drawdowns than each individual strategy in isolation.

Figure 7: Performance metrics (29/08/2014 – 30/06/2023)

Source: WisdomTree, FactSet. Data from 29/08/2014 – 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

Figure 8: Aggregate Fundamentals (as of 30/06/2023)

Source: WisdomTree, FactSet. Data from 29/08/2014 – 30/06/2023. Historical performance is not an indication of future performance and any investments may go down in value.

Sources

1 Source: FactSet. Data from 30/06/2008 – 30/06/2023.

2 Source IIF. 13 July 2023.

3 WisdomTree includes companies incorporated and listed in the following countries Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Russia, Saudi Arabia, South Africa, Taiwan, Thailand or Turkey.

4 ESG exclusion filters were added to the strategy in October 2020.

Related Products

+ [WisdomTree Emerging Markets Equity Income UCITS ETF](#)

+ [WisdomTree Emerging Markets ex-State-Owned Enterprises ESG Screened UCITS ETF](#)

+ [WisdomTree Emerging Markets SmallCap Dividend UCITS ETF](#)

Important Risks Related to this Article

IMPORTANT INFORMATION

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.

An investment in exchange-traded products (“ETPs”) is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in this document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this

document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

WisdomTree Issuer ICAV The products discussed in this document are issued by WisdomTree Issuer ICAV ("WT Issuer"). WT Issuer is an umbrella investment company with variable capital having segregated liability between its funds organised under the laws of Ireland as an Irish Collective Asset-management Vehicle and authorised by the Central Bank of Ireland ("CBI"). WT Issuer is organised as an Undertaking for Collective Investment in Transferable Securities ("UCITS") under the laws of Ireland and shall issue a separate class of shares ("Shares") representing each fund. Investors should read the prospectus of WT Issuer ("WT Prospectus") before investing and should refer to the section of the WT Prospectus entitled »Risk Factors¼ for further details of risks associated with an investment in the Shares.

Notice to Investors in Switzerland – Qualified Investors This document constitutes an advertisement of the financial product(s) mentioned herein.

The prospectus and the key investor information documents (KIID) are available from WisdomTree¼s website: **https://www.wisdomtree.eu/en-ch/resource-library/prospectus-and-regulatory-reports**

Some of the sub-funds referred to in this document may not have not been registered with the Swiss Financial Market Supervisory Authority ("FINMA"). In Switzerland, such sub-funds that have not been registered with FINMA shall be distributed exclusively to qualified investors, as defined in the Swiss Federal Act on Collective Investment Schemes or its implementing ordinance (each, as amended from time to time). The representative and paying agent of the sub-funds in Switzerland is Société Générale Paris, Zurich Branch, Talacker 50, PO Box 5070, 8021 Zurich, Switzerland. The prospectus, the key investor information documents (KIID), the articles of association and the annual and semi-annual reports of the sub-funds are available free of charge from the representative and paying agent. As regards distribution in Switzerland, the place of jurisdiction and performance is at the registered seat of the representative and paying agent.

For Investors in France: The information in this document is intended exclusively for professional investors (as defined under the MiFID) investing for their own account and this material may not in any way be distributed to the public. The distribution of the Prospectus and the offering, sale and delivery of Shares

in other jurisdictions may be restricted by law. WT Issuer is a UCITS governed by Irish legislation, and approved by the Financial Regulatory as UCITS compliant with European regulations although may not have to comply with the same rules as those applicable to a similar product approved in France. The Fund has been registered for marketing in France by the Financial Markets Authority (Autorité des Marchés Financiers) and may be distributed to investors in France. Copies of all documents (i.e. the Prospectus, the Key Investor Information Document, any supplements or addenda thereto, the latest annual reports and the memorandum of incorporation and articles of association) are available in France, free of charge at the French centralizing agent, Societe Generale at 29, Boulevard Haussmann, 75009, Paris, France. Any subscription for Shares of the Fund will be made on the basis of the terms of the prospectus and any supplements or addenda thereto.

For Investors in Malta: This document does not constitute or form part of any offer or invitation to the public to subscribe for or purchase shares in the Fund and shall not be construed as such and no person other than the person to whom this document has been addressed or delivered shall be eligible to subscribe for or purchase shares in the Fund. Shares in the Fund will not in any event be marketed to the public in Malta without the prior authorisation of the Maltese Financial Services Authority.

For Investors in Monaco: This communication is only intended for duly registered banks and/or licensed portfolio management companies in Monaco. This communication must not be sent to the public in Monaco.