

# Emerging markets - in need of a jab

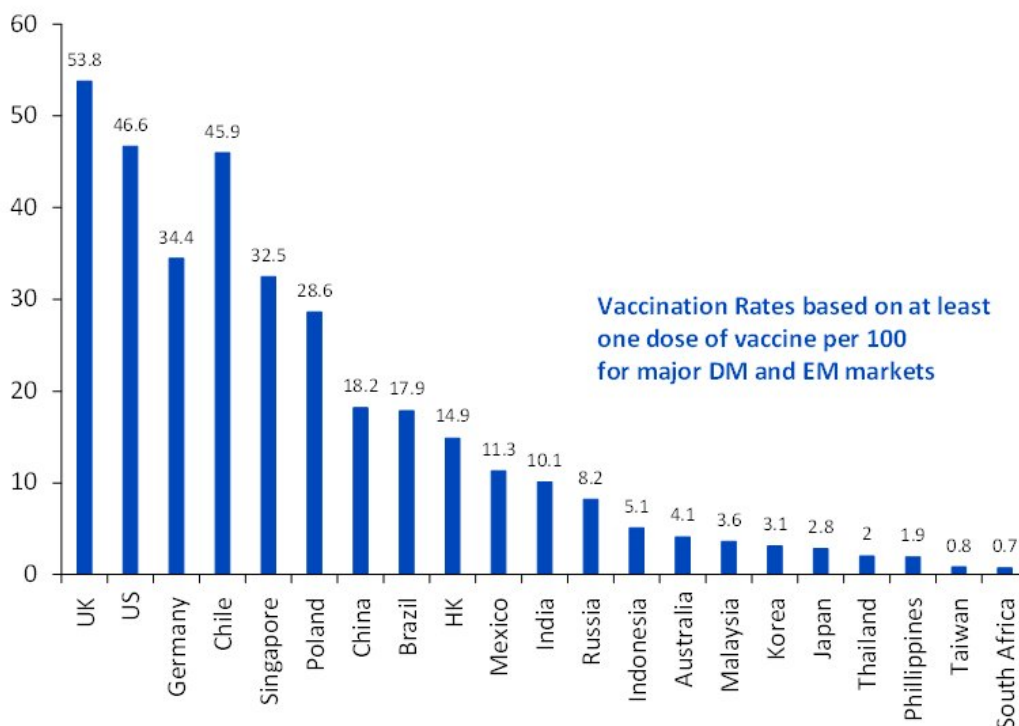
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The COVID-19 pandemic has led to a bifurcation between Emerging Markets (EM) and Developed Markets (DM). Constraints on the supply of Covid-19 vaccines have resulted in a slower roll-out of vaccines in EMs relative to DMs.

**Figure 1: Covid Vaccination Rates: Almost all EMs lag DMs**

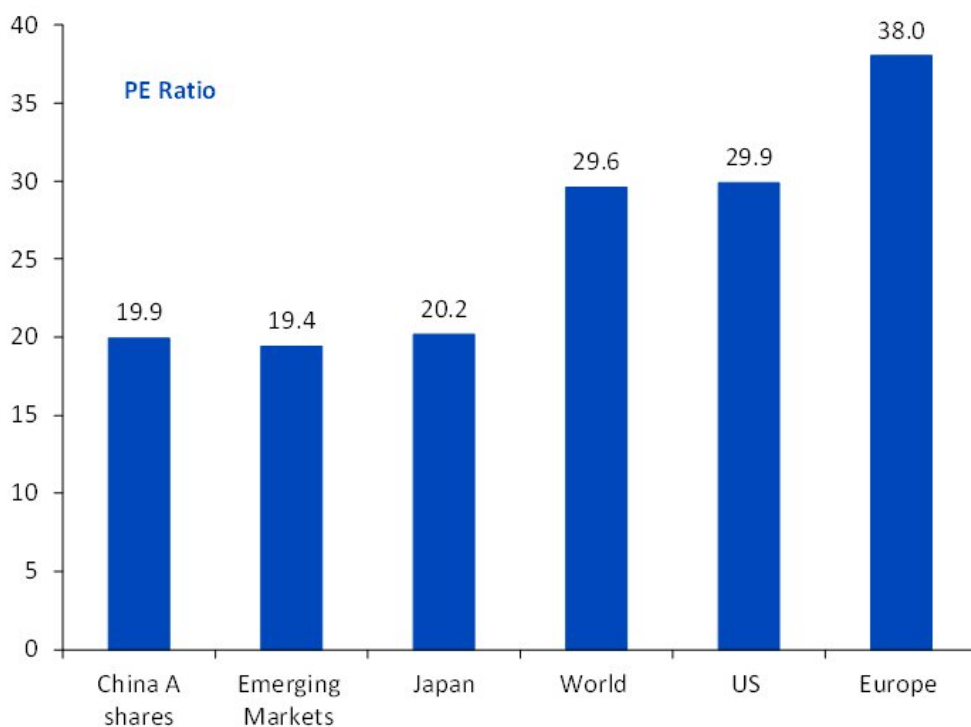


Source: Worldometer, Bloomberg, WisdomTree as of 15 May 2021

There have been some bright spots – China, Russia, Chile, and Central Eastern Europe - ramped up the pace of inoculations. India is also expected to accelerate the pace of its vaccinations after the country battles with a major surge in cases and deaths since March 2021. As a global hub for vaccine production, India holds an advantage over other EMs in COVID vaccinations. For now, negative sentiment appears to be clouding the outlook on EM countries as they are stuck in the peak phase of the pandemic. However, as these countries approach the trough of the pandemic and vaccination rates garner momentum, EM economies' paths to full recovery will resume. It's important to bear in mind that EM's remain a multi-year growth opportunity. Its current undervaluation versus global peers presents an attractive opportunity. The

current economic backdrop –weak US dollar, strong earnings momentum, rising commodity prices are poised to benefit EM economies over the long term.

**Figure 2: EM equities are discounted relative to the rest of the world**



Source: Bloomberg, WisdomTree as of 24 May 2021. Please note PE Ratio represents price to earnings ratio.

### US Dollar weakness should benefit EM

As most EM projects are funded in US dollars, any weakening of the US dollar benefits EM economies as it strengthens its growth and increases commodity prices. The fundamental factors for a weaker US dollar remain intact owing to excessive money printing, large fiscal deficit (US\$ 1.9trn stimulus announced by President Biden) amid broadening global growth. The latest minutes from the FOMC1 minutes appear to show some Federal reserve (Fed) officials publicly express that tapering should start sooner rather than later, keeping a 2021 taper squarely on the table. This time around, EM economies are in a better position to withstand Taper risks owing to stronger external positions via narrower deficits and current account surpluses than in 2013. Currently, the market seems to be only pricing in two hikes by the end of 2023.

### Earnings growth led by Eastern Europe and Asia

Earnings growth has been a key driver of EM equity returns. In the first quarter (Q1 2021) of the 45% of market cap reported<sup>2</sup>, EM posted aggregate earnings beats of 5.8%. In terms of larger market surprises, EEMEA3 (+12%) was the strongest region (supported by Russian earnings), followed by Asia Pacific ex Japan (+6%) and Latin America (+5%). Russia's economy has been strengthening since the start of the year. Russia's dividend yield has been increasing over the past years and stands out at 7.4%<sup>4</sup> in

comparison to major global markets. The upcoming dividend season in Russia from May to July is likely to provide further momentum to Russian equities. Higher oil prices have been a mixed story benefiting exporters such as Russia and Latin America in comparison to importers such as China and India. Emerging Asian equities led by China, Taiwan and South Korea have benefited from the reopening of the global economy owing to their export-oriented tilt. China was able to sustain its economy through the COVID shock and was amongst the first economies to recover from the pandemic. In fact, its economy's strong bounce back from COVID has given policymakers confidence to withdraw cyclical support. We expect the slowdown in the Chinese economy to be gradual and its subsequent impact on EM to be contained. Across EM sectors, utilities (+39%), materials (+27%) and consumer discretionary (+15%, of which Auto sector +22%) posted the largest earnings beats. The pandemic has accelerated the use of technology as the world transitions to the new normal of at-home work, education and entertainment which should bolster earnings in the technology sector.

### **Accessing EM via income route**

The spectre of higher inflation has come to the fore alongside higher interest rates. Historically dividend growth rates have held up well against inflation. Amidst these dynamics, income focused strategies could provide better protection against higher inflation.

The WisdomTree EM Equity Income UCITS Index seeks to provide investors with an exposure to high dividend yielding EM companies. Companies which pay more dividends are more heavily weighted. The dividend weighted methodology naturally tilts the weights of the constituents of the index towards the highest yielding stocks. To illustrate this, we observe over the past 10 years, 70% of the weight of the Index belonged to the constituents in the highest dividend paying quartile compared to just 17% for the benchmark<sup>5</sup>.

The Index offers a balanced exposure to stocks that are likely to benefit from a cyclical recovery such as financials (31%), information technology (17%), materials (12%) and communication services (8%). From a geographic standpoint, the dividend weighted methodology of the index allocates a larger share to Taiwan (31%), China (18%), Russia (14%), India (6%) and Hong Kong (5%). The Index also offers a broad exposure across size with nearly 51% in large caps, 34% in midcaps and 14% in small caps EM stocks.

1 FOMC – Federal Open Market Committee

2 As of 9 May 2021

3 EEMEA – Eastern Europe, Middle East and Africa

4 Russia is represented by the MSCI Russia Index

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