

Emerging markets both leader and laggard

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Earlier this year, there were expectations that a global economic recovery would be beneficial for the export-reliant and commodity-sensitive Emerging Markets (EM).

Fast forward to September 2021, and the MSCI EM Index (measured in local currency) was the worst-performing broad index that we track—up just over 1.4% compared to the nearly 16% gain of the broader MSCI All Country World Index (ACWI) Benchmark. However, a dichotomy has emerged within EMs evident from the outperformance of high dividend paying EM stocks versus non-dividend paying stocks. High dividend payers within EMs have shined amid headline risk in Chinese tech stocks. In fact the highest dividend quintile within the MSCI EM Index has outperformed the bottom dividend quintile by over 1,100 basis points and outperformed non-dividend payers by 3,200 basis points.

Figure 1: Outperformance of dividend paying stocks across quintiles

Sources: WisdomTree, MSCI, FactSet, as of 31 August 2021.

You cannot invest in an index. Past performance is not indicative of future returns.

At the Autumn 2020 annual rebalance of the WisdomTree Emerging Markets High Dividend Index, we implemented several risk screens to mitigate exposure to the riskiest dividend payers within the EM universe.

As a by-product of this screen—and a result of the natural under-weights to China's tech sector—the Index has experienced significantly lower volatility than the broad MSCI EM Index while handily outperforming it.

Figure 2: Comparison of fundamental data

Sources: WisdomTree, MSCI, FactSet, as of 27 September 2021.

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While we are still constructive on the long-term growth potential of many of these Chinese tech companies, the near-term uncertainty of a more heavy-handed regulatory environment in China has weighed on the benchmark index's recent returns. China makes up nearly 35% of the index's weight.

Figure 3: Historical comparison of performance

Sources: WisdomTree, MSCI, FactSet, as of 27 September 2021.

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WisdomTree's high dividend Index has under-weight allocations to the companies—mostly in information technology, communication services and consumer discretionary sectors—that have been the main targets of China's regulatory crackdown.

The Index has also been over-weight in the value sectors like financials and materials that have been beneficiaries of an improving global economy and a rally in commodity prices.

Figure 4: Comparison of sector tilts

Sector	WT EM High Dividend	MSCI EM	O/U Weight
Financials	27.94%	19.19%	8.76%
Materials	21.94%	8.91%	13.03%
Information Technology	14.11%	21.31%	-7.20%
Utilities	6.68%	2.18%	4.50%
Communication Services	6.06%	10.62%	-4.56%
Energy	5.97%	5.28%	0.69%
Real Estate	5.53%	1.81%	3.72%
Consumer Staples	4.35%	5.76%	-1.41%
Industrials	4.23%	4.98%	-0.75%
Consumer Discretionary	2.92%	15.22%	-12.31%
Health Care	0.27%	4.74%	-4.47%

Sources: WisdomTree, MSCI, FactSet, as of 31 August 2021.

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From a country perspective, the WisdomTree High Dividend Index has a much smaller allocation to China than the broader MSCI EM Index, at an aggregate weight of less than 20%. That under-weight allocation to China is offset by heavier allocations to Taiwan and Russia.

Figure 5: Comparison of country tilts

Source: WisdomTree, MSCI, FactSet, as of 31 August 2021.

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We think this approach to targeting quality dividend payers may provide a solution for investors interested in enhancing potential income for portfolios, as an active management solution, and/or to tap into a higher inflation thesis, given its tilts to the materials, financials, and real estate sectors.

While its absolute volatility levels are similar to, or even below, that of the MSCI EM Index—depending on the period under consideration—the WisdomTree Emerging Markets High Dividend Index has an active share of 88% against the MSCI EM Index benchmark.

In a challenging year for the headline EM Index, some investors may prefer a diversifying solution with lower correlation to the EM beta.

Figure 6: Historical comparison of performance of WisdomTree Emerging Market High Dividend Index versus MSCI Emerging Markets Index

Sources: WisdomTree, FactSet, MSCI, as of 27 September 2021.

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