

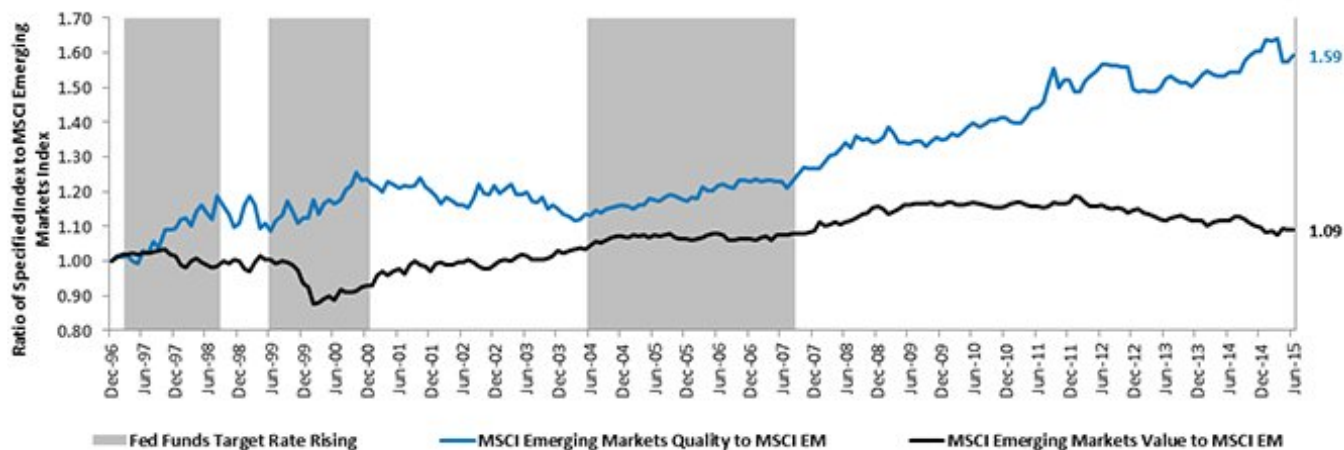
How to Look at Emerging Market Equities If the Fed Raises Rates

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It's difficult to think about global equity markets today without considering the "liftoff" from zero for the U.S. Federal Funds Target Rate that may happen before the end of 2015. *If the Federal Reserve (Fed) is going to raise short-term interest rates, what does this mean for an investment in emerging market equities?* **Quality versus Value Emerging Market Equities** One consideration we often hear about is how companies within emerging markets that issue debt may face a headwind as short-term interest rates rise in the United States. The rationale is that many emerging market companies issue debt in U.S. dollars, and as the dollar strengthens against emerging market currencies, it may be difficult for them to pay this debt back. While it is important to recognize that many emerging market debt issuers do in fact have U.S. dollar revenue streams (many commodities that they tend to be selling are priced in dollars), let us assume that, all other things being equal, lower-leverage emerging market equities are more desirable if the perception is that U.S. short-term interest rates will rise, leading to a potentially strong U.S. dollar against emerging market currencies. • **Quality:** The MSCI Emerging Markets Quality Index (Quality) focuses on, as part of its methodology, firms with relatively lower debt-to-equity ratios. • **Value:** The MSCI Emerging Markets Value Index (Value) does not have a direct focus on debt as part of its methodology, but it does have more significant exposure to certain sectors, such as Financials, that tend to have a higher degree of leverage than other sectors. Ultimately, we looked to examine whether the MSCI Emerging Markets Quality Index or the MSCI Emerging Markets Value Index has outperformed the MSCI Emerging Markets Index (Broad EM) in past periods when the U.S. Federal Reserve was raising interest rates. **Quality Outperformed Value during Past Periods of the Fed Raising Short-Term Interest Rates (12/31/1996–6/30/2015)**



Sources: Bloomberg, MSCI. Period selected due to the available data of the MSCI Emerging Markets Value Index, history for which begins 12/31/96. You cannot invest directly in an index. Past performance is not indicative of future results.

• **Period 1 from March 31, 1997, to August 31, 1998:** The Fed Funds Target Rate went from 5.25% to 5.50%. The upward-sloping blue line indicates that Quality was outperforming the Broad EM. Specifically, Quality returned -32.94% over this period, while Value returned -41.38%. While neither of these returns looks good, it's important to note that the Asian currency crisis was impacting emerging markets over this period.

• **Period 2 from June 30, 1999, to December 31, 2000:** The Fed Funds Target Rate went from 4.75% to 6.50%. Again, the upward slope of the blue line indicates that Quality was outperforming Broad EM. Quality returned -3.96%, Value returned -16.27% and Broad EM returned -11.94%. Again, none of these returns looks very favorable, but it's important to remember that the U.S. Technology sector was experiencing a bubble (and bursting thereof) over this period.

• **Period 3 from June 30, 1994, to August 31, 2007:** The Fed Funds Target Rate went from 1.00% to 5.25%—the largest increase that we saw over any of these periods. Quality returned 41.20%, Value returned 39.00% and Broad EM returned 37.59%. Generally, this was a global "risk-on" period prior to what we now remember as the global financial crisis of 2008–09.

WisdomTree's Emerging Market Equity Toolkit Our longest-standing emerging market equity exchange-traded fund (ETF), the [WisdomTree Emerging Markets Equity Income Fund](#), began trading on July 13, 2007, so we were unable to review live performance during past periods of Fed tightening. However, we can answer the question of which, if any, of WisdomTree's broad-based emerging market equity ETFs have lower leverage, which is one common measure of quality.

• **WisdomTree Emerging Markets Dividend Growth Fund (DGRE):** DGRE tracks the performance of the [WisdomTree Emerging Markets Dividend Growth Index](#), before fees and expenses, and this Index focuses on three-year average return on equity and return on assets in order to achieve an exposure to firms with lower leverage.

• **WisdomTree Emerging Markets SmallCap Dividend Fund (DGS):** DGS tracks the performance of the [WisdomTree Emerging Markets SmallCap Dividend Index](#), before fees and expenses. While this Index does not directly focus on firms with lower leverage, it has tended toward lower leverage due to its focus on small-cap companies. Based on what we've seen, small caps tend to have lower capacity to take on debt within emerging markets than large caps.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing on a single sector and/or smaller companies generally experience greater price volatility. 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. Due to the investment strategy of these Funds, they may make higher capital gain distributions than other ETFs. Please read each Fund's prospectus for specific details regarding each Fund's risk profile.

Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.