

NEW SMART BETA FACTOR IN EMERGING MARKETS

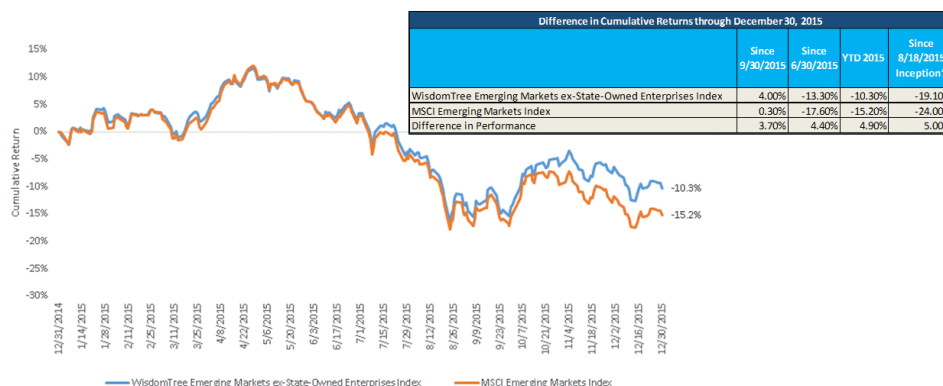
Christopher Gannatti — Global Head of Research
01/05/2016

While near-term allocators to emerging markets may not be easy to find, the economic difficulties in emerging markets (EM) can function as a catalyst for rethinking how these markets can be accessed. We're finding that investors may not want to take all of the [risk factors](#) inherent to an [MSCI Emerging Markets Index](#), traditionally the "beta benchmark" for emerging market equity investments. In other words, not all emerging markets are created equal in today's macroeconomic landscape. **Investors May Not Desire to Invest alongside Emerging Market Governments** Investors in U.S. equities typically don't see the U.S. government taking large, controlling equity positions in the largest [publicly listed](#) companies. EM governments, however, can and do tend to take control of such companies, in many cases either deeming them strategically important or looking for the source of revenue they can provide. On August 18, 2014, WisdomTree launched an [Emerging Markets ex-State-Owned Enterprises Index](#), which has been closely tracking the concept of EM firms owned by governments for more than one year. What we find:

- **The Beta Benchmark Is One-Third Exposed to Government Ownership:** We define "state-owned enterprises" as firms with a greater than 20% ownership by a state or government entity. The MSCI Emerging Markets Index is weighted fairly consistently 30% to 33%¹ toward these companies. In other words, strategies designed to track this Index are as much as one-third exposed to firms that are controlled by governments.
- **Financials, Energy and Telecommunication Services Tend to Be Largest "State-Owned" Sectors:** We screen the universe of emerging markets companies annually, and as of the September 30, 2015, [Index screening](#), more than 40% of the market capitalization of "state-owned" firms that we found was in the Financials sector. Beyond that, nearly 20% of the [market capitalization](#) was in Energy companies, and more than 10% was in Telecommunication Services. So, nearly three-quarters of the market capitalization of state-owned enterprises was in those three sectors.
- More than 60% of the state-owned market capitalization was in China.²

Identifying Exposure to State-Owned Enterprises as a Potential Smart Beta Factor In our view, the most important characteristic of any factor is a persistent experience of differentiated performance—either positive or negative—over time. We therefore analyzed the difference in performance between the WisdomTree Emerging Markets ex-State-Owned Enterprises Index and the MSCI Emerging Markets Index.

Emerging Market Equity Performance



Sources: Bloomberg, WisdomTree. Cumulative performance of the line-chart portion is meant to showcase the YTD 2015 period, specifically from 12/31/14 to 12/30/15.

*August 18, 2014, refers to the inception date of the WisdomTree Emerging Markets ex-State-Owned Enterprises Index.

Past performance is not indicative of future results.

You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

While the MSCI Emerging Markets Index showcases a very challenging environment over the various periods that we show, it is notable that the WisdomTree Emerging Markets ex-State-Owned Enterprises Index has delivered outperformance of anywhere from 3.7% to 5.0%. We explore the reasons from both a sector and country perspective below.³

Sector Perspective on Ex-State-Owned Enterprises We see the most positive contributions in relative performance in the Financials, Information Technology and Energy sectors. Within Financials, avoidance of firms in Brazil, China and even Greece is notable, in that many of these firms have faced very challenging performance environments. In Information Technology, the relative overweight to Chinese companies—many of which list on the New York Stock Exchange—has benefited performance. In Energy, avoiding the largest companies in Brazil and China has helped relative performance. Of course, over these periods, the performance across nearly every sector in emerging markets was, in a word, challenged, so this was really a story of avoiding some of the worst performing firms as opposed to selecting companies that are actually seeing positive performance.

Country Perspective on Ex-State-Owned Enterprises On the country level, the key to understanding the performance differences over these periods lies in understanding the China exposure. If China's equities are market capitalization weighted and state-owned enterprises are not restricted, it is no accident that the largest companies—the big banks, the big energy firms—get significant exposure. If China's equities, on the other hand, are subject to our approach of aiming to avoid exposure to state-owned enterprises, the large banks and energy firms tend to be eliminated, and information technology firms and insurance companies tend to get larger weights. The important goal is not to take a massive under-weight to China (or any country) but rather to recharacterize the exposure to avoid state-owned enterprises.

Implementing an Ex-State-Owned Enterprises Approach in Emerging Markets The bottom line of the WisdomTree Emerging Markets ex-State-Owned Enterprises Index is that it defines an exposure to emerging market equities while aiming to take one risk—exposure to state-owned enterprises—off the table. Investors interested in learning more should look at the [WisdomTree Emerging Markets ex-State-Owned Enterprises Fund \(XSOE\)](#), which is designed to track this Index before fees and expenses.

¹Source: Bloomberg, for period from 8/18/15 to 9/30/15.

²Sources for bullets 2 and 3: Standard & Poor's, WisdomTree, with data as of 9/30/15 Index screening date. ³Sources for sector and country segments: Bloomberg, with data looked at from 8/18/15 to 12/30/15, as well as various subperiods defined as starting on 12/31/14, 6/30/15 and 9/30/15, but all ending 12/30/15.

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. Investments in emerging or offshore 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. Funds focusing their investments on certain sectors and/or regions increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Investments in currency involve additional special risks, such as credit risk and

interest rate fluctuations.

The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's ("S&P"), a division of The McGraw-Hill Companies, Inc., and is licensed for use by WisdomTree Investments, Inc. Neither MSCI, S&P nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits), even if notified of the possibility of such damages.

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](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

MSCI Emerging Markets Index : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as “emerging markets” by MSCI.

Beta benchmark : Characterized by measuring the performance of a particular universe of equities without attempting to utilize selection and weighting to generate differences in performance relative to this universe.

Publicly listed : Companies that list their shares on a stock exchange in order to facilitate their raising money in efforts to enhance the overall value of the entire company.

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.

Annual screening date : The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.

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.