

BRICS BEATING TICKS IN 2016

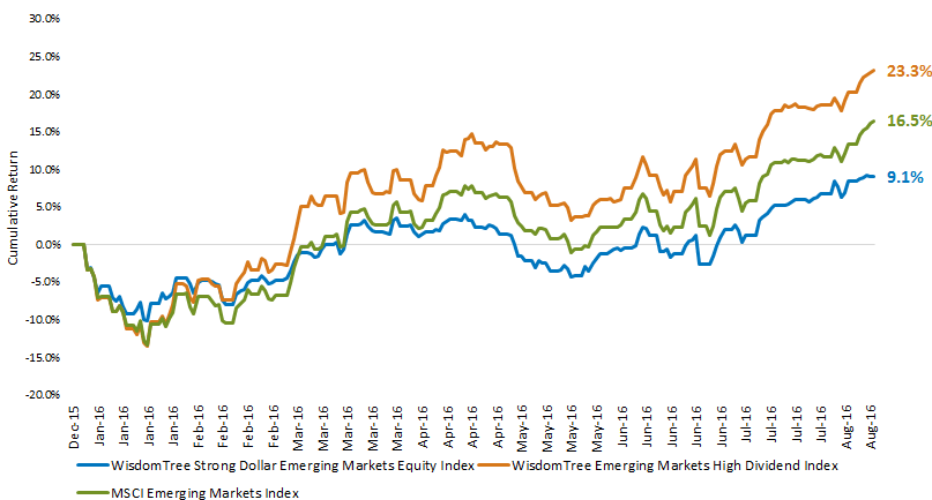
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In a blog post earlier this year, we discussed the outlook from a *Financial Times* article entitled [“The BRICS Are Dead, Long Live the TICKS.”](#) The term “BRICS,” which refers to Brazil, Russia, India and China, was coined by Jim O’Neill during his time at Goldman Sachs. “TICKS” stands for Taiwan, India, China and South Korea and is a newer term meant to capture the growth of more high tech, entrepreneurial industries in emerging markets. **How Has the BRICS vs TICKS Paradigm Shifted?** When the *Financial Times* article was published on January 28, 2016, global equity markets were in turmoil. Since that date:¹

- The price of one barrel of Brent Crude oil went from \$33.89 to \$46.97, an increase of almost 39%.
- Led by the Materials and Energy sectors, the [MSCI Emerging Markets Index](#) rallied more than 28%.
- Commodities, as measured by the [S&P GSCI Index](#), were up almost 10%.

This conflagration of factors has pushed the advantage to the BRICS—especially Brazil and Russia—in 2016, markets known for large companies in the Energy and Materials sectors. The [WisdomTree Emerging Markets High Dividend Index](#) tilts heavily toward the BRICS, predominantly through healthy exposures to energy and materials companies in Brazil and Russia. It has been one of our top-performing equity indexes in 2016. On the opposite side of the emerging markets spectrum is the [WisdomTree Strong Dollar Emerging Markets Equity Index \(WTEMSD\)](#), which we were [writing about back in May](#) as the best exemplification of TICKS-tilted exposure due to the fact that more than 75% of WTEMSD weights are allocated to three of the TICKS—Taiwan, India and South Korea.² Energy and Materials—the best sector performers in emerging markets in 2016—are also excluded from WTEMSD, as they are viewed as more vulnerable to a rising U.S. dollar environment.

Emphasizing the BRICS Has Outperformed in 2016



Sources: WisdomTree, Bloomberg, with data from December 31, 2015, to August 12, 2016. 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.

what’s Next for

Emerging Markets? While this may be the toughest question to conclusively answer, it is among the most important to consider. We can think about a few potential scenarios:

Scenario One: The Rally Continues During the month of July 2016, we saw an interesting phenomenon:³

- The price of a barrel of Brent Crude oil went from \$49.68 to \$42.46, a decline of over 14%.
- The Materials sector was up 9.68%, but Energy was up only 2.88%. Still, all 10 sectors were positive, giving investors an interesting data point, as many would have initially expected that a significant drop in oil would be a big headwind to emerging market equities.
- The WisdomTree Emerging Markets High Dividend Index—which at present emphasizes Energy and Materials—was up nearly 6%, outperforming the MSCI Emerging Markets Index by almost a full percentage point.
- Because Information Technology was actually the second best-performing sector in the MSCI Emerging Markets Index during the month (representing nearly 39% of the WT Strong Dollar Emerging Markets Equity Index over the period), the WT Strong Dollar Emerging Markets Equity Index actually also outperformed the MSCI Emerging Markets Index over the period.

While this scenario may not occur, it does speak to some robustness that an initial decline in oil didn't lead to big negative performance, at least not yet.

Scenario Two: The Rally Breaks and Emerging Market Equities Correct With the negative performance of recent years (2013, 2014 and 2015)⁴, the thought of a potential correction is not yet far from investors' minds. We would note a few items to remember, in the event of a correction:

- Corrections and “[risk-off](#)” environments have tended to be characterized by a strengthening U.S. dollar, especially against emerging market currencies.
- The WisdomTree Strong Dollar Emerging Markets Equity Index was created to access emerging markets in a way that is less vulnerable to a rising dollar yet that would not have to pay expensive [hedging](#) costs due to the high [interest rates](#) of emerging markets.
- In looking at the underlying constituents of the WisdomTree Strong Dollar Emerging Markets Equity Index, we can see that the [beta](#)—the potential sensitivity to movements in the MSCI Emerging Markets Index—is approximately 0.82.⁵ How is this achieved? The answer lies in avoiding the relatively higher-beta sectors of Energy and Materials, while also putting significant exposure in Information Technology and Consumer Discretionary. The current narrative for emerging markets has been reliant on a relatively weak U.S. dollar and rising commodity prices, which favors the BRICs over the TICKs, and the WisdomTree Emerging Markets High Dividend Index in particular. For those who view the future as more TICKs oriented and less centered on the BRICs, the WisdomTree Strong Dollar Emerging Markets Equity Index is a worthy unique representation of stocks for a shifting focus in emerging market strategies, in our view.

¹Sources for bullets: WisdomTree, Bloomberg, with data for period 1/28/16–8/12/16.

²Sources: WisdomTree, Standard & Poor's, with data as of 8/12/16. ³Sources for bullets: WisdomTree, Bloomberg, with data for period 6/30/16–7/31/16. ⁴Source: Bloomberg. Universe of emerging market equities is the MSCI Emerging Markets Index. ⁵Source: Bloomberg, with beta measured against the MSCI Emerging Markets Index for a one-year horizon, measured as of 8/12/16.

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DEFINITIONS

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.

S&P GSCI Index: leading measure of general commodity price movements and performance over time.

Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Interest rates: The rate at which interest is paid by a borrower for the use of money.

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.