
WHAT TO AVOID IN EMERGING MARKETS

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Last week we had the pleasure of speaking with Timothy Reynolds, Senior Portfolio Manager at Employees Retirement System (ERS) of Texas, on our “Behind the Markets” podcast.

Reynolds has a unique worldview, as he is responsible for the international public equities team at ERS Texas, a \$30 billion pension fund.

ERS Texas manages about 70% of public equities in-house with a philosophy that provides “core-like” exposure to markets, rooted in bottom-up research for companies that deliver strong revenue and earnings power.

Reynolds’ team currently believes that international equities are priced to deliver better forward-looking returns than the U.S. market. He has been early to this allocation thus far, but he feels it’s even more true now, while the U.S. [large-cap growth](#) freight train continues to run.

Picking Winners Is as Important as Avoiding Losers

Reynolds believes what you *don’t* do in investing is just as important as what you do.

After discussing this philosophy with Reynolds over five years ago, WisdomTree was motivated to research the impact of [state-owned enterprises \(SOEs\)](#) on emerging market strategies. SOEs tend to be slower-growth banks and energy companies with a prevalent government influence, while non-SOEs tend to be more independent technology and consumer-oriented companies.

There is now approximately \$1.2 billion allocated to funds that track indexes that exclude SOEs, and WisdomTree has Reynolds to thank for our initial work around this concept.

Reynolds first became interested in SOEs when he read a Wall Street Journal article showing how Exxon Mobil had \$400 billion in revenue with 75,000 global employees while Petro China had the same amount of revenue with 544,000 employees. This was a sign to Reynolds that state-owned companies could pursue interests beyond just maximizing returns for shareholders like him in Austin, Texas.

Reynolds believes [environmental, social and governance \(ESG\)](#) investing is a trend that is here to stay, and removing SOEs is one way to improve the governance component. I would add that ex-SOE strategies also indirectly reflect the “E” in ESG due to the removal of many large state-owned energy companies.

Reynolds also likes being [active](#) in emerging markets, and removing SOEs is a way to get deliberate (systematic) *and* active tilts without eliminating stocks individually from a vast universe.

This was a great conversation with an investor whose direct feedback spawned an important new generation of strategies more than five years ago.

Please listen to our full conversation with Timothy Reynolds below.

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](#).

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DEFINITIONS

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term “large market capitalization”. Market capitalization is calculated by multiplying the number of a company’s shares outstanding by its stock price per share.

Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

State-owned enterprise: Companies in which governments have a significant ownership stake and the potential to influence the firms’ actions over time.

ESG: An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible.

Active: Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.