

CHANGING CURRENCY TIDES: EMERGING MARKETS

05/21/2015

Recently, the emerging markets (EM) have been embattled in a storm of currency weakness and disappointing performance. However, that tide may be starting to turn. Case in point: the [WisdomTree Emerging Markets Equity Income Index \(WTEMHY\)](#) has returned 11.52% year-to-date, with currencies contributing 1% to that performance.¹ In recent years, currency moves have dominated investor returns in the emerging market equity space. This was especially the case in 2014, where FX stripped over 15% off the broad-based high-yielding emerging market equity strategy defined by WTEMHY. More generally, the U.S. dollar has had a significant run-up against its trading partners in both the developed and the emerging market complex. For context, the [Bloomberg Dollar Spot Index](#), a liquidity-adjusted measure of the dollar against a broad set of developed and emerging currencies, appreciated 10.31% in 2014 and 13.58% over the most recent nine-month period.²

Are Emerging Market Currencies Offering Good Value? A few emerging market countries screen as being potentially attractive candidates to add exposure to, particularly after the sharp decline in their currencies. While foreign currencies were a large drag on WTEMHY's performance in 2014, they subsequently added 100 [basis points \(bps\)](#) to their performance in 2015. This is in stark contrast to the developed world, proxied by the [MSCI EAFE Index](#), where foreign currencies have detracted 295 basis points from returns in 2015 alone.³ With currencies becoming a performance tailwind in WTEMHY, value hunters may find depressed equity price multiples in EM more enticing.

FX Contribution Dominates Performance



Sources: WisdomTree, Bloomberg, with data 12/31/07-4/27/15.

- **FX has been a drag:** The chart above highlights the various periods under consideration and the jarring reality that FX has been a large driver of performance across the stated periods of three, five and seven years. In the event the higher dollar trend bucks, this could potentially sweeten the EM opportunity, given that the region is trading at 13x [earnings](#) (represented by P/E ratio) and at a 13.5% discount against its 10-year [median](#).⁴
- **Russian Ruble Staking Performance Differential 2014 vs. 2015:** In 2014, currencies stripped 15.6% off performance, while WTEMHY returned -10.6%.⁵ Another way to think about this is that if it were not for currencies, returns would have been positive. A large portion of the FX drag was attributable to the Russian ruble, which depreciated over 43%. Specifically, the ruble contributed -10.1% of the -15.6% underperformance that was currency related. While the ruble was a large detractor in 2014, 2015 was characterized by the ruble adding most significantly to WTEMHY's currency picture: it added 3% of the 1% total currency contribution in 2015.
- **Brazilian Real Stuck in a Rut:** In 2011,

2013 and 2014, the real stripped -2.1%, -1.7% and -1.1%, respectively, off WTEMHY's performance, as the real declined -11.0%, -13.1% and -11.1% in those years. This underperformance continued into 2015 and is largely a function of Brazil's macroeconomic picture that has been saddled with slow growth, sticky [inflation](#), stubborn [twin deficits](#) and a lack of reform. Due to relatively high [short-term interest rates](#) in Brazil, there [may be an opportunity](#) to look at short-term interest rates and currency markets in Brazil as a tactical opportunity. I believe the recent emerging market performance and negative sentiment has created some opportunities. Further, the stabilization of currencies has the potential to improve investors' risk-adjusted returns. Markets may deviate from the underlying fundamental value for a number of reasons and can stay irrational for long periods, but I believe they eventually revert back to underlying fundamentals. One way to take advantage of the EM space is to do so is through a rules-based strategy that hones in on fundamentals and provides sufficient income potential—such as the strategy the WisdomTree Emerging Markets Equity Income Index is based on.

¹Sources: WisdomTree, Bloomberg as of 4/30/15. ²Period measured: 7/31/14–4/30/15.

³Source: Bloomberg, with data from 12/31/14–4/30/15. ⁴Measures on MSCI EM from 4/31/05 to 4/31/15. ⁵Returns measured on WTEMHY at the net U.S. dollar level.

Important Risks Related to this Article

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.

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

WisdomTree Emerging Markets Equity Income Index: A subset of the WisdomTree Emerging Markets Dividend Index measuring the performance of the higher-yielding stocks as measured by trailing 12-month dividend yields, weighted by cash dividends.

Foreign Exchange (FOREX, FX): The exchange of one currency for another, or the conversion of one currency into another currency.

Bloomberg Dollar Spot Index (BBDXY): Tracks the performance of a basket of ten leading global currencies versus the U.S. dollar. Each currency in the basket and their weight is determined annually based on their share of international trade and FX liquidity.

Basis point: 1/100th of 1 percent.

MSCI EAFE Index: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

Earnings multiple: another way of saying price-to-earnings multiple.

Median: The median is the value within a dataset at which 50% of all observations occur above and 50% occur below.

Inflation: Characterized by rising price levels.