

# WHY EM SMALL CAPS NOW: DIVERSIFYING CHINA TECH

Jeremy Schwartz – Global Chief Investment Officer  
08/05/2021

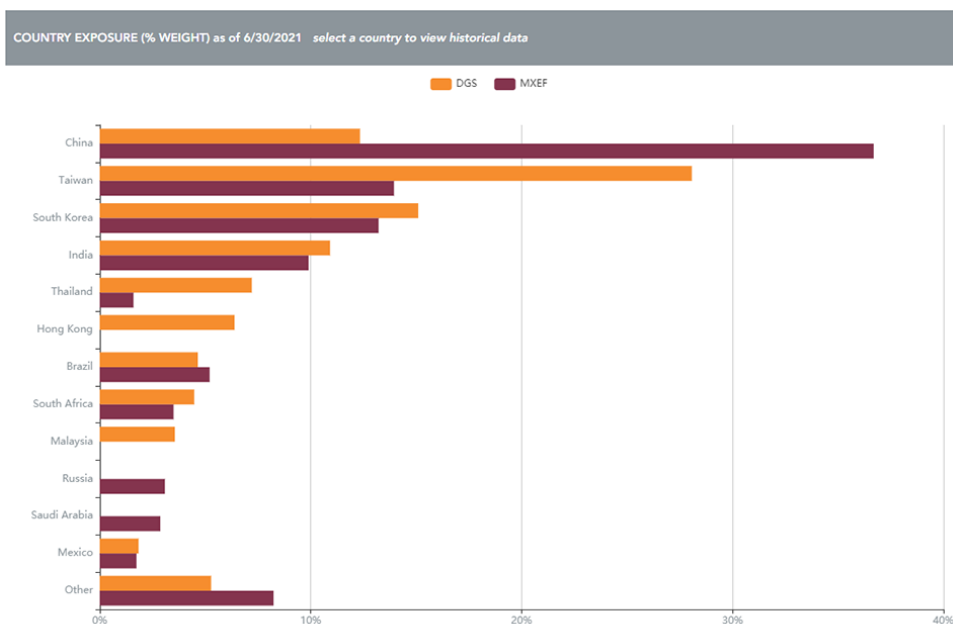
China’s [large-cap](#) technology stocks have come under immense pressure in the last three months—from actions taken against Ant Financial to delay its initial public offering to the latest regulatory actions against the education companies that crippled their ability to earn a profit.

Thus, we believe it may be a good time to review why emerging market [small-cap](#) stocks can help diversify some of the risks in the region, as it may seem counterintuitive that small caps can be less risky than large caps.

## DGS Has Less China Weight

First, let’s take a look at country exposures in the [WisdomTree Emerging Markets SmallCap Dividend Fund \(DGS\)](#) and the broad [MSCI Emerging Markets Index \(MSCI EM\)](#).

China’s weight in the MSCI EM Index has grown to more than one-third with the long-term gains in those large tech giants. DGS, by contrast, had less than a 20% exposure in China and Hong Kong stocks.



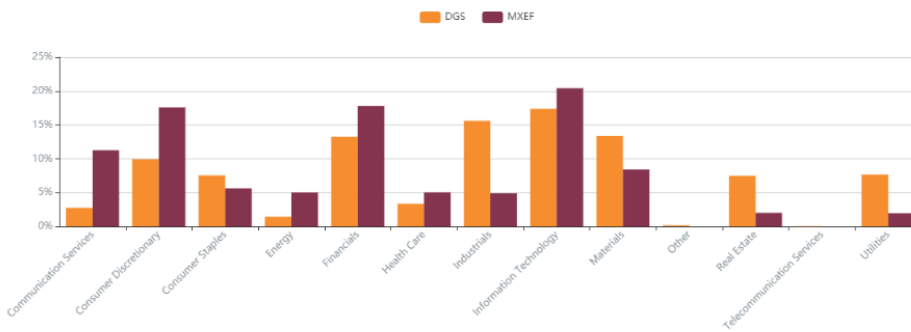
Source: WisdomTree Fund Comparison, as of 6/30/21. Subject to change.

For definitions of terms in the table, please visit the [glossary](#).

## More Cyclical Reopening Stocks

The sector exposures one gets in DGS are also more tilted to [cyclical sectors](#) like Industrials and Materials and away from technology and communication services—further helping diversify portfolios in EM.

SECTOR EXPOSURE (% WEIGHT) as of 6/30/2021 [select a sector to view historical data](#)



Source: WisdomTree Fund Comparison, as of 6/30/21. Subject to change.

### China Tech Still the Big Winner Over Five Years

Despite recent regulation in the Chinese technology sector, China technology stocks still remain top performers over the last five years. In fact, our [WisdomTree China ex-State-Owned Enterprises Index](#) has still outperformed the [S&P 500](#) over the last five years, even with the latest fall from grace.

DGS focuses on [dividend](#)-paying stocks—with a rigorous, valuation-based rebalance discipline. When we look at price-to-earnings ratios on estimated forward-looking earnings, we see [P/E ratios](#) in single digits at only 9.1x—whereas the broad MSCI EM Index is at 14.5x.

It is rare to find any market segment with this low of a market multiple—and this is not some narrow basket, as DGS has more than 750 constituents in its portfolio.

### Why Dividend Payers in EM Small Cap

We often describe dividends as a level of corporate governance in emerging markets because companies must have cash to pay dividends, and you can only “fake” a dividend for so long. Dividends have thus served as a measure of [quality](#) for these companies, and the data shows this was critical.

Whereas the cap-weighted MSCI Emerging Markets Small Cap Index had less than 30% of its weight allocated to those top two quintiles, the [WisdomTree Emerging Market SmallCap Dividend Index](#) had almost two-thirds of its weight allocated to those top dividend quintiles.

This attribution analysis shows the long-term outperformance of the WisdomTree Index was driven both by the over-weights to the highest dividend bucket and the under-weights to the zero and lowest-yield segments.

WTEMSC - WisdomTree Emerging Markets SmallCap Dividend Index VS. MXEFSC - MSCI Emerging Markets Small Cap Index

Dividend Yield Attribution As of: 6/30/2021

MTD QTD YTD 1Y 3Y 5Y 10Y Since Inception\*

[COPY LINK](#) [EXPORT EXCEL](#)

Category	Attribution Component				Average Category Weight			Category Performance	
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
1st Quintile (Highest Div. Yield)	2.24%	-0.35%	-0.52%	1.38%	40.67%	14.49%	26.19%	7.99%	9.57%
2nd Quintile	0.57%	-0.84%	-0.48%	-0.75%	25.50%	15.82%	9.69%	6.15%	9.14%
3rd Quintile	-0.02%	-0.22%	-0.16%	-0.40%	16.72%	16.05%	0.67%	6.12%	6.58%
4th Quintile	-0.00%	0.03%	-0.01%	0.02%	10.09%	15.73%	-5.64%	4.70%	4.78%
5th Quintile (Lowest Div. Yield)	0.73%	-0.59%	0.29%	0.43%	4.06%	17.08%	-13.02%	-1.17%	0.75%
Zero Div. Yield	1.39%	0.72%	-0.79%	1.31%	0.32%	18.37%	-18.05%	5.01%	-0.16%
N/A	0.05%	-0.12%	-0.18%	-0.25%	2.63%	2.48%	0.16%	-3.53%	-6.96%
<b>Total</b>	<b>4.96%</b>	<b>-1.36%</b>	<b>-1.85%</b>	<b>1.74%</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5.70%</b>	<b>3.96%</b>

Source: WisdomTree Fund Comparison, as of 6/30/21. Subject to change. Past performance is not indicative of future results. You cannot invest directly in an index.

### Cyclical Rotation

During this rotation away from [growth](#), we have seen small caps with a [value](#) tilt perform particularly well in 2021 through July with outperformance by significant margins.

But equally interesting is that small caps have similar [volatility](#) as their large-cap brethren. We often think of the Russell 2000 as having significantly more volatility than the S&P 500—partly because there are so many more unprofitable companies in U.S. small caps.

But over the life of DGS, it has displayed volatility levels on par with the broader MSCI EM Index.

PERFORMANCE as of 7/30/2021		Cumulative Returns			Average Annual Total Returns					
Ticker	Fund	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 10/30/2007 - 7/30/2021
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund (NAV)	-0.85%	1.14%	14.74%	34.38%	7.43%	9.53%	3.75%	3.86%	3.86%
MXEF	MSCI EM Index	-6.88%	-5.58%	0.22%	19.74%	7.75%	10.36%	3.60%	-	2.08%

VOLATILITY (STANDARD DEVIATION) as of 6/30/2021		Average Annual Volatility					
Ticker	Fund	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 10/31/2007 - 6/30/2021
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund (NAV)	12.05%	20.91%	17.71%	17.65%	21.26%	21.26%
MXEF	MSCI EM Index	12.25%	18.52%	16.10%	17.59%	-	21.63%

Source: WisdomTree Fund Comparison, as of 6/30/21. Subject to change. Past performance is not indicative of future results. You cannot invest directly in an index. Volatility: A measure of the dispersion of actual returns around a particular average level. Past Performance does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available above. WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total Returns are calculated using the daily 4:00pm net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

For standardized performance of DGS, please click [here](#).

### Factor Diversification

Almost all of WisdomTree's own Model Portfolios have paired DGS with our [Emerging Markets ex-State-Owned Enterprises Fund \(XSOE\)](#) for some time to achieve factor diversification—pairing the growth-tilted core XSOE with small-cap value stocks in DGS. That pairing worked particularly well in 2021—and the current uncertainty surrounding China technology stocks suggests DGS and small caps could play an ever-larger role in diversifying portfolios from the latest risks to emerging markets.

### 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, intervention and political developments. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or

any third party involved in or related to compiling, computing or creating the data 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.

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.

#### Related Blogs

+ [What's Next? How to Think about China Equity in Your Portfolio](#)

#### Related Funds

+ [WisdomTree Emerging Markets SmallCap Dividend Fund](#)

+ [WisdomTree Emerging Markets ex-State-Owned Enterprises Fund](#)

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](http://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

**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.

**Small caps**: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**MSCI Emerging Market Index**: The MSCI Em (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries.

**Cyclical sectors**: Consumer Discretionary, Energy, Industrials, Materials, Financials and Information Technology sectors.

**S&P 500 Index**: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor’s Index Committee designed to represent the performance of the leading industries in the United States economy.

**Dividend**: A portion of corporate profits paid out to shareholders.

**Price-to-earnings (P/E) ratio**: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Quality**: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

**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.

**Value**: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Volatility**: A measure of the dispersion of actual returns around a particular average level.