
EM SMALL-CAPS: ATTRACTIVE VALUATIONS AND DIVIDENDS

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In the pursuit of returns, investors are constantly asking what they potentially missed. Narrow market leadership in U.S. [large caps](#) all but guaranteed outperformance relative to small caps. In the EAFE (Europe, Australasia and the Far East) region, a similar story emerges, but with slightly less concentration. Curiously, in [emerging markets](#) the exact opposite is true. Despite wide-spread concern about the underlying fundamentals of emerging markets and China, small-cap companies are handily outperforming large caps.

In this piece, we highlight drivers of relative performance. For investors focused on [valuations](#), emerging markets [small-cap](#) dividend payers appear worthy of a second look.

The [WisdomTree Emerging Markets SmallCap Dividend Fund \(DGS\)](#), which seeks to track the price and yield performance, before fees and expenses, of the [WisdomTree Emerging Markets SmallCap Dividend Index \(WTEMSC\)](#), was launched in 2007 and provides exposure to small-cap dividend-paying companies in emerging markets.

[DGS](#) is [value](#)-oriented and differs from traditional [market cap-weighted](#) indexes, as outlined below:

- Screen to only include profitable dividend-paying companies from the eligible universe
- Remove companies most at risk of cutting dividends based on quantitative risk screens
- Take a dividend-weighted approach based on each company's [Dividend Stream®](#)

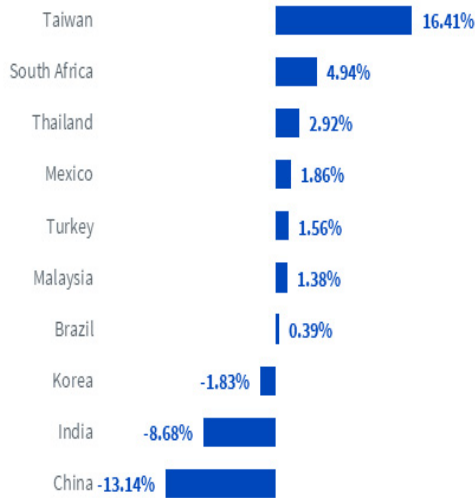
Differentiated exposure

In recent years, investing in emerging markets meant taking a substantial allocation in Chinese companies. Even though the proportion of the [MSCI Emerging Markets Index](#) allocated to China has fallen from its peak of 43% in October 2020, it still constitutes close to a third of the index.

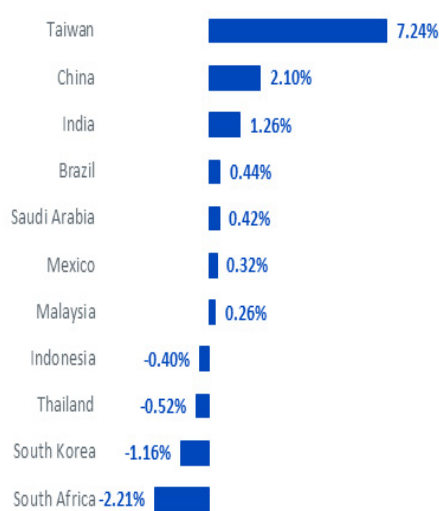
[DGS](#) has significantly lower exposure to China than traditional large caps—which have a lot of tech companies that are low dividend payers.

As of August 31, 2023, the underlying WisdomTree Index had 17% allocated to China and over 31% to Taiwan. The over-weight exposure to Taiwan contributed over 7% to performance while an under-weight exposure to China and India added 2.10% and 1.26%, for a total outperformance of 7.76% relative to the MSCI Emerging Markets Index.

WTEMSC Over/Under-Weight vs. MSCI Emerging Markets Index



YTD Attribution WTEMSC vs. MSCI Emerging Markets Index



Sources: WisdomTree, FactSet, as of 8/31/23.

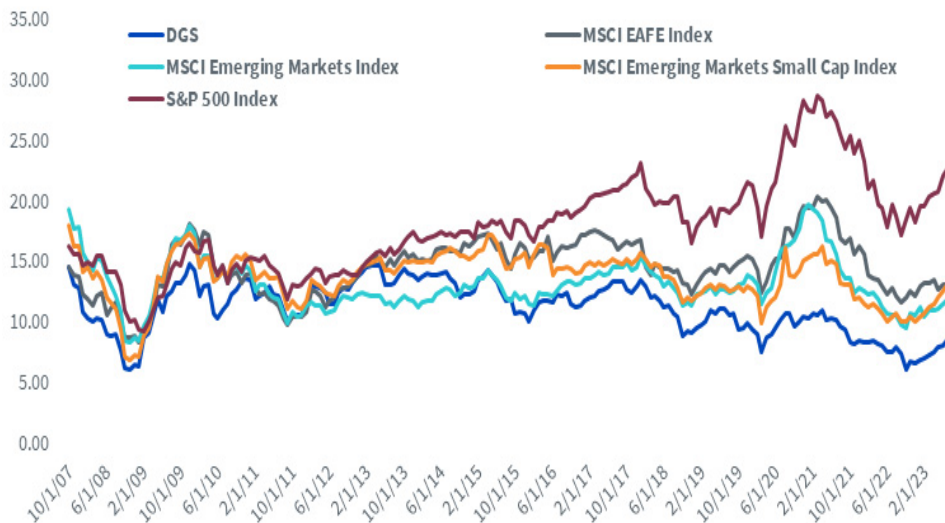
Higher allocation to ex-state-owned enterprises and lower allocation to state-owned enterprises also contributed to year-to-date performance.

Valuations

Current valuations make a compelling case for investing in emerging markets, especially relative to the U.S. market, which had high multiple expansion over the past few years.

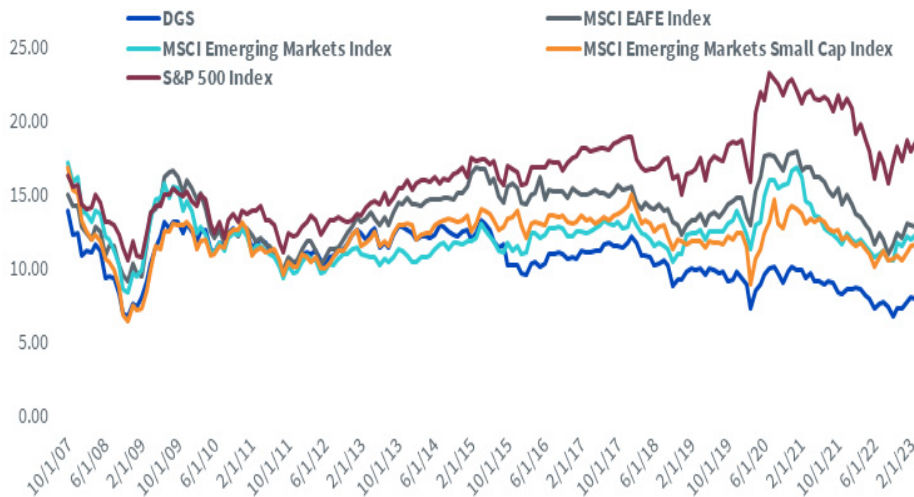
DGS currently offers single-digit price-to-earnings ratios on trailing as well as forward basis. In contrast, valuations for the [S&P 500 Index](#) are currently over 20 and above the long-term average.

Price-to-Earnings



Source: WisdomTree, FactSet, as of 8/31/23.

Estimated Price-to-Earnings



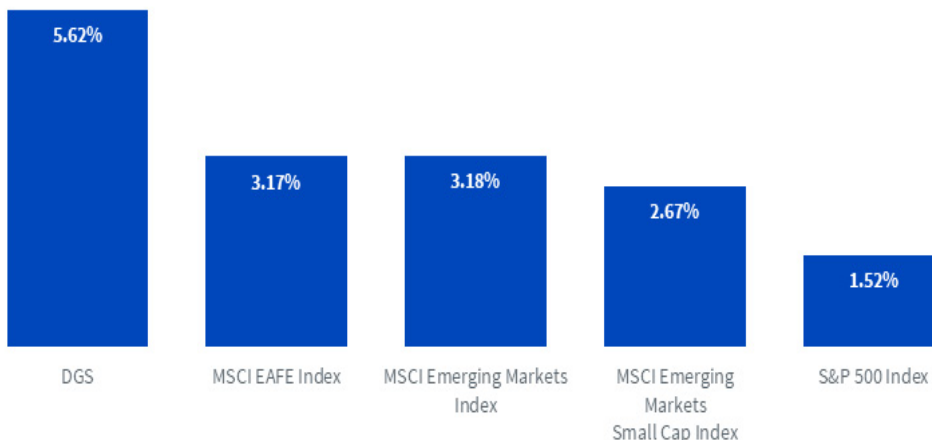
Source: WisdomTree, FactSet, as of 8/31/23.

Quality Tilt

One of the requirements for inclusion in the WisdomTree Emerging Markets SmallCap Dividend Index is profitability, which introduces a quality bias. Less than 3% of the Index is currently invested in unprofitable companies, compared to 5% for the MSCI Emerging Markets Index and close to 11% for the MSCI Emerging Markets SmallCap Index.

In addition to attractive valuations and quality tilt, emerging markets small-cap dividend payers have historically offered considerably higher income than core U.S. and broad international developed equities.

Dividend Yields



Source: WisdomTree, FactSet, as of 8/31/23. The performance data quoted represents past performance and is no guarantee of future results. Investment return 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. Current performance may be lower or higher than the performance data quoted.

For the 30 Day SEC Yield, SEC Standardized Return, and the most recent month-end performance click [here](#).

Investors may be surprised to learn how important of a factor dividend payments were for the small-cap segment in emerging markets. First, unlike the U.S., where less than 50% of the [Russell 2000](#) paid a dividend, among emerging markets small caps, more than 87% distributed dividends. Moreover, our attribution tool shows how important a driver this factor was for emerging markets.

Since Inception Dividend Yield Attribution

Category	Attribution Components				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)	1.88%	-0.28%	-0.41%	1.19%	40.87%	14.48%	26.39%	7.05%	8.49%
2nd Quintile	0.49%	-0.56%	-0.32%	-0.39%	25.66%	15.78%	9.88%	5.60%	8.02%
3rd Quintile	-0.03%	0.02%	-0.10%	-0.11%	16.48%	15.92%	0.56%	5.54%	5.16%
4th Quintile	0.01%	0.04%	-0.01%	0.04%	9.83%	15.74%	-5.91%	3.74%	3.75%
5th Quintile (Lowest Div. Yield)	0.44%	-0.78%	0.42%	0.07%	3.91%	17.29%	-13.38%	-2.41%	0.75%
Zero Div. Yield	1.28%	1.32%	-1.38%	1.22%	0.31%	18.58%	-18.27%	4.73%	-1.52%
N/A	-0.20%	-0.05%	0.06%	-0.19%	2.94%	2.21%	0.73%	-4.00%	-10.02%
Total	3.87%	-0.30%	-1.74%	1.83%	-	-	-	4.88%	3.04%

Sources: WisdomTree, FactSet. WisdomTree Emerging Markets SmallCap Dividend Index vs. MSCI Emerging Markets Small Cap Index. Since Inception returns are calculated from the last trading day of the month, 8/1/07-8/31/23.

Companies that don't pay dividends had returns of -1.52%, more than 4.56% behind the MSCI Emerging Markets Small Cap Index generally.

While the highest dividend yield segment in the WisdomTree Index returned 7.05%, more than 4.01% higher than the MSCI Emerging Markets Small Cap Index.

Since inception, the underlying index for [DGS](#) outperformed the MSCI Emerging Markets Small Cap Index by 1.83%. A higher allocation to the top dividend-yielding segment added 1.19%, while a reduced allocation to non-dividend-paying stocks contributed an additional 1.22% to the overall performance.

Focusing on dividend-paying companies was a key value add to the small-cap strategy in generating excess returns since inception. Paying dividends served not only as a valuation factor but also as a quality measure since companies needed profitability, earnings and financial strength to maintain and distribute dividends.

Conclusion

For investors who believe in the long-run potential of emerging markets, focusing on dividend-paying small caps could be a source of positive total returns as well as income.

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. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of DGS please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/dgs>

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 Funds

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

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

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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.

Emerging market: Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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

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.

Market capitalization-weighting: 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.

Dividend Stream: Refers to the regular dividends per share multiplied by the number of shares outstanding.

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 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.

Russell 2000 Index: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.