

REBALANCING BACK TO VALUATIONS IN EMERGING MARKETS

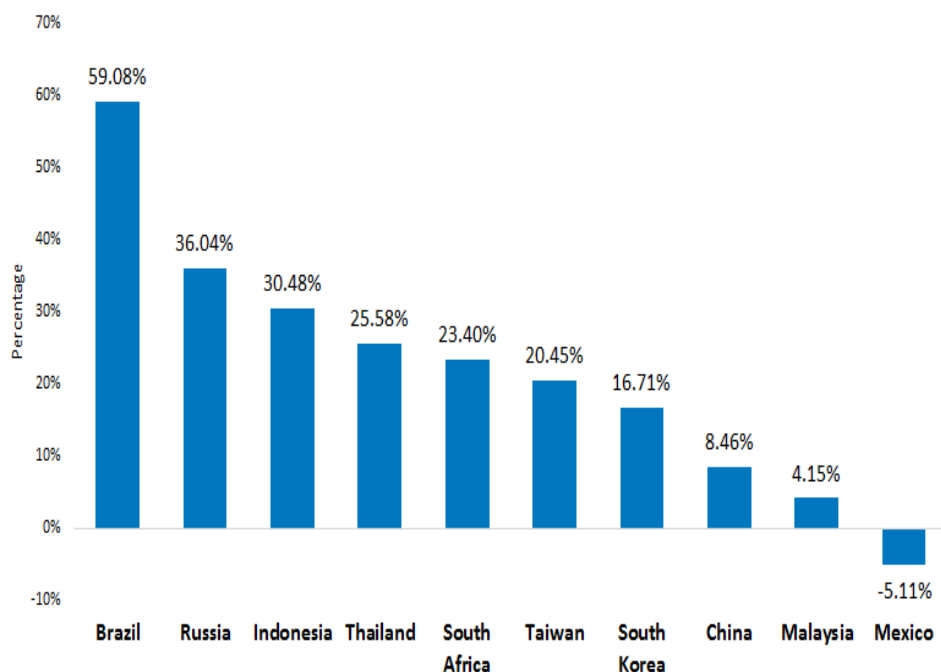
Jeremy Schwartz – Global Chief Investment Officer, Tripp Zimmerman – Director, Research
10/27/2016

After a painful three to five years, [emerging markets \(EM\) have been roaring back in 2016](#) and leading regional performance. The gains began with stability in oil prices in February and the Federal Reserve (Fed) not hiking [interest rates](#), providing support for emerging market currencies and asset prices. But these gains continued in the third quarter on China’s fiscal expansion spending.

Looking across all of WisdomTree’s Indexes covering the global markets, the single best performing Index of more than 70 equity strategies for wisdomTree in the third quarter was a China-focused Index, the [WisdomTree China Ex-State-Owned Enterprises Index](#), signaling renewed market confidence in Chinese equities and a view that China would avoid a “hard landing” in its economy on stepped-up government spending.

There has been a wide cross-section in performance across emerging markets. Below we chart the performance of the 10 largest countries in the [WisdomTree Emerging Markets Dividend Index](#) over the last year.

WisdomTree Emerging Markets Dividend Index: Country Performance (12/31/15–9/30/16)



Sources: WisdomTree, Bloomberg, 12/31/15–9/30/16. Performance is total return, calculated in U.S. dollars, for the 10 largest country allocations in the WisdomTree Emerging Markets Dividend Index. Past performance is not indicative of future results. You cannot invest directly in an index.

Commodity Exporters Lead the Pack

At the top of the performance list was Brazil, which saw large gains in both its equity market and its currency. This was followed by Russia, Indonesia and South Africa soon after. Something these countries all have in common is their connection to commodity prices and exports—following years of subdued and negative expectations, stability in commodities led to a strong rebound in all these markets and their currencies.¹

WisdomTree's best performing emerging market strategy in 2016 has been a high-[dividend](#), value-seeking strategy, the [WisdomTree Emerging Markets High Dividend Index](#).²

This Index has been over-weight Energy and Materials for the last few years, when it started identifying high-[dividend-yielding](#) stocks in these sectors at the 2012 [rebalance](#), particularly those with an emphasis on Russian exposure.

While the [market cap-weighted MSCI Emerging Markets Index](#) saw its weight in commodity sectors (Energy and Materials) cut in half—from 29% in September 30, 2009, to 14% on September 30, 2016—the WisdomTree Index actually added to its exposure from its lows in 2010 and 2011. Going in to this year's rebalance, it had more than 30% exposure to those two sectors.

The [Fundamental](#) Difference: Rebalancing

This is a big difference between a cap-weighted index—which rides momentum of stocks to higher and lower weights—and a dividend-weighted and high-yield screened index that is designed to identify opportunities based on changes in relative valuations.

Commodity-oriented sectors and countries have been strong market performers in 2016, and the gains are coming at levels greater than changes in the underlying fundamentals of companies, as measured by their [Dividend Streams](#)[®] in U.S. dollars.

WisdomTree just announced its latest Index constituents, and following the close of trading on October 20, the WisdomTree emerging market Indexes rebalanced into new holdings and weights. From the [annual screening date](#), the Index reduced weight in the commodity sectors by more than 5 percentage points while increasing exposure in Telecommunications and Utilities stocks by a similar total in aggregate.

Brazil is a reflection of this, as its gains were far and above any other country, and Brazil exposure was reduced by more than 5 percentage points. South Korea, Taiwan and Turkey were the biggest recipients of added weight.

The rebalancing process here essentially took some chips off the table from the gains in Brazil, and the Index is taking a bit more of a defensive posture after the rebalance. However, we should note that despite lowering weight, the Index still has more than 25% of its exposure to commodity sectors, and that is still significantly higher than the levels of the MSCI Emerging Markets Index (which had approximately 14% as of September 30, 2016).

Market Cap Indexes: Momentum Following and No Valuation Sensitivity

To reiterate: Traditional market cap-weighted indexes do not look for valuations in setting exposure; they look only at past price trends, and those price trends were negative in commodity sectors for the last seven years.³

While the gains in prices in 2016 were clearly more than the underlying changes in dividends—and hence our Index process lowers exposure to these companies—the overall valuations still result in an over-weighted position.

Of all the Indexes WisdomTree calculates, the lowest valuations and highest dividend yields tend to be found in the WisdomTree Emerging Markets High Dividend Index. Following this rebalance, we expect these portfolio characteristics to be reinforced, resulting in a lowering of valuation metrics such as the [price-to-earnings \(P/E\) ratios](#) and a raising of the Index dividend yields. This rebalance back to value comes at a good time and can help motivate a fresh look at the valuation opportunities in emerging markets.

[For updated WisdomTree Emerging Markets High Dividend Index statistics, please visit this Index details page.](#)

¹Source: WisdomTree, Bloomberg, 12/31/15–9/30/16. Currency return measured against the U.S. dollar.

²Source: WisdomTree, 12/31/15–9/30/16.

³Sources: WisdomTree, Bloomberg, 9/30/09–9/30/16. Refers to the Energy and Materials sectors' performance in the MSCI Emerging Markets Index.

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.

Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time.

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

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

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

Dividend yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Rebalance: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

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.

Fundamentals: Attributes related to a company’s actual operations and production as opposed to changes in share price.

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

Annual screening date: The screening date refers to the date upon which characteristics of eligible constituent firms are measured, whereas the rebalance refers to when the results from the screening date are implemented by way of Index weights and constituents.

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.