

EMERGING MARKETS: JUST EXCLUDE THE PAST

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Not many investors in 2020 give much consideration to the days of European and Asian communism.

But maybe they should.

The map below shows the reach of the USSR in the postwar years. Stalin negotiated well. One legacy the Cold War had on our industry was to leave us with a laundry list of state-owned enterprises (SOEs) that litter indexes such as MSCI Emerging Markets. Placing profits below political consideration, these bureaucratic bloats—mostly incorporated before the fall of the Berlin Wall and still comprising one-quarter of that Index—often drag performance and add risk. So it is with geopolitical hot potatoes.

Figure 1: “Application of Soviet Pressure, 1946–53”



Source: Library of Congress, Geography and Map Division.

When the world Bank’s Antoine van Agtmael coined the term “emerging markets” in 1981, it was probably assumed that by 2020 many of them would have, ahem, emerged. But most are still stuck in the category. Some, like South Korea and Poland, are in that purgatory where some indexers have graduated them to “developed” status but other indexers still declare them emerging. Others, like Israel, built up a tech sector and graduated. And some unfortunates went the other way: “submerging.” Venezuela, for example.

China is now the elephant in the room.

None of us had equities in that country 40 years ago. It was not even “a thing.”

Though Deng Xiaoping started to open the country shortly after Mao’s 1976 death, let’s get real: it could only be engaged by Western capital in the last quarter century or so, and in a heavily restricted manner at that. For that matter, everywhere else with a red star on the Cold War map above was basically uninvestable, too. Even after the USSR

finally crumbled in 1991, Eastern Europe remained a mess throughout the 1990s. With 25% of the MSCI Emerging Markets Index still populated by the Cold War’s leftover SOEs, many investors have significant capital tied up in companies that incorporated under Mao Tse-tung and Joseph Stalin.

Figure 2 shows the founding years of the 10 largest underweights in the [WisdomTree Emerging Markets ex-State-Owned Enterprises Index](#), which kicks these companies out.

Figure 2: WisdomTree Emerging Markets ex-State-Owned Enterprises Index’s Underweights’ Founding Year

		Domicile	WisdomTree Emerging Markets ex-State-Owned Enterprises Index	MSCI Emerging Markets	Amt. WisdomTree Underweight	Founding Year	
Largest Underweights	1	Taiwan Semiconductor	Taiwan	4.76%	5.79%	-1.03%	1987
	2	China Construction Bank	China	0.00%	0.97%	-0.97%	1954
	3	China Mobile	China	0.00%	0.62%	-0.62%	1997
	4	Vale SA	Brazil	0.00%	0.61%	-0.61%	1942
	5	Sberbank	Russia	0.00%	0.50%	-0.50%	1841
	6	ICBC	China	0.00%	0.50%	-0.50%	1984
	7	Gazprom	Russia	0.00%	0.41%	-0.41%	1989*
	8	Bank of China	China	0.00%	0.39%	-0.39%	1912
	9	Qatar National Bank	Qatar	0.00%	0.35%	-0.35%	1964
	10	Al Rajhi Bank	Saudi Arabia	0.00%	0.34%	-0.34%	1957
Average						1949	
Median						1957	

Source: WisdomTree, as of 10/5/20. *Transformed ownership structure to stock-based, with the state owning 100%. Weights subject to change.

You thought you were in emerging markets to capture 21st century growth, right?

Look at China Construction Bank, incorporated in 1954, 18 years before Richard Nixon visited the country. How about Sberbank? That one makes the Chinese banking monoliths look like fintech start-ups. Forget Stalin or Khrushchev; this Russian megabank came into being during Tsar Nicholas I’s reign.

Not that old companies are “bad,” per se. Procter & Gamble has been around since 1837, Pfizer since 1849. But those are U.S. companies, founded to turn a profit.

State-owned companies are often a different animal.

Figure 3 shows the over-weights in our Index. Of the six that are Chinese, Mao never met them. The median founding year for the list is 1994.

Figure 3: Founding Year, 10 Biggest Overweights in the WisdomTree Emerging Markets ex-State-Owned Enterprises Index

		Domicile	WisdomTree Emerging Markets ex-State-Owned Enterprises Index	MSCI Emerging Markets	Amt. WisdomTree Overweight	Founding Year	
Largest Overweights	1	Alibaba Group	China	10.87%	8.62%	2.25%	1999
	2	Tencent	China	8.14%	5.95%	2.19%	1998
	3	Netease	China	2.27%	0.35%	1.92%	1997
	4	Meituan Dianping	China	2.49%	1.75%	0.74%	2010*
	5	Ping An Insurance	China	0.80%	0.11%	0.69%	1988
	6	Reliance Industries	India	1.82%	1.36%	0.46%	1977
	7	Samsung Electronics	South Korea	4.17%	3.74%	0.43%	1969
	8	Public Bank Berhad	Malaysia	0.60%	0.17%	0.43%	1966
	9	JD.com	China	1.38%	1.05%	0.33%	1998
	10	Top Glove Corp	Malaysia	0.47%	0.15%	0.32%	1991
Average						1989	
Median						1994	

Source: WisdomTree, as of 10/5/20. Weights subject to change.

When we look at the emerging world, there are hundreds of listed SOEs that make their way into indexes such as MSCI Emerging Markets. If we could write their real mission statements, is it “to further the interests of entrenched politicians?” I think it is.

WisdomTree has three emerging market ETFs that are designed to stay away from SOEs.

Because really, why own them if you do not have to?

The ETFs are:

[XSOE: WisdomTree Emerging Markets ex-State-Owned Enterprises Fund](#) (Expense ratio = 0.32%)

[CXSE: WisdomTree China ex-State-Owned Enterprises Fund](#) (Expense ratio = 0.32%)

[IXSE: WisdomTree India ex-State-Owned Enterprises Fund](#) (Expense ratio = 0.58%)

To see their performance, please see their factsheets [here for XSOE](#), [here for CXSE](#) and [here for IXSE](#).

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DEFINITIONS

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

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.