

# WHERE IN THE WORLD HAVE SMALL CAPS PERFORMED BEST?

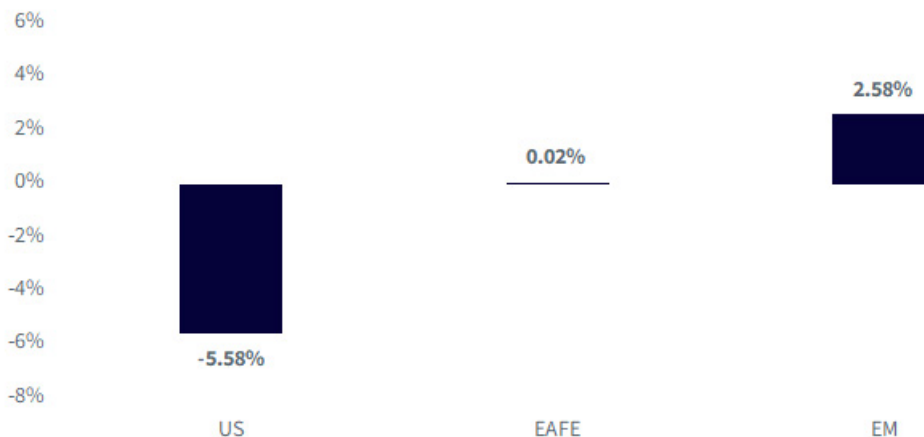
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Many are drawn to [large-cap](#) stocks, especially the technology giants that have dominated the market in recent years. These mega-cap companies have shown impressive growth and resilience amid the pandemic and the economic downturn, while [small caps](#) have languished both in absolute and relative terms.

But there are some locations where small caps have done quite well, and they may surprise you. Small caps in [emerging markets \(EM\)](#) have shown strong performance and diversification benefits, as well as higher dividend yields and lower valuations than U.S. small caps.

For all the talk of the “death” of the size factor, small caps have handily outperformed large caps in EM for the last decade.

## Trailing 10-Year Returns: Small vs. Large Caps



Sources: WisdomTree, S&P, Russell, MSCI, as of 1/31/24. U.S. large caps = S&P 500. U.S. small caps = Russell 2000. EAFE and EM large caps and small caps measured by respective MSCI regional broad benchmarks and small-cap benchmarks.

In addition to the strong relative performance case, some other points we’ll review that may be surprising:

- **Do small caps even pay dividends in emerging markets?** The universe is quite large and broad-based. More than 80% of EM small caps pay a dividend, and the weighted average [dividend yield](#) is more than 5% on the [WisdomTree EM SmallCap Dividend Index](#)<sup>1</sup>
- **Emerging market small caps had lower volatility** than U.S. small caps as measured by the [MSCI EM Small Cap Index](#) compared to the [Russell 2000](#) over the trailing 3-, 5- and 10-year [standard deviations](#)<sup>2</sup>

- While U.S. small-cap indexes are littered with many unprofitable companies, WisdomTree’s EM small-cap Index filters for profitable dividend payers that favor higher-quality companies as opposed to the more speculative titled U.S. small-cap indexes

Let’s drill into each of these points in more detail.

**Performance: Five Stars**

The [WisdomTree Emerging Markets SmallCap Dividend Fund \(DGS\)](#) received the prestigious five-star accolade from Morningstar, which is one way of quickly surmising it has strong risk-adjusted performance relative to its broad emerging market category.

Over the last 10- and 15-year periods, [DGS](#) ranked in the top decile of the emerging markets category, with more than 2% per year better performance than the category average return.

Over the last three years, while the average emerging market fund had a -5% per year return, [DGS](#) had a +5.8% per year return—a dramatic spread of outperformance.

**Morningstar Performance: WisdomTree Emerging Markets SmallCap Dividend Fund (DGS)**

Trailing Returns	Day End			Month End			Quarter End		
	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year	15-Year	
Total Return % (Price)	-3.10	10.75	-3.10	7.78	5.81	5.49	5.13	9.16	
Total Return % (NAV)	-2.30	11.79	-2.30	9.49	6.06	5.86	5.09	9.22	
Category (NAV)	-3.51	8.43	-3.51	0.35	-5.43	2.30	2.92	6.98	
Index (NAV)	-4.21	7.60	-4.21	-1.48	-6.15	1.80	3.60	7.50	
Quartile Rank	III	III	III	III	III	III	III	III	
Percentile Rank	26	19	26	13	3	13	7	6	
Tax Adj. Returns %*	-2.30	11.37	-2.30	7.37	4.20	4.12	3.62	7.76	
Percentile Rank (tax)	24	16	24	15	3	16	13	11	
Tax Cost Ratio	—	—	—	1.94	1.76	1.64	1.40	1.34	
# of Invest. in Cat.	840	837	840	814	716	660	402	216	

Source: Morningstar, as of 1/31/24. Category: Diversified Emerging Mkts. Index: Morningstar EM TME NR USD. You cannot invest directly in an index. Past performance is not indicative of future returns.

Category: Diversified Emerging Markets. Overall rank based on 716 funds in category, 3-year percentile rank based on 716 funds in category, 5-year percentile rank based on 660 funds in category, 10-year percentile rank based on 402 funds in category.

The Morningstar Rating for Funds, or “star rating,” is calculated for managed products with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product’s monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance.

The top 10% of products in each product category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars, and the bottom 10% receive one star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three- and five-year Morningstar Rating metrics. The weights are: 100% three-year rating for 36–59 months of total returns and 60% five-year rating/40% three-year rating for 60–119 months of total returns.

What are some of the drivers of this? Many of the major benchmarks and active funds had heavy exposure to the Chinese technology companies that came under significant pressure. Focusing on dividend payers avoided those stocks.

### Dividends a Key Sign of Quality

The [WisdomTree Emerging Markets SmallCap Dividend Fund \(DGS\)](#) seeks to track the price and yield performance, before fees and expenses, of the WisdomTree Emerging Markets SmallCap Dividend Index.

Since the inception of the WisdomTree Emerging Markets SmallCap Dividend Index, it outperformed the broad emerging markets by 347 basis points annualized.

Almost half the outperformance came from the top dividend-yielding stocks, which our Index had more than 40% exposure to on average, whereas the cap-weighted Index had less than 16% exposure.

The stocks in our Index in this top-yielding quintile returned 7.36% per year, while the MSCI EM Index returned just 1.60% as a whole—showcasing the dividend factor as a key driver of relative returns.

Even more interesting were the zero dividend payers in EM, which averaged almost 10% of the weight of the broad [EM Index](#) and had -6.9% per year returns.

### Index [Dividend Yield Attribution](#): WisdomTree Emerging Markets SmallCap Dividend Fund vs. MSCI Emerging Markets Index

Dividend Yield Attribution									
Category					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)	1.38%	0.14%	0.06%	1.59%	40.84%	15.80%	25.04%	7.36%	6.63%
2nd Quintile	0.22%	0.56%	0.06%	0.84%	25.72%	18.82%	6.90%	5.86%	3.21%
3rd Quintile	-0.19%	0.53%	-0.11%	0.23%	16.52%	19.21%	-2.70%	5.38%	2.80%
4th Quintile	0.00%	0.18%	-0.04%	0.15%	9.81%	17.66%	-7.85%	3.71%	2.01%
5th Quintile (Lowest Div. Yield)	0.33%	-0.28%	0.11%	0.15%	3.88%	19.63%	-15.75%	-2.15%	-0.01%
Zero Div. Yield	0.60%	0.88%	-0.88%	0.60%	0.30%	8.06%	-7.75%	3.29%	-6.93%
<b>Total</b>	<b>2.28%</b>	<b>2.05%</b>	<b>-0.86%</b>	<b>3.47%</b>	-	-	-	<b>5.07%</b>	<b>1.60%</b>

Sources: WisdomTree, FactSet, MSCI (7/31/07–1/31/24). You cannot invest directly in an index. Past performance is not indicative of future returns.

### Russell 2000 vs. EM Small Caps

People don't think of U.S. small caps and dividends going together. Only half of companies pay a dividend.<sup>3</sup>

The culture of paying dividends is much more prevalent in emerging markets.

DGS includes almost 1,000 companies with an average market cap similar to the levels in the Russell and a slightly higher median market cap.

The dividend yield averages more than 5% for DGS and just 1.4% for the Russell 2000.

Twenty-six percent of the Russell 2000 is not profitable, while less than 1% of DGS is not profitable.

### Characteristics and Fundamentals Comparison

SIZE CHARACTERISTICS as of 1/31/2024 <i>select a characteristic to view historical data</i>			
	DGS	RU2000	MXEF
# of Stocks	973	1963	1440
Total Market Cap in Billions	\$1492.50B	3006.93B	19219.00B
Average Market Cap in Billions	\$1.54B	1.54B	13.35B
Median Market Cap in Billions	\$1.24B	0.95B	5.62B
Weighted Average Market Cap in Billions	\$2.03B	3.24B	100.94B

DIVIDEND & BUYBACKS as of 1/31/2024 <i>select a characteristic to view historical data</i>			
	DGS	RU2000	MXEF
Dividend Yield	5.13%	1.37%	2.94%

VALUATION RATIOS as of 1/31/2024 <i>select a characteristic to view historical data</i>			
	DGS	RU2000	MXEF
Price/Earnings (P/E)	10.18	36.96	13.00
Price/Earnings (P/E) Excl. Negative	10.07	14.62	11.90
Percent Negative Earn	0.93%	26.02%	4.28%

Sources: WisdomTree, FactSet. RU2000 = Russell 2000 Index. MXEF = MSCI Emerging Markets Index. Screenshot from WisdomTree Fund Comparison tool. You cannot invest directly in an index.

The performance data quoted represents past performance and is no guarantee of future results. 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.

For the most recent month-end standardized performance, please click [here](#).

Emerging market small caps are an attractive asset class for investors seeking diversification, growth potential and income. However, not all emerging market small caps are created equal, and some may expose investors to higher risks and lower returns.

### EM Small Caps Lower Volatility Than U.S. Small Caps

You might think EM small caps involve a lot more risk than U.S. small caps, but the data on historical volatility shows [DGS](#) had lower volatility over all longer periods than U.S. small caps.

Over 10 years, [DGS](#) had similar volatility as broad EM large caps.

### Volatility Comparison

VOLATILITY (STANDARD DEVIATION) as of 1/31/2024			Average Annual Volatility					
Ticker	Fund	Inception Date	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 10/31/2007 - 1/31/2024
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund (NAV)	10/30/2007	14.55%	16.09%	19.02%	16.99%	20.60%	20.60%
RU2000	Russell 2000 Index	1/1/1970	22.00%	21.06%	23.67%	20.18%	-	21.16%
MXEF	MSCI EM Index	1/1/1970	16.40%	17.20%	18.76%	17.09%	-	21.19%

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

Sources: WisdomTree, FactSet. RU2000 = Russell 2000 Index. MXEF = MSCI Emerging Markets Index. Screenshot from WisdomTree Fund Comparison tool. You cannot invest directly in an index. Past performance is not indicative of future returns.

The performance data quoted represents past performance and is no guarantee of future results. 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.

For the most recent month-end standardized performance, please click [here](#).

And over every standardized period, it had a [down capture](#) below 90%, cushioning some of the drawdown in down months for the MSCI EM Index.

### Down Capture Comparison

DOWN CAPTURE (MSCI EM INDEX) as of 1/31/2024								
Ticker	Fund	Inception Date	1-Year	3-Year	5-Year	10-Year	Since Inception	Common Period 10/31/2007 - 1/31/2024
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund (NAV)	10/30/2007	62.19%	61.78%	81.45%	86.25%	87.43%	87.43%

Down Capture : Measure of the performance of an investment relative to a benchmark index during a down market

Sources: WisdomTree, FactSet. RU2000 = Russell 2000 Index. MXEF = MSCI Emerging Markets Index. Screenshot from WisdomTree Fund Comparison tool. You cannot invest directly in an index. Past performance is not indicative of future returns.

The biggest sector difference between [DGS](#) and the Russell 2000 is in Health Care, where there are a vast number of unprofitable biotech companies in the U.S.

Relative to the MSCI EM Index, [DGS](#) has less exposure to Communication Services, Financials and Information Technology—sectors where major Chinese tech companies (Comm. Svcs. and Info. Tech.) and Chinese SOE banks (Financials) are populated.

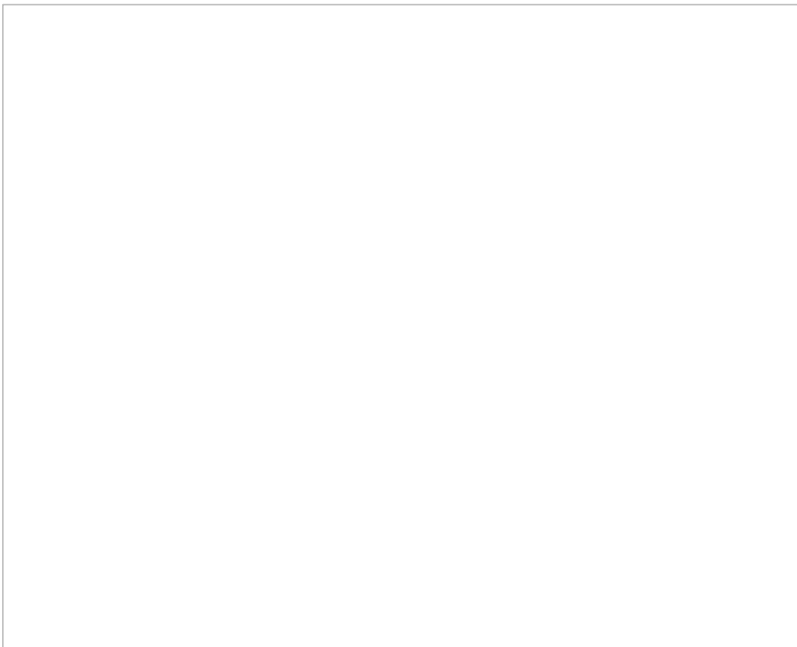


From a country perspective, we mentioned that the performance of [DGS](#) has benefited from both an absolute return and risk perspective by being underexposed to China—8% for [DGS](#) versus 25% for MSCI EM.

In exchange for less China exposure, there is an increased allocation to Taiwan, South Africa, Thailand and Malaysia.

For investors looking to minimize the China risk, [DGS](#) offers a compelling solution without having to make a single country or regional bet.

#### Country Comparison



#### Conclusion

Emerging market small caps are an attractive asset class for investors seeking diversification, growth potential and income. However, investors need to be selective and avoid the pitfalls of traditional market cap weighting, which can expose them to higher risks and lower returns.

[DGS](#), the WisdomTree Emerging Markets SmallCap Dividend Fund, offers a dividend-weighted approach that aims to enhance the risk-return profile of emerging market small caps and deliver higher income and lower volatility than the broader benchmarks.

[DGS](#) outperformed the broader benchmarks thanks to its dividend-weighted methodology, sector and country allocation and exposure to value and quality factors.

<sup>1</sup> Sources: WisdomTree, FactSet, MSCI, as of 1/31/24. Percent of EM small-cap dividend payers based on sum of index weight for dividend payers in the MSCI Emerging Markets Small Cap Index.

<sup>2</sup> Sources: WisdomTree, MSCI, Russell, as of 1/31/24.

<sup>3</sup> Sources: WisdomTree, FactSet, Russell, as of 1/31/24. U.S. small caps measured by the Russell 2000 Index.

#### Important Risks Related to this Article

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

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## DEFINITIONS

**Large-cap Value**: Refers to companies with a market capitalization value of more than \$10 billion, 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

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

**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.

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

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

**MSCI EM Small Cap Index**: Includes small cap representation across 21 Emerging Markets countries. The small cap segment tends to capture more local economic and sector characteristics relative to larger Emerging Markets capitalization segments.

**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.

**Standard deviation**: measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

**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.

**Down Capture**: Measure of the performance of an investment relative to a benchmark index during a down market.