

# GROWTH, QUALITY AND OUTPERFORMANCE IN EMERGING MARKETS

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In 2013 WisdomTree brought out what we believe to be a revolutionary way to focus Indexes on potential future dividend growth in equity markets around the world. One of the more interesting applications of the methodology thus far has been in emerging markets. **The Meaning of “Growth” and “Quality”** Since these words can mean so many different things when discussing equities, we want to start by clarifying what we mean:

- **Growth:** Specifically long-term earnings growth expectations, focused on operating earnings over the next full business cycle, typically three to five years in duration.
- **Quality:** A combined focus, weighted equally, on three-year average [return on equity \(ROE\)](#) and three-year average [return on assets \(ROA\)](#). Looking at both measures generates a sensitivity to [leverage](#), penalizing those firms that may have high ROE but low ROA.

**The Contrast of Dividend Growth vs. Dividend Yield in Emerging Markets** The [WisdomTree Emerging Markets Equity Income Index](#) (EM Dividend Yield) provides a stark contrast to the [WisdomTree Emerging Markets Dividend Growth Index](#) (EM Dividend Growth). The focus here isn’t on any measures of growth or quality but rather on potentially finding some of the most attractive [valuation](#) opportunities in emerging markets.

**Dividend Growth vs. Dividend Yield: Growth, Quality & Valuation**

	EM Dividend Yield	EM Equities <sup>1</sup>	EM Dividend Growth
Price-to-Earnings (P/E) Ratio	7.9x	10.8x	13.3x
Median Long-Term Earnings Growth	8.2%	12.1%	12.5%
Dividend Yield	5.7%	2.8%	3.9%
Return on Equity (ROE)	20.8%	18.1%	26.5%
Return on Assets (ROA)	9.2%	7.3%	11.9%
Leverage	2.3x	2.5x	2.2x

Sources: WisdomTree, Bloomberg, with data as of 4/25/14.  
<sup>1</sup>EM Equities: Refers to the MSCI Emerging Markets Index universe.  
Past performance is not indicative of future results.

*For definition of terms in the chart, please visit our [Glossary](#).*

- **P/E Ratio** and Earnings Growth: EM [Dividend Yield's](#) P/E ratio was more than 40% below that of EM Dividend Growth, but EM Dividend Growth’s median long-term earnings growth expectations were approximately 50% above those of EM Dividend Yield.
- **Quality:** EM Dividend Growth’s ROE and ROA figures were also significantly

higher than those of the other two Indexes shown, leading to a higher-quality bias and ultimately lower leverage. **Key Themes of 2014 Playing Out in Emerging Markets** What we've seen year-to-date through April 30, 2014, is that EM Dividend Growth has outperformed EM Dividend Yield by approximately 5.7% and EM Equities by nearly 3.9%.<sup>1</sup> Why has this occurred? **Theme 1: Russia & China** Thus far in 2014 we've seen strong opinions among investors regarding state-owned enterprises—particularly energy firms in Russia and financial companies within China. These are some of the deepest pockets of value among emerging market equities, and EM Dividend Yield focuses a lot of weight here since it is a value-seeking strategy. On the other hand, EM Dividend Growth is more selective, and the largest state-owned Chinese banks did not qualify for selection, nor did the largest Russian energy firms. **Theme 2: Markets on the Comeback Trail** In 2013, equity markets within Indonesia and Thailand had a tough time. However, this was mostly driven by weakness in their respective currencies, with the Indonesian rupiah down 19.54% and the Thai baht down 6.47%.<sup>2</sup> When currencies behave in this manner, we believe it speaks more to sentiment with regard to macroeconomic issues than to specific [fundamentals](#) of underlying equities. Indonesian equities are generally characterized by high ROE and ROA compared to broad EM Equities, whereas Thailand's equities are characterized by high growth prospects. Both markets have been coming back strongly in 2014, with Indonesia leading the 21 markets currently within EM Equities and Thailand not far behind in fifth position.<sup>3</sup> **Theme 3: Consumer Staples** The largest single sector over-weight of EM Dividend Growth relative to EM Dividend Yield is Consumer Staples—not surprising, as the sector has a P/E ratio above 20.0x.<sup>4</sup> Strategies hunting for value in EM Equities would do well to avoid this sector, but as of April 30, 2014, EM Dividend Growth's stocks in this sector had an ROE that was approximately twice that of EM Equities. A similar story held true for ROA.<sup>5</sup> This was a greater than 16.0% over-weight for EM Dividend Growth versus EM Dividend Yield, and a nearly 10% over-weight for EM Dividend Growth versus EM Equities. **Conclusion: Not All Dividend Payers Are Created Equal** While some of the largest payers of cash dividends in emerging markets are Chinese financials and Russian energy firms, these aren't the only payers of cash dividends in this region. EM Dividend Growth provides a very interesting contrast in exposure to EM Dividend Yield, and we believe it could be an interesting avenue through which to consider risk mitigation through a focus on higher-quality, higher-potential-growth companies. <sup>1</sup>Source: Bloomberg, with data covering 12/31/13 to 4/30/14 <sup>2</sup>Source: Bloomberg, with data as of period 12/31/12 to 12/31/13 <sup>3</sup>Source: MSCI, with data covering period 12/31/13 to 4/30/14 <sup>4</sup>Refers to the P/E Ratio of the MSCI Consumer Staples Index as of 4/30/14. Source: Bloomberg <sup>5</sup>Source: Bloomberg

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## DEFINITIONS

**Return on Equity (ROE)**: Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

**Return on assets (ROA)**: Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Leverage**: Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

**WisdomTree Emerging Markets Dividend Growth Index**: A fundamentally weighted index designed to track the performance of dividend-paying emerging market companies that WisdomTree believes have the potential to increase their dividends due to certain factors, which include estimated earnings growth, return on equity and return on assets. Weighting is by trailing 12-month cash dividends.

**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.

**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.

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

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