SEEKING SMARTER EXPOSURE TO INDIA’S STOCK MARKET

Gaurav Sinha – Associate Director, Asset Allocation and Modern Alpha
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There is little doubt in my mind that India is currently my favorite pick in emerging markets (EMs) for investors aiming for strategic growth. Driven by global “risk-on” and a host of local factors that I have covered in depth, the Indian equity markets have bee n doing very well for the last few months.

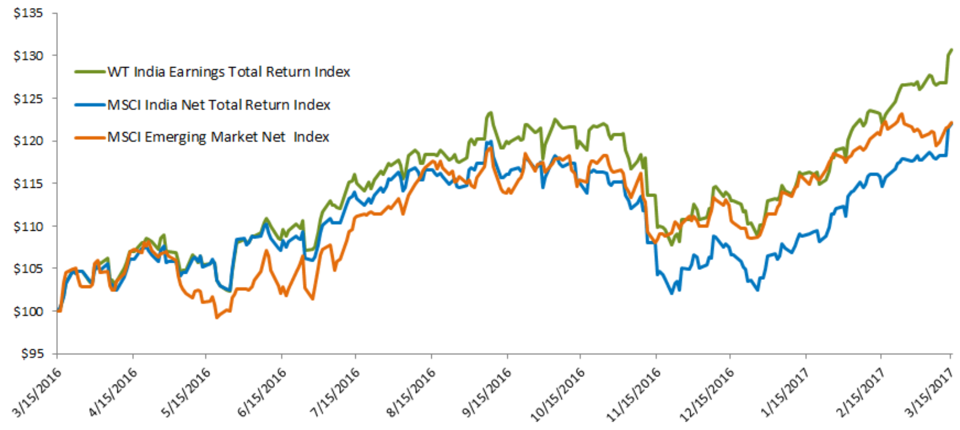
A more interesting question is this: What kind of exposure makes sense to allocate in the Indian equity landscape? The answer might be surprisingly simple for this large and fairly complicated economy: Stick to investing in fundamentals.

Let’s take a dive into two common approaches to accessing Indian stock markets: WisdomTree’s earnings-weighted “smart-beta” approach versus the MSCI market cap approach.

WisdomTree Earnings Methodology Racing Ahead of Cap Weighting

The chart below compares the performance of the WisdomTree India Earnings Index (WTIND) with that of the MSCI India Index (MXIN) over the last year—a period in which Indian markets performed well alongside the rest of EM. With total returns of 30.69%, the WisdomTree India Index outperformed the MSCI India Index by well over 800 basis points (bps). That is, simply put, massive!

Indian Equity vs. Emerging Markets Last 1 Year, 03/15/2016-03/15/2017



	Total Return	Underperformance Compared To WTIND
WT Earnings Index (WTIND)	30.69%	N/A
MSCI India Net Index	21.98%	-8.71%
MSCI Emerging Market Net Index	22.13%	-8.56%

Source: Bloomberg, as of 3/15/17. Past performance is not indicative of future results. You cannot invest directly in an index. Double-digit returns were achieved primarily during favorable market conditions. Investors should not expect that such favorable returns can be consistently achieved. A fund's performance, especially for very short periods, should not be the sole factor in making your investment decision.

Reasons for Outperformance

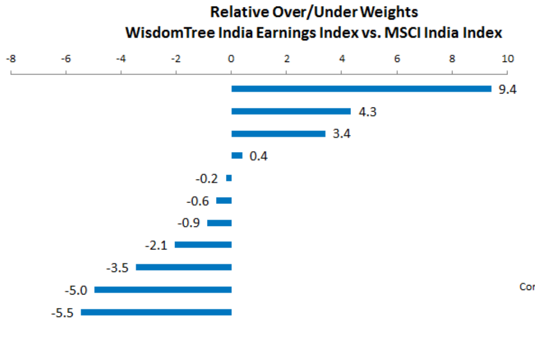
The next question arises—what is driving this outperformance by WisdomTree's India Index? The answer has two parts:

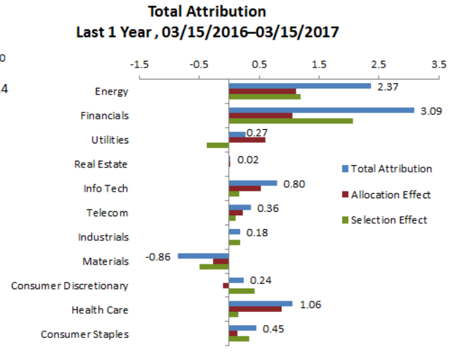
A. Methodology—Sector Allocation & Stock Selection

The first clue to this outperformance lies in WisdomTree's sector over/under-weight and then its selection of companies within those sectors.

The left chart below shows WTIND's relative over-weight in traditional sectors like Energy and Financials and its under-weight in the Consumer and Health Care sectors. The right chart shows how these sector bets helped or hurt the WisdomTree Index. The right chart is an attribution breaking down total outperformance (blue bar) into sector bets (red bars) and stock bets (green bar).

It is evident: Most of the outperformance comes from the Energy and Financial sectors—the top two relative over-weights in WTIND. What is even more interesting is if we break this total attribution (blue) into sector bet (red) versus stock bet (green), it becomes pretty obvious—not only did sector bets (i.e., over-weight to Energy/Financials and under-weight to Health Care) help, but stock bets within those sectors were the key drivers of overall outperformance by WTIND Index.





Source: Bloomberg, as of 3/15/17. You cannot invest directly in an index.

B. Investing 101—Invest in Profitable Companies and Be a Frugal Buyer

At a higher level, these sector and stock selections are driven by WTIND's methodology, which selects only profitable companies and then weights them by their profits, or net income, to be precise.

Thus, an immediate outcome of this index methodology is that it more fundamentally emphasizes profits. In comparison, the MSCI India Index, which follows a market cap-weighted indexing process, selects and weights companies simply by their market cap size. Because WTIND weights by profits, the more profitable a company is, the greater its weight in the Index.

Finally, a disciplined approach implemented through an annual rebalance ensures a consistent applicability of this screen. Thus, if a company no longer remains profitable or its profits dwindle, no matter its size, it will be kicked out or reduced in weight.

The table below compares average price-to-earnings (P/E) ratio earnings per share (EPS) of the top three relative sectors' over- and under-weights in WTIND, as of March 15, 2017. It is very clear that WisdomTree's methodology and its disciplined implementation ensured over-weights in sectors that had lower valuations.

Comparing WisdomTree India Earning Index Fundamentals to MSCI India Index		PE Ratio
Sector Overweights	Energy	10.9
	Financials	13.1
	Utilities	14.2
Sector Underweights	Consumer Discretionary	21.1
	Health Care	32.0
	Consumer Staples	45.1

Source: Bloomberg, as of 3/15/17.

Simply put: WisdomTree's methodology focuses on buying less expensive and more profitable portions of the market.

Conclusion

It is pretty clear that Indian markets have been doing well for some time, and EM investors could have potential upside by investing in India.

However, I believe that, in order to maximize profits, investors need to go back to basics and stick to the fundamentals of investing, which is what smart beta methodologies in general, and the WisdomTree India earnings approach in this instance, offer.

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.

Investments focused in India increase the impact of events and developments associated with the region, which can adversely affect performance.

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

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You cannot invest directly in an index.

DEFINITIONS

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

Smart Beta : A term for rules-based investment strategies that don't use conventional market-cap weightings.

Market Capitalization : 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.

MSCI India Index : A market capitalization-weighted index designed to measure the performance of the Indian equity market.

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.

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.

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

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.