

PRICING STATE OWNERSHIP RISK: PETROBRAS

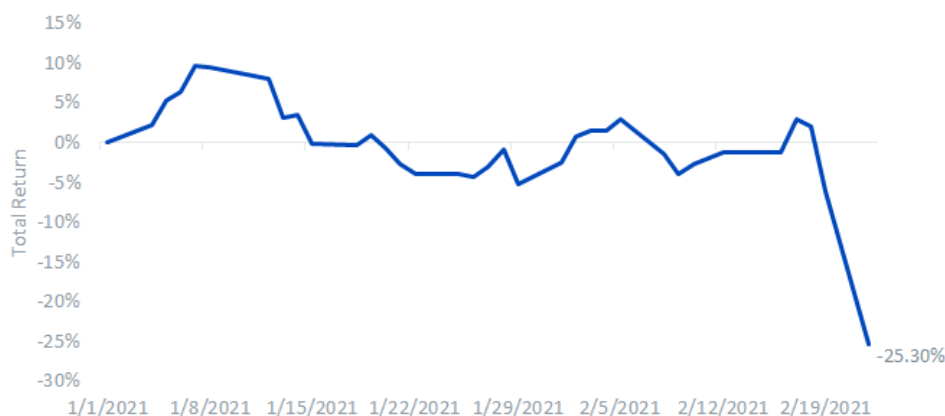
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The embedded risks for investors from [conflicts of interest in state-owned enterprises](#) (SOEs) is something we've highlighted in recent months. A quantifiable example of this conflict is unfolding right before our eyes and lends some insight into how the market can rapidly re-price this risk.

On Friday, February 19, Brazilian President Jair Bolsonaro removed the head of Petróleo Brasileiro SA (Petrobras), a state-owned Energy company. Bolsonaro argued that CEO Roberto Castello Branco was “not showing commitment to Brazil,” as the country’s economy struggles to keep up with rising gasoline and diesel prices.

The market’s immediate reaction to the replacement of Castello Branco—a University of Chicago-educated economist—with former military general Joaquim Silva e Luna was not favorable. Shares of Petrobras fell more than 25% from Friday’s opening prices. The rest of the Brazilian equity market, which is tracked by the Ibovespa Index, also suffered losses, with other state-owned companies joining Petrobras on the way down.

Cumulative Performance Petrobras (Year-to-Date)



Sources: WisdomTree, FactSet. Data as of 02/22/21.

Petrobras is no stranger to political scandal. In 2014, the company was at the center of Operation Car Wash in which the Federal Police of Brazil investigated cases of money laundering at the company. This investigation shook the country and led to the impeachment and removal of then-President Dilma Rousseff.

[Ex-State-Owned Enterprises Index](#)

In 2014, WisdomTree launched the WisdomTree Emerging Market ex-State-Owned Enterprises Index (EMXSOE) which removes companies with significant government participation from its investable universe. Removing these companies has improved the Index’s growth, profitability and [ESG](#) metrics compared to the broad [MSCI EM Index](#).

Importantly, it aims to side-step the risk of owning state-owned companies that can experience a situation like the one we are seeing transpire with Petrobras.

Top 10 MSCI Emerging Markets Weights Screened Out by SOE			
Name	Weight	Sector	Country
China Construction Bank	0.93%	Financials	China
Vale S.A.	0.79%	Materials	Brazil
Petroleo Brasileiro	0.59%	Energy	Brazil
ICBC	0.53%	Financials	China
Sberbank Russia PJSC	0.50%	Financials	Russia
China Mobile	0.44%	Comm. Svcs.	China
Gazprom PJSC	0.43%	Energy	Russia
China Merchants Bank	0.42%	Financials	China
Bank of China Limited	0.36%	Financials	China
Kweichow Moutai Co.	0.29%	Cons. Staples	China

Sources: WisdomTree, FactSet. Top 10 MSCI emerging markets weights screened out by SOE based on 12/31/20 MSCI Emerging Markets Index weights of companies not eligible for the WisdomTree Emerging Markets ex-State-Owned Index based on state ownership criteria.

Excluding SOEs has also been a significant driver of excess performance since EMXSOE's inception, resulting in 377 [basis points \(bps\)](#) of annualized outperformance versus the MSCI EM Index. During this period, SOEs in the MSCI EM Index have underperformed non-SOEs by 750 bps and have been a negative contributor to performance.

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Category ^	Attribution Component			Average Category Weight			Category Performance		
	Allocation	Stock Selection	Interaction	Total Attribution	Index Weight	Benchmark Weight	+/- Wgt	WT Index Return	Benchmark Return
SOE	1.25%	0.00%	0.00%	1.25%	0.00%	24.68%	-24.68%	0.00%	-0.47%
XSOE	0.38%	1.62%	0.53%	2.53%	100.00%	75.32%	24.68%	9.35%	7.19%
Total	1.62%	1.62%	0.53%	3.77%	-	-	-	9.35%	5.58%

Sources: WisdomTree, FactSet, 12/31/14-01/29/21.

This is why we believe removing SOEs should be a common approach for an investor's core EM exposure.

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](#).

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DEFINITIONS

ESG: An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible.

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.

Basis point: 1/100th of 1 percent.