

# DIAMOND IN THE ROUGH: THE EMERGING MARKETS CONSUMER STORY

02/10/2015

Over the past few years, some investors have become frustrated with the underperformance of the emerging markets (EM)—especially when compared to the U.S. markets.<sup>1</sup> But there is a subset of the emerging markets, the [EM consumers](#), that may offer a lot to get excited about. One of the major themes that we believe will drive much of the global economy over the coming years is the rise in potential growth from EM consumers. Given the youthful demographics of emerging markets and the potential for their low [per capital incomes](#) to catch up with those of the developed world, the likely ramifications of this trend could be large. More importantly, we note that the rise in the middle class in EM is more than a “sector” idea. Companies from a wide cross-section of the economy and markets—such as insurance companies, banks and health-care companies—could have as much potential to benefit from a growing emerging market middle class as a typical car company (Consumer Discretionary) or food company (Consumer Staples). The [WisdomTree Emerging Markets Consumer Growth Fund \(EMCG\)](#) seeks to broadly reflect the growth in [purchasing power](#) of consumers in these local economies by including a broad cross-section of sectors, outside of the typical Consumer Discretionary and Consumer Staples exposures. As of December 31, 2014, EMCG beat 96% of the 793 emerging markets [open-ended \(OE\) mutual funds](#) and exchange-traded funds (ETFs) in 2014 based on total return.<sup>2</sup> This, in our opinion, illustrates the strength of the EM consumer in the face of heightened uncertainty. In contrast, the [Dow Jones Emerging Markets Consumer Titans 30 Index \(DJECON\)](#) ranked 297 of 793 managers and beat a paltry 63% of its peer group. Table 1 details the key rationale for EMCG’s 5.80% outperformance compared to the DJECON and its 6.26% outperformance against the [MSCI Emerging Markets \(MSCI EM\) Index](#) in 2014. **EMCG Beats 96% of Its Peers in 2014**

| MorningStar Category: U.S. OE and ETF Diversified Emerging Markets | EMCG   |                 |                        | Peers            |                 |                        |
|--|--------|-----------------|------------------------|------------------|-----------------|------------------------|
|  | 1-Year | Peer group rank | % of Peer Group Beaten | Since Inception* | Peer group rank | % of Peer Group Beaten |
| WisdomTree Emerging Markets Consumer Growth Fund                   | 4.07%  | 29              | 96%                    | 3.21%            | 82              | 89%                    |
| DJ EM Consumer Titans 30 Index                                     | -1.73% | 297             | 63%                    | -1.88%           | 486             | 32%                    |
| MSCI Emerging Markets Index (USD)                                  | -2.19% | 330             | 59%                    | -0.32%           | 352             | 51%                    |
| Number of Managers   | 793    |                 |                        | 718              |                 |                        |

\*Since EMCG Fund inception; period covers 10/1/13–12/31/14.

Periods shown correspond to rankings of EMCG and DJECON compared with the Morningstar Diversified EM peer group. Past performance is not indicative of future results. You cannot invest directly in an index. Source: Morningstar Direct, as of 12/31/2014.

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Returns

as

of

Average Annual  
12/31/2014

| Fund   | Total Return NAV (%) |       |        |                      | Market Price (%) |       |        |                      |
|--|----------------------|-------|--------|----------------------|------------------|-------|--------|----------------------|
|  | 1-Yr.                | 3-Yr. | 5-Yr.  | Since Fund Inception | 1-Yr.            | 3-Yr. | 5-Yr.  | Since Fund Inception |
| WisdomTree Emerging Markets Consumer Growth Fund | 4.07%                | N/A   | N/A    | 2.31%                | 2.22%            | N/A   | N/A    | 1.55%                |
| DJ EM Consumer Titans 30 Index                   | -1.73%               | 7.06% | 10.46% | -2.60%               | -1.73%           | 7.06% | 10.46% | -2.60%               |
| MSCI Emerging Markets Index                      | -2.19%               | 4.04% | 1.78%  | -1.29%               | -2.19%           | 4.04% | 1.78%  | -1.29%               |

source: WisdomTree, data since fund inception; period is 9/27/13–12/31/14

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. 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. Performance data for the most recent month-end is available at [www.wisdomtree.com](http://www.wisdomtree.com).

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• Performance

**Drivers—Explaining EMCG’s Sector Exposure Compared with MSCI EM:** The MSCI EM Index has more than 20% of its exposure in the Energy and Materials sectors, the two worst-performing sectors in the MSCI EM Index in 2014.<sup>3</sup> EMCG, on the other hand, excludes the aforementioned sectors and instead has approximately 65% of its weight in domestic demand sectors<sup>4</sup>. We believe that these sectors are consistent with the theme of growth in the emerging markets’ middle class and are therefore supportive of domestic demand.

• **EMCG for Income Potential:** Even though EMCG weights according to net income, which results in a lower [P/E ratio](#) (EMCG P/E 11.9x; DJECON P/E 25.1x), EMCG’s 2.6% [dividend yield](#) offers an important income buffer for those seeking exposure to the emerging markets. EMCG’s dividend yield is a full 0.7% higher than that of DJECON and is comparable with the MSCI EM Index’s dividend yield.

• **An Emphasis on Quality:** EMCG’s valuation story is incomplete without a discussion of quality. EMCG’s underlying index methodology rewards companies that show promise in terms of [return on equity \(ROE\)](#) and [return on assets \(ROA\)](#). This combination of ROE and ROA not only rewards companies that are highly efficient in utilizing their assets and equities to generate net income, it also penalizes companies that employ immense leverage in doing so. As a result, EMCG has the highest ROE and ROA, at 18.1% and 8.1% respectively, compared with DJECON (ROE 14.2%, ROA 5.8%) or MSCI EM Index (ROE: 11.6%, ROA: 2.4%).<sup>5</sup> In conclusion, EMCG’s construction has resulted in a vehicle that has had more attractive valuations and a higher quality bias than its peers. Its broader sector focus, outside of the two regular consumer sectors, has helped provide diversification and offer a potentially more robust way to access the EM consumer.

<sup>1</sup>Source: Bloomberg, references the fact that the MSCI Emerging Markets Index has lagged the S&P 500 Index over the most recent three-year period from 12/31/11–12/31/14. <sup>2</sup>Source: Morningstar; refers to 12/31/13–12/31/14.

<sup>3</sup>Sources: Bloomberg, WisdomTree, as of 12/31/14. <sup>4</sup>Domestic demand sectors are Consumer Staples, Consumer Discretionary, Telecommunication Services, Utilities and Health Care.

<sup>5</sup>Source: Bloomberg, as of 12/31/14.

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## DEFINITIONS

**Emerging market consumer**: Broad-based EM consumer represented by Consumer Discretionary, Financials, Consumer Staples, Telecommunication Services, Information Technology, Industrials, Utilities and Health Care.

**Per capita income**: The sum of the value of all goods and services produced in a particular country divided by the total population of that country. Higher values imply a higher standard of living for that country's citizens.

**Purchasing power parity**: Academic concept stating that exchange rates should adjust so that equivalent goods and services cost the same across countries, after accounting for exchange-rate differences.

**Open-End Mutual Funds**: Type of mutual fund that does not have restrictions on the amount of shares the fund will issue, so if demand is high enough the fund will continue to issue shares. These funds buy back shares when investors wish to sell.

**Dow Jones Emerging Markets Consumer Titans 30 Index**: Index designed to measure the performance of the 30 leading emerging market companies in the consumer goods and consumer services industries. Weighting is by float-adjusted market capitalization, subject to diversification requirements.

**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.

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

**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.