EMERGING MARKETS: ALTERNATIVE INDEX STRATEGIES CAN OUTPERFORM

Wisdomtree EU
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Investors looking to gain exposure to emerging markets often feel compelled to use an active manager. This is based on the belief that these markets are less efficient and there is greater potential for value added over time. At WisdomTree we have been managing equity assets that track our emerging market indices for over ten years. Our family of dividend-based indices can demonstrate a live track record of how structured, disciplined and rules-based strategies tied to smart index construction have added value over traditional market cap-weighted indices.

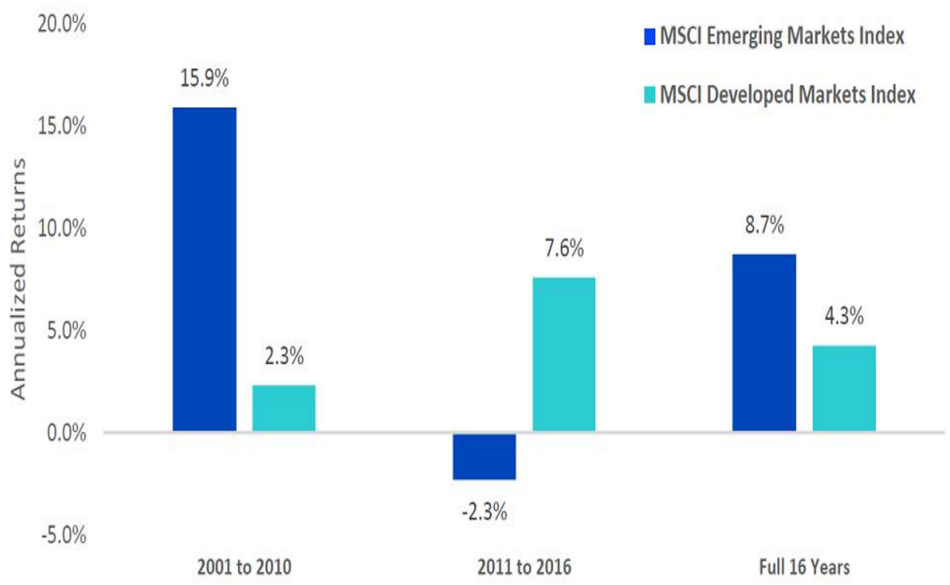
The attractive live performance of WisdomTree's Emerging Market Dividend Index family

From the inception of the WisdomTree Emerging Markets High Dividend Index in May 2007, the MSCI Emerging Markets Index (MSCI EM Index) delivered a 2.28% average annual return. Notably, the WisdomTree Emerging Markets High Dividend Index, which has a value tilt, outperformed the MSCI EM Index by 151 basis points per year, despite MSCI value indices lagging growth.

From the inception two months later of the WisdomTree Emerging Markets SmallCap Dividend Index, the MSCI Emerging Markets Small Cap Index (MSCI EM Small Cap) delivered a 1.32% average annual return. The WisdomTree Emerging Markets SmallCap Dividend Index added 267 basis points per year relative to the MSCI EM Small Cap Index and 100 basis points per year relative to the MSCI Small Cap Index.

While the WisdomTree Indices outperformed their market capitalisation-weighted benchmarks, it's even more notable that this was achieved with a lower risk level across the board. This was true whether risk was measured as absolute standard deviation or relative beta to a benchmark.

Chart 1: The inherent problem of emerging markets

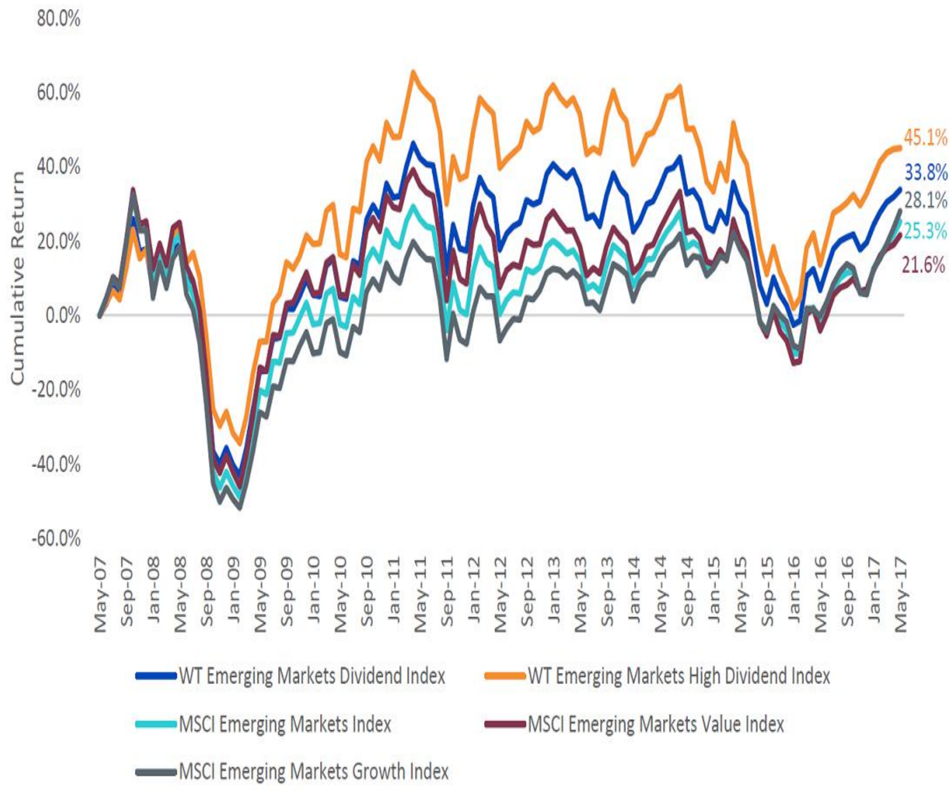


Source: WisdomTree, Bloomberg.

The last 16 years in emerging market equities provide a window into investor psychology as over the full period they have outperformed developed market equities by over 4.4% per annum. Over the past five years developed markets have shifted back into prominence. However, for many clients there is an expectation that this recent period of quantitative easing-based outperformance is likely to end. Over this period clients have hesitated to allocate to emerging markets, especially as it has been characterised by generally weaker emerging market currencies.

Psychologically, it is difficult not to try to chase returns. It's also hard to hold volatile equity markets like emerging markets over full cycles. Finding a way to make it easier for investors to stay exposed to emerging market equities over a full market cycle was one of the reasons WisdomTree created its suite of emerging market dividend indices.

Chart 2: WT Emerging Markets Dividend & Emerging Markets High Dividend Indexes vs. MSCI Emerging Markets Index Benchmarks (June 1, 2006 to May 31, 2017)



Source: WisdomTree, Bloomberg.

WisdomTree now has 10 years of real-time results across its Emerging Market Dividend Stream- weighted indices covering high yield and small-cap dividends. We believe the success of the track records shows that the conventional narrative—that an investor must use an active manager to capitalise on pricing inefficiencies and mispricing in emerging markets—is misguided and that index strategies can also be utilised to provide value-added enhancements over the market beta.

The above article is a summary and excerpt of our recently published whitepaper: Celebrating 10 Years in Emerging Markets which you can read here. This whitepaper drills into how and why the WisdomTree Indices were created and, specifically: examines the philosophical and fundamental underpinnings for the creation of the WisdomTree Emerging Markets Dividend Indices more than 10 years ago; deconstructs some of the critical factors that were most influential in determining periods of outperformance and underperformance relative to market capitalisation-weighted benchmarks, and highlights how we think these strategies fit into what we believe to be an appropriate asset allocation framework today, including how small caps can add value to a broad allocation in emerging markets.

You might also be interested in reading…

- Five reasons why we believe Indian equities could spice up your portfolio
- Why Chasing Momentum in Emerging Markets May Be Short-Lived: Rebalancing to take advantage of better value
- Smart beta ETFs: Why not all strategies are created equally

Related products:

- WisdomTree Emerging Markets Equity Income UCITS ETF (DEM)
- WisdomTree Emerging Markets SmallCap Dividend UCITS ETF (DGSE)

View the online version of this article here.

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