New Emerging Markets ETF Option: HILO Debuts

by **Michael Johnston** on August 4, 2011 | ETFs Mentioned: **DEM** • **EDIV** • **EEM** • **HILO** • **VWO**

EGShares, the only ETF issuer focused exclusively on **emerging markets**, announced today the introduction of another product offering exposure to equities of developing markets. The new Emerging Markets High Income Low Beta ETF (HILO) will seek to replicate the **Indxx Emerging Markets High Income Low Beta Index**, a 30-stock benchmark designed to provide lower volatility and higher income than cap-weighted emerging markets indexes (such as those to which ETFs such as **EEM** and **VWO** are linked).

HILO gives investors another option for accessing emerging markets, as the new product is designed with the goal of exhibiting low volatility relative to broad-based emerging markets indexes. In order to be eligible for inclusion in the underlying index, component stocks must meet certain minimum liquidity standards and have paid a cash dividend during each of the last three years (i.e., 2008 through 2010). That filter screens out companies that were forced to eliminate distributions during the most recent recession, resulting in a universe consisting generally of high quality emerging market stocks. The index actually excludes stocks with a dividend yield of more than 10%, a restriction put in place to steer clear of securities exhibiting historical yields that clearly aren't sustainable going forwards [**Using ETFs To Round Out Emerging Markets Exposure**].

Another screen is applied to identify companies with a beta of less than 1.0 and a correlation factor of less than 0.7 relative to the local equity market. The result is a basket of securities that will exhibit relatively low sensitivity to broad-based indexes such as the **MSCI Emerging Markets Index**, and that should offer better preservation of capital when markets struggle. There is a maximum weight of 5% at time of purchase, and a five stock limit for any one country.

A look back at the backtested three year history of the underlying index highlights the potential benefits of the HILO strategy over a full market cycle. Though the focus on dividend paying equities with lower volatility than the broad emerging markets universe may lag behind other products during prolonged rallies, the strategy has the potential to better insulate investors against steep losses during bear markets [see **Emerging Markets, Inflation, and ETFs: Q&A With Richard Kang**] .

Emerging Markets ETFs

Ticker	*1 Year*	*3 Year*
HILO	20.5%	15.5%
EDIV	31.9%	15.3%
DEM	20.5%	9.4%
EEM	17.5%	5.4%

Reflects performance for underlying index as of 7/29/2011.

Source: Bloomberg.

Dividend Weighting…With A Twist

Another unique feature of HILO is the weighting methodology employed; stocks that meet the index construction criteria are weighted based on dividend yield. That approach differs somewhat from products such as the WisdomTree Emerging Markets Equity Income Fund (DEM), which weights component companies based on cash dividends paid. Because larger companies will generally issue larger distributions to shareholders, the DEM approach may feature greater overlap with cap-weighted benchmarks. Because the relationship between dividend yield and market cap is not nearly as strong, HILO may be more likely to focus in on securities that receive little or no weighting in broad-based emerging markets benchmarks.

The dividend yield weighting methodology may also be appealing to investors looking to steer clear of potential drawbacks in market cap weighted methodologies. Indexes that link stock price and individual security weightings have a tendency to overweight overvalued companies and underweight undervalued ones. A number of new emerging markets ETFs have popped up in recent years offering exposure to the developing world through alternative weighting techniques, including DEM, EWEM (equal weight), and PXH (RAFI weighted). State Street's S&P Emerging Markets Dividend ETF (EDIV) is also linked to an index that implements a dividend yield-weighted methodology [**Emerging Market ETFs: Alternative Weighting Edition**].

According to the HILO fact sheet, as of July 15 the underlying index had a dividend yield of about 5%.

Under The Hood

Like all EGShares ETFs, the new HILO excludes quasi-developed markets such as **Taiwan** and South Korea that make up substantial chunks of EEM and VWO. Those two markets are classified as "emerging" by some index providers, but have been in the "developed" bucket as determined by the IMF for decades [see **Truth About Your Emerging Markets ETF**]. The biggest country allocations in HILO are afforded to **Malaysia**, South Africa, **Brazil**, China, and **India**. Also represented are **Thailand**, Mexico, Morocco, the Philippines, and **Turkey**; noticeable omissions include oil-rich Russia.

Among the largest individual holdings of HILO are Redefine Properties (a South African real estate company), Telecomunicacoes de Sao Paulo SA (Brazilian telecom), and Maroc Telecom SA (Moroccan telecom). As of July, dividend yields on the index components ranged from just over 2% to more than 9%.

Fitting In HILO

HILO could fit into long-term portfolios in a number of different ways, including as a core source of emerging markets exposure. The fund could also be used to compliment existing emerging markets exposure achieved through funds such as EEM or VWO, bringing potential yield enhancement and risk reduction benefits. Or it could be a more tactical play for yield hungry investors looking to beef up the current returns from the equity portion of their portfolios.

The launch is the 9th new ETF from EGShares so far in 2011; in June the **company completed** its suite of sector specific emerging markets ETFs. HILO is the first new ETF introduction of August, and snaps a bit of a quiet period for the industry. The last new ETP launches came when UBS **rolled out a pair** of Internet IPO ETNs on July 21.

[For more on the new ETF, see the **HILO fact sheet**. For analysis on all new ETFs, bookmark the **ETF launch center**]

Disclosure: No positions at time of writing.

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Mauisun **3 months ago**

This is really funny! This story came up on GoogleNews under my Hawaii section -- because the symbol is HILO! Aloha from Maui.

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