Outlook: Top-Down Risk Readings in Frontier. Where Frontier Markets Go From Here.

"If no one ever took risks, Michaelangelo would have painted the Sistine floor." Neil Simon

Macro model results. Kyklos is a bottom-up investor, but we do not ignore macro country risk. GDP growth is a key driver for corporate profit, and the operating returns of Frontier companies are sensitive to currency exchange rates which sometimes change dramatically. Currency price changes are also a direct addition to, or subtraction from, our investment returns in US dollars. We use a proprietary macro country model to score and rank overall macro risk using six factors.

The model now includes all Emerging and Frontier index countries, plus many non-index names, and it captures risks relative to the Emerging as well as Frontier markets that compete for investment flows.

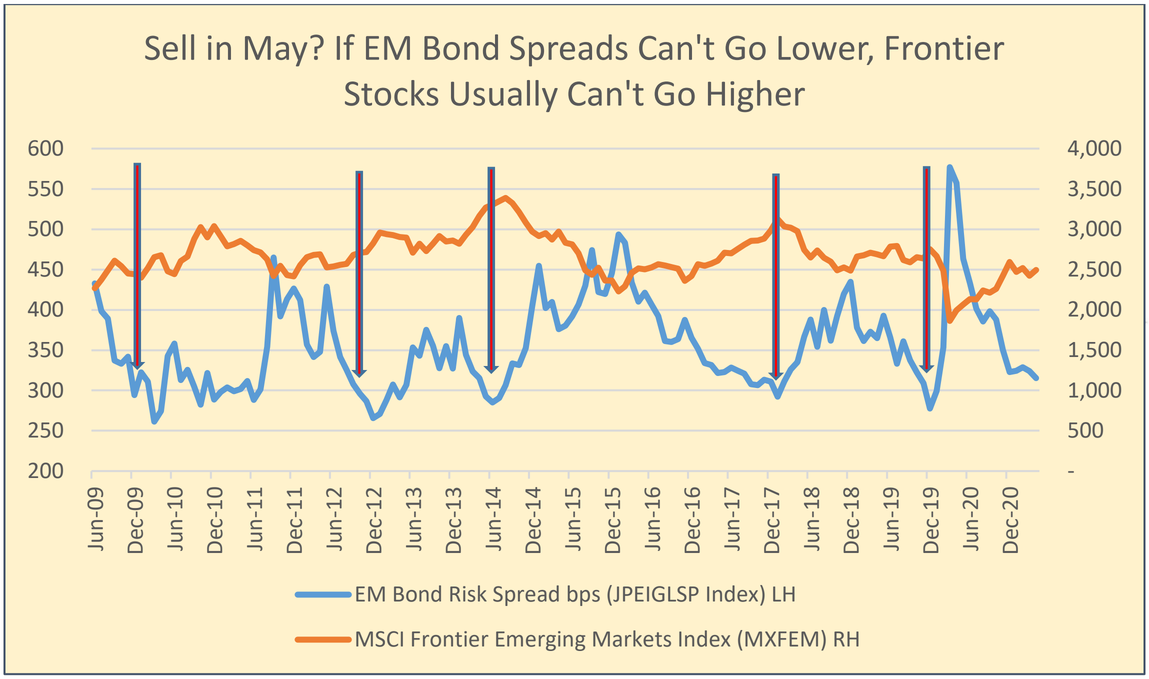
In the latest model results, Frontier countries and Kyklos exposures make out pretty well, underlining the significant growth and quality advantages that we see in our portfolio and our space. We are currently invested in three of our top-five-ranked countries, Slovenia, Georgia, and Botswana, and three more of our exposures, Pakistan, Kazakhstan, and Ghana, rank in the top third of all countries in the model. Only two countries Kyklos has exposure to, Estonia and Nigeria, are in the bottom third.

The Near Future in Frontier. Some day, the post-Covid rally in global equity markets shall end. Our bet on the most probable catalyst comes from interest rates. Emerging and Frontier countries often borrow foreign currencies to finance their deficits and development. When the investors in that debt accept exceptionally low yields versus Developed-country bonds, equity investors should usually sell before debt costs rise again and economic growth weakens. The magic number for the spread between Emerging and Developed bond yields is about 3% (below), and the current level is 3.15%. Investors in the MSCI Frontier Emerging Index (MXFEM) who sold the last time 3% was breached in December 2019, would have saved themselves from a Covid-driven -22% bloodbath in the following six months. Following a similar rule since 2009 would have worked almost 75% of the time, and avoided average 6-month equity losses of 6%.

As for timing, with dovish central banks throughout the heavyweight Developed world, we see a likely gradual rotation out of cyclicals rather than a sudden shift. We will continue to add to positions in defensive sectors like healthcare and food, companies with sustainable profitability in downturns, which were out-of-favor during 2020's boom of all things cyclical.

1350 Avenue of the Americas
2nd Floor
New York, NY 10019
t: 646.738.8078
cgushee@kykloscapital.com

Kyklos Capital



Charlie Gushee
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1350 Avenue of the Americas
2nd Floor
New York, NY 10019
t: 646.738.8078
cgushee@kykloscapital.com

Kyklos Capital

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cgushee@kykloscapital.com