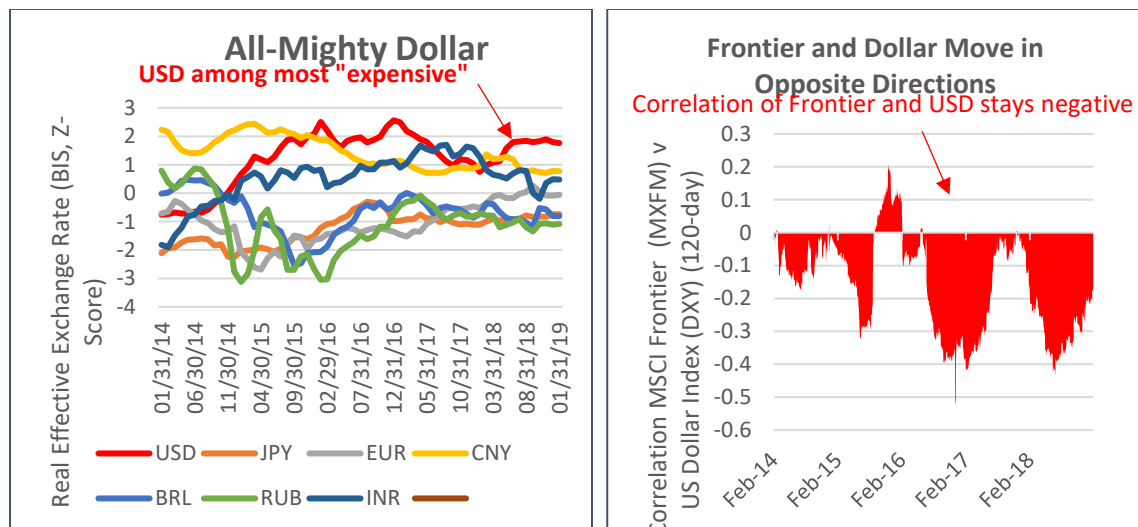


Outlook: Why 2019 is Looking Good for Frontier Markets

"Buy low". John Templeton

Unlike most New Year resolutions, the optimism for Frontier markets is well-founded, because many of the headwinds they suffered from in 2018 are likely to become tailwinds in 2019.

First, there is a potential lift from the U.S. dollar, whose 2018 rally was powered by a hawkish Fed, stronger GDP growth in the U.S., and U.S. tax cuts. Now one of the world's most expensive currencies according to REER, the dollar is now faced with declining GDP estimates, a sharp Fed reversal, and ramping U.S. sovereign debt issues to cover the newly bloated deficit (read Grant's Jan 31 rundown [here](#)). Frontier markets and the dollar generally move in opposite directions in a negative correlation, so dollar weakness should be good news for Frontier equity investors.

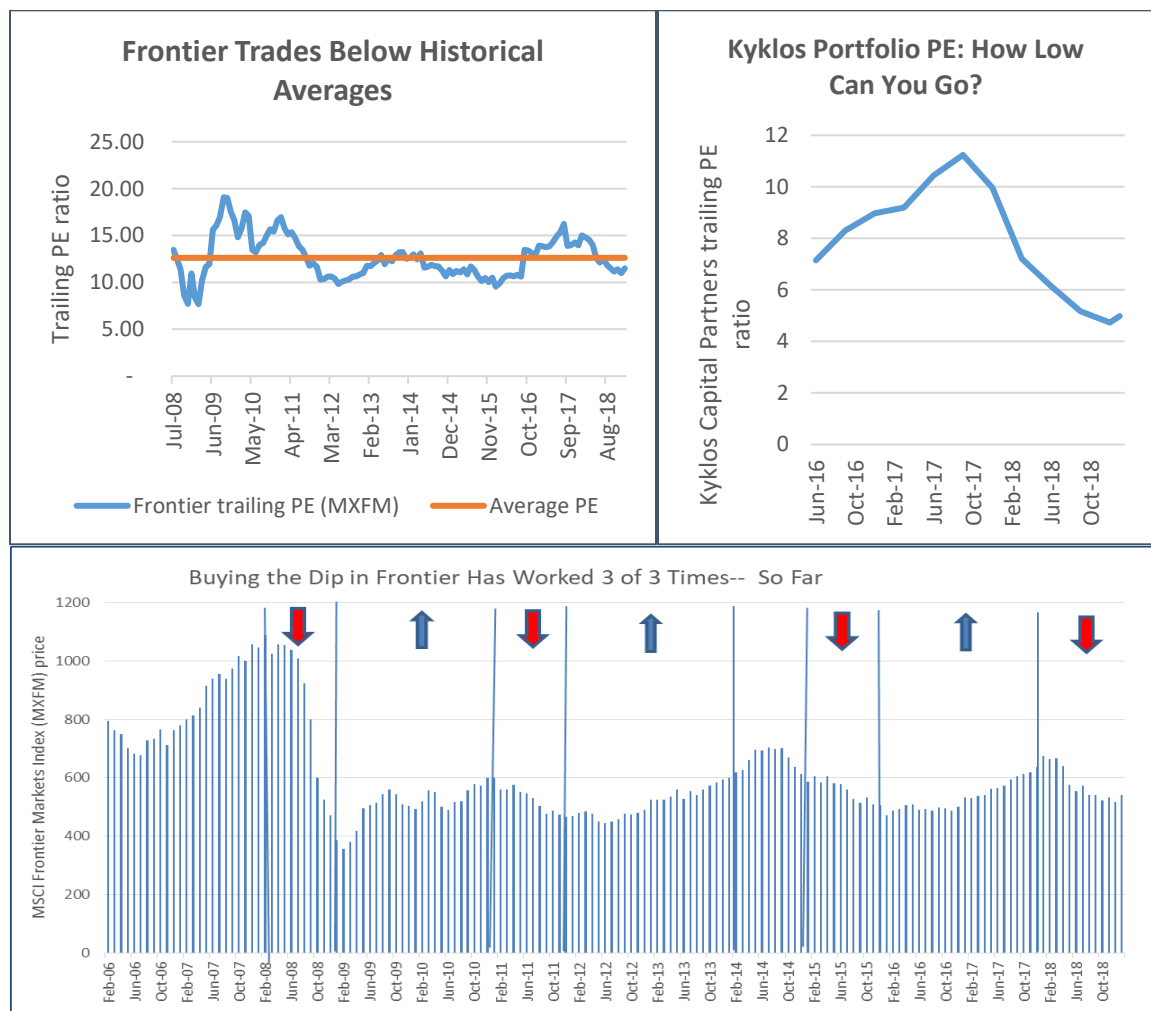


Second, Frontier economies feature a number of countries with improving macro trends. Highlights include Egypt (comment further below), Pakistan, and potential election catalysts in Nigeria and Argentina. Kyklos's three biggest portfolio weightings, Nigeria, Egypt and Sri Lanka, are all expected to show an acceleration in GDP growth in 2019, unlike the U.S.

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Lastly, discounted valuations in Frontier markets generally, and in Kyklos's holdings, are big. Frontier markets are now below long-term average valuations even on depressed 2018 profits, and Kyklos's portfolio PE is near the cheapest level since its launch.

Bottom line: Buying after a bad year in Frontier equity markets is likely to work again in 2019, as it did in 2009, 2012, and 2016.



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Update on Egypt: In January I met with about 20 Egyptian and regional companies, government officials and local investors in Cairo. The overall investment case for Egypt is positive (as highlighted in Kyklos's December letter), with stability in its government, a recovering economy after a long crisis, declining inflation and interest rate trends, and overall low valuations on many of its listed stocks. In addition, the government shows a clear focus on improving foreign investment inflows by reforms and budgetary discipline, which is somewhat reassuring as the IMF is set to end its role as a financial watchdog for the country in March. We have added to our holdings in the country.

Charlie Gushee
January 31, 2019

Interesting January Reading

- (from Sept 2018) McKinsey singles out the economic growth success factors for developing countries:

<https://www.mckinsey.com/featured-insights/innovation-and-growth/outperformers-high-growth-emerging-economies-and-the-companies-that-propel-them?cid=soc-web>

- A balanced view on Emerging markets from Hermes:

<https://cdn.savvyinvestor.net/cdn/farfuture/L7ZfXLWcnP5jrGm5tGkVWjJQ2NDU14MLlixG-StjG0l/1548433274/sites/default/files/node/paper/file/hermes-ahead-of-the-curve-january-2019.pdf>

- State of play in governance from Transparency:

https://www.transparency.org/news/feature/cpi_2018_global_analysis

- Contrast demand from foreign college students to come to the US:

<https://www.migrationpolicy.org/article/international-students-united-states>

Versus China: <https://www.economist.com/china/2019/01/26/why-china-is-lavishing-money-on-foreign-students>

- Capital Economics sees a cliff for global GDP:

<https://www.capitaleconomics.com/blog/as-the-data-collapse-what-might-we-be-missing/>

- The Economist highlights all-time cheap USD-to-Big-Mac exchange rates:

<https://www.economist.com/graphic-detail/2019/01/12/the-big-mac-index-shows-currencies-are-very-cheap-against-the-dollar>

- Mongolia follows the path of the Gilet Jaunes:

<https://www.economist.com/asia/2019/01/19/mongolians-are-getting-angry-about-corruption>

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IMPORTANT DISCLOSURE INFORMATION

* Prior to the launch of Kyklos Capital Partners April 1, 2016, Charles Gushee ran a personal account which generated a real-money track record, utilizing a similar methodology to Kyklos Capital Partners. Audited 2015 results for that account are available upon request. The investment process for that account is representative of the investment process that Kyklos Capital intends to employ in most situations. However, Kyklos Capital may deviate from that process on a case-by-case basis in its discretion. Future quarterly updates will discuss Kyklos Capital Partners' performance. The fact that the Account has realized gains in the past is not an indication that any fund or account managed by Kyklos Capital will realize any gains in the future. **Past performance is not necessarily indicative of future results.** This information is intended solely for the addressee, for informational purposes only, is confidential, is not intended for public use or distribution, and may not be reproduced or distributed without the express written consent of Kyklos Capital LLC ("Kyklos Capital") or Charles Gushee.

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