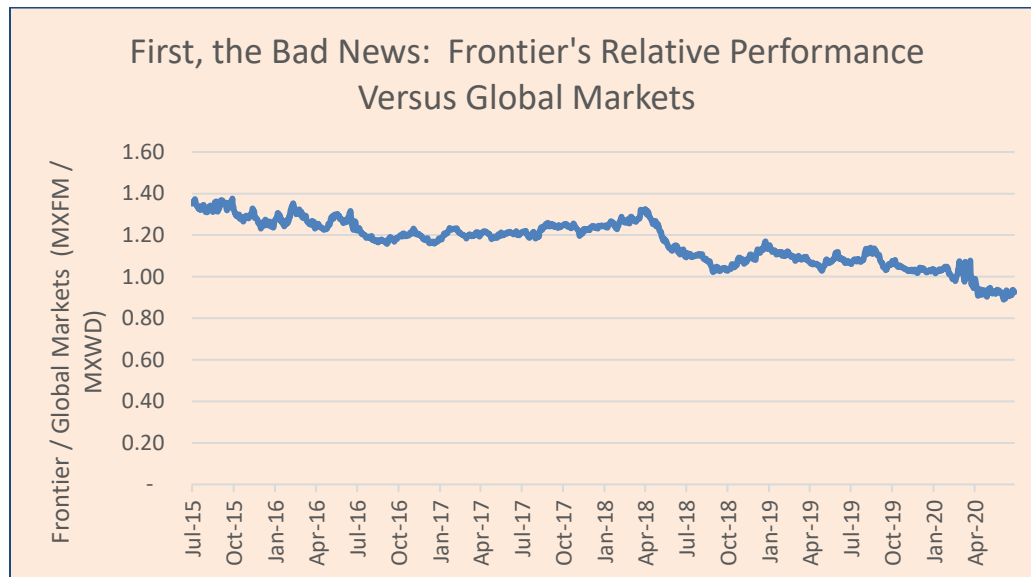


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Outlook: So Frontier is cheap. What can turn it around?

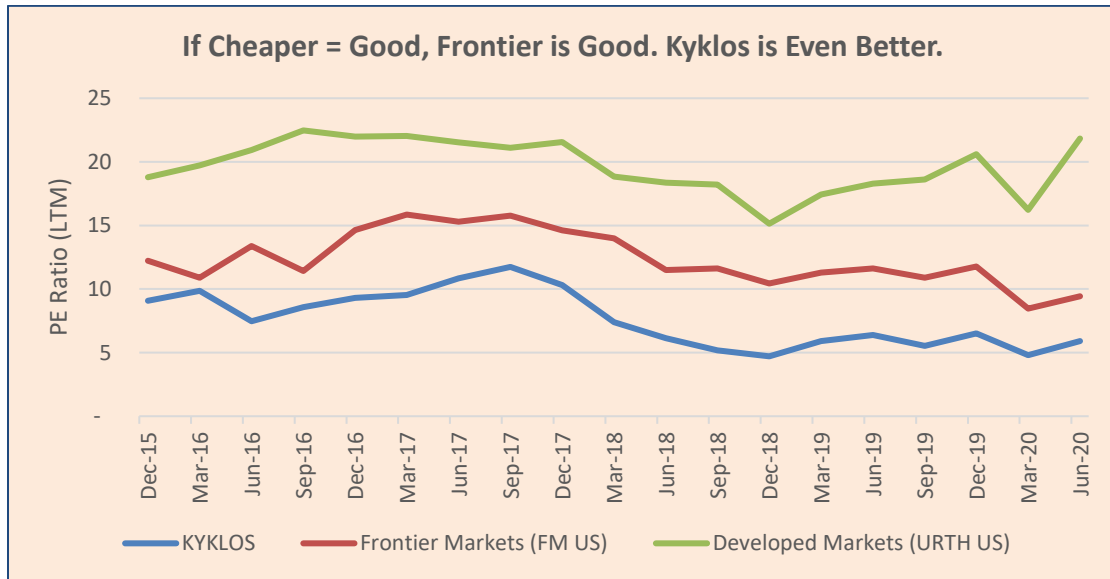
"The thing is to be able to outlast the trends." Paul Anka

The MSCI Frontier Markets Index has rebounded about 16% from its March lows, only about one-half the bounce of the global Developed and Emerging markets. That Frontier underperformance fits a longstanding trend that has accelerated especially in the past five years (see the chart below, showing the steady decline in Frontier relative to Global markets). It has left Frontier shares trading on the cheapest valuation multiples of any equity asset class, which, we argue, should tempt long-term active investors. But what is likely to change this picture?



The underperformance has left Frontier valuations at deep discounts to Developed equity markets, at a near-record low trailing PE ratio. Furthermore, the depressed valuations offer Kyklos, as an active value investor, opportunities to invest at significant discounts even to Frontier average valuations. Our portfolio's trailing PE is currently 5.8, a whopping 70%+ discount to Developed equity markets. Other valuation ratios show a similarly dramatic Frontier discount.

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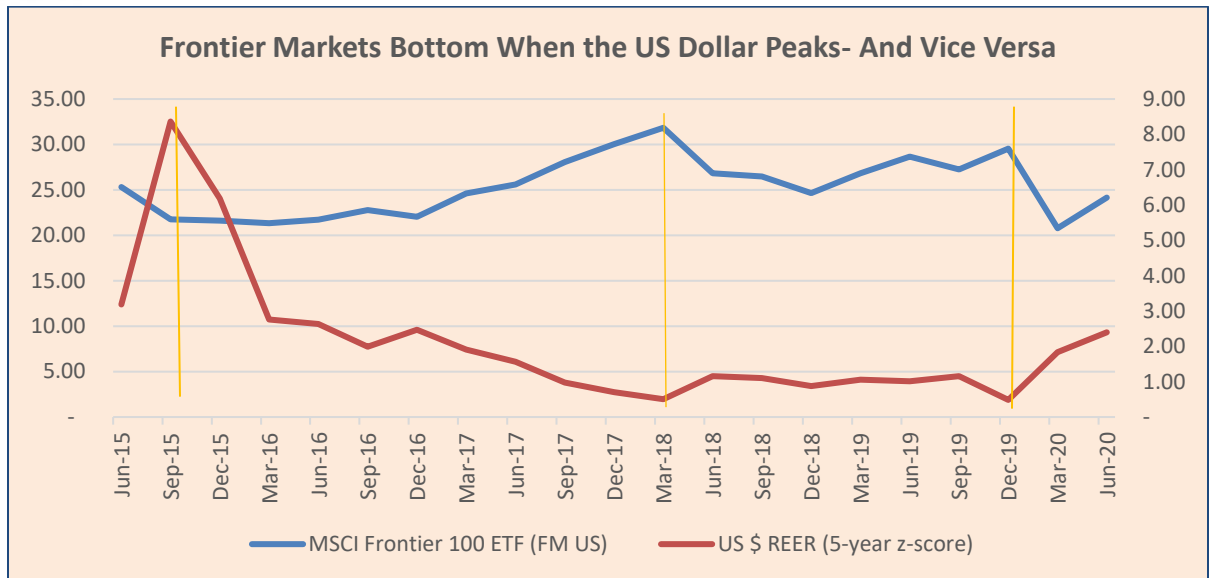


What, however, will make Frontier reverse the trend and outperform Global markets? A change in trend requires a change of foreign investors' behavior, since they come and go, while local individuals and institutions stay focused on home markets. No prizes, then, for guessing that foreigners have been dumping their Emerging and Frontier equity holdings, which are now three times below historical ranges (as in 2.9 standard deviations below five-year averages¹). What will make foreign investors come back to Frontier equity?

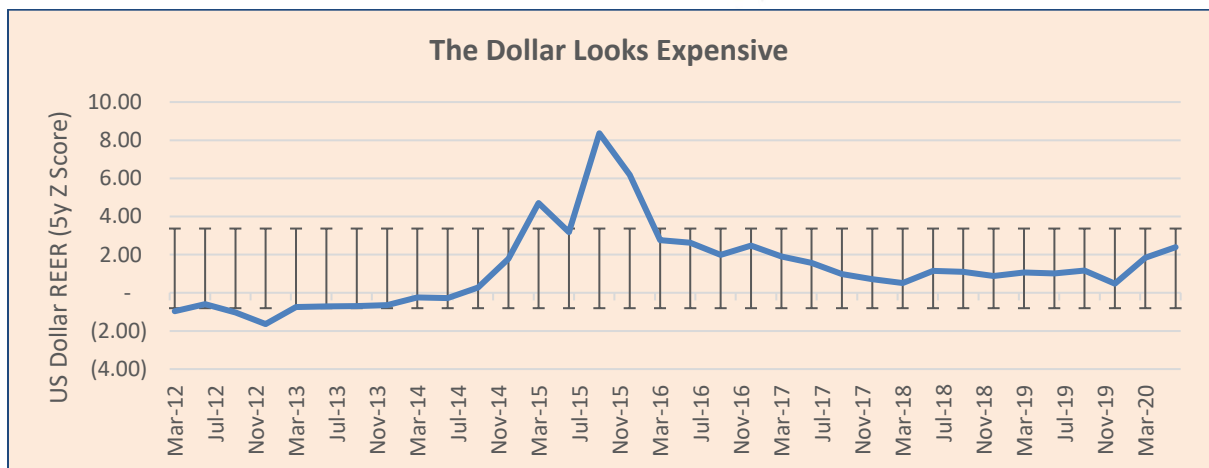
A reversal in the mighty US dollar would probably do the trick. For dollar-based investors with Frontier holdings, dollar strength is a direct subtraction from their investment returns in local terms. Dollar peaks have historically coincided with Frontier equity bottoms, and vice versa (below).

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¹ Simon Flint, Bloomberg Macro View, June 28, 2020.



As it happens, the US dollar today is one of the world's most expensive currencies, in economic terms, and is near the top of its valuation range (near one standard deviation above the five-year average).



It's not a timing tool, but the potential for a reversal in the US dollar accompanied by a rebound in Frontier performance is clear. Our money is where our mouth is.

Charlie Gushee
June 30, 2020

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