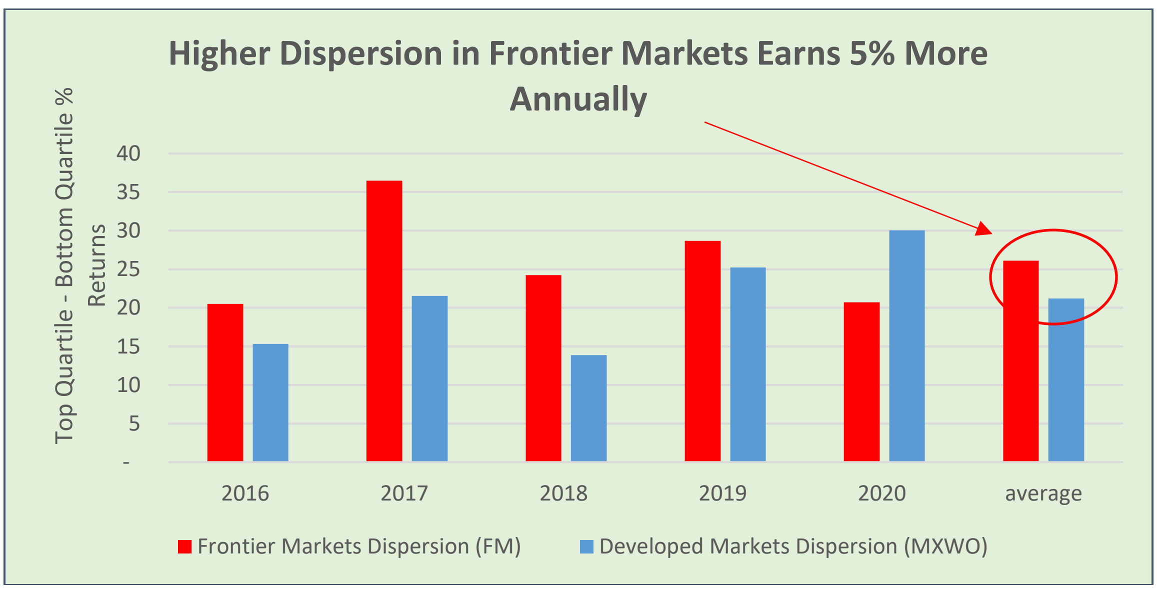
Kyklos Capital

Being Right Brings Big Rewards in Frontier Markets. Liquidity is a Mixed Picture.

"Strength lies in differences, not in similarities." Stephen Covey

Bottom-up active investors, such as Kyklos, are opportunistic. The price changes of different stocks increase our investment choices, and our returns depend on owning the good ones and not owning the bad ones. The bigger the difference in performance between the best and the worst-- dispersion, in finance-speak-- the bigger our opportunity to outperform. That opportunity is significantly bigger in Frontier than in Developed and Emerging markets overall.

We compared the performance of the best- and the worst-performing stocks for Frontier markets and for global Developed and Emerging markets, using index ETFs (FM and MXWO), for the past 5 years (below). By definition, both Frontier and Developed/Emerging investors who owned the best group of their stocks earned high returns versus owning the worst group. But the Frontier investor *earned an additional annual 5% return*, versus the Developed/Emerging investor. That dispersion was significantly greater for Frontier than for Global markets in all years except 2020 (possibly related to Covid's impact). Being right about stocks pays much better in Frontier, nearly all the time.



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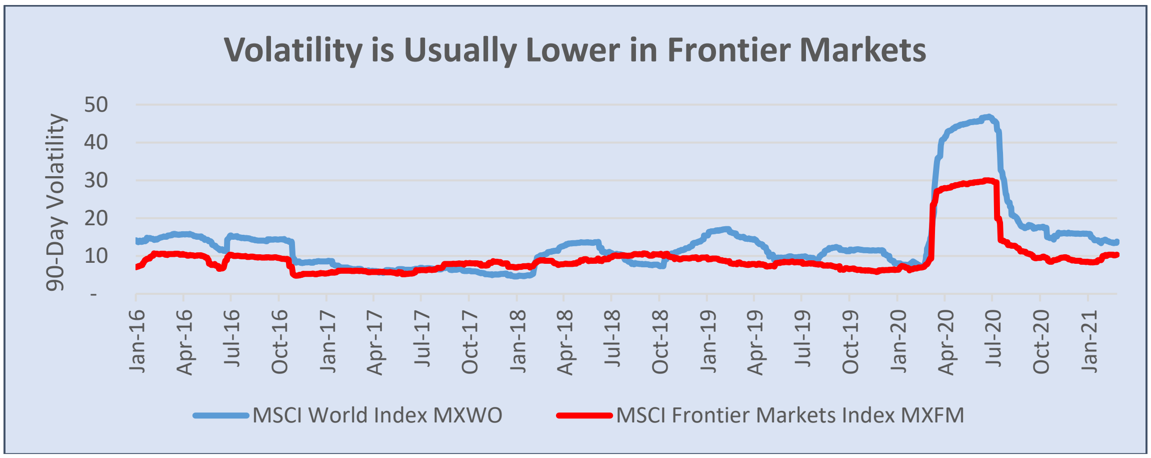
Frontier's better opportunity does not necessarily imply higher risk, however. Volatility, which measures risk, is lower for Frontier markets than for Developed and Emerging markets overall (below). Big variations between Frontier countries in the economic trends that drive their stock markets tend to offset each other at the group level. Think, for example, of oil-producing Nigeria, with its fiscal and trade balances and stocks celebrating when oil prices rise, versus oil-importing Kenya, whose balances and stocks suffer from the same thing. As one zigs, the other zags.



A Liquidity Update in Frontier Markets

Trading liquidity in most Frontier stock markets has recently picked up. This tide has not lifted all boats, however (below, courtesy of Tellimer). Trading on Asian stock exchanges, and especially Vietnam, has climbed dramatically, driving overall Frontier trading liquidity upwards. Africa, on the other hand, remains deeply in the dumps. Asia is Kyklos' top-weighted region and Vietnam our biggest country exposure, so our portfolio liquidity has improved. But Africa, at almost a 29% total portfolio weighting in Kyklos, contains several low-liquidity positions. We continue to lower liquidity risk by adding more-liquid names to the portfolio and exiting less-liquid stocks as appropriate.

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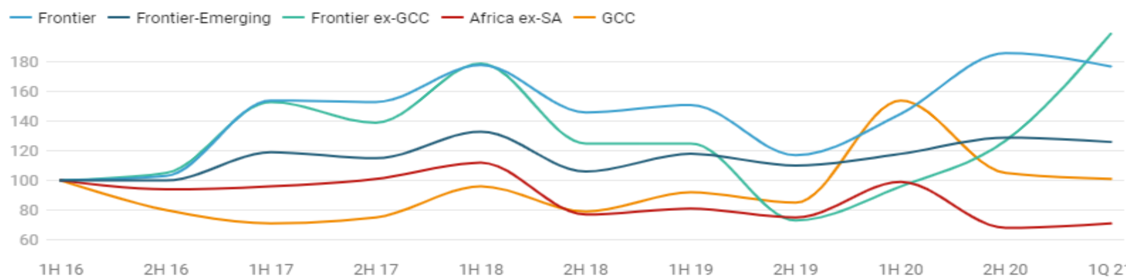
Frontier market equities appear to have missed out on liquidity pick up (up in Asia , flat in GCC, down in Africa)

Average daily value traded in equities in each period (normalised to 100 in January 2016)



Frontier is now mainly Vietnam, Morocco, Kenya, Romania, and Bahrain. Frontier Emerging is now mainly Philippines, Vietnam, Peru, Colombia, and Morocco.

Chart: Hasnain Malik • Source: Bloomberg, MSCI, Tellimer Research • Get the data • Created with Datawrapper

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