

Outlook: Trade, Growth, and Frontier Markets

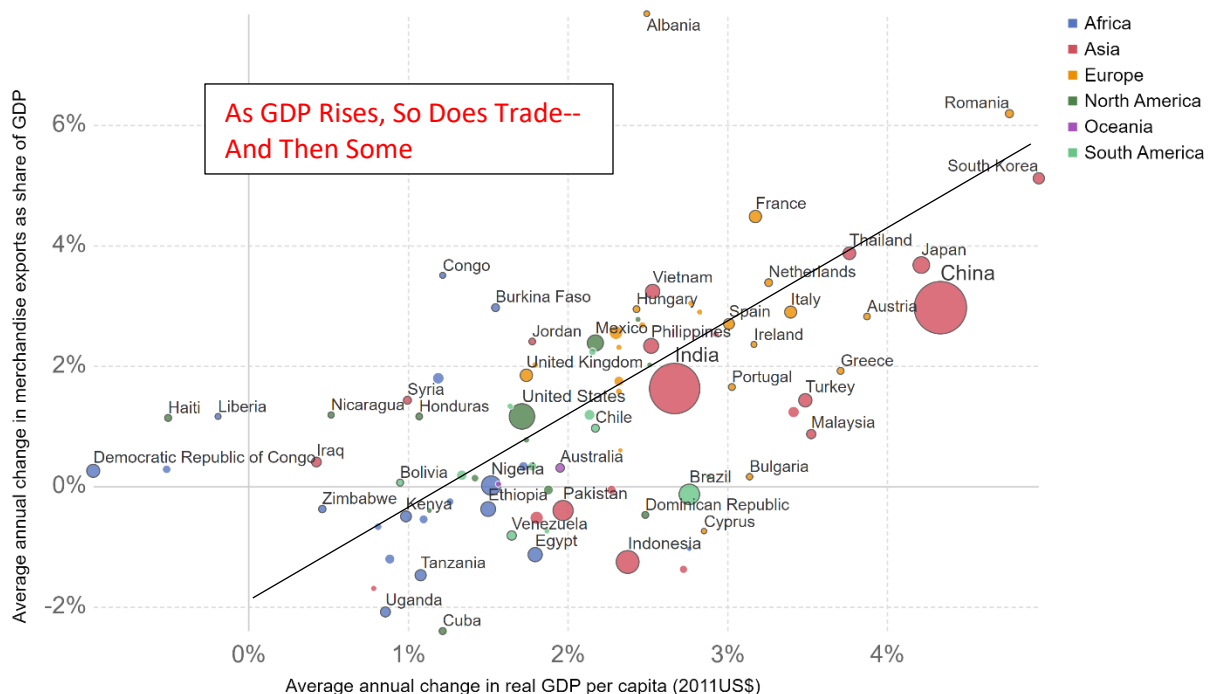
"I pass my life in preventing the storm from blowing down the tent, and I drive in the pegs as fast as they are pulled up." Abraham Lincoln

Frontier countries feature much higher economic growth rates than Developed economies, as we have highlighted frequently, largely thanks to their young and growing populations who will produce and consume as they enter the workforce. The tricky bit for investors is to benefit from that long-term growth, since markets efficiently price the expected future company profits generated by growing economies. “You can’t buy GDP” is a bitter cliché, and Frontier stocks are not immune to short-term bear markets despite the stronger growth outlook.

Kyklos owns several positions in the trade sector, which is one of the most direct plays on Frontier's GDP growth because it normally grows revenue faster than the economy, as shown here:

Growth of income and trade, 1945 to 2014

Average annual change in real GDP per capita vs Average annual change in export volumes.

Our World
in Data

Source: Fouquin and Hugot (CEPII 2016), Maddison Project Database (2018), Population (Gapminder, HYDE(2016) & UN (2019))
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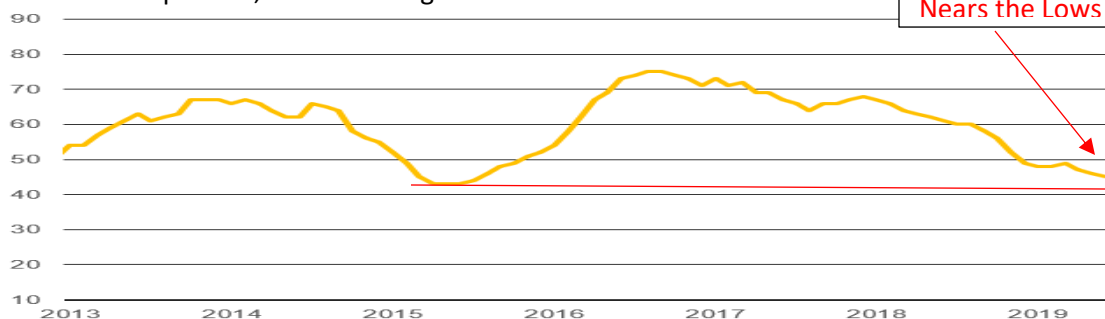
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The “Why, When, and What” to Buy

Starting with “Why” to buy: Trade is one of the surest outcomes of population growth. More young people means more jobs to produce goods and services, including exports, and more consumption as they spend their wages, including on imports. Also, the stereotype of Frontier markets as a simple boom-and-bust oil story is a misperception. The value of Frontier exports of manufactured goods now outweighs that of energy or mined resources, and is more economically valuable in terms of employment and retained profit¹. Trade conditions, of course, are currently stressed by political developments, and show no signs of short-term improvement as shown below. No surprise, then, that trade-sensitive companies feature prominently when Kyklos screens for attractively undervalued stocks.

DHL Global Trade Barometer – World

Index 2013 – present, 50 = no change



“When” is a harder question, because the overall long-term growth in trade can suffer long periods of underperformance. We are already several years into this decline in the outlook for global trade, and although the short-term indicators remain negative, sharp-eyed readers of the above chart will note that this trend is already near its recent lows. Risk remains, but the negative cycle is already old. Potential catalysts in the form of elections and trade deals may happen, but timing is unpredictable.

To compensate for that uncertainty, “What” reflects Kyklos’ risk management, by the profiles of the businesses in which we invest. The trade companies we own do business in the key geographies that would benefit when and if we see a rebound in volumes. As for all our portfolio generally, our trade investments feature high sustainable returns, low or no debt, strong managements, and cheap valuations. They tend to require few fixed assets and little capital, unlike other sector players such as container shippers and airlines, and they are better able to maintain their margins in a downturn.

Charlie Gushee

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¹ <https://sdgpulse.unctad.org/developing-economies-in-international-trade/>

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Interesting Reading in November

- Trade: includes a live graphic showing container ships worldwide in real time: <https://ourworldindata.org/trade-and-globalization>
- Why remittances from immigrants are bigger—triple in the U.S.— and better than foreign aid budgets (June article): <https://www.hoover.org/research/immigrant-remittances-are-private-foreign-aid>
- Excellent rundown on fintech in Africa: <https://ftpartners.docsend.com/view/hzrphqt>
- Tellimer makes the bull case for Frontier 2020: <https://view.tellimer.com/the-return-of-frontier-and-small-emerging-markets>
- One-time boom story Mongolia's Oyu Tolgoi mine is still a cautionary tale: <https://www.economist.com/business/2019/11/26/mongolia-seeks-better-terms-for-its-vast-mining-project>
- Eastern European corruption could get worse as the U.S. backs off: <https://www.economist.com/europe/2019/11/23/americas-losing-battle-against-corruption-in-eastern-europe>
- North African jihadis are prolific gold traders: <https://www.economist.com/middle-east-and-africa/2019/11/14/how-west-africas-gold-rush-is-funding-jihadists>
- To reduce deaths from pollution in Asia, incomes must grow: <https://www.economist.com/graphic-detail/2019/11/09/indias-toxic-smog-is-a-common-affliction-in-middle-income-countries>
- FRONTIER DEBT: investor demand has peaked. <https://www.bloomberg.com/news/articles/2019-11-06/hot-demand-for-frontier-debt-set-to-cool-as-default-risks-rise?mod=djem> Frontiers

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