



Frontier Market Liquidity in a Dry Season

By Lawrence Speidell

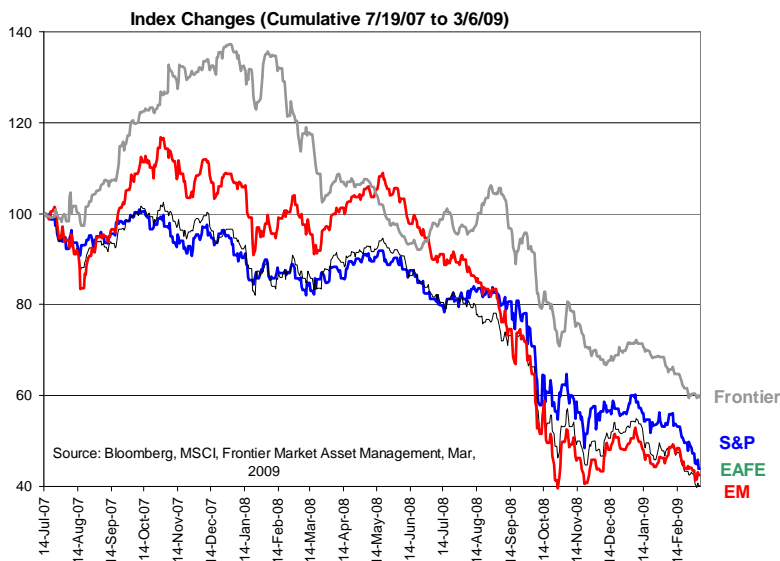
March 2009

With the global financial crisis impacting all corners of the world, it is time to take a closer look at frontier markets and their numbers. For more than a year, we have been monitoring the trading volume of more than 300 stocks in frontier markets using data that is readily available from Bloomberg. We believe this data can provide a good indication of the vibrancy of the frontier market asset class.

Before turning to this, however, the tables and chart below summarize the bear market in terms of the major indexes plus our own composite of 28 frontier markets. From the high in mid-2007, our average of frontier markets is down 40% compared with 56% for the S&P; in 2009, to date, the declines are 16.7% and 24.3% respectively.

Exhibit 1

	S&P 500	DJIA	EAFE	Emerging Mkts	Frontier Markets (Average of 28)
7/19/2007	1,553.1	14,000.4	2,327.9	1,144.1	100.0
12/31/2007	1,468.4	13,264.8	2,253.4	1,245.6	138.3
8/31/2008	1,282.8	11,543.6	1,821.1	956.3	105.1
12/31/2008	903.3	8,776.4	1,237.4	567.0	72.1
3/6/2009	683.4	6,626.9	935.6	488.2	60.0
% Chg 7/19/07-3/6/09	-56.0%	-52.7%	-59.8%	-57.3%	-40.0%
Chg 12/31/07-12/31/08	-38.5%	-33.8%	-45.1%	-54.5%	-47.9%
% Chg 8/31/08-12/31/08	-29.6%	-24.0%	-32.0%	-40.7%	-31.4%
% Chg 12/31/08-3/6/09	-24.3%	-24.5%	-24.4%	-13.9%	-16.7%



	Frontier Markets (Average of 28)	Frontier Asia (3)	Frontier Africa (4)	Frontier Europe (9)	Frontier Mid-East (12)
% Chg 7/19/07-3/6/09	-40.0%	-33.8%	-25.6%	-74.3%	-7.9%
% Chg 12/31/07-12/31/08	-47.9%	-51.7%	-21.7%	-67.7%	-18.5%
% Chg 8/31/08-12/31/08	-31.4%	-29.4%	-21.8%	-50.2%	-27.3%
% Chg 12/31/08-3/6/09	-16.7%	-20.5%	-19.0%	-20.7%	-4.0%

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Meanwhile, there are some interesting changes in the economic indicators we monitor:

Exhibit 3

	Oil Brent Futures	Gold	Copper	Euro	3 mo T-Bill	10 Yr Gov	10 Yr TIPS	Expected Inflation
7/19/2007	74.0	677.5	7920.0	1.38	4.98	5.02	2.64	2.38
12/31/2007	89.8	833.9	6715.0	1.46	3.24	4.03	1.70	2.32
8/31/2008	118.7	831.2	7450.0	1.47	1.7	3.81	1.67	2.15
12/31/2008	51.3	882.1	2935.0	1.40	0.08	2.21	2.09	0.12
3/6/2009	44.8	939.4	3665.0	1.27	0.20	2.87	2.03	0.85
% Chg 7/19/07-3/6/09	-39.5%	38.6%	-53.7%	-8.3%	-96.0%	-42.7%	-23.1%	-64.4%
% Chg 12/31/07-12/31/08	-42.9%	5.8%	-56.3%	-4.2%	-97.5%	-45.0%	22.9%	-94.7%
% Chg 8/31/08-12/31/08	-56.8%	6.1%	-60.6%	-4.8%	-95.3%	-41.9%	25.4%	-94.3%
% Chg 12/31/08-3/6/09	-12.7%	6.5%	24.9%	-9.4%	148.1%	29.8%	-3.2%	595.1%

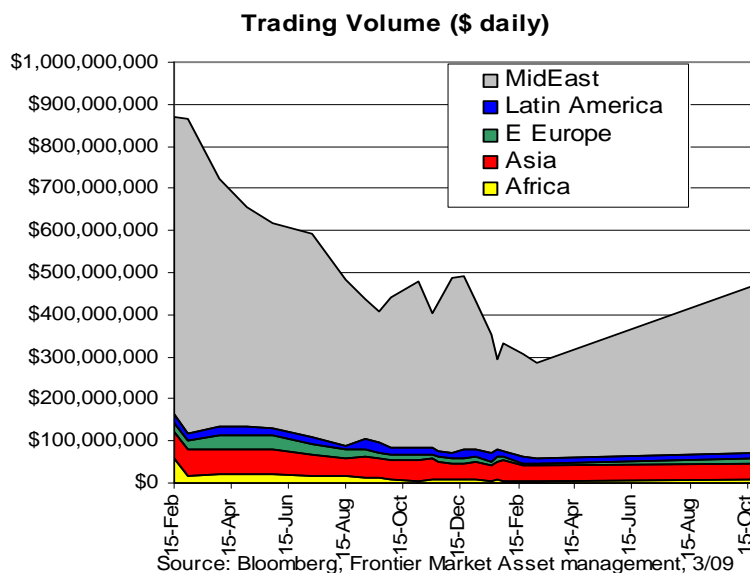
Source: Bloomberg, Frontier Market Asset Management, Mar 2009

Some signs of improvement can be seen in the rises in copper prices and expected inflation this year, however, it is our view that relaxation of financial markets has yet to occur.

Trading Volume

As shown in exhibit 4, trading volume has dropped sharply in the past year with the lion's share of frontier market volume being generated in the Middle East. Volumes have actually risen in that region lately as a result of the recent firming in oil prices which dominate that region's economic outlook.

Exhibit 4



Looking at regional totals of volume since the plunge in markets began in October 2008, the daily dollars traded are down sharply in all the regions with the greatest drop of more than 50% in Eastern Europe.

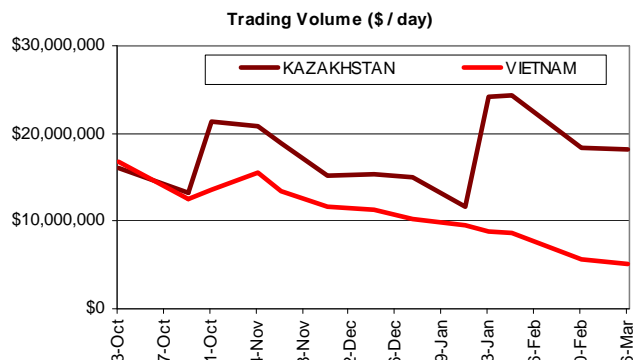
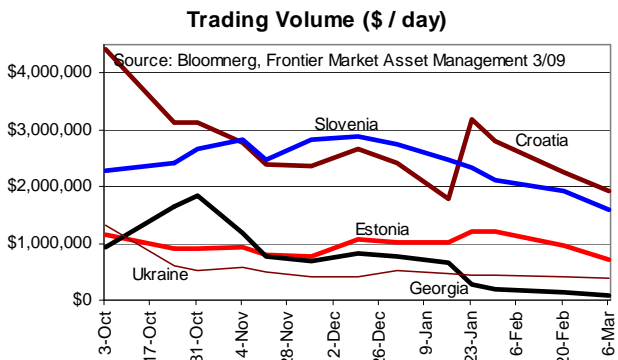
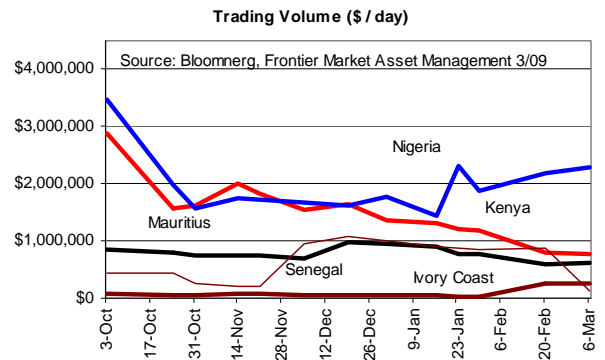
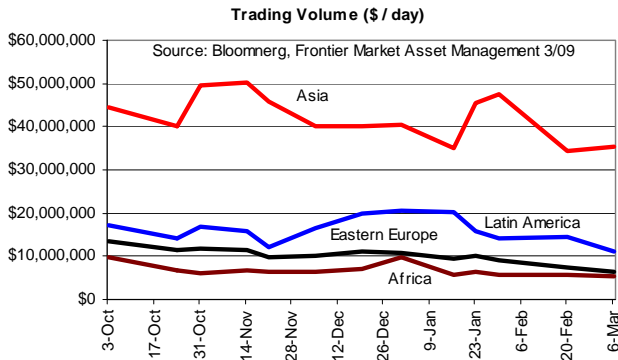
Exhibit 5

	10/3/2008	3/6/2009	% change
Africa	\$9,620,050	\$5,354,799	-44.3%
Asia	\$44,475,667	\$35,403,221	-20.4%
E Europe	\$13,491,511	\$6,511,808	-51.7%
Latin America	\$17,219,535	\$11,257,164	-34.6%
MidEast	\$356,742,715	\$227,359,599	-36.3%
	\$441,549,478	\$285,886,591	-35.3%

Source: Bloomberg, Frontier Market Asset Management, March 2009

Our focus for investing in this asset class is on the poorest frontier countries outside the Middle East (ex-GCC); we examine them in more detail below. Although volumes are down, these regions collectively trade roughly \$58 million per day. Individual countries have fared differently with volume in a few markets up during the past five months, while others are down sharply.

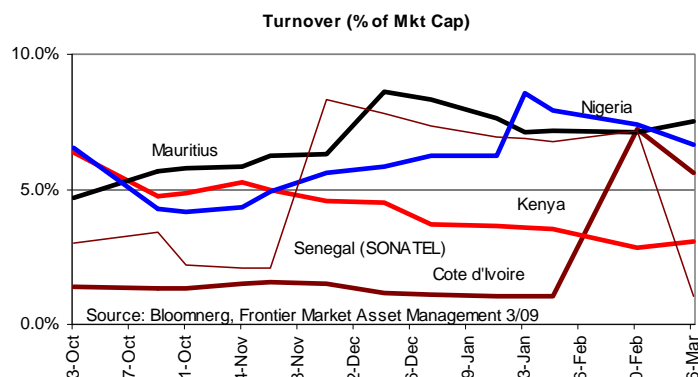
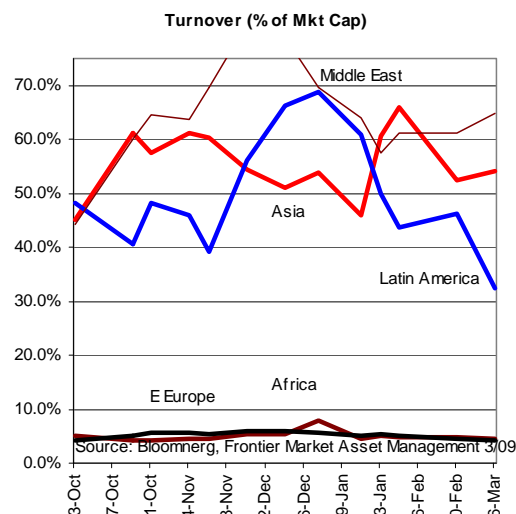
Exhibit 6



Georgia, for example, has seen trading slide from \$2.5 million/day before the Russian invasion, to \$90,000 per day now. On the other hand, volume in the small sample of banks we track in Kazakhstan has risen from just over \$16 mil/day in October to \$18 million recently. At the other extreme, the volume of local stocks traded on the BRVM exchange in Cote d'Ivoire has jumped from roughly \$85,000 per day in October to \$250,000 recently.

Since the declines in dollar volume equivalent of trading are heavily impacted by the recent strength of the U.S. dollar, we also look at an estimate of annual turnover by comparing market capitalization with the latest average daily volume multiplied by 200 days.

Exhibit 7



Some markets are clearly more active than others, with the Middle East, Asia and Latin America having turnover around 50%, while in Eastern Europe and Africa it is closer to 5%. Part of this difference is cultural, while part also may be due to a higher portion of market cap in closely held positions of strategic partners rather than in the float. In general, turnover in markets has not declined despite lower market levels. While dollar trading equivalent volumes have declined, trading activity has continued in these markets.

In our universe of more than 300 stocks, there are 98 stocks that currently trade more than \$100,000 per day, compared with 112 stocks last October. The median decline in daily dollar volume since October 3 2008, has been 58%, but as indicated below, it is our view that there is still significant volume in stocks across many markets.

Exhibit 8

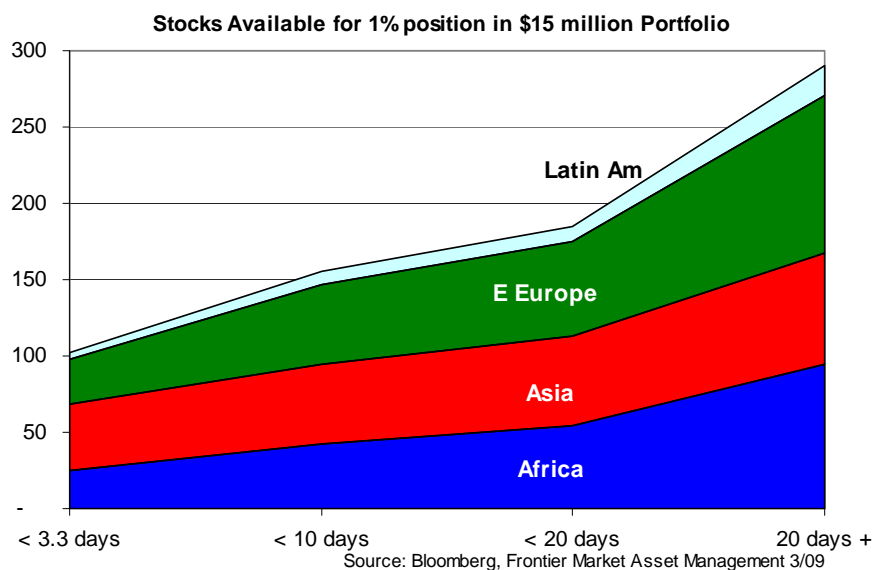
NAME	COUNTRY	Volume \$/Day 3/6/09
KAZMUNAIGAS EXPLORATION -GDR	KAZAKHSTAN	\$6,751,018
BEXIMCO PHARMACEUTICALS LTD	BANGLADESH	\$2,691,679
SUMMIT POWER LTD	BANGLADESH	\$1,924,931
SURAMERICANA DE INVERSIONES	COLOMBIA	\$1,778,784
TITAS GAS TRANSMISSION & DIS	BANGLADESH	\$1,731,325
HRVATSKE TELEKOM DD	CROATIA	\$1,171,129
CEMENTOS ARGOS SA	COLOMBIA	\$1,029,709
SAIGON THUONG TIN COMMERCIAL	VIETNAM	\$990,133
KAZAKHGOLD-REG S GDR	JERSEY	\$930,462
KRKA	SLOVENIA	\$918,856
INVERSIONES ARGOS SA	COLOMBIA	\$895,239
INTERCONEXION ELECTRICA SA	COLOMBIA	\$829,016
BANCOLOMBIA SA	COLOMBIA	\$813,527
ALMACENES EXITO SA	COLOMBIA	\$683,359
FPT CORP	VIETNAM	\$670,321
UTTARA BANK LIMITED	BANGLADESH	\$661,301
ACI LIMITED	BANGLADESH	\$602,273
NATIONAL BANK LIMITED	BANGLADESH	\$599,160
UNITED BANK FOR AFRICA PLC	NIGERIA	\$591,550
ACCESS BANK PLC	NIGERIA	\$569,731
SONGDA URBAN & INDUSTRIAL ZO	VIETNAM	\$515,520
SQUARE PHARMACEUTICALS LTD	BANGLADESH	\$463,468
BEXTEX LTD	BANGLADESH	\$454,789
NEAL & MASSY HOLDINGS LTD	TRINIDAD	\$454,145
		\$28,721,425

Source: Bloomberg, Frontier Market Asset Management, March 2009

Finally, we consider the stocks currently available for a pro forma \$15 million portfolio at various levels of liquidity. For the purpose of this example, we look at a \$15 million portfolio, (ex-GCC) which is targeting a minimum of 1% positions, equal to \$150,000 each.

Exhibit 9

\$150,000 =	< 3.3 days	< 10 days	< 20 days	20 days +
Africa	25	42	54	95
Asia	44	53	59	72
E Europe	29	52	62	104
Latin America	4	8	10	19
	102	155	185	290



There are 185 stocks where a \$150,000 position would be less than 20 days volume. For 155 of these, it would be less than 10 days volume and for 102 stocks it would be less than 3.3 days. Considering the 102 stocks in the most liquid group, the average stock is liquid enough to actually hold 4.4% of the portfolio rather than 1%. If we chose the best quartile of these, we could invest in 25 stocks at 4% each, for a total of \$15 million. We might, however, include some of the additional 53 stocks in the next layer, where a 1% position is greater than 3.3 days volume but less than 10 days. The average potential position size for this group before exceeding 10 days volume would be 2.1% of the portfolio. If we chose the best quartile of this group, we could hold 13 stocks equaling roughly 25% of our \$15 million portfolio.

Finally, there are another 30 stocks where \$150,000 equals more than 10 days trading but less than 20 days. The average potential position in these before exceeding 20 days trading is 1.4 days, so the best seven of them could fill another 10% of our portfolio. There are many other potential combinations, but the conclusion is that considerable flexibility still exists for portfolio construction. This projection changes further if one ventures into the roughly 400 additional stocks in these markets that are less liquid or into the much more liquid Middle Eastern markets.

For a firm overall, where liquidity needs are spread across different clients, we believe that it is reasonable to manage positions sizes to 15 days trading volume. As mentioned above, total daily volume across the regions of Africa, Asia, Eastern Europe, in exhibit 5 (page 2), is roughly \$58 million. If a firm were to own the best quartile of these stocks, the average daily trading volume of its holdings would be \$14.5 million. If the firm held an average of 15 days volume, it would have the capacity for roughly \$215 million in assets under management. These projections could prove overly conservative if markets return to the more generous liquidity that existed prior to October 2008 when capacity calculated in the same way would have been \$315 million.

Conclusion

These are very challenging times, but we believe that frontier markets remain an attractive opportunity. Liquidity continues to be available to traders, but even greater opportunities exist for long term investors. When Warren Buffett was asked about his preferred holding period, he said “forever”. With this in mind, we believe the most attractive frontier market investment opportunities rest not on their natural resources or their productive workers, but on the consumer sector with the prospect of rising discretionary disposable personal income in the coming years.

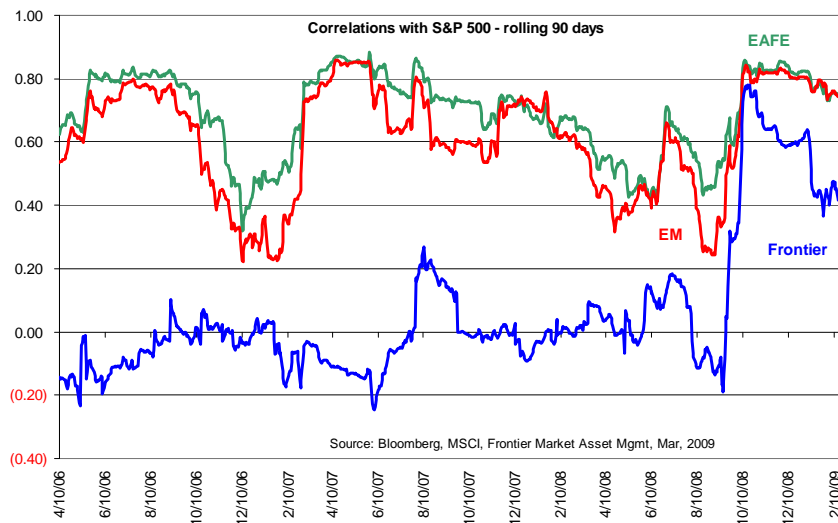
The IMF has forecast continued growth in emerging and frontier countries while GDP in developed countries shrinks. In the frontier, we believe that there are three advantages that will help them through this difficult time:

- 1) Economic growth can be credit or productivity driven. Frontier economies are the latter. Simply adding cell phones raises productivity, let alone improving agriculture (fertilizer) and urbanizing the population.
- 2) China is a positive driver: Its loan growth is up, its stimulus (16% of GDP) is happening now, not in 2010, and China's demand has boosted Baltic freight rates and stabilized several commodity prices (copper, for example, which is a big help for Zambia).
- 3) The simplest economies will be the easiest to fix. Many of them didn't have much credit to begin with.... In most frontier markets, banks are funded with deposits, not borrowings. Loan deposit ratios are around 70%, and they made almost no mortgages, let alone sub-prime ones.

To these positive points, we add the diversification benefits for investors from low correlations, which rose last October but have now returned half way toward the low levels of prior years. Finally, an investor can find exceptional values in the markets where many stocks have PE ratios below 5x and yields of 10% or more.

We believe this is a good time to invest in the frontier.

Exhibit 10



About Frontier Market Asset Management

Founded in 2006, Frontier Market Asset Management holds more than 35 years worth of investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.

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