



Eight Days of Southern Summer: *Kenya, Mauritius & South Africa*

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Nairobi National Park, 15 minutes from downtown, FMAM photo

There are newer hotels in Nairobi, but if you stay at the venerable Stanley, you would sleep where Teddy Roosevelt and Ernest Hemingway did when they came to shoot nearby lions. One hundred years have passed since a lion has wandered into the Nairobi public library, but you can still shoot them...with a camera, 15 minutes away in Nairobi National Park.

If you leave The Stanley at 6 A.M., you can spot 4 lions, 100 zebras and a dozen hart beasts on your way to a 9 A.M. meeting at East Africa Breweries.

The female's two young cubs in the photo above are symbolic of the young people of Africa, who are making a difference in the face of old traditions that die hard. Literacy is a good measure of their progress. For example, in Kenya, literacy has increased 6% within 10 years, from 81% in 2000 to 87% in 2010.

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Literacy Rates	First Year	Latest Year	% Chg	
High income: nonOECD (1990 - 2010)	83%	91%	10%	20 years
Middle income (1990 - 2010)	72%	83%	16%	20 years
Low & middle income (1990 - 2010)	70%	81%	16%	20 years
Low income (1990 - 2010)	51%	63%	24%	20 years
Least developed cties (1990 - 2010)	46%	60%	30%	20 years
Brazil (1980 - 2009)	75%	90%	21%	29 years
China (1990- 2010)	78%	94%	21%	20 years
South Africa (1980 - 2007)	76%	89%	16%	27 Years
Turkey (1975 - 2009)	62%	91%	47%	34 Years

Source: World Bank WDI Database, 2013

The table above shows broader changes in literacy over longer periods. Although it would be nice to have this data for all countries, the message is clear: young people are more educated than their parents. Steven Pinker insightfully summarizes the implications of this message in *The Better Angels of Our Nature*.

“Schooling...increases people’s confidence in their government that it can do at least one thing right. It gives them skills that they can parlay into jobs rather than brigandage and warlording. It keeps teenage boys off the streets and out of the militias.... At least part of the pacifying effects of education consists of giving people tools with which they can resolve disputed peacefully.”¹

	Kenya	Mauritius	Mozambique	Zimbabwe	South Africa
GDP Growth (2013 est)	5.0%	3.7%	7.0%	5%+	2.5%
Inflation	3.5%	3.8%	10.0%	4.0%	5.0%
Population (mil)	43.0	1.3	23.5	12.7	48.8
People / km sq	74	644	29	32	40
% Literate	87%	89%	56%	91%	86%
% Literate Female	84%	86%	43%	87%	86%
% under age 15	43%	22%	46%	42%	28%
Life expectancy	63.0	74.7	52.0	51.8	49.4
% Urban	22%	42%	38%	38%	62%
GDP / cap (PPP)	\$1,800	\$15,600	\$1,100	\$500	\$11,300
Electricity/cap kWh	128.3	2,046.5	432.9	982.7	4,223.4
% Unemployed	40%	9%	21%	60%	24%
Land (km sq)	580,367	2,040	799,380	390,757	1,219,090
Market Cap (\$ bil)	\$10.2	\$6.5	\$0.5	\$10.9	\$855.7
Market Cap/GDP	24.4%	55.0%	3.9%	108.2%	218.9%
GDP (Official Exch Rate)	\$41.8	\$11.9	\$12.8	\$10.1	\$390.9
Military exp % GDP	2.8%	0.3%	0.8%	3.8%	1.7%

Source: CIA Factbook, 2013

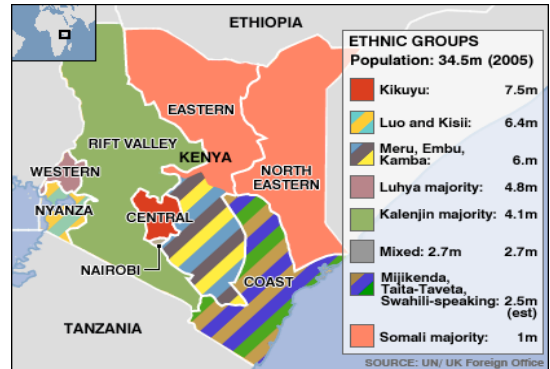
¹ The Better Angels of Our Nature – Why Violence Has Declined, Steven Pinker, Penguin Books, 2012



Kenya

While democratic elections have proceeded without drama in Ghana, Botswana, Zambia and even Nigeria, Kenya is a special case because tribalism still outweighs nationalism.

The prior election, in late 2007, pitted the Lou tribe of 6.4 million against the Kikuyo tribe of 7.5 million. The remaining population of 20 million people had their own grudges against the Kikuyo, who are centered around the city of Nairobi and who have been in power for years.



After the 2007 election, violence broke out, and more than 1,500 people died. Finally, under international pressure, a coalition government was formed with the opposition candidate, Odinga, while several other politicians were indicted for inciting violence.

Under the coalition, Kenya muddled along with a bloated government of 46 ministers who gave everyone a piece of the pie. Kenya has also recently undertook military action in Somalia which has resulted in reprisals, including bombings in downtown Nairobi, from Al Shabab in Somalia

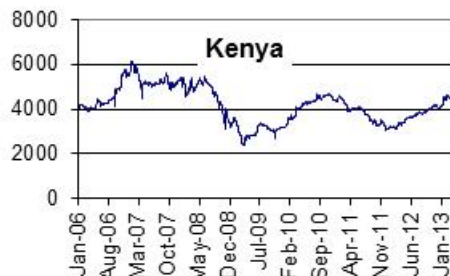
Following our February visit, the election was relatively peaceful. Kenyatta, a Kikuyo, won by a narrow margin. This time, Odinga protested in the courts, and the courts finally declared Kenyatta the winner.

Meanwhile, economically, Kenya is doing fine. It is making the transition from an agrarian society to one with increasing numbers of people holding wage jobs. Now, wage work and self-employment have a greater share of employment than family farming:

Jobs in Kenya (Mill)	1989	1999	2009
Family Farming	4.5	6.2	6.5
Non-Farm Self-Employment	0.9	1.7	2.9
Wage Work	1.9	3.5	5.1

Source: The World Bank, Kenya Economic Update, 2012

Furthermore, an unexpected discovery of oil in the Rift Valley has improved the economic equation for a nation that was thought to be bereft of resources.



Source: Bloomberg, 2013



The Kenyan stock market has performed well lately, up 51% in 2012 and 26% in 1Q 2013. Some of this is the result of good economic growth after the central bank successfully coped with high inflation and a falling currency at the end of 2011. Another explanation of Kenya's returns is due to the relative liquidity of its market at a time when global investors are discovering the opportunities in the frontier. Kenya's place in the world is shown in the table below:

Market capitalization of listed companies (current US\$)

	\$ Billion	2011		\$ Billion	2011		\$ Billion	2011		\$ Billion	2011
China	\$3,389.1		Nigeria	\$39.3		Ukraine	\$25.6		Costa Rica	\$1.4	
Brazil	\$1,229.0		Zimbabwe	\$10.9		Croatia	\$21.8		Paraguay	\$1.0	
India	\$1,015.4		Kenya	\$10.2		Romania	\$21.2		Uruguay	\$0.2	
South Korea	\$994.3		Tunisia	\$9.7		Serbia	\$8.4		Total Lat Am	\$103.9	
South Africa	\$855.7		Uganda	\$7.7		Bulgaria	\$8.3		Saudi Arabia	\$338.9	
Russia	\$796.4		Mauritius	\$6.5		Slovenia	\$6.3		Qatar	\$125.4	
Mexico	\$408.7		Cote d'Ivoire	\$6.3		Slovak Republic	\$4.7		Iran	\$107.2	
Malaysia	\$395.1		Botswana	\$4.1		Lithuania	\$4.1		Kuwait	\$100.9	
Indonesia	\$390.1		Zambia	\$4.0		Malta	\$3.4		United Arab Emirates	\$93.8	
Chile	\$270.3		Ghana	\$3.1		Montenegro	\$3.3		Jordan	\$27.2	
Thailand	\$268.5		Tanzania	\$1.5		Cyprus	\$2.9		Oman	\$19.7	
Turkey	\$201.8		Malawi	\$1.4		Macedonia	\$2.5		Bahrain	\$17.2	
Colombia	\$201.3		Namibia	\$1.2		Iceland	\$2.0		Lebanon	\$10.2	
Philippines	\$165.4		Guyana	\$0.4		Estonia	\$1.6		West Bank and Gaza	\$2.5	
Israel	\$145.0		Total Africa	\$106.3		Latvia	\$1.1		Total Mid East	\$842.9	
Poland	\$138.2		Kazakhstan	\$43.3		Georgia	\$0.8		Total GCC	\$695.8	
Peru	\$79.3		Pakistan	\$32.8		Total E Europe	\$117.9		Other ME ex-Iran	\$39.9	
Morocco	\$60.1		Bangladesh	\$23.5		Argentina	\$43.6		Total Frontier	\$1,325.0	
Egypt	\$48.7		Sri Lanka	\$19.4		Trinidad	\$14.7		Total Frontier ex-GCC	\$522.0	
Czech Republic	\$38.4		Vietnam	\$18.3		Panama	\$10.7				
Hungary	\$18.8		Papua New Guinea	\$9.0		Jamaica	\$7.2		World Totals	2011	
Total EM	\$11,109.4		Nepal	\$4.5		Ecuador	\$5.8		United States	\$15,640.7	
			Mongolia	\$1.6		El Salvador	\$5.5		EAFE	\$16,382.2	
			Fiji	\$1.4		Venezuela	\$5.1		Emerging Markets	\$11,109.4	
			Kyrgyz Republic	\$0.2		Barbados	\$4.6		Frontier	\$1,335.0	
			Total Asia	\$154.0		Bolivia	\$4.1		World Total \$ Billion	\$44,467.3	

Source: WDI database, 2012

Trading volume is most important for large investors. The sample of stocks we monitor shows that Kenya's daily volume was up to \$4.9 million in April 2013, quadruple the level of January 2012 (based on average daily volume from Bloomberg). One Pan-African brokerage firm says that 25% of its business is in Kenya, 60% in Nigeria and 10% in Zimbabwe.



Mauritius

Technically a part of Africa, the oval island of Mauritius is a mere thirty miles from top to bottom. It sits in the Indian Ocean, five hundred miles east of Madagascar and 1,400 miles east of the African coast. Once controlled by the Dutch, then the French and then the British, Mauritius gained independence in 1968. The capital of Port Louis has a colorful mix of colonial buildings among new office towers. They sit in the shadow of sharp peaked hills that are remnants of an ancient volcano that created the place.

Mauritius is a melting pot of 1.2 million people: two thirds from the Indian sub-continent, a quarter from Africa and a sprinkling of Chinese and French; most people speak local Creole, but French and English are used for business; half are Hindu, a third is Christian and one out of eight is Muslim. In a different place, this could be a recipe for strife, but here there is harmony. Since everyone came from somewhere else (as in the USA), there are no ancient territories to dispute. Perhaps equally as important, the government has been fair and the economy has been good. In fact, Mauritius has been a model of resourceful self-sufficiency and harmony in a changing world.



A park in Port Louis preserves and protects some ancient Banyon trees, which are figs that grow on and overwhelm a host tree. Banyons display strong hanging vines that Tarzan could safely use to swing from tree to tree. Swinging from tree to tree is an image that is paralleled by the history of the Mauritius' economy.

Originally, business was based on sugar production. When sugar prices fell in the 1970s, the economy moved into textiles. In the 1990s, Mauritius added tourism. Now one million visitors arrive each year, with a third from France and one out of five from the UK. Lately, Mauritius has also become a financial center, as it now has thirty six dual taxation agreements with other countries, including China, India, most of Africa and Europe.



For years, many global investors often avoided high taxes on the stock market in India by setting up Mauritius subsidiaries. Multinational commercial enterprises benefit as well by having a presence in Mauritius. An added incentive is that Mauritius introduced a flat tax of 15% in 2007, with a further 80% exemption for some foreign enterprises.

A persistent threat comes from Indian politicians, who have talked about cancelling the favorable tax treaties with Mauritius. Some say that Singapore has encouraged this rift. Most, however, expect that the current "three year study period" will only result in some minor adjustments, perhaps closing the loophole that allows "round-tripping" by some Indian companies through Mauritius. The optimists believe that Mauritius serves a useful function for Indian politicians, allowing them to rant against exploitation by foreign investors, while preserving an efficient path for foreigners to invest.

Other challenges have affected the tourism industry: In 2005, a meningitis virus from mosquitos discouraged tourists from coming to the island. Although dormant now, the virus could return. More recently, the Euro crisis has caused hotel occupancy rates to fall from 80% to 60%, which has resulted in a rise of loan loss provisions for hotel borrowings. Due to the falloff in tourism, unemployment is up to 8.5%, with 24% unemployment among youths. With economic growth stuck around 3-4%, joblessness will be a continuing problem.

The Mauritius stock market has a listed board of 40 stocks with 33 more traded over the counter. Recent growth in the banking sector has been driven by increased fee-based income. The banks have growth prospects of 10-12% and sell around 8-9 times earnings. They are high quality, but lower PEs are available elsewhere in Africa. Among commercial companies, many suffer from a lack of focus, with over-diversification into everything - from retail to fish processing to car dealerships. Pure plays are hard to find except in the hotel sector, where the business is capital intensive and times are tough.

South Africa

Even though my stop in Johannesburg was to speak at a CFA Society conference, I also had the opportunity to meet with one of the brokerage firms we use for trades in frontier markets throughout Sub-Saharan Africa.

South Africa is considered an emerging market, so it is not part of our frontier universe. It is a good contrast to the frontier, because its modern expressways and efficient airports show how poorer countries can evolve. Sadly, South Africa has descended into political stalemates that have discouraged investment and limited the country's potential.

Conclusion

Our trip during Africa's southern summer was a reminder that impressions from abroad are often contradicted on the ground. The countries we met are far from perfect, yet they are doing well relative to many struggling developing countries.



Nairobi National Park, in sight of the city

In the Heritage Foundation ranks of Economic Freedom shown below, Kenya has slipped due to its cumbersome government since 2009, but it still ranks above India and China. Kenya is higher than both those BRIC countries on Business Freedom, Monetary Freedom and Investment Freedom. Big improvements are needed in Kenya's corruption score (which comes from Transparency International), but at least the change has been in the right direction. Following Kenya's recent election, a streamlined government could boost Kenya's scores in the years to come. Meanwhile, Mauritius continues to be a

good place to do business. Its score of 76.9 compares favorably with the United States (76.0), the United Kingdom (74.8), Germany (72.8) and France (64.1).

	Kenya		Mauritius		South Africa		India		China	
	2013	4 yr % chg	2013	4 yr % chg	2013	4 yr % chg	2013	4 yr % chg	2013	4 yr % chg
Total Score	55.9	-5%	76.9	4%	61.8	-3%	55.2	2%	51.9	-2%
Business Freedom	58.0	-13%	78.2	-6%	74.7	0%	37.3	-31%	48.0	-7%
Trade Freedom	66.7	-7%	87.9	1%	76.3	2%	63.6	25%	72.0	1%
Fiscal Freedom	77.5	-1%	92.1	0%	70.5	2%	78.3	6%	70.2	-1%
Govt Size	73.5	-10%	81.9	1%	69.2	-11%	77.9	0%	83.3	-6%
Monetary Freedom	73.8	0%	75.4	6%	75.8	2%	65.3	-6%	71.6	-2%
Investment Freedom	50.0	0%	90.0	13%	45.0	-10%	35.0	17%	25.0	-17%
Financial Freedom	50.0	0%	70.0	0%	60.0	0%	40.0	0%	30.0	0%
Property Rights	30.0	0%	70.0	17%	50.0	0%	50.0	0%	20.0	0%
Freedom from Corruption	22.0	5%	51.0	9%	41.0	-20%	31.0	-11%	36.0	3%
Labor Freedom	57.1	-10%	72.3	1%	55.6	-2%	73.6	18%	62.6	1%

Source: Heritage Foundation, 2013

Beyond the insights of the Heritage Foundation ranks, there is no substitute for travel to appreciate the opportunities on the ground in these countries. This trip reinforced our optimism about Africa.

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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