FRONTIER MARKET
Asset Management, LLC
...the road less traveled

Frontier Markets – Worth the Risks?

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> *"It is not a case of choosing those which, to the best of one's judgment, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligences to anticipating what average opinion expects average opinion to be."*
> *– John Maynard Keynes, General Theory (1936)*

Frontier markets are often viewed as quite risky. Indeed they are not without their share of headline grabbing political, military and economic events that are disturbing to investors. However, we believe they need to be measured in comparison to other markets, both emerging and developed, which have demonstrated many often unexpected risks in recent years. In this paper, we discuss the measures of risk presented by the Heritage Foundation and also some of the structural risks that investors must face in frontier markets. We conclude with some thoughts regarding the "beauty contest" in Keynes' quote above describing the challenge of stock market investing.

Economic Freedom:

We believe that the Heritage Foundation provides an excellent framework for comparing the overall mosaic of policies affecting economic opportunity across countries in their rankings of Economic Freedom, www.heritage.org. This score is based on the individual dimensions of business freedom, trade freedom, fiscal freedom, government size, investment freedom, financial freedom, property rights, corruption and labor freedom. Each of these nine factors in turn is based on several sub-components, and the sources used include the World Bank, the Economic Intelligence Unit, the U.S. Dept of Commerce, the World Trade Organization, the OECD, Eurostat and the International Monetary Fund.

BUSINESS FREEDOM
• Starting a business—procedures (number), time (days), cost (% of income per capita), minimum capital (% of income per capita)
• Obtaining a license—procedures (number), time (days), cost (% of income per capita)
• Closing a business—time (years), cost (% of estate), recovery rate (cents on the dollar)
TRADE FREEDOM
• The trade-weighted average tariff rate
• Non-tariff barriers: quantity restrictions, price restrictions, regulatory restrictions, investment restrictions, customs restrictions, and direct government intervention
FISCAL FREEDOM
• The top tax rate on individual income and on corporate income
• Total tax revenue as a percentage of GDP
GOVERNMENT SIZE
• Government spending % of GDP
MONETARY FREEDOM
• The weighted average inflation rate for the most recent three years
• Price controls
INVESTMENT FREEDOM
• Restrictions in sectors related to national security or real estate
• Expropriation risk
• Access to foreign exchange
• Restrictions on transfers or capital transactions

FINANCIAL FREEDOM
• Central Bank Independence
• Freedom of credit allocation
• Contract enforcement
• Presence of private financial institutions
• Foreign financial institutions not restricted
PROPERTY RIGHTS
• Private property guaranteed by the government
• There is no corruption or expropriation
• The court system enforces contracts efficiently and quickly.
• The justice system punishes those who unlawfully confiscate private property
CORRUPTION
• Transparency International's Corruption Perceptions Index (CPI)
LABOR FREEDOM
• Ratio of minimum wage to the average value added per worker
• Hindrance to hiring additional workers
• Rigidity of hours
• Difficulty of firing redundant employees
• Legally mandated notice period

We believe that the Heritage Foundation does a thorough and diligent job of assessing and comparing the risks for investors and business owners around the world. Their results can also provide a good measure of the risks and opportunities for portfolio investors. Frontier countries are underlined in exhibit 1.

Exhibit 1

Economic Freedom Ranks - Heritage Foundation 2009

Hong Kong	90.0	**Botswana**	**69.7**	**Mongolia**	**62.8**	Cambodia	56.6	Maldives	51.3
Singapore	87.1	Taiwan	69.5	**Namibia**	**62.4**	Algeria	56.6	Guinea	51.0
Australia	82.6	**Slovak Republic**	**69.4**	Colombia	62.3	**Zambia**	**56.6**	Vietnam	51.0
Ireland	82.2	Czech Republic	69.4	Madagascar	62.2	Serbia	56.6	***Russia***	***50.8***
New Zealand	82.0	**Uruguay**	**69.1**	**Kyrgyz Republic**	**61.8**	**Senegal**	**56.3**	Haiti	50.5
United States	80.7	Saint Lucia	68.8	Turkey	61.6	**Sri Lanka**	**56.0**	**Uzbekistan**	**50.5**
Canada	80.5	South Korea	68.1	Italy	61.4	Mozambique	55.7	Laos	50.4
Denmark	79.6	**Trin & Tobago**	**68.0**	**Macedonia**	**61.2**	Mali	55.6	Lesotho	49.7
Switzerland	79.4	Israel	67.6	**Paraguay**	**61.0**	**Croatia**	**55.1**	**Ukraine**	**48.8**
United Kingdom	79.0	**Oman**	**67.0**	**Fiji**	**61.0**	**Nigeria**	**55.1**	Burundi	48.8
Chile	78.3	Hungary	66.8	Greece	60.8	Gabon	55.0	Togo	48.7
Netherlands	77.0	**Latvia**	**66.6**	Poland	60.3	**Ivory Coast**	**55.0**	**Guyana**	**48.4**
Estonia	**76.4**	**Costa Rica**	**66.4**	**Kazakhstan**	**60.1**	**Moldova**	**54.9**	Ctrl African Rep	48.3
Iceland	75.9	**Malta**	**66.1**	Nicaragua	59.8	Papua New Guinea	54.8	Liberia	48.1
Luxembourg	75.2	**Qatar**	**65.8**	Burkina Faso	59.5	Tajikistan	54.6	Sierra Leone	47.8
Bahrain	**74.8**	Mexico	65.8	Guatemala	59.4	***India***	***54.4***	Seychelles	47.8
Finland	74.5	**Kuwait**	**65.6**	Dominican Republic	59.2	Rwanda	54.2	**Bangladesh**	**47.5**
Mauritius	**74.3**	Jordan	65.4	**Swaziland**	**59.1**	Suriname	54.1	Chad	47.5
Japan	72.8	**Jamaica**	**65.2**	**Kenya**	**58.7**	Tonga	54.1	Angola	47.0
Belgium	72.1	Portugal	64.9	Honduras	58.7	Mauritania	53.9	Guinea-Bissau	45.4
Macau	72.0	**UAE**	**64.7**	**Tanzania**	**58.3**	Niger	53.8	Congo	45.4
Barbados	71.5	**Panama**	**64.7**	Montenegro	58.2	**Malawi**	**53.7**	Belarus	45.0
Austria	71.2	**Bulgaria**	**64.6**	**Lebanon**	**58.1**	**Bolivia**	**53.6**	**Iran**	**44.6**
Cyprus	**70.8**	Peru	64.6	**Ghana**	**58.1**	Indonesia	53.4	Turkmenistan	44.2
Germany	70.5	Malaysia	64.6	**Egypt**	**58.0**	***China***	***53.2***	Libya	43.5
Sweden	70.5	**Saudi Arabia**	**64.3**	**Tunisia**	**58.0**	**Nepal**	**53.2**	**Venezuela**	**39.9**
Bahamas	70.3	South Africa	63.8	Azerbaijan	58.0	Bosnia and Herzegov	53.1	Eritrea	38.5
Norway	70.2	Albania	63.7	Bhutan	57.7	Ethiopia	53.0	Burma	37.7
Spain	70.1	**Uganda**	**63.5**	Morocco	57.7	Cameroon	53.0	Cuba	27.9
Lithuania	**70.0**	France	63.3	Pakistan	57.0	**Ecuador**	**52.5**	**Zimbabwe**	**22.7**
Armenia	**69.9**	**Romania**	**63.2**	Yemen	56.9	Argentina	52.3	Korea, North	2.0
Georgia	**69.8**	Thailand	63.0	Philippines	56.8	Syria	51.3		
El Salvador	**69.8**	**Slovenia**	**62.9**	Brazil	56.7	Eq. Guinea	51.3		

One can see that Russia (50.8), China (53.2), India (54.4) and even Italy (61.4) have lower scores than many frontier countries, such as Uganda (63.5), Panama (64.7) and Botswana

(69.7). Furthermore, the average of all frontier countries is 73.0 versus 75.3 for emerging countries, 83.2 for EAFE and 83.7 for the United States. Since 1995, the average of frontier countries has improved by 18 points, emerging countries by 13 points and EAFE by one point, while the US is flat. Based on these ranks, investors who are already investing in emerging markets should understand that the relative risks of investing in frontier markets are not significantly different.

A sample of changes in ranks over the past fourteen years is in exhibit 2, which makes several interesting points: Hong Kong remains at the top, Japan has dropped a bit, Botswana has risen above Korea, while Thailand has dropped below Bulgaria and Romania. Also, Mongolia has improved dramatically, while Argentina and Venezuela have plunged. And Ukraine and Bangladesh have made good improvements.

Exhibit 2

Heritage Foundation Economic Freedom Ranks

	1995	2009	% Change
EAFE	70.9	75.3	6%
Emerging Markets	59.7	61.3	3%
Frontier	56.6	60.3	7%
Hong Kong	88.6	90.0	2%
United States	76.7	80.7	5%
Japan	75.0	72.8	-3%
Botswana	56.8	69.7	23%
South Korea	72.0	68.1	-5%
Bulgaria	50.0	64.6	29%
Romania	42.9	63.2	47%
Thailand	71.3	63.0	-12%
Mongolia	47.8	62.8	31%
Colombia	64.5	62.3	-3%
Kenya	54.5	59.6	9%
Morocco	62.8	57.7	-8%
Brazil	51.4	56.7	10%
Ghana	55.6	56.7	2%
India	45.1	54.4	21%
Bolivia	56.8	53.6	-6%
China	52.0	53.2	2%
Argentina	68.0	52.3	-23%
Vietnam	41.7	51.0	22%
Russia	51.1	50.8	-1%
Ukraine	39.9	48.8	22%
Bangladesh	38.7	47.5	23%
Venezuela	59.8	39.9	-33%

Source: Heritage Foundation, 2009

We believe that governments are paying attention to studies like these. Shinning light on government inefficiencies helps to change them. We do not believe it is a coincidence that the World Bank's "Doing Business" project shows reductions in red tape. Also, several governments are taking action to simplify their tax codes. Mauritius reduced tax rates from 25% to 15% (though now they are going up to 17%). Meanwhile, Kazakhstan is taking its corporate tax rate from 30% in 2008 to 20% in 2009, 17% in 2010 and 15% in 2011. It would be better to implement the full reduction immediately because much business activity will be delayed, but the changes are still in the right direction. Perhaps Qatar has the best policies. There is no income tax, and they have drafted a law to cut the corporate tax from 35% to 10%.

Structural Risks:

In addition to the macro factors affecting economic freedom, investors in frontier markets face challenges from an implementation standpoint. Money managers cannot overlook operational risk when investing in frontier countries. Notable risks that are most concerning to institutional investors are related to custody, trading and settlement. They also include liquidity constraints, transparency, foreign exchange, and counterparty risks. These risks can impact how money managers invest in frontier countries and can be limiting for some. Operational limitations serve to narrow the universe of money managers investing in frontier markets and the breadth of their geographical coverage.

Bureaucracy: The bureaucracy involved in opening local accounts can be taxing in the face of Byzantine regulations or local limits on foreign purchases. Recently there was only one stock in Tanzania with less than the 60% foreign ownership limit, so foreign investors needed to seek out other foreign investors to trade with, often a premium prices to the market. In some cases, such as Vietnam, it can take over a year and a half for a foreign investor to obtain regulatory approval to invest, and then that approval requires the selection of a single broker with whom all trades must be done.

Order handling presents challenges as well, with close monitoring needed to prevent orders from being “lost” or even executed in the wrong stock. Also, initial public offerings generally favor local investors, and sometimes exclude foreigners altogether. Finally, commissions and fees can result in one-way transaction costs that run from a low of 1% to a high of 5%, with most trades falling in the 2-3% range. In Mongolia and Iraq, commission charges alone are over 4%.

Exhibit 3

Bid-Ask Spreads	Average	Median
U.S. (sample)	0.06%	0.06%
PANAMA	0.11%	0.11%
QATAR	0.36%	0.33%
JORDAN	0.84%	0.64%
TUNISIA	1.13%	0.73%
GEORGIA	0.78%	0.78%
VIETNAM	1.24%	0.88%
ROMANIA	1.80%	1.14%
LITHUANIA	2.53%	1.35%
LATVIA	1.76%	1.54%
SLOVENIA	3.02%	2.25%
ESTONIA	2.52%	2.26%
SRI LANKA	3.77%	2.33%
BAHRAIN	2.89%	2.89%
CROATIA	5.33%	3.26%
UKRAINE	8.12%	4.29%
KAZAKHSTAN	7.66%	5.21%
JAMAICA	5.93%	5.35%

Source: Bloomberg, Oct. 3, 2008, based on 155 frontier stocks

Counterparty Risk: Counterparty risk can be significant in trading and settlement relationships. Existing issues include delivery of stock and payment arrangements which, depending on the arrangement, could result in settlement delays. While measures like a central counterparty system to reduce settlement delays and insurance are in place in several relationships, these measures are sometimes inadequate. Also non DVP (Delivery versus Payment) markets like Bangladesh, Ukraine, Qatar, and Kuwait require a trading account where shares are moved for execution. In Bangladesh, risk is reduced because of an effective custodian network, while in Qatar payment is through the clearing house. In other cases, however, brokers have access to the trading account and could move shares in pending state, which exposes the client to counterparty risk. Interestingly, this situation also exists in Russia, a popular emerging market. On an overall basis, the operations department at Auerbach Grayson, a brokerage firm with local broker relationships around the world, says that trading in frontier markets is little different from trading in emerging markets, since practically every market has moved to using a central depositary system.

Foreign Exchange: Foreign exchange risk needs to be evaluated carefully because certain frontier currencies are very volatile. Global custodians have the predominate practice of restricting frontier market currencies to in-house foreign exchange conversion, where they sometimes impose sizeable charges that range from 0.5% to 2.5% or more. The few markets that require prefunding, like Mongolia and Malawi, can expose investors to both counterparty risk and foreign currency risk. In some cases, like Vietnam, the prefunded amount can be held in a U.S. dollar account. There can be risk of capital controls, which constitute a significant form of foreign exchange risk. In December 2008, managers experienced delays in executing foreign exchange orders in Nigeria following a sharp fall in the Naira after the authorities placed controls on its foreign exchange market.

While these operational risks do exist, money managers who are already investing in the frontier markets are quick to note that the investment environment in frontier markets is not different from what it was when they first started investing in emerging markets. Money managers who were pioneers investing in emerging markets seem to also be the early adopters in frontier markets. Money manager experience, strong internal risk controls, and partnerships with entrenched global custodians and brokers are all helpful in mitigating these risks.

The Beauty Contest:

While our bias is towards bottom up research, we believe that is worth considering the beauty contest among stocks markets in light of the quote from Keynes at the start of this paper. There are many interesting studies of the top down macro factors that seem to be related to positive economic growth and stock market success. Unfortunately, history is littered with examples of failures in policy, and those have received attention lately. Easterly (2002) has recounted the poor policy ideas in the developing world over recent decades, and he and others, including Moyo (2009), have criticized the corruption and waste that have undermined aid programs.

More positive is some recent work by Goldman Sacks (2007) that has extended their study of the BRIC countries (Brazil, Russia, India and China), they examine a universe they call the Next Eleven (N-11):

1) Bangladesh (frontier)
2) Egypt (emerging)
3) Indonesia (emerging)
4) Iran (frontier, but closed to U.S. investors)
5) South Korea (emerging)
6) Mexico (emerging)
7) Nigeria (frontier)
8) Pakistan (frontier)
9) Philippines (emerging)
10) Turkey (emerging)
11) Vietnam (frontier)

This is a set of large-population countries that have the potential to become significant economic factors in the world. In their studies, Goldman considers the following elements in their Growth Environment Score (GES):

Macroeconomic stability: inflation, government deficit and external debt
Macroeconomic conditions: investment and openness (trade)
Human capital: schooling and life expectancy
Political conditions: political stability, rule of law and corruption
Technology: number of personal computers, telephones and internet users

Of the frontier countries in the N-11, Vietnam is closest to “Best in Class” in GES, while Nigeria is the lowest.

On the other hand, there may be merit in looking at “beauty” in frontier markets from the forward looking perspective of the potential for change rather than simply measuring current conditions. When looking at emerging and frontier markets, it is important to realize that the greatest opportunities may lie in those places that are nowhere near beautiful today, but have the potential for change. The California Public Employees’ Retirement System (CalPERS) fell into this trap when it voted to exclude countries from its investible universe if they failed to meet its standards (that included measures of political stability, transparency, labor practices liquidity, volatility, regulation, investor protection, openness, settlement proficiency and transaction costs.) Unfortunately, by excluding countries with low ranks, such as Russia, Indonesia, Sri Lanka and Thailand, CalPERS penalized the return of its investments in emerging markets significantly, because the poorly ranked countries were precisely the ones that were able to make the greatest improvements.

We have already reviewed the methodology of the Heritage Foundation in their Economic Freedom scores, and they provide a history of their scores back to 1995 in a spreadsheet that can be downloaded from their website.

We believe that a good indicator of potential is the recent change in Economic Freedom, so we looked at the recent changes from 2005 to 2009. Obviously, there are many other perspectives one could bring to bear on the question, but this may be a useful starting point to identify some countries of interest.

Exhibit 5

	2009	Chg 05-09	% Chg		2009	Chg 05-09	% Chg
Georgia	69.8	13.34	23.6%	Bangladesh	47.5	(1.36)	-2.8%
Romania	63.2	11.23	21.6%	Senegal	56.3	(1.62)	-2.8%
Turkey	61.6	10.00	19.4%	Singapore	87.1	(2.63)	-2.9%
Nigeria	55.1	6.96	14.4%	Jamaica	65.2	(2.41)	-3.6%
Kazakhstan	60.1	6.78	12.7%	Ivory Coast	55.0	(2.67)	-4.6%
Mauritius	74.3	7.04	10.5%	Italy	61.4	(3.45)	-5.3%
Morocco	57.7	5.07	9.6%	Trinidad	68.0	(4.35)	-6.0%
Japan	72.8	6.04	9.1%	Sri Lanka	56.0	(4.63)	-7.6%
Uzbekistan	50.5	4.17	9.0%	Brazil	56.7	(5.01)	-8.1%
Macedonia	61.2	4.70	8.3%	Iran	44.6	(3.99)	-8.2%
Israel	67.6	5.17	8.3%	Bolivia	53.6	(5.64)	-9.5%
Norway	70.2	5.21	8.0%	Venezuela	39.9	(5.58)	-12.3%
Algeria	56.6	3.95	7.5%	Ukraine	48.8	(7.26)	-13.0%
Vietnam	51.0	3.40	7.1%	Zimbabwe	22.7	(12.41)	-35.4%

Source: Heritage Foundation, 2009

Exhibit 5 shows countries with the greatest gains and losses, sorted by percent change, and it contains an interesting mix of frontier, emerging and developed countries. By this measure, Nigeria shows good progress, along with developed Japan and emerging Israel, while the disasters in Zimbabwe and Venezuela are well known, but it is interesting to see the declines in Italy and Singapore.

We look at the components of the ranks of some of the gainers in exhibit 6 to see that Romania and Kazakhstan have made huge gains in investment freedom (lower expropriation risk and restrictions on transactions), while in Nigeria, the corruption score has improved from an abysmal level. In Mongolia, bureaucracy has been reduced, reflected in better business freedom and slammer government.

Exhibit 6

	Romania 2009	Romania % chg	Nigeria 2009	Nigeria % chg	Kazakhstan 2009	Kazakhstan % chg	Mongolia 2009	Mongolia % chg
Total Score	63.2	21.6%	55.1	14.4%	60.1	12.7%	62.8	6.3%
Business Freedom	74.9	36.2%	55.1	0.1%	57.9	5.3%	71.0	29.0%
Trade Freedom	85.8	21.9%	61.8	15.7%	86.2	32.6%	81.2	5.5%
Fiscal Freedom	87.0	24.0%	84.4	0.5%	82.8	0.3%	81.3	10.4%
Gov't Size	70.0	1.7%	64.3	32.3%	87.5	1.9%	69.9	74.4%
Monetary Freedom	75.0	19.8%	77.9	17.8%	70.0	-5.3%	76.7	-12.5%
Investment Freedom	60.0	100.0%	30.0	0.0%	30.0	200.0%	60.0	20.0%
Financial Freedom	50.0	0.0%	40.0	33.3%	60.0	100.0%	60.0	20.0%
Property Rights	35.0	16.7%	30.0	0.0%	25.0	-16.7%	30.0	-40.0%
Freedom from Corruption	37.0	32.1%	22.0	57.1%	21.0	-12.5%	30.0	-30.2%
Labor Freedom	57.1	4.8%	85.8	21.6%	80.5	4.8%	67.7	5.7%

Source: Heritage Foundation, 2009

Among countries where things have deteriorated, in exhibit 7, Zimbabwe's government has become bloated relative to its shrinking economy, while hyperinflation has resulted in no monetary score at all. Venezuela's problem has been the abrogation of property rights by the Chavez government, while Ukraine has seen its growing government leading to burdensome bureaucracy which lowers business freedom.

Exhibit 7

	Zimbabwe 2009	Zimbabwe % chg	Ukraine 2009	Ukraine % chg	Venezuela 2009	Venezuela % chg
Total Score	22.7	-35.4%	48.8	-13.0%	39.9	-12.3%
Business Freedom	30.8	-44.1%	40.5	-26.3%	50.8	-7.6%
Trade Freedom	50.4	-17.4%	84.0	10.2%	59.6	-4.5%
Fiscal Freedom	44.1	-33.2%	77.0	-7.2%	70.6	-6.8%
Gov't Size	4.6	-93.9%	39.0	-50.4%	69.3	-13.6%
Monetary Freedom	-	-	68.1	-10.7%	53.7	3.4%
Investment Freedom	10.0	0.0%	30.0	0.0%	10.0	0.0%
Financial Freedom	10.0	0.0%	40.0	-20.0%	30.0	0.0%
Property Rights	5.0	-50.0%	30.0	0.0%	5.0	-83.3%
Freedom from Corruption	21.0	-8.7%	27.0	17.4%	20.0	-16.7%
Labor Freedom	51.2	22.8%	52.4	-10.6%	30.1	-15.4%

Source: Heritage Foundation, 2009

For comparison, we show the scores of the BRICs in exhibit 8. The best result is India, with no change, while the others have small drops except for Brazil, on of the worst in exhibit 5. Brazil and Russia have both had worsening government policies, reflected in taxes (lower fiscal freedom) and size of government. Both have also had worsening problems of corruption, while India has made a big improvement and China a small one. It is interesting that the scores of the BRICs are only slightly above Ukraine and below those of even Nigeria.

Exhibit 8

	Brazil 2009	Brazil % chg	Russia 2009	Russia % chg	India 2009	India % chg	China 2009	China % chg
Total Score	56.7	-8.1%	50.8	-1.5%	54.4	0.0%	53.2	-0.6%
Business Freedom	54.4	-22.3%	54.0	-1.8%	54.4	-1.0%	51.6	-6.3%
Trade Freedom	71.6	9.8%	60.8	-3.8%	51.0	34.2%	71.4	31.3%
Fiscal Freedom	65.8	-23.6%	78.9	-13.7%	73.8	-2.4%	70.6	3.9%
Gov't Size	50.3	-28.0%	70.6	19.8%	77.8	2.0%	88.9	3.4%
Monetary Freedom	77.2	6.3%	65.5	-0.1%	69.3	-10.5%	72.9	-14.1%
Investment Freedom	50.0	0.0%	30.0	0.0%	30.0	-40.0%	30.0	0.0%
Financial Freedom	50.0	0.0%	40.0	33.3%	40.0	33.3%	30.0	0.0%
Property Rights	50.0	0.0%	25.0	-16.7%	50.0	0.0%	20.0	-33.3%
Freedom from Corruption	35.0	-10.3%	23.0	-14.8%	35.0	25.0%	35.0	2.9%
Labor Freedom	62.7	-2.4%	60.0	-6.9%	62.3	-1.3%	61.8	-1.9%

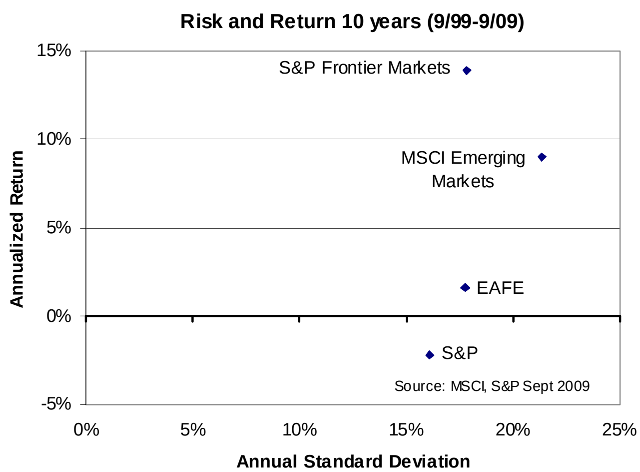
Source: Heritage Foundation, 2009

The changes in scores of frontier countries are encouraging, and we believe that Romania, Nigeria, Kazakhstan and Mongolia are countries to watch for the future. At the same time, countries that have deteriorated over the past five years can present an opportunity if there is a change in direction. This could be happening now in Zimbabwe, and the stock market there has recently soared on that hope. There is clearly a difference between countries that seem to be building long-term momentum in Economic Freedom and those that move from bad to slightly less bad. The beauty contest will be won by those countries that succeed in attracting long-term capital, from direct investors and from portfolio investors like ourselves.

Global Portfolios:

Despite the challenges, we believe frontier markets are worth the work. In exhibit 9, we show the results of frontier, emerging and developed markets over the past decade. While this is not predictive, it does show that frontier markets have been a good place to be invested. We need to combine our awareness of history with and understanding of the current low valuations and high inefficiencies of frontier markets. If that matches with an optimistic outlook then it is not hard to justify at least a market weighting in frontier markets. In the section 1 or this monograph, exhibit 3 showed that frontier markets are currently 3.1% of world market capitalization according to World Bank data. They are also 12.5% of the combined emerging/frontier weighting. Based on the excellent returns they have demonstrated, it would not be hard to suggest higher weightings than those.

Exhibit 9



	S&P 500	EAFE	Emerging Markets	Frontier BMI
10 year return to 9/09	-1.5%	34.1%	137.1%	283.4%
Correlation to S&P	1.00	0.87	0.79	0.50
Standard Deviation	16.2%	18.0%	21.5%	18.1%

Source: MSCI, S&P, Frontier Market Asset Management, 2009

Conclusion:

After examining the risks of frontier markets, we believe that they are quite similar to those of emerging markets. While many investors still perceive frontier markets as being in decline, ravaged by wars, disease, famine and authoritarian governments, this view often reflects media reporting rather than reality. Many frontier countries have undergone a radical restructuring of their economies since the early 1990's, and their macroeconomic fundamentals are often sound and encouraging. Often real per capita GDP is rising, inflation is low, currency exchange rates are becoming more stable, and corporate profits and return on investment are relatively high. Thus, from an economic standpoint frontier market countries are indeed emerging rather than stagnating. They are not formally recognized as emerging today, but with further progress it will not be possible to ignore them much longer.

Looking ahead, these markets may represent the final frontier for global capital. As the emerging markets of today move on to become part of the developed world, the stage is set to bring along a new set of emerging candidates in the frontier markets. While available information is often sparse, local regulations are varied and complex and research coverage by analysts and brokerage firms is limited, these were also the characteristics of emerging markets as recently as ten years ago. Challenges such as these create opportunities for investors to uncover neglected companies with healthy or improving operations and to identify stocks that have been ignored by the mainstream investment community. With patience, care and good diversification, we believe that frontier markets can prove very rewarding and can make a significant contribution to global portfolios. Furthermore, our own investments in these markets will make them broader, deeper, more liquid and more efficient. We believe that frontier stock markets will have the opportunity to create a win-win situation, for both investors and frontier countries themselves.

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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.

other investments and will reduce the portfolio return. Consult the fund's offering memorandum for complete risk disclosures and other important information.

The information has been compiled from sources we believe to be reliable, but we do not hold ourselves responsible for its correctness. Opinions are presented without guarantee.

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