

Sur le Chemin de la Paix (*On the Path to Peace*)

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By Lawrence Speidell

Africa is at a turning point.

Cote d'Ivoire is ending a five year civil war - an example to other African states of the terrible consequences of bad politics, religious/tribal discrimination, a fragmented army and a surplus of weapons in the hands of teenagers. Meanwhile, Kenya's recent election, rife with cheating, was a close call for a country with much to lose. Reason has prevailed based on both pressure from abroad and, ultimately, cool heads in the country.

Both countries have looked into the abyss... and blinked.



Kids in the Market, Abidjan, Cote d'Ivoire; Source: FMAM

Now rubber and palm oil plantations are back in business in the west of Cote d'Ivoire, where not long ago, mercenaries from Liberia did dirty work for both the northern and southern forces. Liberia is at peace too, and the result is a virtuous circle in West Africa, where trade and commerce can offer more jobs, rising incomes and better lives. The only losers seem to be the Liberian refugees in Ghana, now protesting government orders to return home.

With the African economy growing at 5-6% in most countries, progress is good, but there is potential for acceleration to 8-10% if improvements can occur in the remaining black holes: the Congo and Zimbabwe.

Poor Cote d'Ivoire, stable Ghana and rich Kenya stretch from west to east 3000 miles across equatorial Africa. Our March research trip with clients visited twenty companies in finance, energy, materials, power, water and agribusiness. We looked at macro factors, micro factors and market factors; and we met people in the streets, people in market stalls, and people in top floor executive offices. In Cote d'Ivoire, we found cheap stocks, some with good managements. In Ghana, we found improvements in the electricity shortages and excitement over last year's oil discovery. And in Kenya, we found optimistic people doing "business-as-usual" despite hysterical headlines in the foreign press reporting on the recent political strife.

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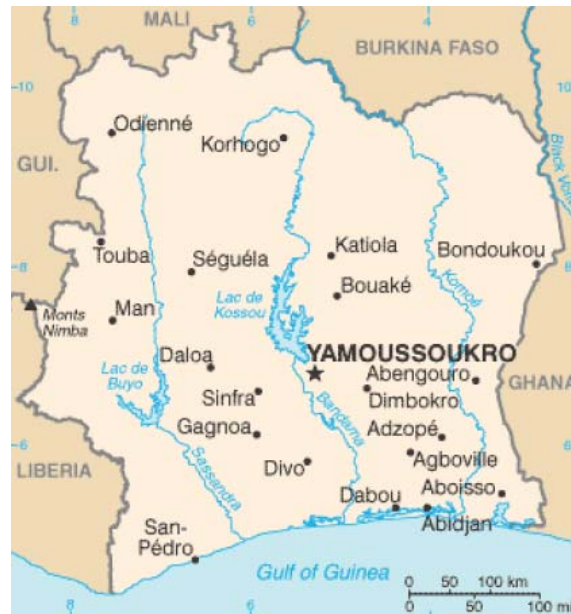
	Cote d'Ivoire	Ghana	Kenya	Emerging Mkts	USA	EAFE
RGDP Growth (2008e)	2.5%	4.5%	2.5%	4.0%	2.0%	2.0%
GDP/Capita	\$576	\$300	\$456	\$4,290	\$38,165	\$26,753
Inflation	2.0%	8.0%	10%	3.5%	2.0%	1.5%
Population (mil)	18.2	22.1	36.1	4,756.6	296.5	582.2
Population % <15 years	42%	39%	43%	29%	21%	17%
Population % > 65 years	3%	4%	3%	7%	12%	15%
Corruption (10=best)	2.1	3.7	2.1	4.1	7.2	8.2
Market Cap (\$ mil)	\$2,914	\$3,000	\$12,000			
Float (S&P/IFC)	\$400	\$489	\$2,953			
PE	10.1	10.2	20.9	17.0	17.2	14.2
PB	2.5	3.2	4.7	2.8	2.8	2.2
ROE	24.8%	31.5%	22.5%	16.6%	16.4%	15.4%

Source: World Bank, S&P, MSCI & Frontier Market Asset management, 2008



Cote d'Ivoire (Ivory Coast)

After five years of civil war, the streets of Abijan are filled with potholes - just like the country's path to peace. Once called the Paris of West Africa, office towers in "Le Plateau" of the city are now shabby, with tattered blinds and several broken windows. One can still dine in comfort on the best French cuisine at La Croisette, but if you travel across the lagoon to Trechville or Marcory in the southern part of the city, you can see where many of Abidjan's five million people live, including the two million new refugees from war-torn areas. Teeming markets are colorful, and the people friendly, but their conditions are desperate. However, their potential is shown by the vendors weaving through cars stuck in traffic at every intersection. You can buy food, household products, sunglasses, CDs - practically anything from the comfort of your driver's seat! If the country could tap this entrepreneurship and move from 50% unemployment to a more robust formal economy, the growth could be astonishing.



Cote d'Ivoire's problems began in 1999 when the government de-listed voters unless both their parents had been born in the country. Next came a coup and followed by increased persecution of Muslims in the north. It deteriorated when the army fragmented along religious lines (35% of the country is Muslim), and civil war broke out. The country was divided, with the poor arid north fighting the rich south to a standstill. Peace agreements were made and violated again and again, almost on a monthly basis. Parts of the economy, especially rubber and palm oil plantations, were shut down. Now finally, there is peace, with a coalition government. At last, the postal service is sorting through a five year backlog of mail for customers in the north (one student learned that he had been accepted to the Sorbonne years ago). Nine thousand French and West African UN troops remain in the country, working on disarmament, demobilization and rehabilitation. The key to the future is voter registration, and this will take time. The long awaited election, scheduled for June 2008, will be postponed, probably to next year.

Because of the war, the economy lost 20% of its potential growth, but it still has a lot of potential. Although weaker than it was, the education system is still the best in the region. With the CFA Franc tied to the Euro, inflation is only 2%, and currency risk is low. Cote d'Ivoire has oil and gas and is increasing production. Despite deferred infrastructure maintenance (25% of electric power is "lost"), there is a power surplus, with CIE exporting 700 megawatts out of 2,000 mw production to Burkina Faso, Benin and Ghana. Additionally, the agricultural base is huge, with, palm oil, rubber and cocoa (600,000 farmers grow 40% of world's production).



Boulevard General de Gaulle runs along the Lagoon

Meanwhile, stocks are cheap in this \$2.9 billion market (excluding the \$4.3 billion of Sonatel, the Senegal telecom that trades here). The average trailing PE is 10x, and the dividend yield is more than 6%. Stocks are quite diverse, including banks (subsidiaries of French institutions), plantations, utilities, food and trading companies. Foreign investors currently hold 25% of the stocks and do 70% of the trading. This could change, but so far, the stock exchange has done little to help build an equity culture among potential retail investors.



Ghana

While waiting at passport control in Accra beneath big banners proclaiming "Akwaaba" (welcome), it was not hard to notice that a third of the arrivals were from China. One of the big stories on the continent today is the willingness of the Chinese to invest with few strings attached, and to establish a presence in local business. In Accra, the Chinese built the new national theater. On my way home from this trip, I met a squad of investment bankers from Shanghai searching for non-ferrous metals deals at a Sub-Saharan Africa conference in London. In Ghana, China has negotiated freedom for its people to set up businesses without hassles.



Chinese 200 megawatt power plant being built

Unfortunately, this inbound investment brings out the bad side in politicians, who seem committed to extracting some personal wealth from the situation. While the country struggles to grow its economy in the face of damaging power shortages, an important project has been delayed by an approval process designed to benefit certain officials.

Despite this, Ghanaians are hard working and optimistic. Power plants will be coming on line later this year, natural gas will soon come from Nigeria, the country's own oil

discovery is expected to come on line next year, and the December elections are expected to be peaceful. With these improvements, inflation should drop and the central bank rate may go from 13.5% to 11% by year end. During the past year, the stock market has done well - up more than 35% - and soon liquidity should improve when the exchange becomes automated in June.



Kenya

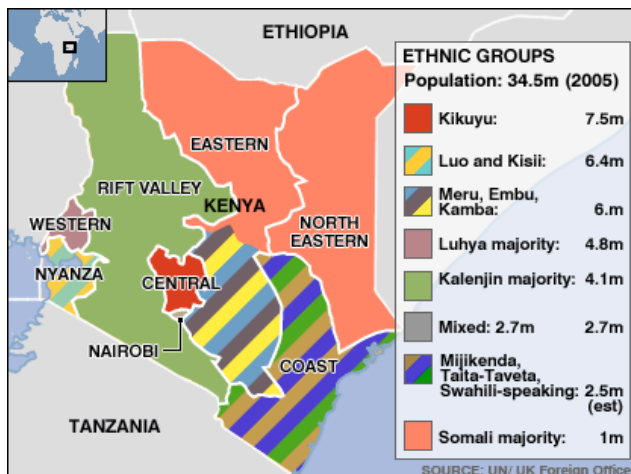
After a night flight from Ghana, our arrival in Nairobi coincided with morning rush hour.

With traffic at a standstill, it took two hours to reach the center. Somewhat ominous was the sight of dozens of giant vultures, normally found out in the bush, perched in trees over the clogged road, peering down for road-kill. Soon the traffic conditions will improve, when highway construction is finished (with help from the Chinese), but more important will be improvement in the political situation.



Vultures looking for road kill

When we visited our friends in Kenya last October, clouds seemed to be brewing over the stock market. The election contest was heating up and the challenger, Raila Odinga was ahead in the polls against the somewhat boring figure of 76 year-old Kibaki. The long awaited public offering of Safaricom, the dominant mobile operator, was also expected to occur, providing IPO gains to subscribers. Raila had sure to prevent this, but it looked like the offering would go forward ahead of the December election, currying favor with voters and weighing on the stock market (Safaricom will be 25% of Kenya's market cap).



The election was really a tribal conflict, with the Lou tribe of 6.4 million, feeling that they had been excluded from positions of power by the Kikuyo tribe of 7.5 million, which is mostly centered around Nairobi. The remaining 20 million people had their own grudges against the Kikuyo, but they could go either way.

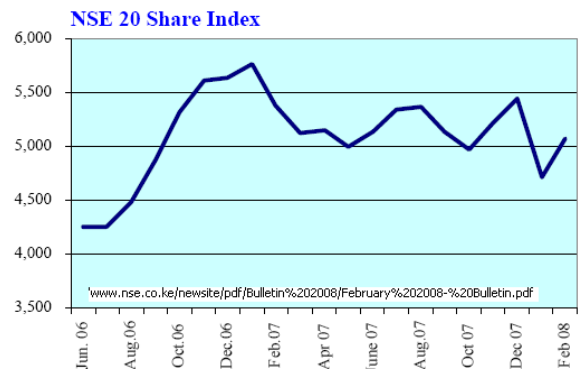
It was puzzling then that the stock market rose right up to the election....

Results were close, with cheating on both sides, but Kabaki immediately declared himself the winner and appointed a minority tribesman as Vice-President. Violence broke out, especially in

the Rift Valley, and more than 1,500 people were killed. As Kofi Anan arrived in the country to negotiate a settlement, Kibaki went ahead and appointed half his cabinet....

Sitting by the pool in the posh 100 year old Muthaiga Club, it is easy to assume that the country's troubles are over. The Club is integrated, and it is serene though a bit stuffy despite several kids playing in the water. On the streets of Nairobi, things are more chaotic, but it is a good chaos comprised of busy people trying to get from place to place, keeping the economy going. Tourism has collapsed, and exports of tea, coffee and flowers have been disrupted by transportation problems, but most of the economy is trying to get back to normal; and seems to be doing a pretty good job of it.

Even the stock market is holding up. The Kenyan shilling dipped to a low of 77 to the dollar in January 2008, but it is 67 now, just where it was in October 2007; and the Nairobi Stock Exchange Index was 5,000 in October 2007, 4,700 at its January low and up to 5,100 now.



It is difficult to know if the power-sharing agreement between Raila and Kibaki will hold up. It is difficult to know if plans to rewrite the constitution will proceed smoothly (probably not....); and with Safaricom still scheduled to come to market in the near future, we're inclined to be observers and let the dust settle a bit.

Conclusion

As optimists on Africa, we believe it is important to look at the trouble spots. Clearly progress is irregular, and the path the peace in Cote d'Ivoire and Kenya will be irregular. On the other hand, lessons learned from the tragedy of Rwanda have made the global community more sensitive to the dangers and more active in its response. One cannot predict that all the trouble spots in frontier markets will be resolved, but solving a few of them will produce gains that will more than offset the losses elsewhere.



Ghanaians celebrating their 51st Independence Day at the slave castle in Cape Coast

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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