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## The Street's Rush Into Far Frontiers Offers Big Game and Bigger Risks

By JEFF D. OPDYKE

June 16, 2008; Page C1

(See *Corrections and Amplifications* [item below](#).)

Wall Street's specialty is chasing returns. And these days it's chasing returns in places like Nigeria and Oman.

As stocks in the U.S. and other developed markets flounder, financial-services firms are creating investment vehicles designed to tap into some of the tiniest -- albeit fastest-growing -- economies in the world.

These frontier markets have notched big gains in recent years. Bangladesh has more than tripled since 2004. Bulgaria was up nearly fivefold before a recent selloff. Lebanon and Jordan have nearly doubled in the past year.



James Yang

markets could be just the latest example of Wall Street providing Main Street investors access to new and risky products only after the easy money has been made.

Remember the tech-stock bubble of the late 1990s? Or the biotech boom of the early '90s that spawned a wave of volatile single-sector funds? And only after commodities and currencies

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But while frontier markets offer high-return potential, they

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can also implode. Vietnam's stock market, for instance, more than tripled in recent years, but this year has shed more than half its value as investors flee rampant inflation and a sagging currency.

As such, the rush into frontier



soared did Wall Street begin packaging those into investment products for Main Street.

Invesco PowerShares and Claymore Securities both recently filed to launch new exchange-traded funds that will invest exclusively in frontier markets, particularly the Middle East and Africa. **State Street Global Advisors** last month registered ETFs that will track Southeast Asia, emerging Africa and Persian Gulf countries. **T. Rowe Price** last fall introduced its Africa & Middle East mutual fund, and it has quickly swelled to \$780 million in assets.

MSCI Barra in November unveiled 19 indexes tracking some of the world's most obscure exchanges, including Slovenia, Mauritius and Sri Lanka.

Many of these new indexes are expected to serve as the basis for new mutual funds and ETFs; the Barclays Global Investors Frontier Markets Fund, launched in March for institutional investors by the unit of **Barclays** PLC, tracks the new MSCI Frontier Markets Index. Merrill Lynch and Standard & Poor's also have recently launched various frontier indexes.



Should Main Street investors invest their money in countries most folks never think about unless war, famine or disaster makes the evening news?

Frontier markets offer opportunities to participate in some of the world's fastest-growing economies. Parts of Africa, Central and Eastern Europe and the Middle East have been clocking growth of about 6% or more in recent years.

That trend is largely projected to continue through at least 2009, far outpacing developed-economy growth of about 1.3%.

Yet, frontier economies are some of the most volatile financial markets around. Kenya's stock market, rocked by political strife, lost more than 11% in just 10 days earlier this year.

Romania, which nearly quintupled in the four-year run-up to its recent inclusion in the European Union, has fallen more than 37%

in the past year.

The inflationary pressures emerging globally could pose another challenge while likely increasing social and political unrest in these countries. By and large, stock markets generally dislike inflation, since it reduces the value today of the earnings generated tomorrow. There are exceptions: Zimbabwe's surreal inflation -- exceeding 100,000% -- actually has local investors flocking to stocks since there are few other ways to keep pace with debilitating consumer-price increases.

Many frontier markets are already richly priced. Bangladeshi companies tracked by S&P traded in May at 33 times trailing earnings, more than three times the level of 2004. Bulgaria, at a single-digit price-earnings ratio earlier this decade, today trades near 40. And Vietnam, though it has crumbled, still trades near 37.

Frontier markets also are illiquid, meaning investors can have trouble building a position without moving the share price, and can struggle to exit a stock amid chaos. On a recent Wednesday on



the West African regional stock exchange in Abidjan, Cote d'Ivoire, only about half the 39 listed companies traded in just 113 total transactions.

The **S&P Emerging Middle East & Africa** fund, managed by State Street Global, tracks the S&P/Citigroup BMI Middle East and Africa Index. However, "in many cases we can't acquire some companies in the index," says Jim Ross, a senior managing director at State Street. "Some shares are virtually uninvestable" because they are so illiquid.

Meanwhile, industry breadth can be narrow, with heavy dependence on banking, locally traded units of global consumer companies and various infrastructure sectors. S&P's Africa 40 Index is heavily devoted to banks, half of them Nigerian. Banks dominate Merrill Lynch's Frontier Index as well, comprising 39% of the index.

Some frontier-market economies are riding high commodity prices -- particularly many African markets, where oil is fueling growth in places like Nigeria and Ghana. If oil prices crack, they will suffer. Other markets are exporters of agricultural products, and a retreat in food prices would hurt them.

Perhaps the best argument for frontier markets is that they perform so differently.

A decade ago, investors flocked to places like Brazil and the Czech Republic because those emerging markets weren't well correlated with the U.S., meaning the markets didn't move in tandem with the Dow Jones Industrial Average. Today, that is increasingly not the case. Emerging markets are about 80% correlated with developed markets, says Frank Nielsen, an executive director at MSCI Barra.

By comparison, frontier markets as a whole are about 25% correlated with developed markets, and correlations for many individual countries are substantially less.

That means frontier markets, can provide some support to a portfolio when developed markets are weak, such as now. Case in point: T. Rowe Price's Africa & Middle East fund is up 9.6% this year, while both the Dow and S&P 500 stock-index are both down 5% or more.

Not all frontier funds are created equal, however.

While the T. Rowe fund is up strongly on the year, S&P's fund is flat. And where T. Rowe's fund invests heavily in the United Arab Emirates, Egypt, Qatar and Oman, the S&P fund has the bulk of its assets in substantially more-developed markets like South Africa and Israel.

Moreover, because the S&P fund tracks a passive index, its fees are 0.6%. T. Rowe's fund is actively managed and charges annual fees of 1.92%.

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### **Corrections & Amplifications:**

Claymore Securities Inc. launched its Claymore/BNY Mellon Frontier Markets exchange-traded fund last week. This article reports that Claymore had filed to launch the ETF, but fails to note that the launch had occurred.



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