
Victor Juhasz for Barron's

Finding Riches on the New Frontier

Barron's

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THE FRONTIER IN AMERICAN HISTORY was a place where the adventurous could hit gold if they weren't scalped first. Global "frontier" stock markets offer similar opportunities and risks for the modern investor.

The roughly 60 countries that make up this sector could be the emerging markets of tomorrow. They can be found anywhere from Asia, like Vietnam and Kazakhstan, to the Middle East and sub-Saharan Africa, like Morocco and Zambia, to even parts of Eastern Europe, like Romania and Bulgaria, to a large swath of South America. They are small, but fast-growing: Their combined market value is less than the $415 billion of ExxonMobil.

Despite the risks, or maybe because of them, frontier markets have become increasingly popular with institutional investors. Since emerging markets are more evolved, frontiers can offer greater payoffs due to "inefficiencies" in asset pricing, information flow and valuations, says Antoine Van Agtmael, chief investment officer of Emerging Markets Investors in Arlington, Va. "Frontier markets are where emerging markets were, in some cases, 10 to 20 years ago," says Van Agtmael -- who's credited with inventing the term "emerging markets" in the 1980s.

Right now, there are bargains to be had for the careful investor in a surprisingly wide range of businesses, from banks to flour mills. The consumer-growth potential is attractive, too, as these markets represent some 1.2 billion people, a good number of them young. While many are very poor, incomes are rising, thanks to globalization and the commodity boom. The frontier markets also offer diversification of risk, with returns weakly correlated to one another and to developed markets.

BUT LIKE THE OLD WEST, THE GLOBAL FRONTIER presents a host of perils, both for the institutional and individual investor. Political and foreign-exchange risks abound, along with outright corruption, as most of these countries are only in the nascent stage of installing rule-of-law cultures. Some of the most popular frontier markets are beholden to one commodity, such as oil, diamonds or cocoa. Zambia, for example, depends heavily on the price of copper. Political coups or a commodity bust could puncture the good returns seen over the past decade or so.

At times, they can also be volatile, and there are technical deterrents as well, particularly for the individual investor: There may be elaborate application procedures and ownership limits; expensive bank and trading fees; stock-certificate custody issues; and poor corporate information flow and governance. And, as might be expected, traditional sell-side analyst coverage is almost nonexistent.

Yet those risks have been balanced by high long-term returns. Lawrence Speidell, who runs the Frontier Market Select hedge fund for Ondine Asset Management, points out the total return of frontier markets, as measured by the S&P Frontier Composite -- composed of 21 country indexes -- has vastly outperformed both the Morgan Stanley Capital International Emerging Market index and the Standard & Poor's 500 index since 1995. The frontier index was up 250% in that span.

Where It Pays to Play

Asian and African nations have been providing stellar returns; strong demand for commodities has been a boon for many.

Market	Return on Investment	P/E Ratio	Market Cap ($US)	Number of Stocks
Bangladesh	13.4%	16.73	$931.98	25
Botswana	34.1	20.76	906.21	6
Bulgaria	16.3	26.83	1008.85	12
Cote d'Ivoire	17.7	11.29	824.93	14
Croatia	9.1	92.73	3774.17	12
Ecuador	20.4	18.31	1399.35	5
Ghana	109.0	8.29	528.80	11
Kenya	18.0	29.22	1905.58	17
Mauritius	15.5	9.74	1495.45	15
Romania	8.1	27.43	4485.20	14
Tunisia	6.2	18.58	1465.73	20

*As of Sept. 30, 2006 Sources: S&P, InvestinginAfrica.net

And for investors eager to take the plunge, there are some indirect ways to do it, including buying mutual funds, exchange-traded funds and shares of publicly traded companies with operations in the markets.

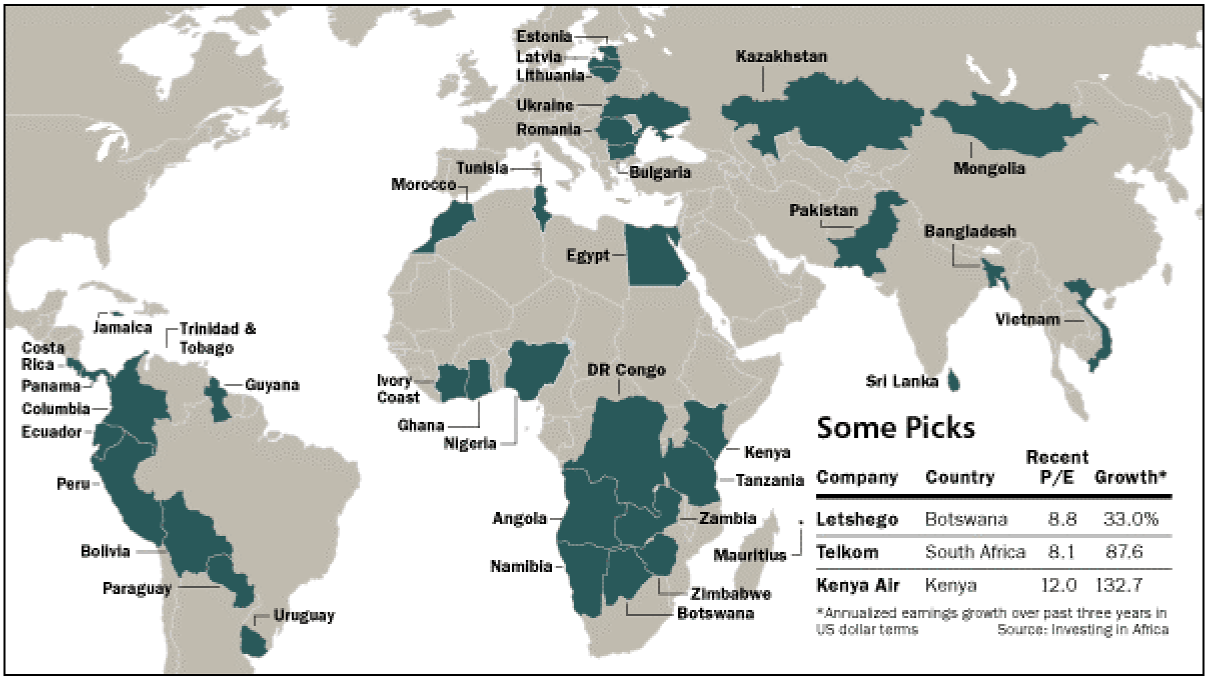
Here are some of the mutual funds which put a tiny portion of their money in frontier areas: Templeton Developing Markets Trust (ticker: TEDMX); Fidelity Emerging Markets (FIDLEMI LX); Bear Stearns Emerging Markets Debt Portfolio (EMDFX); Imara African Opportunities (very limited access for U.S. investors); and T. Rowe Price Institutional Emerging Markets Equity (IEMFX).

AWARENESS OF THE MARKETS CLEARLY HAS INCREASED, particularly among money managers in the U.S. and Europe. While Standard & Poor's has had its frontier index since 2000, notes Alka Banerjee, chairperson of the firm's Global Benchmark Indices, interest "has been growing only in the last two years." S&P just announced it will add Vietnam to the frontier index on Dec. 1.

Brokerages specializing in trading these markets have benefited nicely. Since 2004, "there's been a huge increase in this area, from no interest whatsoever," notes Jenni Chamberlain, a managing director at Securities Africa, a Bermuda-based boutique investment bank founded last year.

In general, the mainly U.S. and U.K. fund managers coming to her bank view stock valuations in the rest of the world as pricey, and growth in frontier markets as stronger, she says. For example, gross-domestic-product expansion in sub-Saharan Africa -- excluding South Africa, which isn't a frontier market, and oil-rich Nigeria -- is expected to be a tigerlike 7.4% this year.

Little wonder that sub-Saharan Africa is suddenly drawing a lot of interest. "It's the latest one to pop up on the radar screen," say Zachary Venegas, co-founder and managing partner of Scimitar, a small private-equity firm that invests in companies in global frontier markets. The firm, which has invested in Romania and the Middle East in the past, is now looking to Botswana, among other places in Africa.



The New World: A sampling of frontier markets.

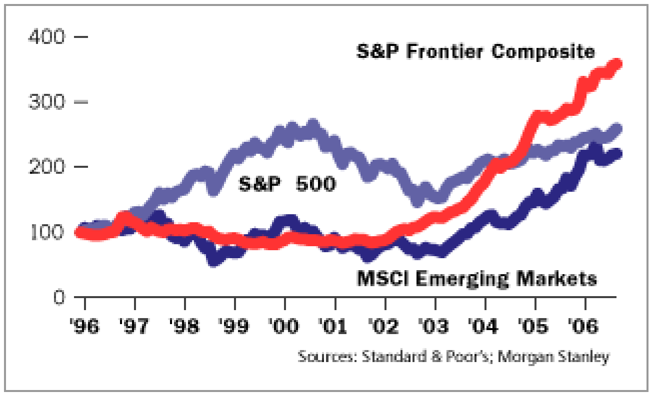
ALTHOUGH SUB-SAHARAN AFRICA IS FULL of "high-risk countries," notes Konrad Reuss, a London-based analyst with S&P, "there is a window of opportunity we haven't had for a long time," thanks to debt relief, strong demand for their commodities, and a few years of steadily improving economics with lower inflation.

For example, cocoa- and gold-rich Ghana has equity returns above 100% (see table, Where It Pays to Play).

Philippe de Pontet, an analyst a Eurasia Group, a political-risk consultant, adds that political risk in the region is not as high as it was in the 1980s and 1990s, when coups were more common and elections less so. There are some cases of backsliding, but "political risk is on the decline...this is a continent by and large desperate for investment."

Still, even professional investors will encounter practical problems when trying to invest in such regions. "It's extremely difficult to get exposure," laments Donald Elefson, portfolio manager of the Excelsior Emerging Markets Fund (UMEMX).

One way to begin might be to invest in larger emerging-market companies that are expected to do well in the frontier markets, he adds. He owns South Africa's MTN Group (MTNOY), a holding company with mobile-phone businesses in sub-Saharan Africa, and African Bank Investments Limited (AFRVY), which makes consumer loans in South Africa but whose business model, Elefson maintains, will easily be exportable to neighboring countries in the future. Both are fast-growing, and trade at a reasonable price-to-earnings multiple of about 11. Nestlé (NSRGY) meanwhile, has some affiliates with separate shares in these countries, including Nigeria and Pakistan.



Way Out Front: Frontier markets have trounced emerging markets and the S&P.

It's also possible, Elefson notes, to invest directly in emerging-market countries, like South Africa, whose companies will likely benefit from regional growth in adjacent frontier markets. One holding he owns partly for that reason is iShares MSCI South Africa (EZA), an exchange-traded fund. Over the past 12 months, it has returned 24%. (ETFs are increasingly popular low-cost index-tracking funds that trade like stocks.)

THOSE INTERESTED IN MORE DIRECT INVESTMENTS would do well to visit Investing in Africa, a Website run by Ryan Shen-Hoover (www.investinginafrica.net[1]). The subscription-based site offers a wealth of information, particularly on banks in frontier markets that will establish stock trading accounts for overseas investors. A couple of stocks Shen-Hoover likes are Kenya Airways and Letshego, a fast-growing finance company that trades in Botswana and makes loans to government employees.

The Bottom Line

Frontier markets and stocks offer bargain buys, and robust returns are expected to continue over the long term. The best way in for investors may be indirect plays like stocks or funds with some exposure to the regions.

But some frontier markets may already be overbought. Vietnam, with a typical P/E of 20, is getting "too demanding," says Axel Krohne, a partner at Ondine who runs the Krohne fund. He likes Sonatel, a fixed- and mobile- phone company that trades in Senegal and is 42% owned by **France Telecom** (FTE) and 28% by the government.

There are frontier markets in Europe also, like Romania and Bulgaria. Those two are set to join the European Union next year. Even with the typical political risks of frontier countries, they will get the kind of financial oversight and support from the EU that many frontier countries won't. That significantly improves the risk-reward outlook for Bulgaria and Romania compared with other frontier markets, argues Rudolph-Riad Younes, co-manager of Julius Baer International Equity Fund.

One good play in Romania, says Kim Catechis, London-based investment director at Scottish Widows Investment Partnership, is Banca Transilvania (TLV RO). The country is underbanked and this bank, which uses Western accounting standards, has an acceptable level of transparency, and operates in one of the country's most developed regions. It has grown assets by about 36% since 2003, says Catechis.

Like the Old West, the frontier isn't a place for widows and orphans, nor big bets. But as globalization continues apace, these markets and their stocks should continue to outperform, so that even a small stake could help energize an entire portfolio's return.