

A Brave New Frontier

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We are in uncharted waters.

However, as a friend once said, “we cannot avoid risk, we must choose risk”.

With that in mind, this is a good time to consider the position of frontier markets both in the pandemic and in our portfolios.

While epidemiologists’ models of the COVID-19 have made headlines, economic models have been broken because their assumptions are inadequate to deal with the supply and demand shocks we are experiencing. Despite our hopes, a good off-ramp from the pandemic highway we are traveling may not come as soon as we like.

It is difficult to find a firm place to start building our thoughts on the global and frontier outlook, but the latest International Monetary Fund (IMF) forecasts may be better than some. We’ll also look at recent COVID-19 data.

International Monetary Fund World Outlook

The IMF World Economic Outlook, April 2020, is titled “The Great Lockdown”ⁱ, and it presents revised 2020 GDP growth forecasts which are dramatically changed since their last report in October 2019.

The IMF says that this crisis “likely dwarfs the 2008 financial crisis” and presents “severe uncertainty about the duration and intensity of the shock”.

The IMF points out that because of containment measures, efforts to stimulate economic activity are severely constrained in the most affected areas. These include retail, sports and travel, where social distancing is imperative while the virus is circulating without more effective treatments or a vaccine.

In its baseline GDP forecasts, the IMF is projecting a drop in world output of 3.0% in 2020, followed by a 5.8% recovery in 2021, with the impact by region shown in the table below.

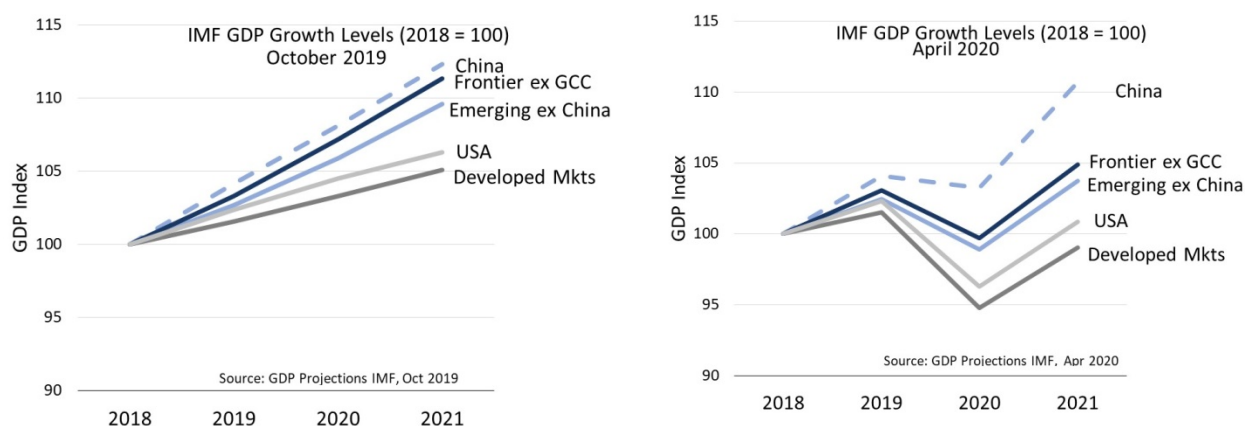
GDP % Changes	Averages		Projections		
	1997- 2007	2008- 2018	2019	2020	2021
Developed	3.3	1.4	1.5	-6.7	4.5
China	7.9	6.1	4.1	-0.8	7.2
Emerging ex China	4.6	3.6	2.5	-3.5	4.9
Frontier ex GCC	4.6	3.6	3.1	-3.2	5.2
United States	3.2	1.6	2.3	-5.9	4.7

Source: IMF April 2020

Developed markets are hit the hardest, down 6.7% in 2020, followed by the US, down 5.9%. Frontier markets drop 3.2%, while emerging markets ex China drop 3.5%. Meanwhile, the IMF forecasts only a modest decline of 0.8% for China this year.

In the IMF's baseline forecast, there will be a strong recovery in 2021, with China recovering to growth that is similar to its growth rate since 1997. This baseline forecast, however, assumes "that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound".

The charts below compare the IMF April forecasts with those from last October for the US, developed markets, China, emerging markets ex China and frontier markets. We show indexed growth trends based at 100 as of the end of 2018. The trends in the October 2019 forecast are shown at the left, contrasted with those in the April 2020 forecast at the right.



GDP % Changes	Oct 2019 est 2020	Apr 2020 est 2020	% Diff 2020	Oct 2019 est 2021	Apr 2020 est 2021	% Diff 2021
Developed	1.7	-6.7	-8.4	1.7	4.5	2.8
China	3.8	-0.8	-4.6	3.9	7.2	3.3
Emerging ex China	3.1	-3.5	-6.6	3.5	4.9	1.4
Frontier ex GCC	3.8	-3.2	-7.0	3.9	5.2	1.3
United States	2.1	-5.9	-8.0	1.7	4.7	3.0

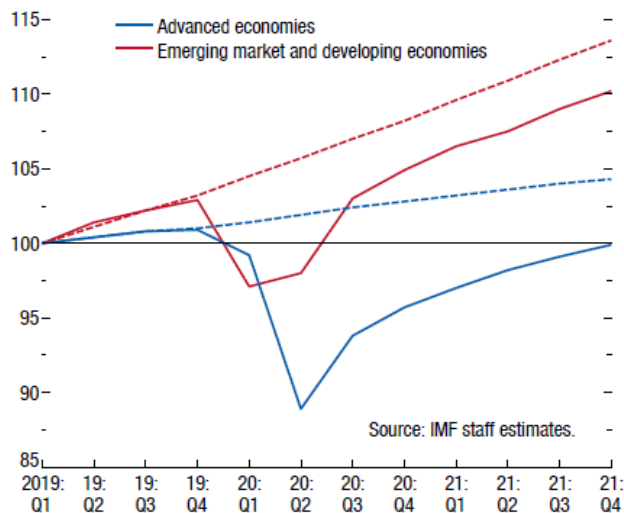
Source: IMF April 2020 & Oct 2019

On an index basis, the April forecast implies that China ends 2021 only 1.6% below where it would have been without the pandemic, while the US is 5.5% below the target back in the October forecast. Developed markets are 6.1% below the old forecast, emerging markets ex China are 5.8% below and frontier markets ex GCCⁱⁱ are 6.4% below. Frontier will have lost more ground versus the old forecast than emerging, because in October 2019 frontier was expected to grow 0.7% faster than emerging (3.8% versus 3.1%), whereas frontier is now expected to decline 0.3% less (-3.2% versus 3.5%). The good news for frontier is that in 2021, its rebound is expected to be the second strongest, after China.

It is important to note, however, that the IMF also considers three other scenarios: 1) containment in 2020 takes longer, 2) resurgence in the virus occurs in 2021 and 3) longer duration of the outbreak in 2020 and a resurgence of the virus in 2021. The baseline scenario is presented below at the left (and in our charts and data above), while the more cautious scenarios are presented in the chart below at the right.

Quarterly World GDP

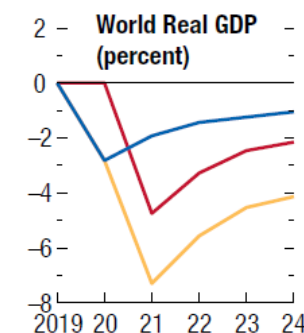
(2019:Q1 = 100; dashed lines indicate estimates from January 2020 World Economic Outlook Update)



Alternative Evolutions in the Fight against COVID-19

(Deviation from baseline)

- Longer outbreak in 2020
- New outbreak in 2021
- Longer outbreak in 2020 plus new outbreak in 2021

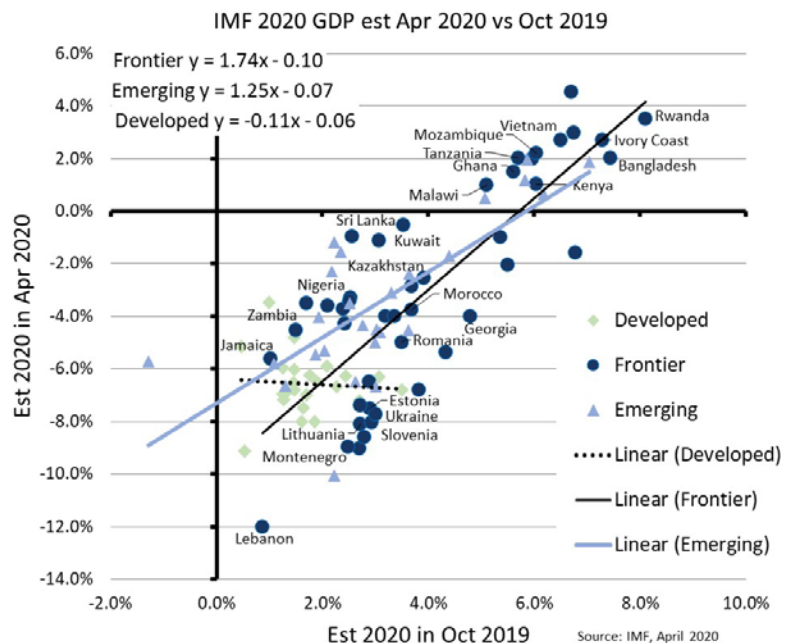


The IMF revisions for 2020 are worth examining by country in more detail. The scatter chart compares the new forecasts for 2020 on the vertical axis with those made last October on the horizontal axis.

As a general rule, the developing countries that were growing faster in the October estimates for 2020 (at the right in the scatter chart) were penalized less in the new forecasts.

This group includes Vietnam and Bangladesh in Asia, and Ghana and Kenya in Africa. On the other hand, countries in Eastern Europe are likely to feel pain from the slowdown in Europe as a whole. This group includes Romania, Estonia, Lithuania and Montenegro.

The table below shows these and other representative countries in terms of the forecast changes.



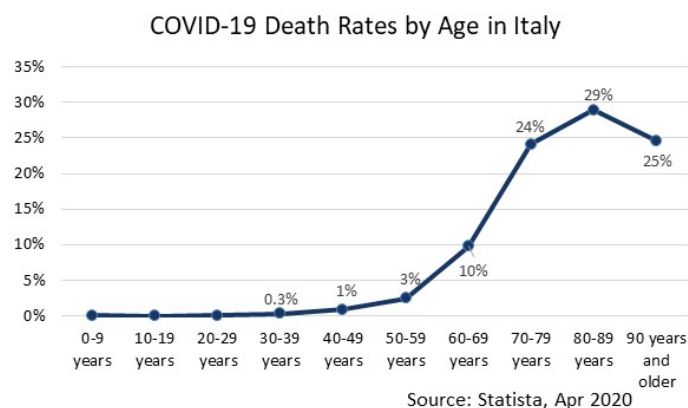
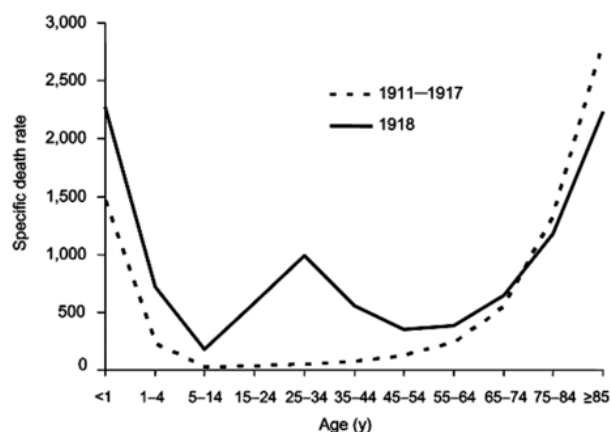
GDP % Changes	Oct 2019 est 2020	Apr 2020 est 2020	% Diff 2020	GDP % Changes	Oct 2019 est 2020	Apr 2020 est 2020	% Diff 2020
Vietnam	6.5%	2.7%	-3.8%	Pakistan	2.4%	-1.5%	-3.9%
Bangladesh	7.4%	2.0%	-5.4%	Egypt	5.9%	2.0%	-3.9%
Ghana	5.6%	1.5%	-4.1%	China	5.8%	1.2%	-4.6%
Kenya	6.0%	1.0%	-5.0%	Philippines	6.2%	0.6%	-5.5%
Romania	3.5%	-5.0%	-8.5%	United States	2.1%	-5.9%	-8.0%
Ukraine	3.0%	-7.7%	-10.7%	Germany	1.2%	-7.0%	-8.2%
Lithuania	2.7%	-8.1%	-10.8%	Spain	1.8%	-8.0%	-9.8%
Montenegro	2.5%	-9.0%	-11.5%	Greece	2.2%	-10.0%	-12.3%

Source: IMF April 2020 & Oct 2019

COVID-19 impact

Despite comments by some pundits, and even some government leaders, COVID-19 is not like the seasonal flu. The infection fatality rate of seasonal flu is sometimes quoted as 0.1% of those infected, although it may be as low as 0.04%ⁱⁱⁱ if all asymptomatic individuals were to be tested. On the other hand, COVID-19 has seen case fatality rates of 10% or more of cases, and it is even higher among older victims, especially those in nursing homes.

Furthermore, the preponderance of fatalities appears to be among older people, unlike the Spanish Flu of 1918-1919, which had a spike in mortality among 20-40-year-olds as shown in the charts below.



The terrible tragedy of the COVID-19 deaths is not lessened by the age of the victims, but it does make it difficult for young citizens in some countries to accept the sacrifices they are being asked to make under the lockdowns for the benefit of all.

Frontier markets have suffered from the virus just like the rest of the world, and their response in terms of lockdowns and other measures has been quick, starting in mid-March: Sri Lanka - March 17, Morocco - March 20, Georgia and Pakistan - March 24, Egypt - March 25, Bangladesh - March 26, Kenya - March 27, Nigeria - March 30. In addition, there have been more than 60 interest rate reductions in frontier countries, and stimulus packages have been widely implemented.

In addressing the potential casualties, however, it is important to note that the demographic profile of the frontier is quite different from that of the developed world.

The table at the right shows the percent of each country's population in the vulnerable group of ages 65 and older. In Japan, for example, this cohort represents 27.1% of the total population. Italy is not much lower, at 22.5%, and Sweden is at 20%. The US is lower than EAFE, at 15% versus 18.5%.

Frontier ex GCC averages 8.8% ages 65 and older, which is lower than emerging markets at 9.9%. Meanwhile, the frontier regions vary widely, from 15.9% at 65 and older in Eastern Europe, to only 3.7% in Africa, where 60% of the population is under the age of 25^{iv}. The median age of people in Africa is 19 years, versus 40 in Europe and 38 in the US.^v

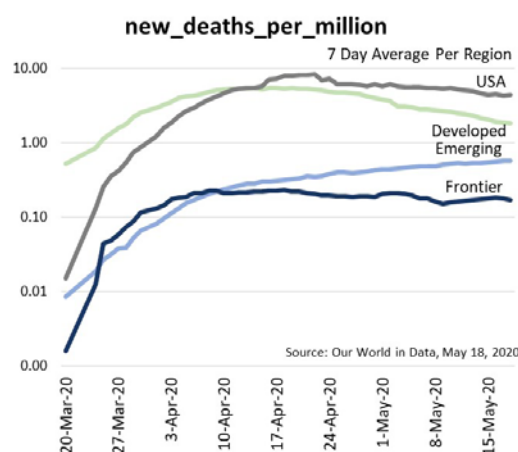
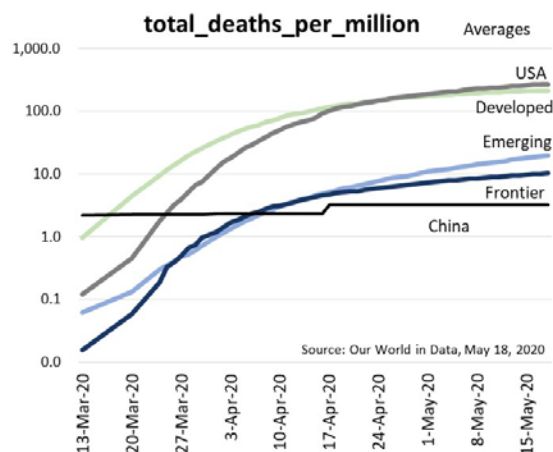
While Africa's high birth rate explains much of its demographic bias toward youth, the low percentage of older people in Africa is sadly the result of many other health problems on the continent, where COVID-19 is simply one more disease on top of malaria, typhus, typhoid and Ebola.

Another perspective, however, is provided by the COVID-19 statistics on deaths, cases and tests. The charts below show that the frontier has been lower in both total deaths per million and new deaths per million. On the other hand, the curves of new deaths are trending lower in the developed world, but higher in emerging markets and flat in the frontier.

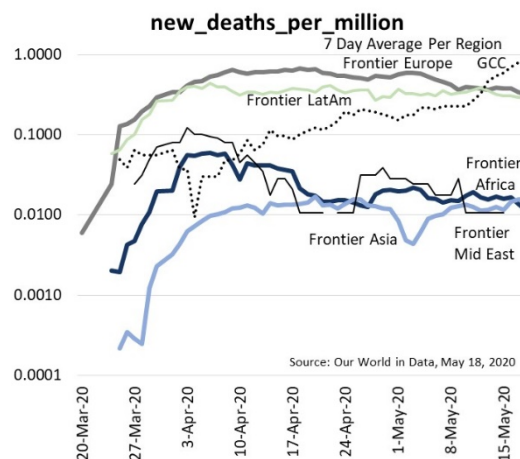
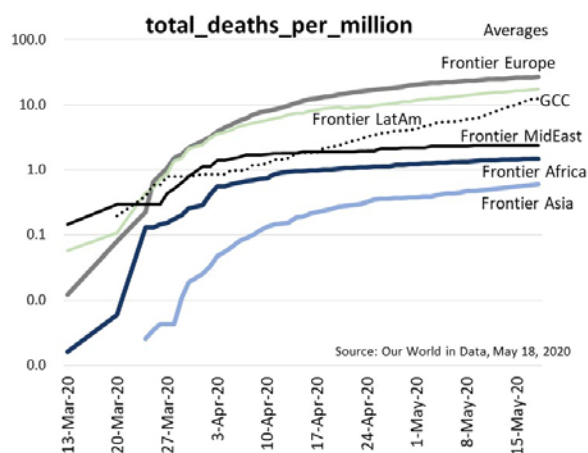
Population ages 65 and above (%)

EAFE	18.5%
United States	15.0%
Emerging Markets	9.9%
Frontier ex GCC	8.8%
Frontier Africa	3.7%
Frontier Asia	5.6%
Frontier Europe	15.9%
Frontier Latin America	9.0%
Frontier MidEast	4.4%
Japan	27.1%
Italy	22.5%
Sweden	20.0%
France	19.7%
Spain	19.1%
Belgium	18.6%
United Kingdom	18.3%
Romania	17.9%
Ukraine	16.2%
Russia	14.3%
China	10.3%
Brazil	8.6%
Vietnam	7.0%
India	6.0%
Egypt	5.2%
Bangladesh	5.1%
Pakistan	4.3%
Nigeria	2.7%
Kenya	2.3%

Source: World Bank WDI Database, 2020

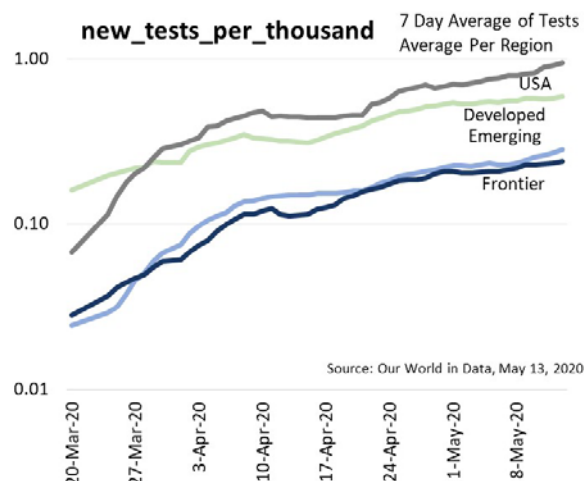
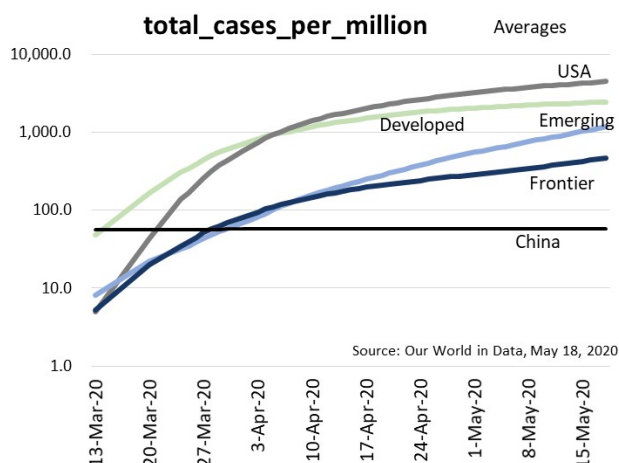


In terms of deaths per million in frontier regions, at the left below, Eastern Europe has been the hardest hit, while frontier Asia has fared the best so far. Meanwhile, new deaths per million, at the right below, as measured by the 7-day averages, shows Eastern Europe improving from a high level, while the others are roughly flat except for GCC, which is worsening.



We view the data on cases, below at the left, with some suspicion, because identifying cases is a function of testing, and testing is low everywhere. Nonetheless, in terms of total cases per million, the US is relatively high at 4,500, versus 3,700 in Italy and 4,800 in Belgium. Qatar is even higher at 11,300, but they have done more tests, 53 per 1,000 people versus 32 in the US.

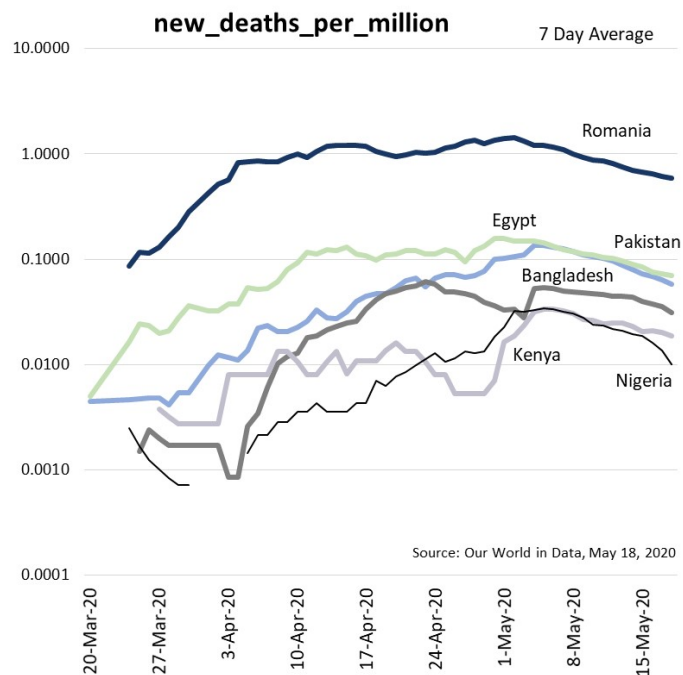
Overall, the GCC has been doing a strong job of testing. Bahrain, for example, has been doing a weekly average of 3.8 new tests per 1,000 people, versus 1.9 in Denmark, 1.2 in Australia and 0.94 in the US.



The final chart, at the right, shows selected frontier countries in terms of the trend in new deaths per million on a 7-day moving average basis.

All the curves show improvements in May, but the highest level is 0.59 in Romania at on May 18th versus its peak of 1.4 on May 2nd. The other frontier countries are declining from much lower levels.

These figures compare with the US at 4.3 on May 18th versus its peak of 8.2 on April 22nd, the UK at 5.8 versus 13.9 on April 15th, Belgium at 4.9 versus 28.8 on April 17th and Sweden, which did not order a lockdown, at 6.4, the highest of any country in the May 18th report.



The table below shows some of the data we have discussed and includes a column of the case fatality rates. We estimate these by dividing the current total deaths, as of May 18, 2020, by the total cases one week earlier. The actual lag between cases and fatalities varies and is perhaps longer, but this gives a rough approximation. These estimated case fatality rates highlight the terrible toll of the virus, especially in the developed world, where COVID-19 hit many countries in Europe quickly, overwhelming their health care systems. In France, for example, this percentage is 20%, while in the UK it is 16% and in Italy, 15%.

Much of the other data below shows favorable trends in many regions and countries, and we hope this will continue, although there could be reversals as people emerge from their lockdowns.

18-May-20	New Deaths per Mil 7 Day Avg	7 Day % chg	Total Deaths per Mil	7 Day % chg	Total Deaths	Case Fatality Rate % Death/ Cases -7	Total Cases per Mil	7 Day % chg	New Cases per Mil 7 Day Avg	7 Day % chg	New Tests per 1000 7 Day Avg	7 Day % chg
Developed	1.83	-27%	214.2	6%	161,661	12%	2,447.5	6%	19.2	-23%	0.59	8%
United States	4.33	-15%	270.6	13%	89,562	7%	4,491.7	12%	67.7	-9%	0.94	24%
Emerging	0.57	9%	19.9	25%	41,736	4%	1,170.6	35%	43.5	32%	0.28	23%
Frontier	0.17	4%	10.3	13%	3,674	3%	466.2	23%	12.7	32%	0.24	16%
China	0.00		3.2	0%	4,638	6%	58.4	0%	0.0	0%	-	
Frontier Africa	0.01	-40%	1.5	6%	623	3%	63.1	18%	1.4	-10%	0.02	73%
Frontier Asia	0.02	24%	0.6	22%	371	2%	82.6	36%	3.1	50%	0.12	0%
Frontier Europe	0.32	-17%	26.8	9%	2,197	5%	658.3	5%	4.7	-15%	0.46	5%
Frontier Latin Am	0.28	-22%	17.2	13%	302	3%	663.6	12%	10.3	-7%	0.08	11%
Frontier Mid East	-	-100%	2.3	0%	35	3%	96.8	10%	1.2	-29%	-	
GCC	0.76	182%	12.5	74%	146	1%	2,860.3	53%	141.8	53%	1.27	35%

Source: Our World in Data, May 18, 2020

Conclusion

"We're not just fighting an epidemic; we're fighting an infodemic,"
World Health Organization (WHO) Director-General Tedros Adhanom Ghebreyesus

It is difficult not to be overwhelmed by our social isolation, by the heart-wrenching news of victims and their families, and by the selfless heroism of healthcare workers on the front lines. Meanwhile, we are flooded with news and opinions that unfortunately are sometimes misleading or dangerous.

We hope that this review of the IMF forecasts and the COVID-19 data can help to provide a framework for thinking the crisis and about our investments. We don't know which of the IMF's scenarios will prove correct, but we lean toward caution.

Nevertheless, many frontier countries are doing better than we had expected. They have been diligent in responding with lockdowns^{vi}; most countries have implemented fiscal and monetary stimulus; and many countries have received support from the IMF.

Many frontier countries have had GDP growth rates among the highest in the world, and now many are likely to have high relative 2020 growth, albeit negative in most cases.

More important, it appears that many of these poor countries are being spared the worst of the ravages of COVID-19, thus far at least. In the context of their lives, this virus is yet another challenge, but the people of the frontier are young, brave and bright. We believe they will brave this storm and will prevail.

Within our portfolios, we are carefully adding to companies whose managements we hold in high regard, especially in Asia and Africa and in consumer staple and financial sectors.

We believe that this is a good time to be invested in the frontier.

*"You're young and you're brave and you're bright....
Buck up, do your damndest, and fight"*
- Robert Service, 1912

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ⁱ International Monetary Fund, World Economic Outlook, April 2020

<https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>

ⁱⁱ GCC countries are the rich oil-producing nations in the Gulf Cooperation Council.

<https://www.britannica.com/topic/Gulf-Cooperation-Council>

ⁱⁱⁱ "The Coronavirus Really Isn't Just the Flu, Bro", Justin fox, Bloomberg, April 24, 2020

^{iv} "The Covid-19 Riddle: Why Does the Virus Wallop Some Places and Spare Others?" New York Times, May 3, 2020

^v "Low Covid-19 death toll raises hopes Africa may be spared worst", Financial Times, April 27, 2020

^{vi} Why covid-19 seems to spread more slowly in Africa, The Economist, May 16, 2020

<https://www.economist.com/middle-east-and-africa/2020/05/16/why-covid-19-seems-to-spread-more-slowly-in-africa>