Frontier Markets

ALL I WISH FOR FRONTIER MARKETS

KEY POINTS

▪ After a strong year, we remain confident that there are enough drivers in place to maintain momentum for frontier markets.

▪ Despite a long wish list for 2018, indicators look positive for the year ahead. Combined with durable secular growth and low correlation to the global cycle, this could increase attention to these sometimes overlooked markets.

▪ Africa is our greatest hope for improvement, and here, the signs are good. Encouraging political developments and higher oil prices are helping to support our positive views on these markets.

▪ Elsewhere, we see strong potential again for Asia and in Latin America. Argentina remains one of our favored markets.

Frontier markets had a strong year in 2017, outperforming most other regions as global investor sentiment remained supportive and as frontier countries made tangible economic progress. Encouragingly, we predict a favorable environment going forward with enough evidence that the wheels are only just starting to turn for these markets. Importantly, even despite the recent gains, valuations remain attractive against most global equity asset classes.

AFRICA—CALL OF THE WILD

After being plagued by drought and economic stagnation, 2018 could be the year Africa returns to focus for all the right reasons. While not a country in the frontier markets benchmark, the economic health of South Africa has ramifications for a large part of the vast continent. With Jacob Zuma’s resignation as national president in February, we are hopeful for a major reversal of fortune in the coming years under the stewardship of Cyril Ramaphosa, the recently elected African National Congress (ANC) president and now national president.

In a very well-timed trip to South Africa in the final week of January, we were fortunate enough to spend some time with three of the “Top 6” members of the ANC, the key
Importantly, even despite the recent gains, valuations remain among the most attractive across global equity asset classes.

This all comes at a time when South Africa is at a cyclical economic bottom, so in addition to the above catalysts we are likely to see more positive macroeconomic data going forward, which may surprise in the coming quarters.

Good things may well come in pairs, as the positive development in South Africa unfolded only shortly after President Robert Mugabe was ousted after 37 years as president of Zimbabwe. We welcome the change and hope to see fully free and fair elections this year, which would provide much needed legitimacy to the government. This should also free up substantial investment dollars to reinvest and help reestablish the former "bread basket of Africa." As investors in listed equities, we would welcome a return to what was previously one of the largest and most liquid stock markets on the continent.

As the backdrop in South Africa improves, it should have a positive knock-on effect to neighboring countries such as Namibia, Botswana, and Zambia. Commodity producer Zambia has been benefiting from some recovery in the copper price, but this tailwind must be cemented by finalization of their pending International Monetary Fund (IMF) deal, which has yet to be fully agreed. Hopefully, Mozambique will see an end to the effects of the "Tuna Debt" crisis and a resumption of previously sky-high GDP growth rates—supported by investment in its extensive gas fields.

Tanzania could be on the cusp of a new positive era, should we note clear evidence that President John Magufuli’s clampdown on select industries is genuinely an anticorruption drive. Although not a frontier country, we also keep watch on Egypt, given its relative importance to regional growth. After the devaluation of the Egyptian pound in 2016, we have seen a sharp rise in inflation and look forward to a domestic recovery and the reelection of President Abdel Fattah el-Sisi.

Following recent elections, Kenya’s President Uhuru Kenyatta will now start thinking about his legacy. The most important development to watch is a lifting of caps on interest rates charged by the banks. The cap has meant banks have not been able to price risk sufficiently and have withdrawn credit extension from the economy—particularly in the small and medium-sized enterprises (SME) area, which is the lifeblood of any thriving economy. As for Morocco’s economy, we believe it is well positioned to benefit from continued momentum in the European recovery. Ongoing calm in relation to Islamic extremism is also a must, due to the importance of its tourism sector.

In Nigeria, the strong stock market return in 2017 would suggest that the country is back on the investable map again. Indeed with a better functioning exchange rate system and the benefits of U.S.$60–U.S.$70 per barrel oil, things are feeling a lot better on the ground. A recent trip confirmed to us that the fragile economic recovery is gaining strength, and Nigeria should return to positive GDP growth this year. However, we want to see unification of all the various exchange rates, as well as for the resulting official exchange rate to be free-floating. This would provide the necessary confidence for significant foreign reinvestment in the country and accelerate the economic improvement that now looks to be underway with help from a stronger oil price.
MIDDLE EAST—A MORE MIXED PICTURE
In the Middle East, after a good year for Kuwait equities in 2017, we require further confirmation that the hangover in the domestic banking system, following on from the 2008 financial crisis, has ended. In tandem, we are watching for continued crane movement as evidence that the government remains necessarily focused on important infrastructure projects. It was a fairly tumultuous year in Saudi Arabia last year, where Crown Prince Mohammed bin Salman consolidated his power base and initiated a raft of reforms to bring the Saudi budget under control with less reliance on oil. Having arrested a number of members of the royal family and high profile business leaders on corruption charges, a period of calm is now needed to ensure there is no blowback.

The two main concerns in Oman remain its susceptibility to the oil price and the question of who will succeed aging Sultan Qaboos bin Said al Said. If we get clarity on the latter and the start of proper reform to acknowledge the lower oil price environment, Omani equities would become interesting again.

Our wish list for 2018 may be long, but positive news can travel fast across the frontier universe—where small, positive changes can quickly lead to the unlocking of vast economic potential.

EASTERN EUROPE—LOOKING BEYOND THE CORE
In Europe, less aggressive fiscal stimulus and tighter monetary policy would be welcome in Romania, to ensure the current cycle endures and does not get out of control. Georgia needs an ongoing commitment to meeting its IMF targets and for GDP growth to finally reach its potential of at least 5%. The smaller economies of Lithuania and Croatia are finally in recovery mode after suffering long hangovers inflicted by the global financial crisis and related property crashes. In 2018 we seek a continuation in economic recovery trends, such as falling levels of debt, improved labor market dynamics, and increased fixed investment.

ASIA—THE TIGER CONTINUES TO ROAR
Looking toward Asia, we would like to see a continuation of strong foreign direct investment trends in Vietnam and an ongoing recovery of the domestic economy—with inflation remaining low. Sri Lanka needs its large pipeline of investment projects to start in earnest. We also hope the country can avoid a repeat of flooding, which caused considerable pain for consumer businesses in 2017. However, this does provide a low base for consumer sector earnings this year. Bangladesh will hopefully soon see an end to the currency volatility that appeared in December, as well as smooth and peaceful elections toward the end of 2018.

ARGENTINA—A POSTER CHILD FOR FRONTIER MARKETS
Argentina typifies the investment case for frontier markets—namely improving politics leading to better macroeconomic management which, in turn, leads to attracting investment and results in earnings growth for companies. This year, we are laser-focused on inflation and need to see it continue its decline below 20%, in line with President Mauricio Macri’s reissued inflation targets. We would also welcome further reform progress and acceleration of the domestic recovery.

A LONG WISH LIST, BUT IF ATTAINABLE COULD OFFER REWARDS
Our wish list for 2018 may be long, but positive news can travel fast across the frontier universe—where small, positive changes can quickly lead to the unlocking of vast economic potential. While we have witnessed many examples of this in Asia and Latin America, our biggest wish of all this year is for the positive recent political developments in Africa to lead to a real reversal of economic fortunes.
Important Information

Call 1-800-225-5132 to request a prospectus or summary prospectus; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

The I Class generally requires a $1,000,000 minimum initial investment. Certain exceptions may apply. See the prospectus for details.

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of April 2018 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Investors will need to consider their own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy.

Past performance cannot guarantee future results. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., Distributor.

T. ROWE PRICE, INVEST WITH CONFIDENCE, and the bighorn sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc. © 2018 T. Rowe Price. All rights reserved.