



The Catalysts Set to Drive Frontier Markets

Elections, MSCI reclassifications and political change poised to make an impact.

April 2019

KEY INSIGHTS

- Market conditions over the remainder of 2019 are likely to improve, as political and economic developments that weighed on asset prices last year abate.
- With asset prices reflecting the challenges of last year, the shift in sentiment could provide an uplift.
- Primary catalysts set to drive asset prices: elections, MSCI reclassifications, and geopolitical and trade developments.



Oliver Bell

*Portfolio Manager,
Institutional Frontier Markets
Equity Fund*

While frontier markets experienced a challenging 2018, we have identified three catalysts that potentially could drive a turnaround in performance in 2019. The global economy presented headwinds last year, but the low correlation of the asset class with the global cycle meant that it was often country-level political and economic developments that weighed on frontier markets the most.

In 2018, Argentina was mired in a crisis, Saudi Arabia struggled with foreign investor perceptions, Sri Lanka faced a leadership vacuum, and harmful tax measures in Kenya and Romania took a toll on their respective financial sectors. As these issues are addressed or fade, 2019 could present a silver lining.

Catalysts Set to Drive Markets

Adopting a broad, overarching view, we have identified three factors that have the potential to drive improved frontier market performance in 2019: elections, MSCI reclassifications, and geopolitical and trade developments.

Key Elections in the Pipeline

Argentina is set for a crucial general election in October 2019, with President Mauricio Macri likely to run for reelection. If Macri wins and obtains control of the lower house, the pace of reform can meaningfully accelerate. While the crisis has dented his popularity, it is possible that the timing of the election will coincide with resurgent growth.

(Fig. 1) Key Developments in Frontier Market Economies

There is scope for markets to recover.

As of January 31, 2019

	Market Challenges in 2018	Optimism for 2019
Argentina	<ul style="list-style-type: none"> Multitude of factors necessitated a bail out from the International Monetary Fund (IMF). A ballooning fiscal deficit and runaway inflation, which sparked a run on the peso, capital flight, and liquidity concerns. 	<ul style="list-style-type: none"> Funding requirements met until late 2019; response of authorities promising. Upcoming elections will be vital, ahead of which President Mauricio Macri needs to build his political capital. Argentina set for inclusion in MSCI Emerging Markets (EM) Index in May 2019.
Saudi Arabia	<ul style="list-style-type: none"> Crown Prince Mohammed bin Salman (MBS) has taken steps to liberalize country economically and socially. But the Khashoggi affair—and efforts to identify those implicated in the murder of the journalist—has weighed on foreign investor sentiment. 	<ul style="list-style-type: none"> Investors looking for signs of continuity in MBS's reform program: reducing country's dependence on oil revenues and diversification to attract foreign investment. Saudi Arabia due to be included in MSCI EM Index in May 2019. Likely uptick in consumption.
Sri Lanka	<ul style="list-style-type: none"> Currency weakness and political woes weighed on sentiment. Former President Mahinda Rajapaksa gave up on an attempt to return to government; Ranil Wickremesinghe was reinstated as prime minister. 	<ul style="list-style-type: none"> Despite political developments, economy remains on solid footing. Manufacturing purchasing managers' index high on the back of a surge in new business inflows and output as companies divert supply chains away from China.
Kenya	<ul style="list-style-type: none"> Pandering to populist sentiment, authorities maintain a cap on interest rates that banks can charge—constraining lending and dampening economic growth prospects. 	<ul style="list-style-type: none"> Some speculation that the cap will be removed, aided by International Monetary Fund demands that it be repealed as a condition for Kenya to access balance of payments support.
Romania	<ul style="list-style-type: none"> The introduction of a levy on bank assets if interbank lending rates exceed 2% (set to take effect in 2020) is likely to erode earnings. 	<ul style="list-style-type: none"> Any change or alleviation in tax measures should boost investor sentiment. Positive sentiment about the Romanian economy as rising wages are supportive of the consumer and banks continue to clean up their loan books.

Argentina's funding requirements have been met until late 2019, and the response of authorities has been promising.

— Oliver Bell
Portfolio Manager,
Institutional Frontier Markets Equity Fund

It is uncertain who will contest Macri in the election, with some speculation that former President Cristina Kirchner would run (20% probability)—and her victory would be overwhelmingly market unfriendly, bringing with it the potential reintroduction of capital controls. If Macri is reelected, however, this would be a positive catalyst for the asset class, as he is highly likely to continue broad-based fiscal adjustment.

Nigeria headed to the polls in February. Incumbent President Muhammadu Buhari of the All Progressives Congress ran against former Vice President Atiku Abubakar

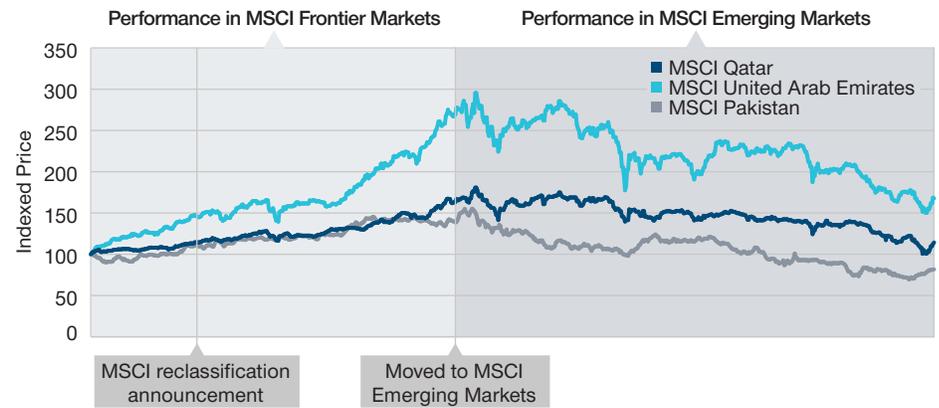
of the People's Democratic Party, winning with 56% of votes. With the country emerging from recession, economic leadership is at stake. Continuity should be a positive sign, as the naira is at a more appropriate level, the minimum wage has increased, and both oil and non-oil sectors are making gains. From here we watch for a stronger government focus on economics and the convergence to one exchange rate. Investors would likely welcome more market-driven policies, and the introduction of measures to boost domestic business and investment.

2019

Argentina and Saudi Arabia set for inclusion in MSCI Emerging Markets Index.

(Fig. 2) Catching the Reclassification Rally

Markets have tended to rally into index inclusion.
As at January 31, 2019



Past performance is not a reliable indicator of future performance.

Sources: MSCI, FactSet, as of January 31, 2019. Qatar and the United Arab Emirates were reclassified in May 2014. Pakistan was reclassified in May 2017. The data are rebased to 100 for comparison and are for illustrative purposes only. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

MSCI Reclassifications

Countries shifting from the frontier to the emerging markets universe are likely to attract inflows ahead of index inclusion, as we have seen in the case of Qatar, the United Arab Emirates, and Pakistan in the past.

Argentina and **Saudi Arabia** are set for inclusion in May 2019. **Kuwait**, which has already been upgraded by index provider FTSE, is due to be reviewed midyear by MSCI (for inclusion in 2020) and looks set to meet the criteria for inclusion.

Markets that are upgraded are typically subject to significant inflows ahead of inclusion, as passive fund investors look to fill quotas in accordance with the new weightings. This tends to benefit existing investors, and our approach is to gain exposure to this trend and gradually reduce our holdings after index inclusion if valuations have become too stretched through the process.

Geopolitical and Trade Developments

Investors are watching the trade tensions between the U.S. and China closely, waiting to see if tariff barriers are raised further. If these tensions ease, investor risk appetite should pick up, benefiting frontier markets.

However, countries such as Vietnam and Bangladesh, because of their role in the global supply chain, stand to benefit from ongoing tensions, as companies look to shift production away from China and are attracted by the cheap labor on offer. Vietnam, for its size, is disproportionately geared into the global economic cycle due to its large export market.

Stock Selection Guided by Catalysts

Our bottom-up stock selection has been guided by these catalysts, and we are well positioned in key areas should these catalysts come to have an impact. Maintaining a diversified portfolio helps in this regard.

(Fig. 3) What to Watch in Frontier Markets in 2019

Investor focus on catalysts.

As of January 31, 2019



Conclusion

In our view, the outlook for frontier markets should continue to improve as several of the country-level developments weighing on markets resolve. With much of this already

reflected in asset prices, markets are potentially primed for an improvement in sentiment as elections, MSCI reclassifications, and trade and geopolitical developments play out over the year.

WHAT WE'RE WATCHING NEXT

Against this backdrop, we are more favorable to Saudi Arabia (off benchmark), Nigeria, Vietnam, Argentina and Kuwait. On a sector basis, we are finding attractive investment opportunities in cheaply valued banks and consumer-oriented stocks that benefit from favorable population dynamics in frontier markets.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term. To learn more, please visit troweprice.com.

T.RowePrice®

Important Information

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

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 February 2019 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 is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. The risks of international investing are heightened for investments in emerging market and frontier market countries. Emerging and frontier market countries tend to have economic structures that are less diverse and mature, and political systems that are less stable, than those of developed market countries. All charts and tables are shown for illustrative purposes only.

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

© 2019 T. Rowe Price. All rights reserved. T. Rowe Price, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.