



## INDEX EXITS WILL NOT DENT FRONTIER'S PROSPEROUS FUTURE

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We have recently witnessed reports questioning the long-term viability of frontier market equity market strategies.

The scepticism stems from MSCI's recent announcement of Argentina's upgrade from the Frontier Markets Index to the Emerging Markets Index next year, as well as the news that Saudi Arabia, currently a 'standalone' index, will move straight into the emerging benchmark. In addition, the largest market in frontier, Kuwait, has also been put on review for a potential 2020 upgrade.

Some market participants are now concerned about the impact these future rebalancing acts will have on the frontier index. However, contrary to some commentary, in our view it is ludicrous to suggest the frontier classification will soon be rendered obsolete. There are 195 countries in the world and there are only 23 developed and 24 emerging markets – leaving a potential 148 frontier candidates. In fact, 108 of those 148 countries have established stock markets.<sup>1</sup>

It is worth remembering why frontier is such a compelling space to invest in. Aside from the strong, structural long-term growth outlook for frontier, a major reason to have exposure to these markets is the inherent low correlation, as frontier stocks react quite differently to developed and emerging counterparts.

As an individual frontier becomes more 'developed', the market increasingly attracts tourist and crossover money – which ultimately results in it behaving like it is in the emerging index. We have witnessed this dynamic in Argentina, which has tracked the recent volatility within emerging markets. Removing Argentina, the naturally low correlation of frontier has remained intact.

### THE MARKETS ON THE PATH TO PROSPERITY

While the future of Argentina was the catalyst for cynicism surrounding the future of frontier, there is no reason why this should be the case. While Argentina currently accounts for 17% of the MSCI Frontier Markets Index,<sup>2</sup> this was only 10% three years ago. As we have seen on numerous occasions since the establishment of the frontier classification, the upgrading of individual countries does not stifle the continued path to prosperity of other markets.

So, which markets are poised take a leading role in the next phase of frontier growth? We are currently witnessing many encouraging developments in a number of outposts – including the established markets of Vietnam, Kenya,

<sup>1</sup> Source: T. Rowe Price

Sri Lanka, Morocco and Romania. In addition, we expect the lowly-weighted Nigerian market, which was once a large part of the frontier benchmark, to return to investor favour over the medium term.

There are also interesting prospects further afield. On a three to five-year view, we have high hopes for several countries not yet in the index, such as Iran, Zimbabwe and Myanmar – which recently opened up its own stock market. The former Soviet republic of Georgia also has a number of intriguing stocks, all of which are currently listed in London and not in the benchmark.

#### **COMPELLING IDEAS BEYOND THE BENCHMARK**

As evidenced by our Georgian exposure, it is also imperative for investors to not solely focus on the MSCI Frontier Markets Index as there are plenty of opportunities to choose from the world's up and coming companies outside of the benchmark. Vietnam Dairy Products, a stock we held off-index for two years until it was finally included in the MSCI benchmark at a 4% weight in 2016, is a prime example.

There is no shortage of compelling ideas outside of the benchmark, in our view. While the MSCI Frontier Markets Index currently has 115 constituents, our universe of investable stocks is somewhere in the region of 300-400 names – with this number likely to rise in the years to come. In fact, we hold 38 off-benchmark stocks outside of the countries – Argentina, Kuwait and Saudi Arabia – on the way out of the classification.<sup>2</sup>

Finally, as for the upcoming 2019 rebalancing, we remain invested in our Argentine and Saudi Arabian companies and will continue to hold these positions until our investment thesis in each stock plays out. There is still just under a year before the upgrade takes place and historically we have witnessed strong performance from a market heading into an elevation – which was the case in Pakistan recently.

<sup>2</sup> Source: MSCI Frontier Markets Index, as at 30 June 2018

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