Investing in Frontier Markets
A Multi-Manager Solution

Generally defined as being in earlier stages of economic and capital market development than their developed and emerging peers, frontier countries have younger populations, rising economic demand, and relatively low levels of penetration of basic consumer services. Listed companies in this under-researched and under-owned universe typically are fewer in number, smaller in terms of market capitalization, and less liquid than those in core emerging markets. As a result, these markets tend to be less transparent and more prone to inefficiencies, creating an attractive environment for skilled investors. In a world where the drivers of markets and asset prices have increasingly intertwined, frontier markets tend to be less correlated to developed and emerging markets, and even to each other. While investing in frontier markets can pose certain challenges, the potential reward for surmounting these hurdles can be substantial. With its extensive network of contacts and specialized knowledge of local dynamics, the Lazard Alternative Emerging Markets team is uniquely positioned to employ its multi-manager approach to extract value from this untapped and often misunderstood asset class.

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Undeveloped. Unstable. Illiquid. Risky. Investors frequently think of these adjectives when contemplating frontier markets as an investment opportunity. In determining the accuracy of these descriptors, a more pressing question arises: what is the definition of a frontier market?

Broad market indices, such as those created by MSCI, are commonly used by the financial services industry to define opportunity sets and asset classes. The MSCI World Index consists of companies from 23 developed market countries, while the MSCI Emerging Markets Index includes stocks from 24 "emerging" countries. If any remaining country is then classified as "frontier," the definition of frontier markets would comprise over 150 countries.[1] Excluding the 40 or so countries that do not currently have stock exchanges, approximately 100 countries would remain in this broad definition of frontier markets.

In approaching this vast opportunity set, our team thinks of frontier markets as three distinct subsets:

- The largest subset consists of developing economies characterized by low levels of consumption and GDP per capita, less developed infrastructure, and poorer social metrics such as literacy, infant mortality, and life expectancy. A number of these countries have large populations and total GDP—such as Argentina, Nigeria, and Bangladesh—while others like Sri Lanka or Georgia have much smaller populations and/or economies.
- The second is a group of countries in the Persian Gulf, such as Kuwait, Oman, and Bahrain.[2] These nations' petroleum-fueled economic development has prompted debate about their frontier market qualification, but their historical lack of economic diversity has suppressed capital market development and kept them in the frontier world.
- The third is a group of countries with unique characteristics, such as Saudi Arabia and Iran, where limited access for foreign investors due to domestic policies and geopolitical constraints, rather than lack of capital market development, has historically excluded them from broad MSCI indices (see next page).

Exhibit 1

Defining the Frontier Markets Universe is Complex

	MSCI Emerging Markets (%)	MSCI Frontier Markets (%)	S&P Frontier BMI (%)	FTSE Frontier (%)
Argentina	—	19.40	15.50	—
Bahrain	—	4.00	3.20	—
Bangladesh	—	2.40	4.10	15.75
Botswana	—	—	0.70	0.65
Brazil	7.23	—	—	—
Bulgaria	—	—	0.40	0.13
Chile	1.24	—	—	—
China	25.06	—	—	—
Colombia	0.44	—	—	—
Croatia	—	1.50	1.80	2.50
Cyprus	—	—	2.20	—
Czech Republic	0.18	—	—	—
Ecuador	—	—	0.30	—
Egypt	0.13	—	—	—
Estonia	—	0.40	0.50	1.09
Ghana	—	—	0.40	0.05
Greece	0.37	—	—	—
Hong Kong	3.77	—	—	—
Hungary	0.35	—	—	—
India	8.70	—	—	—
Indonesia	2.28	—	—	—
Ivory Coast	—	0.20	0.80	1.39
Jamaica	—	—	0.90	—
Jordan	—	1.30	2.70	2.07
Kazakhstan	—	2.00	2.60	—
Kenya	—	5.20	3.50	8.62
Kuwait	—	19.10	13.90	—
Latvia	—	—	0.10	—
Lebanon	—	2.60	1.80	—
Lithuania	—	0.10	0.30	0.33
Malaysia	2.25	—	—	—
Malta	0.03	—	—	—
Mauritius	—	2.80	1.80	2.65
Mexico	3.57	—	—	—
Morocco	—	8.20	6.80	12.52
Namibia	—	—	0.30	—
Nigeria	—	7.90	5.90	15.70
Oman	—	3.20	2.50	5.52
Pakistan	0.10	—	7.30	—
Panama	—	—	3.60	—
Peru	0.39	—	—	—
Philippines	1.09	—	—	—
Poland	1.36	—	—	—
Qatar	0.61	—	—	—
Romania	0.09	3.90	2.70	7.65
Russia	3.27	—	—	—
Senegal	—	0.90	—	—
Serbia	—	0.20	—	0.24
Slovakia	—	—	0.10	—
Slovenia	—	1.70	1.40	2.33
South Africa	6.66	—	—	—
Korea	14.62	—	—	—
Sri Lanka	—	1.40	1.80	3.75
Taiwan	11.86	—	—	—
Thailand	2.15	—	—	—
Togo	—	0.30	—	—
Trinidad and Tobago	—	—	1.30	—
Tunisia	—	0.50	0.60	1.24
Turkey	1.21	—	—	—
United Arab Emirates	0.73	—	—	—
Vietnam	—	9.90	8.20	15.82
Zambia	—	—	0.10	—
Other	0.27[a]	0.90[b]	—	—

As of 31 August 2017

a Includes exposure to Yum China Holdings in the United States.

b Includes exposure to Globant SA incorporated in Luxembourg.

Source: FTSE, MSCI, S&P

■ Country uniquely classified as frontier in MSCI Frontier Markets Index

■ Country uniquely classified as frontier in S&P Frontier BMI

Evolution of Frontier Markets Benchmarks

While there are many frontier market indices, each uses a different selection criteria and construction methodology, leading to a diverse set of underlying constituents in terms of both countries and companies. Unsurprisingly, most broad market indices seem to struggle in fully encompassing the frontier investment opportunity set. For example, the MSCI Frontier Markets Index comprises 29 countries, of which only 24 are active constituents,[3] whereas the S&P Frontier BMI Index and the FTSE Frontier Index include 34 and 20 countries, respectively (Exhibit 1).

The group of frontier markets included in different indices changes over time. Frontier countries can be upgraded to constituents of emerging market indices, and non-benchmark markets can become part of an index. Out of the 19 countries that were constituents of the MSCI Frontier Markets Index in 2007, 16 are still part of the Index as of August 2017. The current index comprises a total of 115 companies, nearly double the size of the universe from a decade ago. Since 2007, MSCI has downgraded Argentina, Jordan, Pakistan, and Morocco from emerging to frontier and in 2014, reclassified Qatar and United Arab Emirates from frontier to emerging market status. Pakistan was assigned frontier status in 2009 and reclassified as an emerging market in 2017.

An Understated Potential for Growth

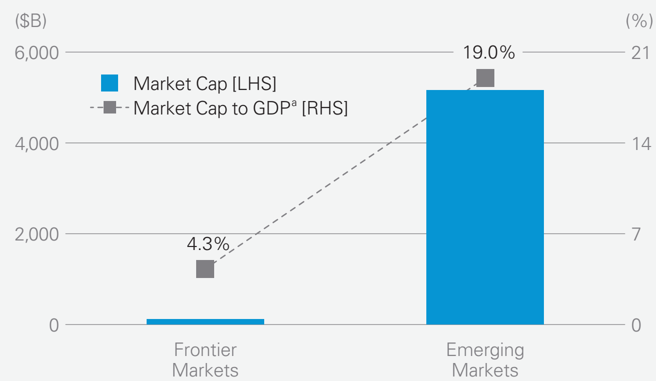
Frontier markets offer substantial potential for growth, exhibiting relatively healthy fundamentals and low penetration of basic goods and services. In many instances, the size of their listed equity markets are small given the relative size of their populations and economies. Whereas frontier countries represent 22% of the emerging markets population and 13% of emerging markets GDP, frontier equity market capitalization, at only 2.5% of emerging markets GDP, has lagged significantly. The optimistic prospect of growth is obvious if frontier markets develop, as many expect, in a fashion similar to emerging markets. Over the last decade, the market capitalization of stocks in the MSCI Emerging Markets Index has risen to 19% of the emerging markets GDP, while the market capitalization of stocks in the frontier index stands at only 4% of its respective GDP (Exhibit 2). Much of the frontier investment opportunity is associated with the infusion of capital needed for helping these markets realize their "catch-up" growth promise.

In comparison to developed or core emerging markets, the under-40 population (as a percentage of the total population) in frontier market countries is much larger while urbanization is much lower (Exhibit 3).

A Unique Example: The Kingdom of Saudi Arabia

While frontier markets share some characteristics, there are also distinctions that make each of them unique. For instance, Saudi Arabia's equity market capitalization of $470.4 billion (as of June 2017) closely trails the total market capitalization of the MSCI Frontier Markets Index as well as the market capitalization of individual developed and emerging equity markets such as Thailand, Indonesia, Belgium, and Malaysia. Saudi Arabia is home to one of the world's most valuable companies (the unlisted, state-owned oil and gas company, Saudi Aramco), with an estimated value of $2 trillion. Despite the fact that Saudi Arabia's equity market has an average daily trading volume (ADTV) of approximately $2.5 billion and over 100 companies with market capitalizations exceeding $1 billion, no Saudi company is currently included in either the MSCI Emerging Markets or Frontier Markets indices.[4] However, positive developments including the anticipated public listing of parts of Aramco and the recent relaxation of restrictions on foreign equity ownership have resulted in MSCI's announcement that it plans to consider Saudi Arabia for potential inclusion in the MSCI Emerging Markets Index as part of its annual market classification review in 2018.

Exhibit 2
Frontier Markets Have Potential



As of 19 September 2017

a The Market Capitalization to GDP ratio, which when compared to the historic ratio, is an indicator that a market is over-or undervalued.

Market cap data are based on free-float market cap of the MSCI Frontier Markets and MSCI Emerging Markets indices.

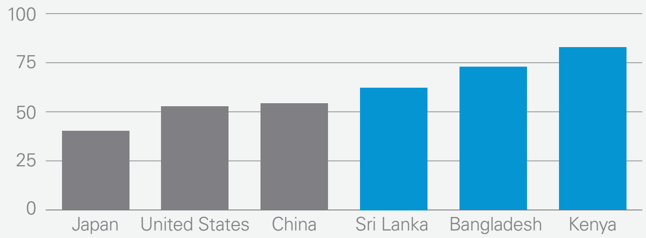
GDP estimate is the sum of 2017 nominal GDP in US dollars for the countries in each index as of September 2017. GDP data per IMF WEO (April 2017).

Source: FactSet, Haver Analytics, IMF, MSCI

Exhibit 3
Frontier Populations are Younger and Less Urban

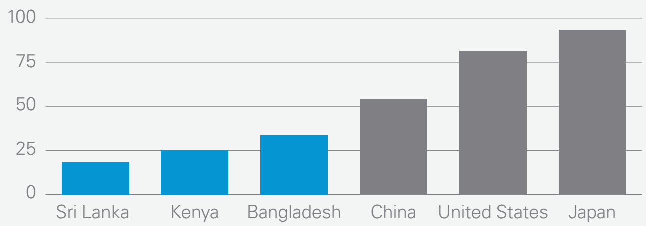
Population between Ages 0–39[a]

(% of total population)



Urban Population[b]

(% of total population)



■ Frontier Market ■ Developed Market or Core Emerging Market

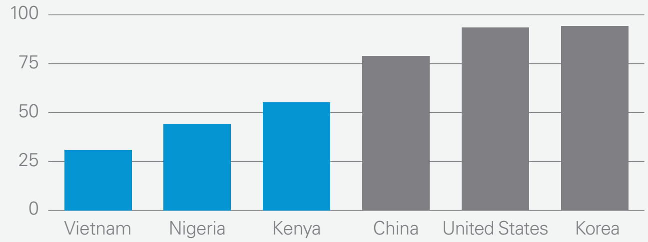
a Source: US Census Bureau—International Data Base. Population based on 2015 estimates

b Source: 2015 World Bank World Development Indicators based on United Nations, World Urbanization Prospects

Exhibit 4
Basic Services are Underpenetrated

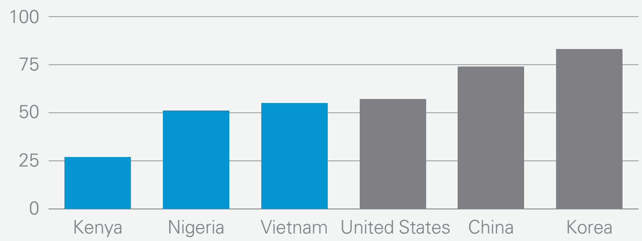
Account at a Financial Institution[a]

(% of age 15+)



Smartphone Penetration[b]

(% of total population)



■ Frontier Market ■ Developed Market or Core Emerging Market

a As of 15 April 2015. Source: 2014 World Bank Global Findex Database

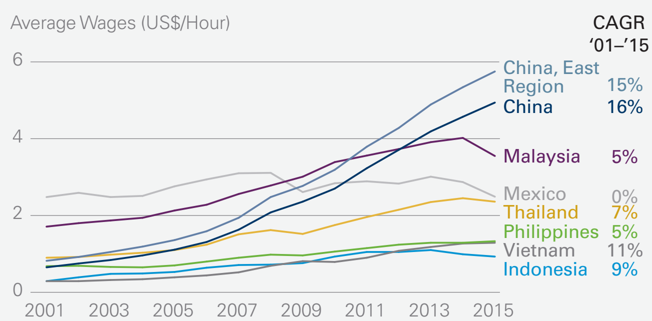
b Source: The Connected Consumer Survey 2014/2015. Consumer Barometer with Google. (http://www.consumerbarometer.com)

These two distinct socioeconomic characteristics of frontier markets have inherent implications. First, investors could expect the emergence of secular growth opportunities as frontier markets catch up to the rest of the world. Second, the catch-up phase could create an excellent backdrop for companies to grow earnings significantly over a prolonged period. Sectors that stand to benefit from the development and gradual maturation of frontier markets include banking, capital markets, education, home construction/furnishings, and infrastructure such as roads, seaports, airports, subway/rail, electrification, water, and sewage.

In the banking sector, less than half of the population aged 15 and older in Vietnam and Nigeria has bank accounts in comparison to 80% to 95% of the population in the United States, South Korea, and China (Exhibit 4). Rising banking penetration is typical for developing economies where a functioning financial infrastructure is necessary for the development of other industries. Combined with population growth, this could generate significant expansion in both revenues and profits for banking and capital market service providers over many years.

In terms of telecommunications, smartphone penetration tends to lag in many frontier markets countries (Exhibit 4). "Developmental leap-frogging," has enabled some of these countries to skip expensive infrastructure build-outs and directly adopt new technologies that positively impact economic growth. For example, some African

Exhibit 5
Wages in China Have Become Less Competitive



As of 31 December 2015

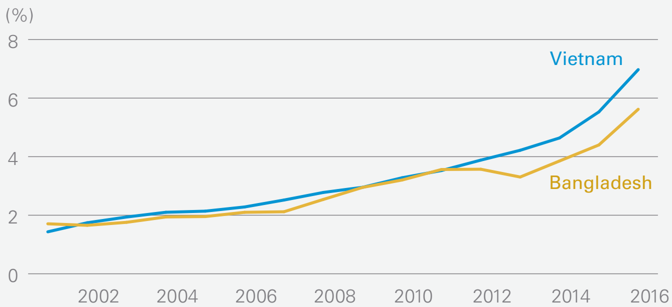
Source: Central Bank of the Philippines, China National Bureau of Statistics, Federal Reserve Board, Haver Analytics, International Labour Organization, Vietcombank, Wall Street Journal

countries with large rural populations have been able to introduce and expand telephonic communications without having to create the infrastructure for landline wiring. Similarly, several frontier countries have grown banking penetration with mobile phone technology without the need to invest in a physical branch network.

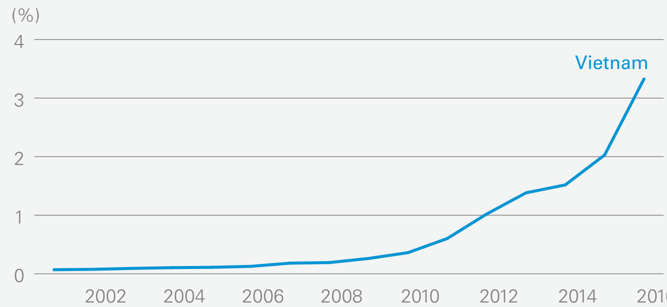
Furthermore, the low labor costs in many frontier countries, combined with accelerating urbanization, are making them attractive destinations for foreign direct investments and new

Exhibit 6
Vietnam and Bangladesh's Growing Market Share of Global Exports

Market Share of Apparel Exports



Market Share of Electrical and Electronic Equipment Exports



As of 31 December 2016
Source: International Trade Centre: Yearly Trade by Commodity Statistics 2001–2016

manufacturing hubs. For decades, China has been the de facto "global factory," but increasing labor costs in recent years have encouraged many companies to migrate their manufacturing facilities to frontier countries such as Vietnam (Exhibit 5) and Bangladesh. As China experienced upward wage pressures, its market share of global exports saw a significant growth downturn in both the apparel and electronics spaces in 2016. Regional frontier markets, in turn, have taken up the reins at the lower end, with their market share of apparel exports increasing exponentially since 2013. Vietnam, one of the frontier markets benefiting from this trend, has tripled its market share of electronics exports since 2012 (Exhibit 6).

Investing in Frontier Markets: A Balancing Act

Given the diverse nature and structure of frontier markets, investors need to be discriminating when considering specific opportunities. While frontier market equities represent a large array of countries with different underlying characteristics, the total number of listed companies in each country can be small.

For instance, out of the 29 countries in the MSCI Frontier Markets Index, 21 have fewer than ten constituents, and 15 have fewer than five constituents (Exhibit 7). Investors should also be wary of concentration from both a sector and country perspective—half of the index constituents are financial and telecommunications companies, and Argentina and Kuwait combined account for over 39% of the total index weight (Exhibit 8). Additionally, out of the 115 companies in the MSCI Frontier Markets Index, the five largest represent more than 15% of the total index weight (Exhibit 9). In terms of liquidity, only 55 companies in the index have a minimum of $500,000 ADTV. Dropping the threshold to $100,000 ADTV expands the list to merely 88 stocks.

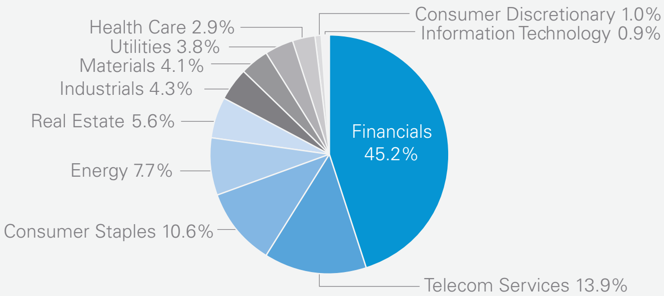
Exhibit 7
Frontier Contributors to Global GDP Are Excluded from the MSCI ACWI

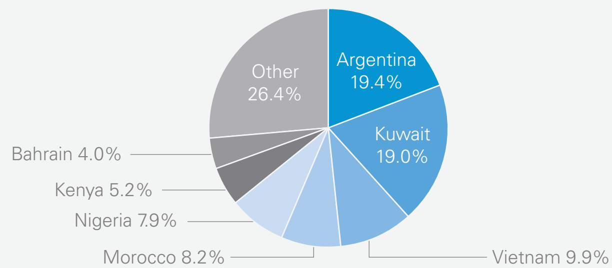
MSCI Frontier Markets Index Country Constituents	% of World GDP (2016)	# of Stocks in MSCI Frontier Markets Index	Total Market Cap (in US$ M)
Argentina	0.7	9	86,980
Bahrain	0.0	5	19,567
Bangladesh	0.3	5	4,976
Croatia	0.1	3	23,682
Estonia	0.0	2	3,111
Ivory Coast	0.0	1	666
Jordan	0.1	4	24,094
Kazakhstan	0.2	2	14,142
Kenya	0.1	4	24,234
Kuwait	0.2	8	89,029
Lebanon	0.1	4	8,804
Lithuania	0.1	2	4,557
Mauritius	0.0	2	11,283
Morocco	0.1	10	65,993
Nigeria	0.5	15	33,782
Oman	0.1	8	20,668
Romania	0.2	5	21,966
Senegal	0.0	1	4,296
Serbia	0.0	2	871
Slovenia	0.1	2	6,410
Sri Lanka	0.1	3	17,245
Togo	0.0	1	1,210
Tunisia	0.1	2	8,893
Vietnam	0.3	14	90,683
Total	3.1	115	587,141

As of 31 August 2017
Source: Bloomberg, MSCI

Exhibit 8

The MSCI Frontier Markets Index Has Significant Sector and Country Concentration





As of 31 August 2017

Source: MSCI

Exhibit 9

The Five Largest Companies Represent over 15% of the MSCI Frontier Markets Index

Country	Company Name	% of MSCI Frontier Index	Market Cap (US $M)	6M Average Daily Trading Volume	P/B (x)	12M Trailing P/E (x)	EPS Growth (%)
Kuwait	National Bank of Kuwait K.S.C.	6.1	14,532	2,611,041	1.5	14.3	14.4
Morocco	Maroc Telecom SA	2.2	12,899	1,071,053	9.5	21.7	6.7
Kuwait	Kuwait Finance House K.S.C.	4.7	11,293	3,802,536	1.9	16.9	24.8
Kenya	Safaricom Limited	2.6	9,929	2,242,691	9.5	20.4	13.1
Nigeria	Dangote Cement PLC	0.6	9,756	2,458,427	4.3	15.2	16.4

As of 31 August 2017

Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

Source: Bloomberg, FactSet Estimates, FactSet Fundamentals

Another interesting anomaly is that even if a country is a constituent of the MSCI Frontier Markets Index, many of the listed companies in that country may not be included. For instance, in Argentina and Kazakhstan, only companies that trade in the US markets as American Depository Receipts (ADRs) are included in the index, which excludes a meaningful number of companies that trade on the domestic exchanges. The addition of these companies to the opportunity set would expand the investable frontier market universe to more than 500 stocks with a median market capitalization of $350 million and a combined ADTV greater than $850 million.[5]

Further, the opportunity that exists beyond the countries and companies in the index is potentially quite large. Exhibit 10 shows the large range in size and market capitalizations of several non-index frontier markets and their largest listed company (by market capitalization). In the five markets shown, there are over 500 listed companies, few of which sell-side analysts actively cover. The scarcity of information explains the unique opportunity that presents itself to frontier market specialist managers. These managers can exploit market inefficiencies and extract value by conducting on-the-ground research and leveraging their local experience and relationships.

Exhibit 10

Select Non-Index Frontier Companies

Looking Beyond Market Indices Expands the Opportunity Set

Country	Total Market Capitalization (US$ M)	# of Listed Companies	P/E (x)	P/B (x)	EPS 1-Year Growth (%)	Dividend Yield (%)
Saudi Arabia	**448,831**	**181**	—	—	—	—
Saudi Basic Industries	81,257	—	16.4	2.0	-5.0	3.9
Zimbabwe	**12,042**	**64**	—	—	—	—
Delta	3,457	—	48.5	6.7	-12.2	1.2
Botswana	**4,276**	**23**	—	—	—	—
Barclays Bank of Botswana	495	—	13.1	2.9	49.4	2.0
Ukraine	**1,599**	**9**	—	—	—	—
Centrenergo PJSC	149	—	2.3	0.6	180.5	1.0
Zambia	**2,777**	**23**	—	—	—	—
Airtel Networks	376	—	15.9	7.5	12.8	11.4

As of 31 August 2017

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Source: Bloomberg

The combination of index and non-index constituents creates a large and often overlooked opportunity set in frontier markets. Given these abundant opportunities to consider, how can investors compare, for example, the attractiveness of an Ethiopian bank versus a Vietnamese brokerage? Having a local presence is critical to understanding, screening, and analyzing businesses based in frontier markets. In order for investors to evaluate and access the opportunities derived from the diverging development trajectories of frontier countries, they need to develop an extensive network of contacts and specialized knowledge about local dynamics.

Access and Liquidity

Although the volatility of frontier markets has not been as high as is commonly thought, investing in frontier markets can pose a number of challenges, including access and liquidity. The three most common ways for investors to access frontier markets currently are: (1) passively managed products such as exchange-traded funds (ETFs); (2) long-only, benchmark-constrained funds; and (3) alternative, specialized strategies.

A Strong Diversifier

Frontier markets tend to be more influenced by local than global economic and political developments, resulting in historically low correlations to developed and core emerging market risks. As a result, frontier equities provide attractive investment opportunities and serve as effective diversifiers when combined with other asset classes in a portfolio.

Correlation to Frontier Markets and Other Equity Universes

	MSCI EMSC	MSCI EM	MSCI FM	MSCI FM ex-GCC	MSCI World	MSCI World ex-US
MSCI EMSC	1.00					
MSCI EM	0.96	1.00				
MSCI FM	0.60	0.59	1.00			
MSCI FM ex-GCC	0.67	0.66	0.75	1.00		
MSCI World	0.83	0.87	0.60	0.65	1.00	
MSCI World ex-Us	0.86	0.89	0.63	0.70	0.97	1.00

For the time period May 2002 to August 2017

All data are in USD based on monthly returns of MSCI indices. The performance quoted represents past performance. Past performance is not a reliable indicator of future results. The indices above are unmanaged and have no fees. One cannot invest directly in an index. This information is not intended to represent any product or strategy managed by Lazard.

Source: Bloomberg, MSCI

Institutional investors allocating a sizable portion of capital to a concentrated number of stocks can have a large impact on these stocks' short-term performance. The countries, sectors, and stocks receiving inflows as a result of such allocations will typically experience periods of strong returns, but overcrowding can often create valuation distortions. When markets undergo corrections or the environment deteriorates, the ensuing rise in volatility can be severe. A period of volatility, particularly if sustained, frequently leads to capital outflows, which can further compound the volatility and reinforce the cycle.

In recent years, there has been a cycle of significant growth in the number and size of frontier market–focused ETFs and long-only products. At the end of 2014, there were fifteen US-listed frontier market funds (both actively and passively managed) with about $5 billion in total assets.[6] Since the frontier market asset class is still relatively young, most of these funds have relatively short track records—ten were launched during or after 2012. One reason these funds have appealed to investors is their offer of daily or intra-day liquidity. By Q2 2017, the number of US-listed frontier markets funds had fallen to eight and the AUM declined to less than $2 Billion.[7]

Nigeria is a great example of this dynamic. From late March to early August 2014, the MSCI Nigeria Index rose more than 24%. However, due to declines in crude oil prices, Nigerian equity prices began falling in August 2014, ending the year down nearly 30%, followed by another 15% decline in 2015.

Nestle Foods Nigeria and Nigerian Breweries, the two largest consumer staple stocks in the MSCI Nigeria Index, are familiar names to many investors and held by many frontier market ETFs. Prior to the pullback in Nigerian equities in late 2014, Nestle Nigeria was trading at a valuation premium relative to its European parent. Despite being a stock that directly benefits from African domestic consumption, the consensus estimates for the company's 2015 and 2016 earnings and revenues were downgraded continually. From 1 July 2014 to 13 February 2015, Nestle Nigeria fell by more than 48% in US-dollar terms.

Whether using a beta approach (e.g., index, regional or country ETF) or a traditional, long-only active strategy, investors face the same liquidity conditions. Investors should be sensitive to a potential mismatch between the liquidity of an investment vehicle and its underlying assets. Additionally, given the specialized nature of frontier investing, beta exposure does not necessarily equate to "low cost." According to Morningstar, individual investor share classes for many frontier market funds typically carry annual expense ratios of 2% or more (institutional share class expense ratios are slightly lower), and ETFs that track frontier market benchmarks have annual expense ratios of approximately 0.7%, a material fee for passive exposure.[8]

For investors seeking risk reduction and alpha generation and those interested in gaining exposure to less liquid, less well-known companies, an alternative approach through a portfolio of specialized managers can be an attractive option. This manager universe typically aims to avoid investing in overbought stocks—or even seeks short hedges from among them. Specialized managers are likely to concentrate more on countries and companies that are less covered or ignored by sell-side economists/analysts and will normally have differentiated portfolios. These managers also tend to carefully manage their capacity and asset base. The combined result is an expectation of compelling returns with substantially less volatility compared to most ETFs or traditional, long-only frontier funds.

Lazard's "Alternative" Approach to Frontier Markets

Lazard's Alternative Emerging Markets team believes that the distinct characteristics of the frontier market opportunity are well suited to an alpha-focused investment approach, achieved through a portfolio of managers with specialized experience, skills, and local presence. While these managers focus on different areas within frontier markets, their strategies are characterized by value consciousness and a willingness to invest outside of the index, mitigating the risk of investing in overcrowded, expensive companies.

To identify what we consider suitable investments for our portfolios, we require potential candidates to undergo a rigorous due diligence process that separately considers a manager's philosophy, approach, governance process, and supporting business infrastructure. Two groups of professionals within the Lazard Alternative Emerging Markets team review the opportunities: one focuses on the manager's operations and processes, while the other focuses on investment capabilities.

We search for managers with skilled and adequate research resources who adhere consistently to sustainable and repeatable investment processes. On the business side, we examine operational, administrative, and governance practices with an approach that leverages a range of skills and resources, including deep, institutional knowledge of capital markets, a global network of reliable contacts, and foreign language capabilities.

Lazard's multi-manager frontier strategy offers investors exposure to a portfolio of specialist frontier managers. These managers typically focus on less well-known stocks, so we expect the portfolio to have, on average, higher earnings growth and a better dividend yield than an ETF or traditional long-only products. In our view, the diversification derived from a multi-manager portfolio would also translate into a less-volatile return profile. To illustrate this point, the top ten holdings of the largest frontier market ETF and the largest traditional, long-only frontier market fund are compared against those of the most representative global frontier specialist manager currently in Lazard's Alternative Emerging Markets strategy. Also shown are each portfolio's exposure to the MSCI Frontier Markets Index's two largest country constituents, Argentina and Kuwait (Exhibit 11). Unsurprisingly, the specialist manager has significantly less exposure to the two largest country constituents as well as a lower concentration to the top ten holdings of the ETF and the long-only frontier market fund.

Exhibit 11

Active Frontier Investments Provide Diversification via Less Crowded Names and Markets

Top 10 Holdings

	iShares MSCI Frontier 100 ETF	(%)	Templeton Frontier Markets Fund	(%)	Global Frontier Specialist in Lazard's Alternative Emerging Markets Strategy	(%)
1	National Bank of Kuwait	5.7	Delta Corp	6.6	Halyk Savings Bank	6.0
2	Vietnam Dairy Products	4.8	DHG Pharmaceutical	5.2	BRAC Bank	5.9
3	Kuwait Finance House	4.5	National Bank of Kuwait	3.6	Habib Bank	4.4
4	Banco Macro	3.8	East African Breweries	3.4	Ultrajaya Milk Ind & Trading	3.0
5	Grupo Financiero Galicia	3.4	KCB Group	3.4	Wizz Air Holdings	2.8
6	Mobile Telecommunications	3.2	Sonatel	3.2	Tullow Oil	2.8
7	Safaricom	3.1	BRAC Bank	2.9	Samba Financial Group	2.8
8	Pampa Energia	3.0	Vietnam Dairy Products	2.9	Square Pharmaceuticals	2.8
9	YPF Sociedad Anonima	2.9	Hatton National Bank	2.8	Georgia Healthcare Group	2.7
10	Itissalat Al Maghrib	2.7	Aramex	2.8	Military Commercial Joint	2.7
Weight of Top 10		**37.0**		**36.7**		**35.9**

iShares MSCI Frontier 100 ETF	(%)	Templeton Frontier Markets Fund	(%)	Global Frontier Specialist in Lazard's Alternative Emerging Markets Strategy	(%)
Total % Exposure to Kuwait	20.5	Total % Exposure to Kuwait	9.4	Total % Exposure to Kuwait	0.0
Total % Exposure to Argentina	18.2	Total % Exposure to Argentina	9.9	Total % Exposure to Argentina	4.7

As of 31 August 2017

Allocations and security selection are subject to change. Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein.

Source: Lazard, BlackRock, Franklin Templeton

When frontier markets rally, we expect a multi-manager portfolio to participate in the upside capture but to lag benchmarks such as the MSCI Frontier Markets Index. However, when frontier markets experience sharp sell-offs or corrections, we anticipate the multi-manager approach to provide downside protection and outperform the index, leading to the possibilities of better compounding of returns over the long term. Relative to passive and traditional options, an active approach could also reduce the risks associated with poor market timing and could outperform on a risk-adjusted basis across different market cycles.

As previously noted, given the tendency for frontier market equities to be more impacted by domestic events rather than global financial or geopolitical developments, our team believes that including frontier exposure in a portfolio can help generate alpha and mitigate risks.

Conclusion: Sourcing Diversification and Alpha

Whether investing in frontier markets within a broad emerging markets portfolio or through a dedicated frontier mandate, the potential alpha offered by the asset class is significant and should not be ignored by allocators. The number of countries and stocks in the opportunity set is large, and the potential range of size, access, and liquidity among them is vast. Avoiding overcrowded stocks and navigating liquidity and capacity constraints are important for any investor contemplating frontier markets exposure. Significant local knowledge and expertise are required for understanding the inherent complexities when identifying and assessing the underlying opportunities.

Investors seeking alpha generation from frontier markets might consider a multi-manager approach that leverages the skill and expertise of a suite of specialized managers. These managers have the capacity to focus on “under the radar” countries and companies, allowing them to create differentiated portfolios. The combined result seeks to generate compelling returns with substantially less volatility compared to most long-only frontier portfolios and ETFs. The Lazard Alternative Emerging Markets team has extensive experience required to select and manage portfolios of specialist managers. Through our frontier market dedicated strategy, investors can further diversify their portfolios while obtaining exposure to a unique source of alpha and performance.

About the Team

Lazard's Alternative Emerging Markets team has a history of utilizing its professional network, built from years of emerging and frontier market investment experience, to source and identify specialist managers in emerging and frontier markets. The team also leverages the firm's unparalleled global research capabilities including the resources that are dedicated to managing $65 billion in emerging markets mandates. The team regularly travels to Asia, Latin America, Africa, and Eastern Europe for meetings with managers, company managements, financial intermediaries, policymakers, and government officials to maintain an informed understanding of shifting local dynamics. Its extensive experience in conducting on-the-ground research is crucial in evaluating the most compelling opportunities and determining how these opportunities should be implemented within a multi-manager portfolio.

Notes

1 The exact number depends on the definition of "country." United Nations recognizes 193 countries as member states, and 2 countries as non-member states: The Holy See and the State of Palestine. In addition, dependent territories such as Bermuda, Guam, and Hong Kong are recognized by the International Olympic Committee.

2 MSCI "upgraded" Qatar and the United Arab Emirates from the Frontier to Emerging Markets Index in May 2014. MSCI will also occasionally "downgrade" a country from Emerging to Frontier Markets index, for example, Argentina in 2009.

3 MSCI classifies Frontier Markets as the following 29: Argentina, Croatia, Estonia, Lithuania, Kazakhstan, Romania, Serbia, Slovenia, Bahrain, Jordan, Kuwait, Lebanon, Oman, Bangladesh, Sri Lanka, Vietnam, Kenya, Mauritius, Morocco, Nigeria, Tunisia, and the West African Economic and Monetary Union (WAEMU) which includes: Benin, Burkina Faso, Ivory Coast, Guinea-Bissau, Mali, Niger, Senegal, and Togo. Currently, the MSCI Frontier Markets Index includes securities from 24 of these 29 countries, since the MSCI WAEMU Indices currently only include securities classified in Senegal, Ivory Coast, and Burkina Faso.

4 Saudi Arabia opened its equity markets in a limited manner for the first time to foreign investors in June 2015. MSCI is in active discussions with the Saudi government and regulators about inclusion. Market speculation is that if or when Saudi Arabia is added to a broader index, it will become a constituent of the MSCI Emerging Markets Index, bypassing the more common practice of a country beginning first as a part of the MSCI Frontier Markets Index. With that said, specialist managers with expertise in the region and extensive knowledge of the Saudi market have been exploiting the opportunity and participating in the market via intermediaries for some time.

5 Source: BlackRock Research

6 Source: Morningstar Manager Research: Frontier Markets Begin to Emerge, 17 December 2014

7 Source: Morningstar

8 Source: Morningstar Manager Research: Frontier Markets Begin to Emerge, 17 December 2014

Important Information

Published on 17 October 2017.

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A portfolio of securities concentrated in one country or geographic region may be subject to greater volatility than a more diversified portfolio. Diversification does not guarantee profit or protect against loss in declining markets.

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