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Frontier markets: multi-year bull market

Interview with Andrea Federici, manager of the Aristea SICAV New Frontiers Equity fund of Banor Capital

At a time when there is much talk of high levels of valuation reached by certain equity indexes, frontier markets offer less expensive valuations. Parallel to the P/E ratio, what do you believe to be the factors that make the asset class appealing?

Andrea Federici

During this current market phase, **frontier markets** offer a **unique opportunity, not only for "cheap" valuations** (our portfolio of securities of companies operating in these countries has an average P/E of 9.5x), but above all for the **growth prospects afforded by these markets.**
Indeed, they are countries characterised by **strongly growing economies with GDPs rising at a rate of between 4% and 8%.** And companies that continue to record solid profits, allowing shareholders to receive **very interesting dividends** of around 4%.
This highly favourable environment is supported by **local social-economic expansion factors**: the very young population with growing income offers long-term support to the domestic demand for products and services, at a far higher level than developed and emerging markets.
In addition, almost all **frontier markets are in key positions along the belt and road**, the strategic initiative of China aimed at improving its commercial connections with the countries of Eurasia and Eastern Africa, which will make for a further driver of economic growth and international relations in these countries.
For example, **Vietnam, Kazakhstan and Kenya will benefit significantly**, precisely thanks to their **geographic position.**
Very briefly, at this unique moment in time, **frontier markets offer "double the growth at half the price".** Which, together with the favourable social-economic conditions and potential of the Belt and Road Initiative, could give rise to a **bull market set to last several years.**
Low levels of capitalisation, political instability and currencies inclined to extreme volatility or devaluation are all risk elements for those investing in the asset class. Which risk factor do you believe to be most dangerous in this market phase?
Although in recent years, the risk levels of frontier markets has reduced considerably, just like any type of investment, these **countries have risks**, including that of possible **currency devaluations.** However, it is important to note that such risks are similar to those that characterised the emerging markets 15-20 years ago, albeit with a significant difference.
The **current governments and central banks**, on the strength of experience of how these situations were addressed in the past by the institutions of emerging countries, **act by paying closer attention to the effects that their interventions can have on the market** and on investors.
It is worth stressing that, although it is true that the individual countries may present high **idiosyncratic risks**, a **global portfolio comprising 10-15 frontier markets** tends to have a **relatively limited comprehensive risk.** On a par with a portfolio comprising **securities from emerging and developed countries**, precisely thanks to the low integration between frontier countries.