

FRONTIER MARKETS

A DIFFERENT APPROACH TO FRONTIER MARKETS



Wytze Riemersma: Portfolio Manager



Marco Balk: Co Manager

What we believe as professional investors in the idea that if you want to make better returns than the average investor, you should start by doing something completely different but in a very structured way.

In 2012 we put this into practice by launching the TCM Global Frontier High Dividend Fund with a listing on Euronext Amsterdam. About a year after the start, the fund returned almost double the benchmark performance (+15,21% in euro's) and was awarded the Investors Choice Award in the category Emerging EM Fund of 2014. Now the fund has a track record of three years (figure 1) with a return since inception of 48% and a 5-star Morningstar rating, indicating that TCM is doing something completely different than the rest. This is also confirmed by the fact that the team applies the same method on two other funds; TCM High Dividend Africa and TCM High Dividend Vietnam, which both have a 5-star Morningstar rating on a 3-year basis. Applying a high dividend strategy for stock selection in combination with investing in Frontier Markets brings together the best of both worlds. According to the IMF,

roughly 900 million people are living in frontier market countries and makeup 12% of the global population, the majority of which is young. This creates enormous potential as this wave of the population begins to enter their most productive years without the burden of a large elderly population to support. In 25 years the emerging markets have grown from approximately 1% of global market capitalization to nearly 10% today. The same way, frontier markets making up less than 1% of global market capitalization could follow that route. For investors, these markets offer portfolio diversification benefits. Not only do frontier markets have low correlations with developed and emerging markets, but they have very little correlations amongst each other as well. Furthermore, frontier markets typically trade at cheaper valuations than their more developed peers and have higher dividend yields. Selecting quality high dividend stocks have been, for decades, a proven way to outperform in developed markets. Applying the strategy to frontier markets is rather unique. Why? Because the most important factor for most frontier market investors is liquidity. The focus is on the larger names for which

research is available. Companies sometimes have restrictions for foreign investors and trading volume is much lower than in developed markets. Therefore the highly liquid stocks trade at a premium. There is much less attention to other fundamentals like dividend yield. For instance, the frontier market ETF trades currently at 11 times earnings and a dividend yield of 4%, whereas the TCM fund trades at eight times earnings and a dividend yield of 7.5%. Dividend stocks are trading at a discount to the market unlike in developed markets were, because of the low-interest rates, the chase for yield has pushed up valuations. TCM has a rigorous investment process. First, we look for countries with large populations and larger local markets. On top of that, we put a weight cap on Middle-East-countries. The second step filters for market capitalization and liquidity. Then the fund applies a quantitative analysis to look for dividend yields north of 4% with a history of dividend increases. On top of that, a sound return on equity, a strong balance sheet and acceptable valuations are needed. The final qualitative step drills down on the short list so that an equally weighted portfolio is constructed. Consequently, the fund weightings can

differ significantly from the frontier benchmark index. The fund currently has 70 equally weighted stock in the portfolio, which are spread over 17 different countries all over the frontier universe, such as Pakistan, Vietnam, Nigeria, Bangladesh and Kenya. Every quarter the portfolio is balanced back in line with the model. Going forward TCM has hired Sustanalytics, an independent external Institute, that will screen the portfolio every quarter on basic social, environmental and corporate governance issues. Thereby TCM will be one of the first Frontier Markets funds that take these factors into account. Together with the mentioned investment process and dividend strategy we have quite a different approach to frontier markets than our peers. That way we have managed to deliver outperformance at a lower volatility level.

The TCM funds now have an AUM of EUR 40 million, which can grow more sizable when the fund becomes accessible for foreign investors as the UCITS license is expected to be formalized by the end of the year.

Trustus Capital Management (TCM)

