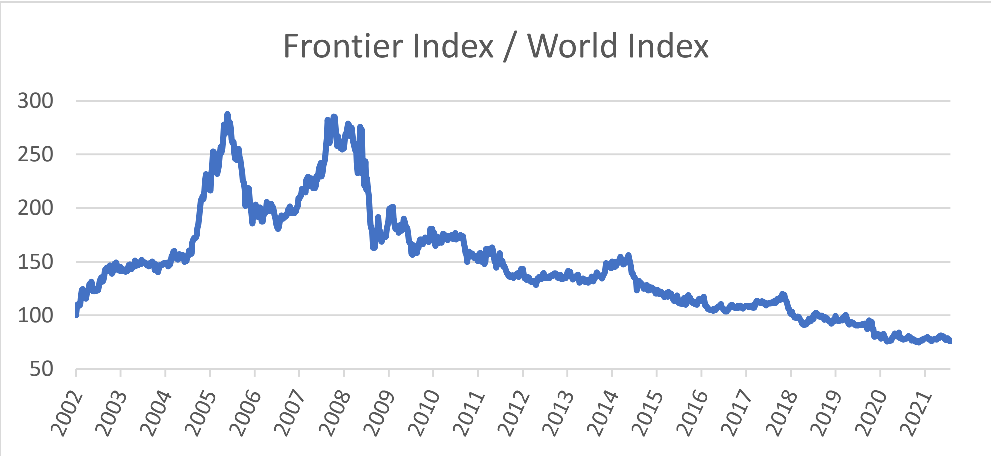
Outlook Frontier Markets 2022

Since the bottom in March 2020, global equity markets have seen a strong rally. The S&P500 for instance has risen 82% during the period and reached 33 times a new all-time high in 2020 and 70 times in 2021. It is not surprising that investors, after such record gains, are becoming a bit nervous about what will come next, given that central banks have started tapering, inflation is rising with rate hikes on the horizon.

20-year relative low

As bonds offer the prospect of a negative return, equities remain the most attractive alternative for investors as long as the risk premium is positive. In that regard, Frontier Markets can be an interesting addition to the portfolio given their low valuations and higher expected economic growth. Despite the fact that this asset class has risen 60% since its March 2020 low, the relative Frontier Markets (FM) performance versus developed markets (DM) is at a 20-year low (see Chart 1). We think that FM may outperform DM in the coming years for several reasons.

Chart 1: Frontier Markets at 20-year relative low versus developed ones, source Bloomberg



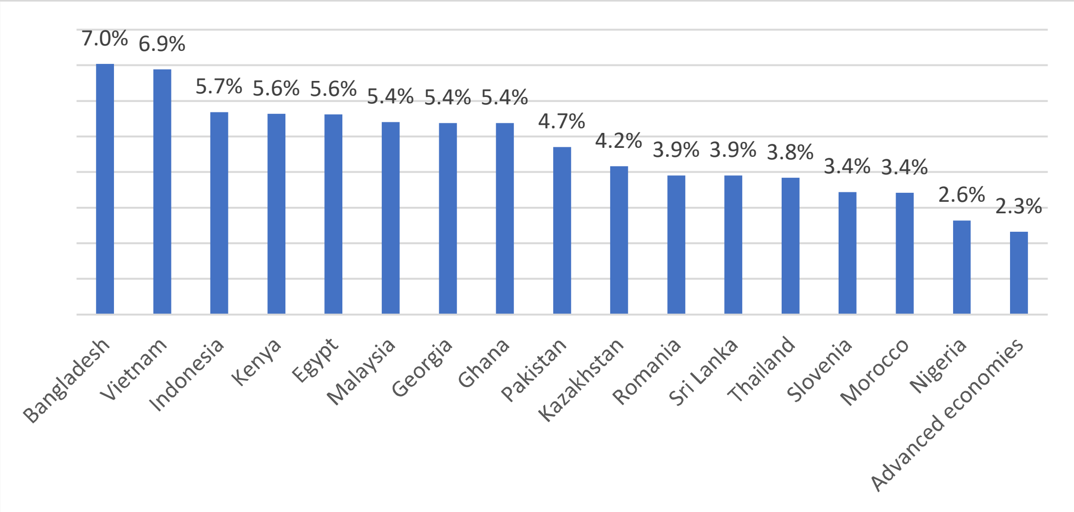
Inflation and Frontier Markets

One of the reasons is that inflation generally affects growth stocks more than it affects value stocks. The world index consists of approximately 50% growth stocks and for the Emerging Markets this is almost 65%. The Frontier Markets index on the other hand consists mainly of value stocks. If inflation and interest rates rise, a lower valuation will be assigned to the future cash flows of growth stocks because of the higher discount rate. Value stocks tend to perform better in periods of higher inflation than growth stocks. The last period in which inflation rose, between 2003 and 2008, we saw a notable outperformance of FM (+120%) compared to DM (+45%), measured in euro.

Higher growth prospects

Another argument is higher economic growth prospects. Unlike the US and Western Europe, many countries in the frontier universe did not have a chance in 2021 to fully reopen their economies due to multiple waves of COVID-19 outbreaks and lower vaccination rates. When the virus becomes milder and the vaccination rate rises, these countries should catch up. For example in Vietnam where at the beginning of 2022 a USD 15 billion dollar stimulus package will be launched. At the same time, the economic growth in developed countries will probably normalize to a lower level because the unprecedented fiscal and monetary incentives will fade out. In the latest World Economic Outlook, the IMF predicts that economic growth in the developed economies will fall to an average of 2.3% in the next 5 years. The average growth forecast of the countries in the frontier universe is a lot higher at 4.8%, with peaks up to 7% for Bangladesh and Vietnam (see chart 2).

Chart 2: Real GDP growth (Average Annual percent change 2022-2026, source IMF)



Vietnam & Bangladesh

Almost 25% of the TCM Global Frontier High Dividend fund is invested in Vietnam and Bangladesh. The cheap labor costs, the political stability and the many free trade agreements make these countries attractive to investors. Because of the trade dispute between China and the US a lot of large companies such as: Samsung, Intel, LG, Nike and Adidas, decided to reallocate more of their production capacity to Vietnam. This trend is expected to continue in 2022, because the pandemic brought the insight that supply chains are too dependent on China. There is a long list of companies who therefore also want to invest in Vietnam, including Apple and Panasonic.

Through its 'Made in Bangladesh' program, Bangladesh is also committed to attracting foreign investment and increasing local production and consumption. Brands like Nokia, Oppo and Vivo have set up local factories or are collaborating with Bangladeshi producers. With over 175 million active mobile connections, Bangladesh is now in the Asian top 10.

In Bangladesh, we have a position in Grameenphone, the telecom operator with the highest number of subscribers and the largest network in Bangladesh. The stock is trading just 12.5x expected earnings at a dividend yield of 8.1%. The ROE is 76% and earnings per share are expected to grow 10.5% this year.
One of our last purchases in Vietnam was MBB bank. The bank has lower financing costs than its peers and retail loans grew by an average of 33% per year in the last 5 years. The net profit growth

for 2022 and 2023 is estimated at 21% and 19% respectively. The stock is trading at 7x earnings with an increasing dividend yield to 5.8%.

Africa

The TCM Global Frontier High Dividend fund currently has a weight of approximately 36% in Africa. The African continent contains 54 countries with a young and fast-growing population. On the basis of United Nations projections, the population will grow from 1.3 billion people to 2.5 billion people in 2050 and that means that soon more than a quarter of the world population will live in Africa. Meanwhile 53 countries have now signed the African Continental Free Trade Agreement. The agreement aims to create a free trade zone serving 1.3 billion people in 53 countries and connect them to 1 market with a combined (GDP) value of US$3.4 trillion. By lowering the trade tariffs and the removal of all kinds of barriers, mutual trade can increase sharply over the years, because now African countries hardly trade with each other. In Europe for example, 68% of exports go to other European countries. In Africa mutual trade is still only 16.6%. There is an enormous growth potential here.

Fintech

Another theme with great growth potential in Africa is Fintech. About 57% of the African population does not have a bank account. It affects people's quality of life and prevents them from investing in their future or building up reserves. In other words, access to financial services is an essential factor. Within the portfolio we have a position in Africa Airtel. The company ensures inclusion by offering financial services through the mobile phone subscription. Airtel Africa serves approximately 118 million customers in 14 countries, mainly in East, Central and West Africa including Kenya, Uganda and Nigeria. However, by far the most interesting part of Airtel's business is the delivery of mobile banking through its majority stake in Airtel Money. Although this part has only 20 million customers so far, the customer base is growing at 30% per year, which is why larger companies like to invest in it. Mastercard has bought a small stake in the subsidiary, allowing Airtel to invest in expansion. Although Airtel's share price has tripled since March 2020 and is significantly above its pre-crisis peak, it is still trades at a very low 11x times 2022 earnings, with a dividend yield of 4%.

Renewable energy

One of the core countries in Africa within the fund is Kenya with a weighting of almost 8%. For 2022 GDP growth of 6% is expected. Due to the high growth, demand for electricity is also increasing strongly. President Uhuru Kenyatta informed the international community on November 2, 2021 in Glasgow saying that Kenya is determined and on track to make a full transition to clean energy by 2030. Within the portfolio we recently bought a position in Kenya Electricity Generating (KenGen). This company generates sustainable energy by drilling 3 km into the ground to extract geothermal hot steam of 350 degrees Celsius to drives turbines. Due to this new technology, there has been strong growth in production. Revenues have also become more stable as this sustainable geothermal generation does not depend on weather conditions like wind and solar. KenGen is the market leader and 60% of its revenues are now coming from this geothermal electricity generation. The company is currently in talks to expand to other African countries such as: Djibouti, Congo and Rwanda. The stock is trading at just 2x expected 2022 earnings at a dividend yield of 9.4%.

Pakistan

With a weighting of over 8%, Pakistan is one of the core countries in the portfolio for the next year. The country was downgraded from Emerging to Frontier Market in November last year by index provider MSCI due to low liquidity and size. The reclassification can be beneficial for Pakistan by reducing the selling pressure from foreigners. Foreigners have sold shares worth USD 730 million (net) since December 31, 2019, of which approximately USD 159 million net in the past year. Partly because of this, the Karachi Stock Exchange 100 index is now trading at a P/E ratio of 4.9x which is a discount of 38% compared to the historical average of 8.1x. The market is projecting earnings growth of 12.4% for 2022. Meanwhile, economic growth is expected to pick up from 3.94% last year to 5.17% for 2022. Within the portfolio, we have a position in OGDC, the largest oil and gas exploration and production company from Pakistan. The stock has fallen so much that it is currently trading at an implied oil price of USD 15.90 compared to the current Arab Light Price of USD 75 and the stock is trading at a P/E ratio of 3.1x with a dividend yield of 14%.

Portfolio
The total portfolio of the TCM Global Frontier High Dividend fund is entering the new year with an expected price/earnings ratio of 10.3x and a price book ratio of 1.5. The ROE and the expected dividend yield is 17.5 and 6.2% respectively. For fiscal year 2022 EPS growth will reach almost 20%. (source: Bloomberg). The next 2 years look promising for the dividend strategy of the fund. Companies that have been prudent in their dividend pay-outs during the pandemic, whether or not at the behest of regulators, will be more generous for shareholders going forward.

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Frontier Markets Team
TCM Investment Funds