Outlook Frontier Markets 2023

Rising energy and food prices combined with a record strong dollar have put frontier markets under pressure over the past year. In addition, specific circumstances caused additional price falls, such as floods in Pakistan, a political crisis in Sri Lanka and fear of the consequences of the war in Ukraine for countries such as Kazakhstan and Georgia.
In Vietnam, the market crashed more than 30% as regulators scrutinized the corporate bond market. This perfect storm has caused frontier markets to experience their worst year since 2008. Since then, every year of decline to date has been followed by a positive year.
The price-to-earnings ratio has reached a record low of 8.6, which seems to have factored in the worst-case scenario. This while the food price index (FAO index) is falling for the 8th month in a row, problems in the supply chains are decreasing, inflation is expected to decline and the dollar has passed its peak. In the most recent World Economic Outlook the IMF forecasts average growth for frontier markets of 4.2% compared to 1.6% for developed markets.

Chart 1: annual returns FM index total return in EUR

Vietnam
With a weighting of 30%, Vietnam is one of the most important markets in the FM index. This stock market in particular suffered the largest correction in more than 10 years, after the government intervened hard after malpractices in the issuance of corporate bonds. The CEO of a real estate company Van Thinh Phat Holding (no position in the fund) was arrested and the rules were tightened precisely at a point where many companies wanted to roll over loans. Liquidity declined and interest rates shot up, causing stocks to plummet and even causing a bank run on Saigon Commercial Bank (no position in the fund). The Vietnamese market is experiencing an influx of local private investors. For example, 1.8 million new securities accounts were opened in the first half of the year. Due to the sharp declines, many investors had to deal with margin calls for the first time, resulting in stocks being sold limit down. Last November, the VN index traded almost 40% lower. Margin calls now appear to be stabilizing and the government is making efforts to revive the corporate bond market.

Disconnect
At the time of writing the VN index is trading at an expected price-to-earnings ratio of just 9.5 for 2023, its lowest level in more than a decade. There seems to be a disconnect between the stock market and the economy, because the underlying Vietnamese economy is robust.

Vietnam is in fact one of the fastest growing economies in the frontier market universe (see chart 2) with an expected GDP growth of 6.6% for the coming years. Given the investor-friendly policies, political stability and consumer demand outlook, foreign companies are keen to invest in the country. Foreign direct investment has doubled in the past 10 years and reached a record high of more than USD 20 billion by 2022. We believe that FDI will continue to grow in the coming years as Vietnam benefits from the restructuring of supply chains in Asia. Companies such as Samsung, Intel, LG, Apple and Adidas have started producing in Vietnam. Another reason for this is that employees are well trained and labor costs are very low. For example, wages in China are three times higher than in Vietnam.

Table 1: Comparison of current PE compared to 10-year average

Country	Actual PE	10 year PE Average	Upside to Average
Sri Lanka	4,0	11,8	192,5%
Kazakhstan	5,1	11,1	117,9%
Pakistan	4,2	9,2	119,4%
Egypt	8,9	17,0	91,4%
Kenya	6,7	12,7	90,1%
Morocco	14,8	23,4	58,7%
Frontier Markets	8,6	12,5	44,8%
Indonesia	12,8	18,0	40,7%
Vietnam	10,5	15,0	43,3%
Nigeria	10,1	13,9	37,7%
Phillipines	15,2	20,5	34,7%
Emerging Markets	10,7	14,2	32,3%
World	16,7	20,2	20,8%
SP500	18,6	20,3	9,6%
Bangladesh	12,2	12,1	-0,4%

(source: Bloomberg)

The currency is stable and supported by rising foreign exchange reserves, which have quadrupled over the past decade to more than USD 100 billion. At 5%, the expected inflation rate is just above the government's target. In the coming year, with the gradual opening of China after the Zero-Covid policy, the Chinese tourists will return to Vietnam. Chinese tourists make up about 32% of the total number of international tourists. Before the pandemic, the contribution from tourism was 9.2% of GDP.

Stimulation package
Another interesting development is that Vietnam has launched a massive $15.2 billion stimulus package (4.1% of GDP). Only 12% of the money has been spent so far. Most of it will be spent in 2023. The spending of 5 billion on infrastructure will have the most impact on the economy. For example, a large part of the money goes to the construction of the North-South highway, which can support real estate prices in the regions and the development of satellite cities and industrial centers outside Ho Chi Minh City and Hanoi. It will also help reduce transportation costs in Vietnam, which are now among the highest in the world.

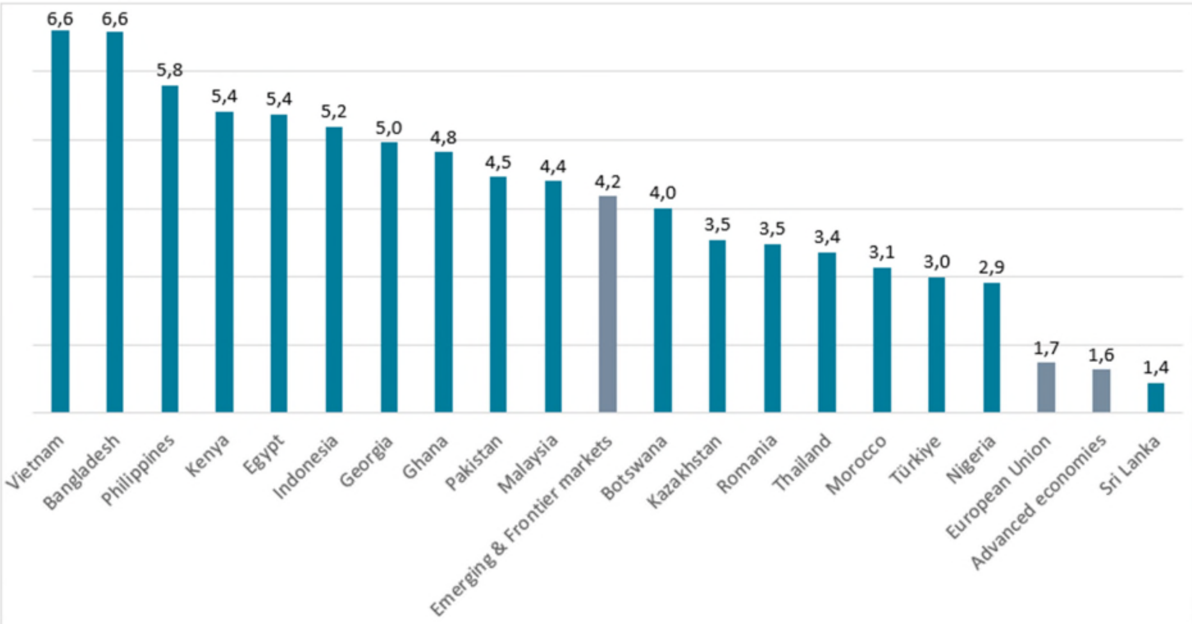
Africa
The fund has a weighting of approximately 33% in Africa. The African continent contains 54 countries with a young and fast-growing population. Based on projections by the United Nations, the population will grow from 1.3 billion people now to 2.5 billion people in 2050, which means that

more than a quarter of the world's population will soon live in Africa. Developments in Africa go in fits and starts and are therefore unfairly ignored by many investors. The continent has 17 active exchanges, but many listed companies are hardly followed by analysts. This provides unique opportunities in terms of stock picking, because some companies are showing strong growth despite all economic fluctuations.

Equity Bank Kenya

For example, within the fund we have selected the Equity Bank in Kenya. The stock is trading at a price-to-earnings ratio of just 3.6 with a dividend yield of 8.8%. The company has shown a net profit increase of about 30% per year for 10 years in a row. The bank has more than 16 million customers and operates in six countries, including Kenya, Uganda and Tanzania. In Congo, the second largest country on the continent in terms of land area, profits are expected to double. About 3000 new accounts are opened every day. At the moment, only 7% of the 100 million inhabitants in Congo have a bank account. In addition, a lucrative deal has been signed with the Congolese government to set up a bond market.

Graph 2: Percentage Real average GDP growth 2023-2027 (IMF Oct 2022)



Egypt

In addition to Kenya, the fund also has positions in Morocco, Nigeria and Egypt. In the past year, Egypt's economy was hit by the war in Ukraine. For example, the country imports 85% of its wheat from Russia and Ukraine and Russian visitors make up a large part of the tourist flow. Due to the increased prices, a financing gap arose. A $22 billion cash injection from the Gulf states, used for food subsidies and the agricultural sector and a deal with the IMF helped the country. In addition, the currency was devalued by 15%. Despite the turbulence, we also see interesting companies here that continue to grow strongly. Within the portfolio, for example, we have a position in OLFI, an Egyptian manufacturer specialized in the production of white cheese. For the tenth consecutive year, both turnover and net profit increased. Due to the crisis, smaller players have disappeared from the market and OLFI has now acquired a market share of 42%. With a population that will grow by 30% over the next 20 years to nearly 150 million people (projected by the United Nations), there are golden opportunities for the Egyptian consumer market. For diversification, OLIF is also active in the production of milk and fruit drinks. The stock is trading at just 6.4x earnings with a dividend yield of over 10%.

Central Asia
After the invasion of Ukraine, fears arose that Russia would also start a war against Georgia and Kazakhstan, where shares initially fell sharply. Given the resistance met by the Russian army, fears have slowly subsided, especially after Chinese President Xi Jinping visited Kazakhstan in September and emphasized that China and Kazakhstan are good friends. In doing so, he sent a clear signal to Moscow. This paves the way for a further recovery in the markets of Central Asia.

Trade hub
Kazakhstan is unique compared to other resource-rich countries because it has a very wide range of resources. Due to its favorable location, the country is also emerging as a major transportation and logistics hub in the region. Kazakhstan is a trade gateway to a market of approximately 150 million consumers in Caspian Sea countries, 50 million in Central Asia and 300 million in Western China. In addition, Kazakhstan has the status of the largest grain producer in Central Asia and is home to the world's first and largest space base. With a growing middle class, Kazakhstan offers trade and investment prospects for companies and investors looking for new opportunities in this growing, market. For example, the fund has a position in the Kazakh fintech company Kaspi, which has more than 9 million users with the “Kaspi Super App”. The company showed earnings growth per share of 36% over 2022. For 2023 and 2024, the consensus is 26% and 30% growth. The stock is trading at a price-to-earnings ratio of just 8.2 with a dividend yield of 7.8%.

In addition, the fund holds a position in DP Eurasia, a master franchisee of the Domino's Pizza brand in Turkey, Azerbaijan and Georgia. Despite last year’s drop in share price, this company showed strong development at an operational level. DP Eurasia's store sales increased by 75% in the first 10 months of 2022. 31 new stores were opened in Turkey, reflecting strong demand. In addition, the company has a network of coffee shops that has doubled from 15 to 30 branches this year.

Inflows
The recent strong inflows in the FM ETF is a signal that investors are attracted by the low valuations in Frontier Markets. For example, the number of shares outstanding in the FM ETF doubled in the last 6 weeks of 2022. This equates to an inflow of approximately $250 million. The American Vietnam ETF has also experienced inflows, the number of outstanding shares increased by more than 40% in the last quarter.

Portfolio
The portfolio of the TCM Global Frontier High Dividend fund starts the new year with an expected price/earnings ratio of 9.2x and a price to book value ratio of 1.2. The ROE and the expected dividend yield are 19.1 and 6.1% respectively.

Joure, January 2023
Frontier Markets Team
TCM Investment Funds