Outlook Frontier Markets 2024

Starting Point
Over the past three years, the economies of the Frontier Markets have faced significant challenges. First, there was the impact of the coronavirus pandemic and subsequent lockdowns. These countries lacked the extensive monetary and fiscal support measures deployed in the West. The war in Ukraine then caused a wave of inflation, resulting in a sharp rise in food prices. This particularly affected consumption and investment in low-wage countries. In countries like Nigeria, Egypt, Sri Lanka, and Pakistan, inflation soared above 25%, and several countries within the investment universe experienced their biggest crisis in twenty years.

Yet Positive Returns
Despite these challenges, the Frontier Markets Index achieved a positive return of 9.4% over the last three years. The TCM Global Frontier High Dividend Fund performed even better with a total return of 11.3%. This reflects the resilience of these emerging countries. Despite current problems in many countries, investors seem to be increasingly recognizing their future potential. In 2023, the fund rose by 7.5%, and the expectation is that this positive trend will continue in 2024, driven by reforms, higher economic growth, and historically low valuations.

Reforms
The economic turbulence of the past three years has also had a positive effect. Crises act as a catalyst for important reforms, as the shortcomings of the existing system are exposed, prompting governments and policymakers to make necessary changes. These reforms are essential for a stronger and more resilient economic structure and lay the foundation for sustainable future growth. An example is Nigeria, where after the election of President Bola Tinubu in May 2023, reforms were implemented in the exchange rate system and the abolition of fuel subsidies. This freed up money for essential investments in infrastructure and reducing the economy's oil dependence. Since then, the Nigerian stock index has risen by more than 40%, but still trades at just 7.4 times the expected Price Earnings Ratio for 2024.

Lafarge Cement
The fund recently invested in Lafarge Africa, one of the largest cement producers in Nigeria, which benefits from increasing investments in infrastructure. With a market share of 30%, four factories (including the largest in Africa), and a sustainable production process, Lafarge Africa is a strong player in the market. The company won the UNCG award in 2018 and is a signatory to the Paris Climate Agreement. The stock trades at a Price Earnings Ratio of just 9.3x with a dividend of 6.3%.

Within Frontier Markets, many more reforms are expected in the short term. In 2024, there are elections in countries like Pakistan, Indonesia, Bangladesh, and Sri Lanka, and in more than 15 African countries. In particular, further reforms are expected in Pakistan, Egypt, and Kenya, which are necessary for economic recovery. Vietnam stands out for its opening up to foreign investments, improved governance, and stable macroeconomic situation. Vietnam could possibly be promoted to an Emerging Market in 2024 or 2025, which historically often leads to a rise in stock prices.

Higher Growth
According to recent estimates by the International Monetary Fund (IMF), economic growth in emerging countries in 2024 (4%) is expected to be significantly higher than in developed countries (1.4%). Within the spectrum of frontier markets, strong growth is seen in Asia, particularly in Bangladesh (6.0%), Vietnam (5.8%), and Indonesia (5%). Economic prospects in the Sub-Saharan Africa region have also significantly improved. Six of the ten fastest-growing countries in the world in 2024 are from this region, including Ivory Coast (+6.6%), Tanzania (+6.1%), and Kenya (+5.3%).

Mapi
An example of a company that can benefit from the accelerating growth is Mitra Adiperkase (Mapi), in which the fund recently took a position. Mapi is the largest retailer in Indonesia, with a presence in 80 cities across the region. With more than 3,200 stores not only in Indonesia but also in Malaysia, Singapore, Thailand, and Vietnam, the company demonstrates its expansive growth strategy. In 2023, Mapi's revenue reached a milestone of EUR 2 billion, supported by a diverse portfolio of 150 brands and the employment of 32,000 workers. Financially, the company is on solid ground with an expected profit growth of 15% for the fiscal year 2024/25. Also impressive is the five-year dividend growth, a robust 14.87%. The stock trades at just 11 times the expected earnings for 2024.

This growth is further bolstered by demographic developments in Indonesia. According to the United Nations, Indonesia's population is expected to grow from 277 million to 350 million by 2050. This increasing population growth translates into higher demand for Mapi's products and services, positioning the company well for continued expansion and success in the future.

Low Valuation
Currently, Frontier Markets are by far the cheapest investment category based on Price Earnings Ratio (P/E). The P/E is just 10.7x for the MSCI Frontier Markets index compared to 14.5x and 20.7x for the MSCI Emerging and MSCI World Index, respectively. Even compared to its own historical ten-year average, the FM index trades at almost a 20% discount. Due to specific stock selection, the valuation of the TCM Global Frontier fund is even more attractive. Based on the fund's capital in relation to the sum of the profits of all companies in the portfolio, the current P/E is 7.5x, around the lowest level since the fund's inception.

Lower Risk
Given the historically low valuation, the downside risk appears to be limited. Although Frontier Markets are often seen as high-risk investments, in reality, they are less risky than generally assumed. This is due to their low correlation, both with developed markets and among individual countries. Bloomberg's statistical data on index trackers over the past 10 years shows that the annual downside volatility is -15.5% and -12.9% for the Emerging Index and the World Index, respectively, and -12.6% for the Frontier Index. Thanks to better diversification and stock selection, the TCM Global Frontier fund even has a lower downside risk, with a value of -11%.

Safaricom
An example of a stock we consider undervalued, with limited downside risk at this level, is Safaricom in Kenya. The company, with a market capitalization of 3.85 billion euros, is a prominent player in the telecom and fintech sectors and one of the most profitable companies in East and Central Africa. Safaricom serves more than 40 million customers and has a 70% market share in Kenya. Since its peak in 2021, the stock has fallen by more than 65%.

The stock was dumped by investors fearing rising inflation and deteriorating economic prospects. However, the figures show that the company may be more resilient than thought. Revenue increased by nearly 27% in the same period, and EBITDA by over 8%. Over the next three years, earnings per share growth of over 15% per year is expected. With the improved economic growth outlook indicated by the IMF and falling inflation figures, this stock now seems outright cheaply valued at a P/E of just 9x and a dividend yield of 10.5%.

Conclusion
We believe that the positive momentum initiated last year will continue into the new year, supported by lower inflation, further reforms, and higher economic growth. Due to historically low valuations, the downside risk appears to be limited, and due to the low correlation with Emerging Markets and developed markets, an investment in Frontier Markets is a perfect addition for diversification of any investment portfolio.

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