



Quick Q & A #22

Q: Are “frontier markets” ready for investment?



A: Expect a wild ride in frontier markets.

What common thread connects Croatia, Kenya, Sri Lanka, and Lebanon?
Answer: they are all gaining attention as so-called frontier markets. Frontier markets are countries with small, unstable and underdeveloped economies, undergoing dramatic social and political changes. You might think of them as the next candidates for emerging market status, although some may never make it that far.

Index provider MSCI Barra lists 25 frontier market countries, including former eastern bloc states, Middle Eastern and African nations, and Asian countries including Vietnam. Argentina and Trinidad & Tobago are the lone



representatives of the Americas. It is a fluid list that changes with the fortunes of these small economies.

The wild west, east and south

Most frontier markets experience significant problems and are challenged by erratic economic indicators. These markets tend to be very risky and illiquid because of general political and economic unrest.

With risk, of course, comes potential profit too. The chart above shows the higher highs and lower lows some frontier market indexes have experienced over the last seven years, relative to developed nations. As volatile as the US market (red) has seemed in recent years, its range of annual returns looks tame compared to frontier markets.

At least five exchange traded funds are promoted as frontier markets plays. Upon closer inspection, however, the funds typically hold significant positions in more established emerging market securities. They are not pure frontier market investments.

We don't utilize these ETFs. We feel emerging market ETFs provide sufficient exposure to fast growing, high potential markets, and that frontier market ETFs are not yet designed well enough to give true frontier market exposure.

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Next time: What can we learn from ETF performance?

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Unlike domestic returns, foreign market returns consist of two main components: market performance and currency fluctuations. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. Frontier-market investments are riskier than developed- and emerging-market investments. Diversification does not eliminate the risk of experiencing investment losses.

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