TUNDRA
FONDER

FRONTIER MARKETS

WHERE WILL YOU BE INVESTED IN THREE YEARS?

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INTRODUCTION
HOW TO DEFINE FRONTIER MARKETS?

What is the definition of a frontier market? The answer is likely to depend on the opinion of the fund manager you ask. The majority would probably refer to MSCI, the world's largest index provider, and narrow their universe down to about 25 markets that are either too illiquid for large foreign investors to move in and out of, or the ones where technical restrictions prevents in- and outflows of foreign investors. Applying the MSCI standards you will have a fund that includes about 20% Kuwait, a country with a 3.4 million population and a GDP/capita of around USD 30 000 (close to the Eurozone average). Further you will add 3% Bangladesh; a country with a population of 150 million and GDP/capita of USD 1 200. Inaccessibility, be it the liquidity or settlement issues, as the defining argument for investing your capital in a frontier market fund might work. At Tundra, however, we never considered that argument particularly compelling.

TUNDRA'S DEFINITION OF FRONTIER MARKETS

Tundra's definition of a frontier market includes the following:

- *A large population* - big enough to become a relevant stand-alone market with local champions evolving; e.g. "the IKEA of Pakistan", "the Danone of Bangladesh".
- *The economy is coming from a low base,* meaning there are more growth opportunities ahead. Societal development has not yet peaked; a substantial part of society is yet to be constructed.
- *An understandable structural growth case* – What will constitute the drivers of growth for this economy? Are economic policies in place for logical assumptions about this economy catching up with the developed world? Will the political framework be stable enough to allow the good companies to grow?
- *Under-researched or abandoned* – Can we find companies in this market which other investors have not already found? Is it worth the time for our investment team to dig into this market?

Understanding a market takes time and resources, regardless of the population size. We therefore focus on the five to eight most significant and promising markets and put all our resources in these markets to try to identify the sectors that will outgrow the economies. Within these sectors we try to find the top three future winners.

Thematic investing allows a more long term planning. Tundra will not have to abandon markets just because an index provider reclassifies from the *frontier market* category to the *emerging market* category. As long as the theme is intact and there are still opportunities to profit from, we will remain invested. It also allows us to invest in what is currently categorized as *emerging markets*, provided that the market characteristics fits into our theme of investing. A recent example of a new market for Tundra is Egypt, which in our view resembles the potential in Pakistan back in 2012.

In the next three years we believe there will be significant changes in the asset class. We believe it is important for our investors to understand how the frontier asset class will change and how Tundra will approach these changes. We hope the next couple of pages will be useful for your understanding. Do contact us directly for questions or clarifications.

Stockholm June, 2017

Mattias Martinsson
Founding Partner / Chief Investment Officer

WHERE WILL YOU BE INVESTED IN THREE YEARS?

When Tundra launched the Tundra Frontier Opportunities Fund in April 2013 it was because we wanted to offer our investors exposure to a number of the most highly populated and least economically developed countries in the world. We were interested in markets like Pakistan, Bangladesh, Vietnam, Nigeria and as we looked for a proper benchmark for the fund, we concluded that the proper classification seemed to be "Frontier". But when we looked at the frontier indices that MSCI provided, we concluded that almost two thirds of the benchmark was constituted of the Gulf countries. The three countries (UAE, Qatar and Kuwait at the time) had a combined population of less than this of Scandinavia and the GDP/capita was well in line with developed parts of Europe – this was not in line with our investment philosophy. Mixing those countries with markets like Pakistan and Bangladesh, countries with a population size similar to the Eurozone's, but in terms of GDP/Capita only 2-3% of the Eurozone, did not make sense to us. These were two completely different cases and we concluded it was an odd blend.

First we decided not to use the MSCI Frontier Markets Index as benchmark, instead we focused on the MSCI Frontier Markets Index excluding GCC-countries. Second, in setting up our fund rules, we concluded that geographical limitations as per MSCI's definitions would be too limiting. The more attractive frontier markets would eventually be liquid and functioning enough to enter into the category emerging markets but the theme and the attractiveness could still make an interesting option.

An example of this is when we launched the Pakistan fund; we expected the market to graduate to the status of an emerging market within 3-4 years. Should we then have to abandon a market because trading in it became easier? Evidently that did not make sense. Better liquidity and more investments to choose from is a positive sign. Our investment, or lack of investment, should be determined by the fundamentals and the underlying theme. A market like Pakistan most likely has at least another 10 years before it is as developed as the larger emerging markets of today. The journey from GDP/Capita of USD 1 500 to USD 10 000 and investing in the companies that benefit from the changes in society that come with such an economic journey is what it is all about for us. Initially we could cope with the odd composition of MSCI's frontier markets indices by simply excluding the GCC-countries but that is becoming increasingly complicated.

As of June 1st Pakistan is no longer a frontier market as defined by MSCI, in June next year Argentina is likely to follow and in three years another favourite market of ours, Vietnam, is likely to exit the category. There is also a probability that Nigeria will be excluded from frontier indices and become a standalone market. In three years this could mean that half the population of the frontier index and 2/3 of the daily traded volume will disappear. Except for possibly Iran there are no new significant liquid equity markets that could become eligible. Investors will be left with a group of smaller, less dynamic markets which are in the frontier category for being a bit odd rather than being promising.

					MSCI FM weights (if no new countries)			
	Nominal GDP/capita (USD)	3m Average daily turnover (MUSD)	Population (m)	Median age	May 31st 2017	June 2017	June 2018	June 2019
Argentina	13400	153	43	31.5	18%	20%	0%	0%
Bahrain	23400	1,3	1,4	32.1	3%	4%	5%	5%
Bangladesh	1200	144	161	26	2%	2%	3%	3%
Croatia	11500	2	4,2	42.7	1%	1%	2%	2%
Estonia	17300	1	1,3	42.4	0%	0%	1%	1%
Ivory Coast	1400	0	23	n.a.	0%	0%	0%	0%
Jordan	4900	12	7,6	22.3	1%	1%	2%	2%
Kazakhstan	10500	4	17,5	30.3	2%	2%	3%	3%
Kenya	1400	5	46	19.5	4%	4%	6%	6%
Kuwait	29000	30	3,9	29.2	17%	19%	24%	27%
Lebanon	8000	1	5,85	29.9	3%	3%	4%	4%
Lithuania	14200	0	2,9	43.4	0%	0%	0%	0%
Mauritius	9100	1	1,26	34.8	3%	3%	4%	4%
Morocco	2900	28	34,3	28.9	8%	9%	11%	12%
Nigeria	2600	7	182	18.3	7%	7%	9%	11%
Oman	15500	14	4,5	25.4	3%	4%	5%	6%
Pakistan	1400	179	189	23.4	9%	0%	0%	0%
Romania	9000	12	19,8	40.7	4%	4%	6%	6%
Serbia	5100	0	7,1	42.3	0%	0%	0%	0%
Slovenia	20700	1	2,1	44.1	1%	2%	2%	2%
Sri Lanka	3900	8	21	32.5	1%	2%	2%	2%
Tunisia	3900	2	11,1	32.4	0%	0%	1%	1%
Vietnam	2100	150	91,7	30.1	9%	10%	13%	0%

Table 1: How MSCI Frontier Markets Index could look like in the next couple of years **Source:** *Tundra, MSCI, IMF*

With the potential changes ahead "Frontier investors" need to think carefully about the rationale for choosing the asset class in the first place. If the reason was mainly to be an early investor in the next generation of emerging markets index, then investing will no longer serve the purpose. We fail to see the logic for any asset allocator to choose an asset class simply because of an illiquid equity market. What we expect is that frontier fund managers around the world increasingly will drift towards emerging markets. Some will try to embrace the new benchmark which will lead to liquidity constraints. Others will change their benchmark where MSCI Frontier Emerging Markets Index might be a popular choice. The main new markets in that benchmark would be Philippines (26% of benchmark; 150 musd/day trading), Colombia (9%; 50 musd/day) and Peru (8%; 10 musd/day). But just as many frontier funds decided to keep (and still keep) UAE and Qatar post their EM inclusions in 2015 we expect the already index agnostic frontier fund managers will end up having vastly different portfolios. This means it will be harder for fund evaluators to compare funds within the category and ultimately it will mean more careful consideration before selecting which fund to invest in. We would not be surprised if many fund evaluators decide to categorize the majority of frontier funds in the small cap emerging market category.

HOW WILL TUNDRA EMBRACE THE CHANGES?

Tundra has always had its own definition of frontier markets. We believe the main attraction is the ability to be an early investor in markets of future significance. That means large population countries coming from a low economic base. Markets that are big enough to eventually host local champions who benefit from the development of society. We do recognize however that monthly deviations to our current benchmark MSCI FMxGCC Net TR will increase and with 40% of the fund invested in emerging markets (Pakistan and Egypt) we acknowledge that more investors will demand an attractive return also vs Global Emerging Markets funds. We consider that a fair expectation. After all we are claiming that careful stock picking, supported by local presence in fewer but more significant early emerging markets will eventually outperform both frontier and emerging markets categories. Over the last 15 years MSCI Emerging Markets Net TR has given an average annual USD return of 10%. Since the launch of Tundra Frontier Opportunities Fund we have beaten the MSCI Emerging Markets by 5.5% and MSCI FMxGCC Net TR by 4.5% (Data as of May 31st 2017) on average net of full fees. Provided we are right in the assumption that our focus markets will be the next generation of emerging markets, a reasonable expectation should be for an average USD-return of 15% a year going forward. As the frontier indices are entering a game of musical chairs in the years ahead maybe that will be a better benchmark for a reasonable year?

Finally a few words on why we love to get up so early in the morning…

The world population is divided in 1 billion people living in developed economies and 6 billion living in countries striving to get there. According to the UN, 100% of added workforce (people in the age of 15-64 years) in the next 50 years will come from outside the OECD economies. This means most new factories, new supermarkets, new universities, new roads and so on, will be built outside the OECD economies. Tundra will focus on the most promising larger economies within this new group of growth economies. With a large investment team and a local presence in the core of this development we will continue our strive to find the next generation of global giants that are yet to be discovered by the investment world at large.

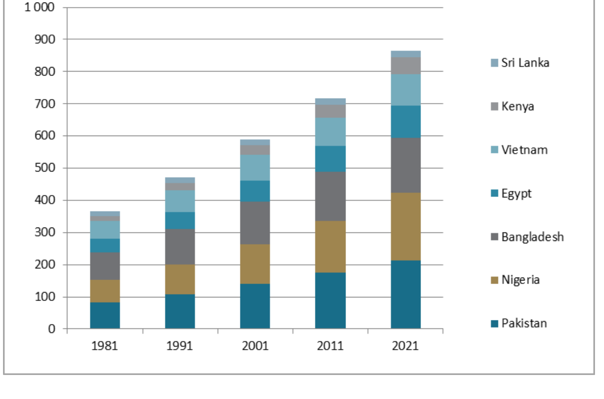

Figure 1: *Population (million) of Tundra's focus markets.*
Source: IMF forecasts

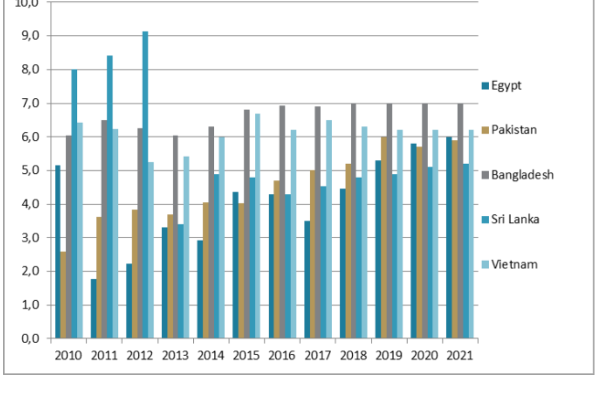

Figure 2*: Real GDP growth in current Tundra's largest country weights*
Source: IMF forecasts

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