

Frontier Markets Begin To Emerge

But for investors, frontier-markets funds have short track records and carry unique risks.

Morningstar Manager Research

17 December 2014

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Executive Summary

Frontier markets represent a tiny segment of the global investment universe, but interest in the asset class has been growing, as investors search further afield for better growth opportunities and pursue new ways to diversify their portfolios.

This report examines the case for investing in frontier markets, discusses the risks, and provides an overview of the mutual fund and ETF investment options.

- ▶ Frontier-markets economies are growing faster than emerging-markets ones. Frontier-markets countries such as Kuwait, Nigeria, and Pakistan are at an earlier stage of development relative to emerging-markets countries and are entering a period of mid- to high-single-digit growth, thanks to a very low economic base, favorable demographics, growth in infrastructure spending, and, in some cases, abundant natural resources.
- ▶ Frontier-markets funds tend to be less volatile than emerging-markets funds. Individual frontier-markets countries tend to have high idiosyncratic risks, but diversified frontier-markets funds (comprising companies from 10 or more countries) tend to be less volatile than emerging-markets funds.
- ▶ They can also provide better diversification. Frontier-markets funds are also less correlated than emerging-markets funds to developed-world equities as frontier-markets countries tend to be less integrated in the global economic and financial markets.
- ▶ But relatively illiquid markets are a significant issue... During the 2008 global financial crisis, the MSCI Frontier Markets Index experienced a larger drawdown relative to the MSCI Emerging Markets Index and the MSCI EAFE Index due to heavy selling in fairly illiquid markets. Low liquidity in frontier markets is a concern for fund managers, and most funds have a low capacity of around \$1 billion–\$2 billion. Recent declines in commodity prices may prompt selling pressure in frontier markets, as many countries in the Middle East and Africa are commodity exporters.
- ▶ ...and fund options are fairly untested. There are 15 frontier-markets mutual funds and ETFs that invest broadly across frontier markets (and, in many cases, smaller emerging markets). The first five U.S.-listed 1940 Act funds only launched in 2008. There are also 14 funds that target specific regions within the frontier markets. Only five of these funds have five-year track records.
- ▶ Harding Loevner Frontier Emerging Markets is on Morningstar’s new Manager Prospects list. Morningstar currently does not have Analyst Ratings on any frontier-markets funds. But among the fund options, we like Harding Loevner Frontier Emerging Markets. This fund is on Morningstar’s new Manager Prospects list, which includes strategies that don’t currently receive analyst coverage but may merit coverage in the future.

Investment Case

Introduction

Frontier markets represent a tiny segment of the global investment universe, but interest in the asset class has been growing, as investors search further afield for better growth opportunities and pursue new ways to diversify their portfolios.

Frontier markets, by definition, are at the far edge of the investment universe and are generally not included in global equity indexes or even in many emerging-markets equity funds. This is because frontier capital markets are not easily accessible. These markets tend to have a small number of liquid securities and restrictions on foreign ownership. Investors mulling the merits of this investment frontier should take a closer look before jumping in: The underlying risks and performance drivers are quite different from those in emerging and developed equity markets.

Surveying the Frontier

The investment case for frontier markets sounds enticing. Countries such as Kuwait, Nigeria, and Pakistan are at an earlier stage of development relative to emerging-markets economies. Many frontier-markets economies are entering a period of mid- to high-single-digit growth, thanks to a very low economic base, favorable demographics, growth in infrastructure spending, and, in some cases, abundant natural resources. And relative to emerging markets, certain frontier countries will benefit from the rapid adoption and dissemination of “new economy” services such as mobile banking and mobile payments, which should contribute to growth in the medium term.

Index providers MSCI and FTSE distinguish frontier markets from emerging markets by capital market size, liquidity, and accessibility thresholds on foreign ownership. In other words, investability is the primary criteria for a country’s classification, with aggregate and per capita GDP figures playing more of a secondary role. Market-cap-weighted frontier-markets benchmarks from these index providers primarily contain stocks listed in Africa, the Middle East, former Soviet Republics (also known as Commonwealth of Independent States or CIS), and less-developed Asian countries such as Pakistan, Vietnam, and Bangladesh. While frontier markets in African and Asian countries tend to have very low per capita GDP figures, the oil-producing states in the Middle East (also known as the Gulf Corporation Council, or GCC countries) are relatively wealthy. The reason these resource-rich nations are considered frontier markets is because they have restrictive foreign ownership limits on their exchange-listed companies.

Exhibit 1 Frontier-Markets Countries

Americas	Europe & CIS	Africa	Middle East	Asia
Argentina ¹	Bulgaria	Botswana ²	Bahrain	Bangladesh
	Croatia	Ghana ²	Jordan	Pakistan ¹
	Cyprus ²	Kenya	Kuwait ¹	Sri Lanka
	Estonia	Mauritius	Lebanon ¹	Vietnam
	Lithuania	Morocco	Oman	
	Kazakhstan ¹	Nigeria	Qatar ²	
	Romania	Tunisia		
	Serbia			
	Slovenia			
	Ukraine ¹			

1. Indicates frontier status by MSCI only

2. Indicates frontier status by FTSE only

Source: MSCI and FTSE.

To be sure, frontier markets are risky. Investors face a myriad of issues, which include political instability, social unrest, corruption, disease, terrorism, underdeveloped financial systems and capital markets, and a fickle regulatory environment. These risks are similar in type to those in emerging markets, but their probability and potential magnitude are greater. During periods of extreme market stress, frontier markets' relatively illiquid stock markets can suffer sharp declines in the face of heavy selling. During the 2008 global financial crisis, the MSCI Frontier Markets Index had the largest maximum drawdown relative to the MSCI Emerging Markets Index and the MSCI EAFE Index (an index comprising developed Asia and Europe equity markets).

Exhibit 2 Frontier Markets Experienced the Largest Drawdown During the 2008 Crisis

Source: Morningstar Direct.

When looking at other measures of risk, however, frontier markets tend to fare a little better. Exhibit 3 is a five-year correlation matrix of the five largest country allocations in the MSCI Frontier Markets Index (left) and the MSCI Emerging Markets Index (right). Partly because of lower levels of integration with the global economy, each frontier-markets country tends to have more idiosyncratic risks, with individual equity markets historically exhibiting low correlations with one another.

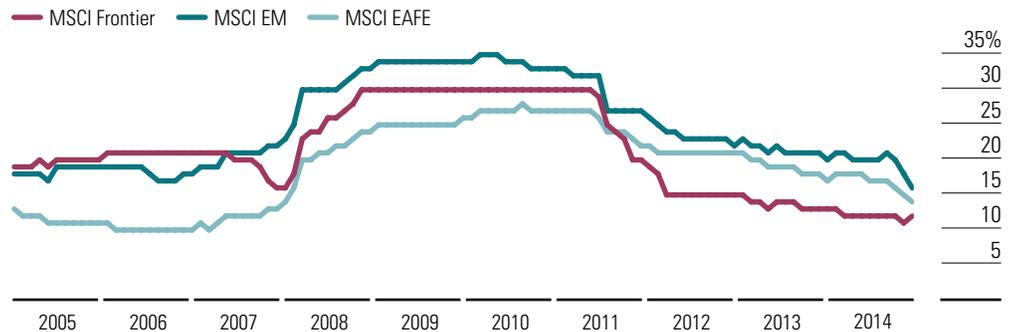
Exhibit 3 But Correlations Between Individual MSCI Frontier-Markets Countries Are Very Low...

Argentina	—				Brazil	—			
Kuwait	0.3				China	0.8			
Morocco	0.4	0.3			Korea	0.7	0.8		
Nigeria	0.2	0.2	0.1		South Africa	0.8	0.6	0.7	
Pakistan	0.2	0.3	0.2	0.5	Taiwan	0.7	0.7	0.8	0.7

Source: Morningstar Direct. Data as of October 31, 2014.

As a result, the MSCI Frontier Markets Index has been less volatile (as measured by the rolling three-year annualized standard deviation of returns) than the MSCI Emerging Markets Index.

Exhibit 4 ...Which Results in Lower Volatility Versus Emerging Markets...



Source: Morningstar Direct.

As for diversification benefits, Exhibit 5 shows that frontier markets have been less correlated to U.S. equities relative to emerging markets. Over the past few years, during “risk-off” periods, volatility in emerging-markets stocks has been exacerbated by fickle foreign fund flows. With low levels of foreign ownership in frontier-markets stocks and bonds, however, this asset class has not been as susceptible to volatile foreign fund flows (except in extreme events such as the 2008 financial crisis). However, frontier markets’ correlations will increase should foreign ownership in frontier-markets stocks continues to rise.

Exhibit 5 ...And Lower Correlations to MSCI USA Index

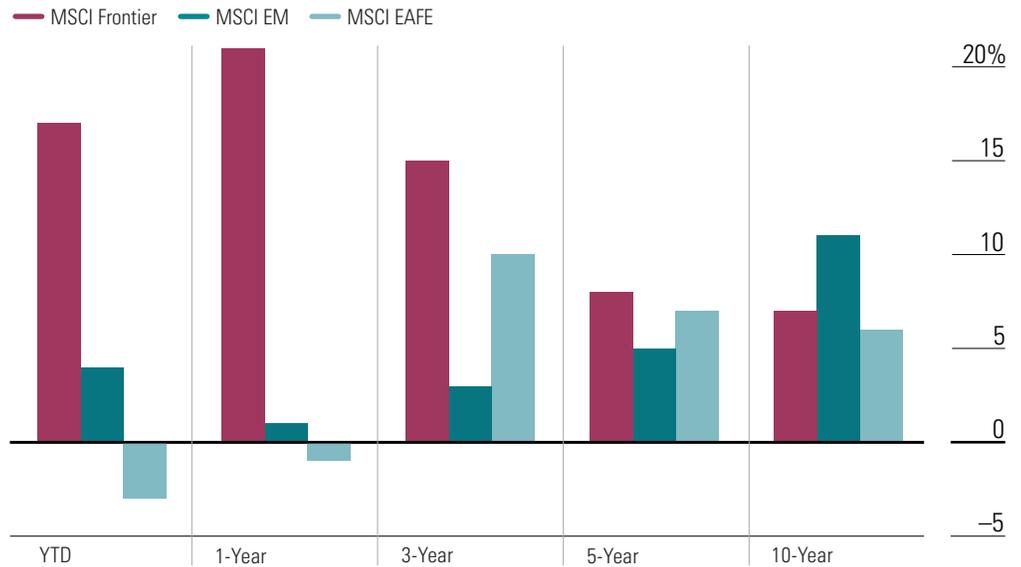
	3-Year %	5-Year %	10-Year %
MSCI Frontier	55	61	58
MSCI EM	68	81	80
MSCI EAFE	80	88	89

Source: Morningstar Direct. Data as of October 31, 2014.

Recent Performance

One of the main reasons frontier-markets equities, a very tiny and relatively inaccessible asset class, are gaining interest among certain investors is their outperformance versus emerging markets over the two years through October 2014. This is often attributed to frontier markets' rosier growth outlook relative to emerging markets, especially as the larger economies such as China, Brazil, and Russia have begun to slow.

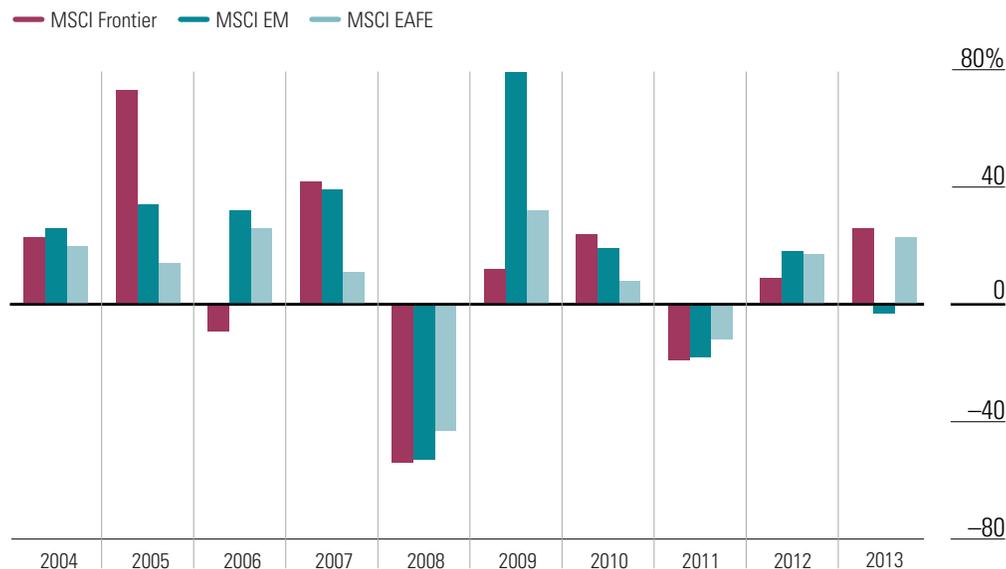
Exhibit 6 Trailing Returns to October 2014



Source: Morningstar Direct. Data as of October 31, 2014.

However, frontier-markets equities' calendar returns over the longer term have been more sporadic. Frontier markets underperformed emerging markets during six out of the past 10 calendar years.

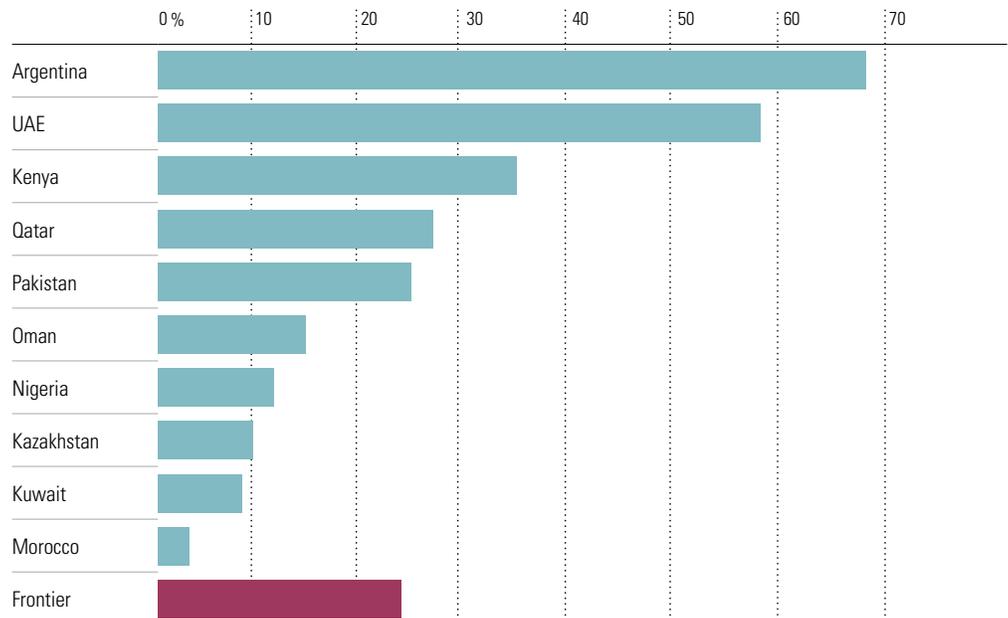
Exhibit 7 Calendar-Year Returns



Source: Morningstar Direct.

A closer look reveals that frontier markets' recent outperformance reflects a confluence of factors—some fundamental, some not, and many that are specific to frontier-markets equities. An examination of some of these factors will help illustrate the notable idiosyncrasies and challenges related to investing in frontier markets.

Over the past two years, the best-performing frontier markets have been Argentina, United Arab Emirates, Kenya, and Qatar. The capitalization-weighted MSCI indexes (in U.S. dollars) for each of these countries returned 67%, 57%, 34%, and 27%, respectively, over the two-year period (annualized) through October 2014. These markets contributed to the MSCI Frontier Markets Index's return of 24% over the same time period.

Exhibit 8 Annualized 2-Year Returns of Individual Frontier-Markets Countries (MSCI Indexes in USD)

Source: Morningstar Direct. Data as of October 31, 2014.

One of the key drivers of performance in Qatar and United Arab Emirates' equity markets was MSCI's announcement in June 2013 that it was going to move both countries from the MSCI Frontier Markets Index to the MSCI Emerging Markets Index in June 2014. That change means there is now a significantly larger potential investor base for these new emerging-markets countries. In addition, any investment product that tracks the MSCI Emerging Markets Index had to buy the index constituents from those countries when MSCI implemented the change in June 2014. In the months following the 2013 announcement, both domestic and foreign investors piled into Qatari and United Arab Emirates stocks in an attempt to get ahead of this reclassification. This surge of assets into these small capital markets—each of which has about 20 liquid stocks—fueled a strong rally. Some positive fundamentals in these markets also contributed to the momentum. Banks and property companies, which dominate each country's index, rallied thanks to recovering real estate prices and rising infrastructure spending. Since Qatar and United Arab Emirates had each accounted for about 15% allocation in the MSCI Frontier Markets Index prior to their move to the MSCI Emerging Markets Index, their market rallies contributed to the strong performance of the MSCI Frontier Markets Index through June 2014.

The performance of Argentina (which takes up approximately 6% of the MSCI Frontier Markets Index) also needs some context. Argentina is actually a G-20 nation and is considered an upper middle-income economy by the World Bank. But due to the failure of its heterodox economic practices, and strict capital controls, MSCI classifies the country as a frontier market. FTSE, which decided to take a more hard-line approach, announced in September 2014 that it will remove

Argentina from its frontier index in June 2015. Argentina's 48% return in the past 12 months through October 2014 may be surprising given the country's recent debt crisis, double-digit inflation, and weakening currency. One explanation is that local investors have been buying shares as a hedge against inflation. Another possibility is that investors are optimistic that a new leader will implement much-needed reforms that will stabilize Argentina's economy. (Current president Cristina Fernández de Kirchner will reach her term limit in 2015.) This might have some merit, as "reform rallies" have recently been observed in countries such as India and Indonesia. But another potential reason Argentinians have been buying equities is because it is reportedly one of the few channels by which they can gain access to the U.S. dollar. Many large-cap Argentinian companies have both a local listing as well as an ADR that trades on the NYSE, so Argentinian investors can buy local shares and then sell ADRs for U.S. dollars.

Kenya, on the other hand, has recently been a frontier-markets success story. Kenya is the largest economy in East Africa. Relative to its neighbors, it has a better-educated population, its economy is more diversified, and it has stronger trade and financial links to the rest of the world. Over the past few years, foreign direct investment has been rising, as many multinationals have sought to establish their East Africa hub in Kenya. Many of Kenya's large-cap public companies are well-run firms with exposure to solid growth trends. These includes mobile operator Safaricom, which has a fast-growing mobile payment business, East African Brewers, whose main shareholder is Diageo, and a number of banks with strong balance sheets.

Conclusion

Frontier markets have a number of the same favorable investment characteristics that emerging markets had 20 years ago. Thanks to healthy growth outlooks, and their relatively lower levels of integration with the global economy, frontier markets offer the potential for higher returns and greater diversification benefits in the medium term. Investors with an above-average risk tolerance may want to consider adding some frontier exposure within their emerging-markets allocation. However, the risks to investing in frontier markets are many, especially the downside risk during periods of heavy selling, as frontier markets tend to be fairly illiquid. In addition, most funds are untested, as they have short track records. Investors should carefully evaluate their options.

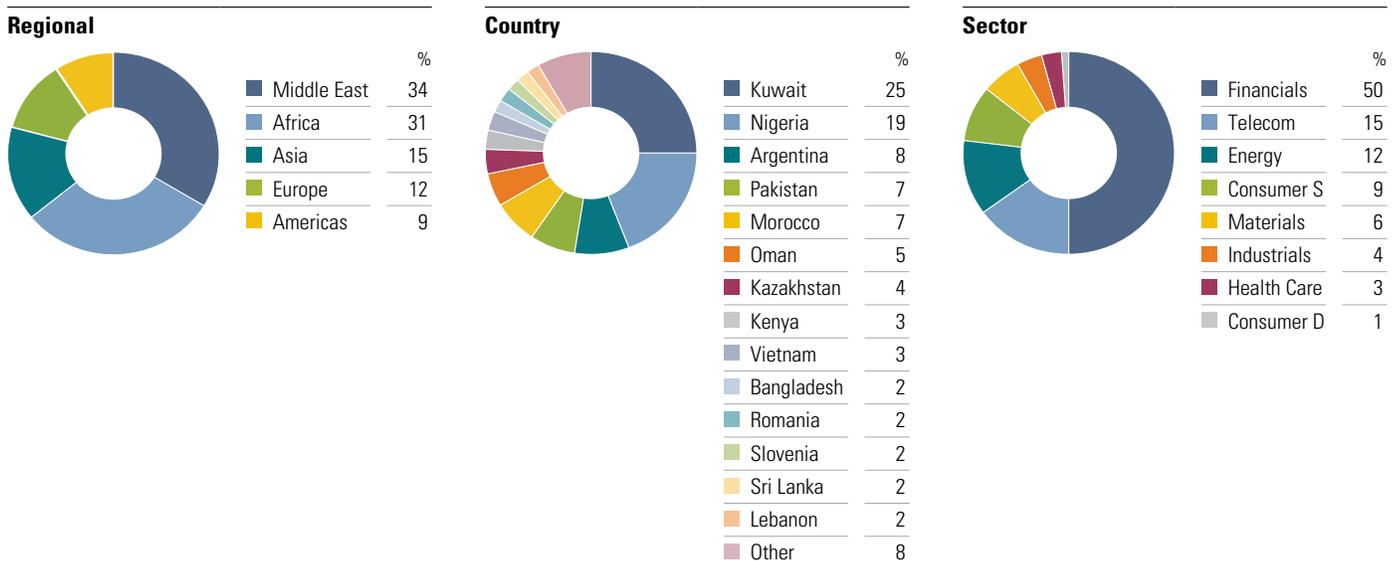
Frontier-Markets Fund Overviews

Background

There are currently 15 U.S.-listed frontier-markets funds (actively and passively managed mutual funds and ETFs), with about \$5 billion in assets. This is equivalent to about 1% of the assets in the 280 U.S.-domiciled emerging-markets funds, which have about \$405 billion in assets. This ratio is somewhat correlated to the relative size of each investment universe. As of October 2014, the total market capitalization of the MSCI Frontier Markets Index was \$106 billion, equivalent to about 3% of the MSCI Emerging Markets Index's \$4.0 trillion.

Below are the country, regional, and sector weightings of the MSCI Frontier Markets Index, which help illustrate the shape of the frontier-markets universe. The MSCI Frontier Markets Index covers 24 markets and includes 127 constituents. The FTSE Frontier Index's country and sector allocations are similar to those of the MSCI Frontier Markets Index, but there are some differences. MSCI classifies Qatar as an emerging market, whereas FTSE classifies it as a frontier market. Conversely, FTSE classifies Pakistan as an emerging market, whereas MSCI classifies it as a frontier market. And as mentioned in the prior section, FTSE has announced that it will remove Argentina from its Frontier Markets Index in June 2015, whereas MSCI will continue to classify it as a frontier market. The two providers also have some differences over which of the very small countries they include in their frontier-markets indexes. However, these countries are fairly insignificant, as they typically account for 1% or less of each index.

Exhibit 9 MSCI Frontier Market Index Weightings



Source: MSCI.

While these indexes *define* the frontier-markets universe, they are not *representative* of the actual investable opportunity, as many frontier-markets securities are illiquid. As evidence of the limited breadth and liquidity in frontier markets, Templeton, Wasatch, and HSBC closed their frontier-markets funds to new investors when they each hit about \$1 billion in assets under management. Other frontier funds have indicated that they have similar capacity constraints. But over the medium term, should frontier-markets countries continue to develop, capital market liquidity, and therefore the potential capacity of frontier-markets funds, should expand.

Interestingly, half of the actively managed frontier-markets funds do not use the MSCI Frontier Markets Index as their benchmark. Those funds use a broader index as their benchmark: the MSCI Frontier Emerging Markets Index, which includes both small emerging markets and frontier markets. In this index, small emerging-markets countries, including the Philippines, Columbia, Peru, and Egypt, account for about half of the index, with frontier-markets countries accounting for the rest. Many managers said that countries around the border between frontier and emerging markets are where many interesting investment opportunities lie. On the frontier-markets side, these are usually countries that are exhibiting improving fundamentals and that have companies that are enjoying strong earnings growth. On the emerging-markets side, these smaller countries tend to be overlooked by international-equity fund managers, who tend to focus on the larger emerging markets. So in a way, the addition of smaller emerging markets is consistent with the general theme of a frontier fund: to provide exposure to areas of the global equity universe that most investors lack. From a portfolio management standpoint, stocks from smaller emerging markets tend to be more liquid than those from frontier markets, so the inclusion of emerging-markets securities allows for greater capacity. Out of the 10 actively managed funds in this space, seven have a 20%-30% allocation to stocks from small emerging markets and one (Deutsche Emerging Markets Frontier) has a 50% allocation. The Morgan Stanley and T. Rowe Price frontier-markets funds tend to have little to no exposure to emerging markets.

Another benchmark issue to note is that the MSCI and FTSE indexes are market-cap-weighted, which means that the countries with the largest capital markets have the largest weightings. In the MSCI index, Kuwait and Nigeria account for 25% and 19%, of the portfolio, respectively. In the FTSE index, Qatar and Nigeria account for 25% and 22% of the portfolio, respectively. Using capital market size to determine country allocations within a frontier-markets portfolio is somewhat arbitrary, especially in an asset class composed of underdeveloped economies, where the equity market capitalization/GDP ratio is very inconsistent across the investment universe. And given each frontier country's idiosyncratic risks, such concentrations would be quite risky. None of the actively managed frontier funds have more than a 15% weighting in any individual country.

Investing in frontier markets is a relatively new phenomenon, and frontier-markets funds have short track records. Out of the 15 funds that exist today, the first five launched in 2008, and the other 10 launched in 2012 or later. Among the funds that inceptioned in 2008, three are actively managed:

Templeton Frontier Markets, Morgan Stanley Frontier Emerging Markets, and Harding Loevner Frontier Emerging Markets. Over their short tenures, the Harding Loevner and Morgan Stanley funds provided higher returns, while exhibiting comparable or lower volatility, relative to the MSCI Frontier Markets Index. This suggests that a good active manager may be able to generate better risk-adjusted returns than the MSCI benchmark, as frontier markets are relatively inefficient versus their developed and emerging peers. That said, there are scant data available to adequately test this hypothesis.

Exhibit 10 Actively Managed Funds With 5-Year Track Records

	Return %	Standard Deviation of Return %	Correlation to MSCI USA %
Morgan Stanley Frontier Emerging	11	13	65
Harding Loevner Frontier Emerging	9	12	70
Templeton Frontier	7	13	74
MSCI Frontier	8	13	61
MSCI EM	5	19	81

Source: Morningstar Direct. Data as of October 31, 2014.

Frontier-markets funds are pricy; Investor share classes typically carry annual expense ratios of 2% or more, and Institutional share classes charge slightly less. The ETFs tracking frontier-markets benchmarks have annual expense ratios of around 0.70%.

While the ETF options are more attractively priced, these index funds do face certain challenges in frontier markets, which is a relatively illiquid asset class. For example, when executing an index change, an ETF portfolio manager might face front-running and/or large market-impact costs. Turnover related to index changes could also result in capital gains distributions, as most frontier markets do not allow for in-kind creations and redemptions (the mechanism that allows ETFs to remove securities from their portfolio without incurring capital gains). That said, index changes generally do not occur that frequently. At this time, MSCI does not have any frontier-markets countries under review for potential inclusion in its Emerging Markets Index.

Given the small size of this asset class, Morningstar does not have a separate category for frontier-markets funds. Broad frontier-markets funds fall in Morningstar's Diversified Emerging Markets Category, and single-country and regional funds that invest in frontier markets fall into Morningstar's Miscellaneous Region Category. The funds in Exhibit 11 are listed in order of assets under management (in U.S.-listed vehicles). The fund overviews are arranged in alphabetical order.

Broad Frontier-Markets Funds

Exhibit 11 Frontier-Markets Funds

Strategy / Name	Ticker	Inception Date	AUM (\$Mil)	Benchmark	New Investor Access	Expense Ratio %	Annualized Return %	Morningstar Risk-Adjusted Return %			Allocation %	
							2-Year	3-Year	5-Year	Emerging Mrkts %	Frontier Mrkts ¹ %	
Actively-Managed Funds												
Templeton Frontier	FFMRX	10-14-08	1,523	MSCI Frontier Emg Mkt	Closed	1.61	9.9	10.2	5.1	30	70	
Wasatch Front Emg Sm Countries	WAFMX	1-31-12	1,254	MSCI Frontier Emg Mkt	Closed	2.25	15.3	—	—	25	75	
Morgan Stanley Frontier Emg	MFMIX	8-27-08	638	MSCI Frontier Emg Mkt	Open	1.85	23.4	18.0	9.2	0	100	
Harding Loevner Frontier Emg	HLFMX	5-27-08	544	MSCI Frontier Emg Mkt	Open	1.75	16.3	12.5	7.6	30	70	
HSBC Frontier	HSFIX	9-6-11	215	MSCI Frontier Mkt	Closed	1.92	21.5	17.4	—	20	80	
Riverside Frontier	RFMIX	2-24-14	23	MSCI Frontier Mkt	Open	1.99	—	—	—	25	75	
Ashmore Emg Mkts Frontier	EFEIX	11-4-13	7	MSCI Frontier Mkt	Open	1.52	—	—	—	20	80	
Deutsche Emg Mkts Frontier	DEFWX	9-23-14	3	MSCI Frontier Emg Mkt	Open	1.98	—	—	—	50	50	
T. Rowe Price Frontier	PRFFX	9-22-14	2	MSCI Frontier Mkt	Open	1.35	—	—	—	5	95	
Nile Global Frontier	NFRNX	12-31-13	0	MSCI Frontier Emg Mkt	Open	2.45	—	—	—	—	—	
Passively-Managed Funds												
iShares MSCI Frontier 100	FM	9-12-12	707	MSCI Frontier Mkt 100	Open	0.79	21.3	—	—	0	100	
EGShares Beyond BRICs	BBRC	8-15-12	322	FTSE Beyond BRICs	Open	0.58	3.7	—	—	75	25	
Forward Frontier	FRNMX	12-31-08	170	MSCI Frontier Mkt	Open	1.01	20.4	11.2	4.0	0	100	
Global X Next Emg & Frontier	EMFM	11-6-13	149	Solactive Next Emg & Frontier	Open	0.58	—	—	—	75	25	
Guggenheim Frontier Markets	FRN	6-12-08	81	BONY New Frontier	Open	0.71	-6.6	-6.4	-2.4	70	30	

1. Includes Qatar and UAE (most active managers consider these to be frontier-market countries)

Source: Morningstar Direct. Data as of October 31, 2014.

Ashmore Emerging Markets Frontier Equity

Inception Date	AUM	Strategy	Morningstar Parent Rating
11-04-2013	\$7 Million	Actively Managed	Neutral

Ashmore Emerging Markets Frontier Equity was launched as a SICAV in 2010 in Luxembourg and as an U.S.-listed open-end mutual fund in 2013. Peter Trofimenko oversees this fund and Ashmore's Frontier Africa strategy (available as a SICAV in Europe), and he has been the portfolio manager for emerging Europe and Africa for the global emerging-markets equity portfolios since 2000. Trofimenko is a member of the Ashmore Emerging Markets Equities Investment Committee, which includes 27 portfolio managers and analysts. He started at the firm's predecessor (Emerging Markets Management, which was acquired by Ashmore in 2011) in 1994.

Trofimenko follows Ashmore's equity investment process in managing this fund; he takes a bottom-up approach to security selection and looks for high-quality companies with good growth outlooks that

are trading at relatively attractive valuations. He also considers country valuations in his investment process by using Ashmore's quantitative equity model. This fund invests in companies from frontier-markets and small emerging-markets countries.

Ashmore is a U.K.-based firm with over 20 years of investing experience in emerging markets. It has a local presence in seven emerging-markets countries and has trading and portfolio management operations in Singapore. Morningstar has a Neutral Parent rating for Ashmore—while fund fees tend to be average for the industry, it does not have a very independent board (only three of the fund board's five trustees are independent). In addition, none of the trustees are invested in any Ashmore funds.

Deutsche Emerging Markets Frontier

Inception Date	AUM	Strategy	Morningstar Parent Rating
9-23-2014	\$3 Million	Actively Managed	Neutral

Deutsche Emerging Markets Frontier launched in September 2014 as a new strategy for the firm. The fund is managed by Sean Taylor, who is head of emerging-markets equities, and he is supported by Deutsche's global emerging-markets research team of over 20 individuals. Prior to joining Deutsche in 2013, Taylor was head of Pioneer Investment's emerging-markets equity group; he has over 20 years of experience investing in emerging markets.

The fund invests in both small emerging-markets and frontier-markets countries. Taylor first identifies country allocations by considering the growth outlook, valuation, and market sentiment of the individual markets. Then he employs bottom-up fundamental analysis for security selection.

Morningstar has a Neutral Parent rating for Deutsche Asset & Wealth Management. Deutsche has a long history of operating in emerging markets and over the past few years has worked to integrate its regional teams into a global emerging-markets investment team.

EGShares Beyond BRICs

Inception Date	AUM	Strategy	Morningstar Parent Rating
8-15-2012	\$322 Million	Passively Managed	N/A

This ETF tracks the FTSE Beyond BRICs Index, which comprises a mix of smaller emerging-markets stocks (75% of the portfolio) and frontier-markets stocks (25%) with 90 constituents in total. Emerging-markets constituents are selected and weighted by market capitalization. Frontier-markets securities are selected on the basis of their liquidity but are weighted by market capitalization. Countries with the largest weightings are Qatar (16%), South Africa (16%), Mexico (15%), and Malaysia (14%). A number of the smaller countries, such as Bangladesh, Columbia, and Oman, are represented by one security.

Forward Frontier

Inception Date	AUM	Strategy	Morningstar Parent Rating
12-31-2008	\$170 Million	Passively Managed	Negative

Forward Frontier is essentially an index fund that tracks the MSCI Frontier Markets Index via total return index swaps. To offset the costs of the swaps, the managers invest about 70% of the cash collateral in short-term investment-grade bonds. Over the past three years on an annualized basis, Forward Frontier has trailed the MSCI Frontier Markets Index by almost 300 basis points, partly because of low yields on its bond holdings. iShares MSCI Frontier 100, which tracks a very similar index, has exhibited much lower tracking error and carries a lower annual expense ratio relative to Forward Frontier.

Morningstar has a Negative Parent rating for Forward. The fund family was founded in 1997 with help from CEO J. Alan Reid Jr. and is owned by Gordon Getty and his family trusts. Forward tends to focus on niche strategies and has a history of quickly opening and closing funds that don't attract assets. Currently, Forward is focused on liquid alternatives and alternative income funds, two trendy areas in the fund industry.

Global X Next Emerging & Frontier

Inception Date	AUM	Strategy	Morningstar Parent Rating
11-6-2013	\$150 Million	Passively Managed	N/A

This ETF tracks the Solactive Next Emerging & Frontier Index. Solactive is a German index provider that began operations in 2007.

The index is structured to have a 75% weighting in smaller emerging-markets stocks and a 25% weighting in frontier-markets names. The index holds 200 securities, and each constituent is weighted by its three-month average daily trading volume. Countries with the largest weightings are Mexico (11%), Malaysia (11%), South Africa (9%), and Thailand (9%).

Guggenheim Frontier Markets

Inception Date	AUM	Strategy	Morningstar Parent Rating
12-31-2008	\$81 Million	Passively Managed	N/A

Guggenheim Frontier Markets appears to provide exposure to frontier markets. It tracks the market-cap-weighted BNY Mellon New Frontier Index, which is composed of depositary receipts, or U.S.-listed securities of foreign firms. However, the starting universe of this fund's index is somewhat arbitrary and narrow, as many foreign companies are only listed on their local exchanges and not in New York. In addition, despite its name, this fund has about a 70% weighting in smaller emerging-markets countries. And it is quite concentrated: Stocks from Chile, Colombia, and Argentina account

for 40%, 18%, and 15% of the fund's portfolio, respectively. Actively-managed frontier-markets funds tend not to have individual countries account for more than 15% of the portfolio, as large country concentrations can be a significant source of risk.

Harding Loevner Frontier Emerging Markets (Morningstar Prospect)

Inception Date	AUM	Strategy	Morningstar Parent Rating
5-27-2008	\$500 Million	Actively Managed	Positive

Harding Loevner Frontier Emerging Markets is relatively seasoned option, as it launched in 2008. The fund has four portfolio managers: Pradipta Chakraborty (lead), Rusty Johnson (lead), Babatunde Ojo, and Richard Schmidt. Johnson and Schmidt also manage Harding Loevner Emerging Markets, which carries a Morningstar Analyst Rating of Silver. The managers focus on selecting high-quality, reasonably valued names to capitalize on a number of growth themes: broader adoption of financial services, rising consumer spending, and infrastructure investment.

Stocks from frontier markets typically account for 70%-80% of the portfolio, with the remaining 20%-30% in companies from smaller emerging markets. Sector and country weightings are a result of individual stock selection, but the managers may make adjustments if the fund has too much exposure to a country with relatively higher macroeconomic or political risks.

The managers indicated that the strategy currently has a capacity of about \$1 billion, but they expect this to rise as liquidity of frontier markets improves over time. This frontier strategy is also available as a UCITS, but assets under management in that fund are low, at around \$10 million.

Morningstar has a Positive Parent rating for Harding Loevner. The firm has focused on global equity strategies since it was founded in 1989 and has had a dedicated emerging-markets strategy since 1998. In total, it has five global and international equity strategies, all of which employ the same quality-growth approach. The portfolio managers have produced impressive long-term risk-adjusted results at the firm's three older funds and earned good shorter-term results at the firm's two younger funds. Harding Loevner has a strong investment team and has done a good job attracting and retaining talent.

This fund is included on Morningstar's new Manager Prospects list. This list is compiled by Morningstar's Manager Research group as a way to single out strategies that don't currently receive analyst coverage but that may merit such coverage in the future. Morningstar analysts consider a variety of quantitative and qualitative factors when proposing candidates for the list, including management experience, uniqueness and durability of the strategy, performance, and fees.

HSBC Frontier Markets

Inception Date	AUM	Strategy	Morningstar Parent Rating
9-6-2011	\$215 Million (Closed to new investors)	Actively Managed	Neutral

HSBC Frontier Markets was first offered in the U.S. as an open-end fund in 2011, but the strategy has been in existence since 2007 when it launched as a Luxembourg SIF. Andrew Brudenell was one of the portfolio managers in 2007, and since 2011 he has been the lead manager. He works with a dedicated frontier-markets team of three individuals who sit in London and is supported by HSBC's global emerging-markets research team. Most of his emerging-markets and frontier-markets investing experience has been at HSBC, which he joined in 2007.

The managers employ a bottom-up security-selection process and focus on attractively valued names in both frontier and smaller emerging markets. They also use a top-down overlay as they consider a country's macroeconomic environment and political and regulatory outlook. The fund closed to new investors in April 2014 when total assets under management (in the U.S. mutual fund, the European UCITS, and separately managed accounts) reached \$800 million.

The Global Asset Management group of HSBC (Hong Kong Shanghai Banking Corporation) has invested in emerging equity markets since 1973 and established a dedicated frontier-markets equity team in 2007. Morningstar's Parent rating for HSBC is Neutral; while investment teams tend to be stable, HSBC's compensation practices may not properly align the interests of managers with those of the investors.

iShares MSCI Frontier 100

Inception Date	AUM	Strategy	Morningstar Parent Rating
9-12-2012	\$700 Million	Passively Managed	Neutral (Blackrock rating)

This ETF tracks the MSCI Frontier Markets 100 Index, which is an investable version of its parent index, the MSCI Frontier Markets Index. Constituents of the MSCI Frontier 100 Index have higher liquidity thresholds and higher foreign room (the proportion of shares still available to foreign investors relative to the maximum allowed) relative to its parent index. While the investable version holds only 100 of the 142 constituents in its parent index, the two indexes have had a correlation of 100% over the five years through December 2013.

Over the second half of 2014, this fund underwent a significant change as a result of MSCI's decision to move Qatar and United Arab Emirates from its Frontier Markets Index to its Emerging Markets Index. While the parent index change was implemented on June 2, MSCI and iShares worked together to create a transition index during which United Arab Emirates and Qatar (which used to account for 14% and 18% of the portfolio, respectively) holdings were gradually removed from the

ETF's portfolio over a six-month period. This was done to mitigate potential execution challenges, as frontier-markets countries tend to have shallow capital markets. MSCI and iShares also tweaked the original MSCI Frontier 100 Index to improve its capacity. iShares estimates that the capacity for its frontier fund is at least \$4 billion, which is significantly higher than the estimated capacity of actively managed frontier funds.

iShares estimates this fund will distribute capital gains for the 2014 tax year amounting to about 6%-8% of NAV. This distribution is attributable to the turnover that resulted from MSCI's reclassification of Qatar and United Arab Emirates. Frontier markets are generally cash markets, which means this ETF was not able to remove securities with embedded capital gains from its portfolio via the in-kind redemption mechanism.

Morgan Stanley Frontier Emerging Markets

Inception Date	AUM	Strategy	Morningstar Parent Rating
10-14-2008	\$600 Million	Actively Managed	Neutral

Morgan Stanley Frontier Emerging Markets launched as a closed-end fund in 2008 and converted into an open-end mutual fund in 2012. Since the inception of the closed-end fund in August 2008, Tim Drinkall has been the lead portfolio manager; he is supported by regional members of the emerging-markets team. Morgan Stanley Investment Management has had a dedicated emerging-markets investment team since 1986. Drinkall has been investing in emerging markets since 1992.

Drinkall and his team first search for countries with a stable macroeconomic environment and a good GDP growth outlook and then employ bottom-up fundamental analysis for security selection. They prefer names with a double-digit earnings growth outlook and are less sensitive to valuation. As a result, the fund tends to have a growth orientation. Among the five frontier-markets funds with five-year track records, this fund has generated the highest risk-adjusted returns. That said, this fund had its largest decline (negative 23%) in 2011, when the MSCI Frontier Index fell 19%. Unlike many peers, this fund generally does not invest in emerging-markets companies.

Including its European-listed vehicles and U.S. separately managed accounts, this strategy has about \$1.2 billion in assets under management, which suggests that Morgan Stanley may institute a soft close soon.

Morningstar has a Neutral Parent rating for Morgan Stanley. Historically, product launches and sales dominated the firm's culture, and this led to growth and profitability goals that seemed to focus more on attracting new investors than serving existing shareholders. However, leadership stability over the past few years, and efforts to merge redundant offerings and further pare back the firm's fund lineup, suggest that the tide has turned.

Nile Global Frontier

Inception Date	AUM	Strategy	Morningstar Parent Rating
12-31-2013	\$0 Million	Actively Managed	NA

Nile Global Frontier and its sibling fund Nile Pan Africa are managed by Larry Seruma, who founded Nile Capital Management LLC in 2004. Prior to Nile Capital, Seruma was a principal at Barclays Global Investors. Nile Capital Management is a very small investment firm, with less than \$50 million in its two mutual funds. Seruma aims to hold a focused portfolio to capitalize on three dominant themes in frontier markets: consumer growth, infrastructure development, and rising demand for natural resources. The fund primarily invests in companies domiciled in frontier markets but can invest in companies domiciled in emerging and developed markets that have significant exposure to frontier markets.

Riverside Frontier Markets

Inception Date	AUM	Strategy	Morningstar Parent Rating
2-28-2014	\$23 Million	Actively Managed	NA

Riverside Frontier Markets is the first and only mutual fund offered by Riverside Advisors, which was founded in 1998 by Kyle Tomlin and primarily focuses on private hedge funds that invest in emerging markets. Ana Kolar has been the lead portfolio manager since the strategy first launched as a separately managed account in 2010. She takes a disciplined value approach to stock selection: She applies valuation screens to identify attractively valued companies with healthy balance sheets and high dividend yields, conducts corporate analysis to avoid low-quality names, and then constructs a diversified portfolio by focusing on names with low intercorrelations. Under normal market conditions, she will target a 70% allocation to frontier markets and a 30% allocation to emerging markets.

T. Rowe Price Frontier Markets Equity

Inception Date	AUM	Strategy	Morningstar Parent Rating
9-22-2014	\$2 Million	Actively Managed	Positive

T. Rowe Price Frontier Markets Equity is a new strategy. It launched as a Luxembourg SICAV in June 2014 and as a U.S.-domiciled open-end fund three months later. The portfolio manager is Oliver Bell, who has been the portfolio manager of T. Rowe Price Africa & Middle East since October 2011. Prior to that, he was at Pictet Asset Management for 14 years, most recently as head of global emerging-markets research. Bell is supported by four dedicated frontier-markets analysts and T. Rowe's 47-member globally based emerging-markets equity and fixed-income research teams. T. Rowe Price has been investing in emerging markets since 1985.

Bell prefers high-quality, fast-growing names and also evaluates the macroeconomic and political environment of the countries in which he invests. His investment universe includes companies that are domiciled in frontier markets and unclassified markets.

Morningstar has a Positive Parent rating for T. Rowe Price. The firm's disciplined, risk-conscious investment process has consistently produced successful results across its fund lineup, often with less volatility than peers. Many managers spend their careers at the firm, providing continuity for fund shareholders. Manager retirements are typically announced well in advance, allowing for a long transition process.

Templeton Frontier

Inception Date	AUM	Strategy	Morningstar Parent Rating
10/14/08	\$1.5 billion (closed to new investors)	Actively Managed	Positive

Launched in 2008, Templeton Frontier is one of the oldest frontier-markets funds and is currently the largest, with \$1.5 billion under management. The fund closed to new investors in June 2013, when it reached \$1.3 billion in assets.

This fund is one of the dozen or so managed by Templeton's Emerging Markets Group, which was established in 1987. The group is headed by Mark Mobius and senior members Allan Lam, Tom Wu, and Dennis Lim, who oversee about 50 dedicated emerging-markets portfolio managers, analysts, and product specialists in 18 offices throughout the world. There are a lot of decision-makers at the portfolio management level, which results in a somewhat unwieldy process. The fund also invests in smaller emerging-markets countries.

Morningstar has a Positive rating on Templeton's parent, Franklin Resources. That said, Morningstar has Analyst Ratings on two funds managed by Templeton's Emerging Markets Group: Templeton Developing Markets, which is rated Negative, and Templeton China World, which is rated Neutral.

Wasatch Frontier Emerging Small Countries

Inception Date	AUM	Strategy	Morningstar Parent Rating
1-31-2012	\$1.3 Billion (limited access for new investors)	Actively Managed	Positive

Launched in January 2012, Wasatch Frontier Emerging Small Countries reached \$1 billion in assets in 24 months, which is notable in an asset class that only has about \$5 billion in assets across 15 U.S.-domiciled frontier-markets funds and ETFs. Laura Geritz has been the lead manager since the fund's inception, and she is also a co-portfolio manager for Wasatch Emerging Markets Small Cap (which carries a Morningstar Analyst Rating of Neutral) and Wasatch International Opportunities.

She has over 15 years of investment experience and joined Wasatch in 2006 as a senior equities analyst on the international research team.

While the bulk of this fund's holdings are in frontier-markets companies, companies from small emerging markets (such as the Philippines, Columbia, and Chile) can comprise around 30% of the portfolio. Geritz likes to maintain what may appear to be a defensive portfolio; currently, the largest sector allocations are in consumer staples (44%, versus 8% in its benchmark) and telecoms (14% versus 12% in its benchmark). However, valuation-sensitive investors may want to note that this fund is trading at a trailing 12-month price/earnings multiple of 23 times. Other actively managed frontier funds are trading at an average multiple of 12 times.

To temper the growth in assets, the fund is open primarily to existing shareholders, but new investors can gain access to the fund by purchasing shares directly from Wasatch. This fund is only available in an Investor share class, whereas most of the other actively managed frontier funds have a cheaper Institutional share class. Morningstar has a Positive Parent rating for Wasatch. The overall quality of Wasatch's fund lineup is high, as most of the older funds have solid records and many of the newer ones have made nice starts.

Regional Frontier-Markets Funds

There are 14 funds that target specific regions within the frontier markets. These funds are primarily ETFs that track market-cap-weighted indexes, but there are three actively managed regional funds. T. Rowe Price Africa & Middle East shares the same portfolio management team as T. Rowe Price Institutional Frontier Markets Equity (see p.18), and the Nile Pan Africa fund shares the same portfolio management team as Nile Global Frontier (see p.18). Matthews Emerging Asia invests in both emerging Asia (60% of the portfolio) and frontier Asia (40%). Taizo Ishida has been the lead manager since the fund's inception in 2013, and he also manages the firm's Asia Growth and Japan strategies, both of which have exhibited good risk-adjusted returns relative to their respective category peers. Morningstar has a Positive Parent rating for Matthews Asia. All of the funds in Exhibit 12 are currently open to new investors. ■■■

Exhibit 12 Regional Frontier-Markets Funds

Strategy / Name	Ticker	Inception Date	AUM (\$Mil)	Benchmark	Expense Ratio %	Annualized Return %	
						3-Year	5-Year
Actively-Managed Funds							
Matthews Emerging Asia	MIASX	4/30/13	110	MSCI EM Asia	1.25	—	—
Nile Pan Africa	NAFIX	11/3/10	42	MSCI Frontier Mkt	2.25	8.3	14.9
T. Rowe Africa & Middle East	TRIAX	4/30/08	245	Lipper Emerging Mkt	1.25	23.3	20.3
Passively-Managed Funds							
Global X Central Asia & Mongolia	AZIA	4/2/13	2	Solactive Central Asia & Mongolia	0.69	—	—
Global X MSCI Argentina	ARGT	3/2/11	20	MSCI All Argentina 25/50	0.75	13.1	0.2
Global X MSCI Nigeria	NGE	4/2/13	16	MSCI All Nigerian Select 25/50	0.68	—	—
iShares MSCI Qatar Capped	QAT	4/29/14	40	MSCI All Qatar Capped	0.61	—	—
iShares MSCI UAE Capped	UAE	4/29/14	46	MSCI All UAE Capped	0.61	—	—
Market Vectors Africa	AFK	7/10/08	108	MV GDP Africa	0.81	0.1	3.8
Market Vectors Egypt	EGPT	2/16/10	76	MV Egypt	0.98	11.7	16.8
Market Vectors Gulf States	MES	7/22/08	22	MV GDP GCC	0.98	27.5	18.4
Market Vectors Vietnam	VNM	8/11/09	549	MV Vietnam	0.76	18.5	7.9
SPDR S&P Emg Mid East & Africa	GAF	3/19/07	57	S&P Mid-East and Africa	0.59	5.0	5.9
WisdomTree Mid East Dividend	GULF	7/16/08	56	WisdomTree Middle East Dividend	0.88	28.4	19.3

Source: Morningstar Direct. Data as of October 31, 2014.