

SHINING A LIGHT ON..... BLACKROCK FRONTIERS INVESTMENT TRUST

At a glance

The BlackRock Frontiers Investment Trust provides investors with access to some of the fastest growing countries in the world. The underlying themes which unite these economies are faster growth, better demographics and low levels of debt compared to both emerging and developed market economies. These are also economies which provide access to untapped commodity resources, lack external investment and have often underperformed in previous years.

The fund has access to around 140 countries covering Africa, The Middle East, Asia, Europe and Latin America and largely these markets are uncorrelated to global markets. This means that for example, if the S&P was negative then Kenya would not necessarily move in the same direction. For highly correlated markets when one moves, the other moves as well.

However, as we have seen with Frontier Market Funds they do come with considerable risk, the New Star Heart of Africa Fund was forced to close and investors lost over 50% of their investments. Diversification across these economies is crucial.

The update with the manager will cover the risks associated with the market and how the fund looks to address these. It will also touch on how stocks are selected and provide some fund highlights.

Who are the team behind the fund?

The fund is managed by Sam Vecht and the co-manager is Emily Fletcher. Sam is head of the BlackRock Emerging Markets Specialist team. He manages the BGF Emerging Europe Fund, the BSF Emerging Markets Absolute Return Fund, the Emerging Europe Investment Trust, the Frontiers Investment Trust and the Emerging Frontiers Hedge Fund.

Emily is a member of the Emerging Markets Specialist team, specialising in African and Frontier markets.

Overall Sam's performance is slightly better than his peer group and over 1, 3 and 7 years he has outperformed his peer group. In the update with Sam he stressed the importance of the global reach of BlackRock and ability to feed this into the fund. The fund is labour intensive to mitigate some of the risks and this means travelling to countries like Iraq, Syria, and Libya to identify potential opportunities.

Although the performance is not significantly better than the peer group the frontier market world is narrow in terms of investment options and this is one of the top funds in this area.

What is the story behind the investment?

When we spoke to the manager he was keen not to emphasise the stories which many investors hang their coats on. Of course these stories shouldn't be ignored but there is much more to the market than this.

However, it is worth just touching on the stories to explain the characteristics of these economies, why they are attractive and the risks.

Some of the key highlights include:

1. According World Bank in 2011 the IMA African nations debt to GDP ratio was 20% whereas in developed economies this was 70%
2. There are around 2 billion people living in frontier markets with an average age of 30.2 compared to 40.5 for the developed world. So a younger and cheaper workforce than most emerging and developed market economies
3. Many are commodity rich, Nigeria has substantial oil reserves but lacks proper road infrastructure. Iraq has incredible potential with energy production and Qatar is another economy benefiting from commodity rich resources
4. These economies make up around 10% of world GDP, this will grow
5. They have significantly less so called 'hot money' than emerging economies which means they have not suffered the same outflows as emerging markets (this may also be because liquidity is poor)
6. The greatest number of middle class over the next two decades is expected to come from these economies and by 2050 it is expected 1/3 of the global economy will come from these economies

On paper the reasons for investing are strong and speaking to Sam he believes you are investing in economies where there are considerable growth prospects and valuations are cheap. On the downside you are faced with considerable challenges. For example in 2012 Bangladesh suffered inflation of nearly 10% and returns were down 16%. Nigeria is plagued by extremists and pipeline vandalism.

So you are investing in economies which are small and / or are unstable where the equity markets are investable but do not have the market capitalisation, liquidity or other market attributes of more mature emerging markets.

In summary the story is really interesting and certainly as a long term investment offers considerable potential. However, Sam is aware of the risks and this is why it is structured as an investment trust (sometimes referred to as a closed ended structure). There are a finite number of shares for the trust in the market and because the shares are traded it shouldn't suffer from short term negative sentiment because all investments reflect a five year timeline. An important point is that the trust will offer all holders the chance to buy back their shares five years from the launch date at net asset value less cost.

Fund highlights?

We covered some of the investment highlights which are shown in this section however I want to cover some basics around the investment style. The fund operates in two ways, it looks to pick companies which have the potential to grow substantially but equally it will consider the political situation of that country which may mean that however good a company is it doesn't make it a good place to invest. Sam may also see the potential within in economies but use developed market companies to access those opportunities where there are no suitable companies within those countries.

The fund invests across 18 countries with around 45 stock positions.

We discussed how the market performed in 2013 and some of the highlights in December. The MSCI Frontier Market Index returned 2.2% in December, bringing the total benchmark return for 2013 to 25.9%. This outstripped mainstream Emerging Markets which fell by 1.5% in December, capping a

poor year in which the index fell by 2.6%. (All calculations are on a US dollar basis with net income reinvested.)

United Arab Emirates was the strongest performer over the month, rising by 17.0%, as the region continues its buoyant recovery. Investors were encouraged by Dubai winning the Expo 2020 as significant infrastructure investments will be required to host the event. The market was led by property company Emaar, which rose by 21% after reporting strong interest in its most recent project launches.

Bulgaria also performed well in December, up by 10.9%, as investors shrugged off the decision of Standard & Poor's to revise its outlook for the country to negative from stable. Investors preferred to concentrate on the country's fledgling economic recovery and low levels of public debt, relative to GDP.

Sri Lanka ended the year on a positive note. Recent economic data releases have shown that the economic outlook for the country is improving, GDP growth accelerated to reach 7.8% in Q3 2013, whilst inflation currently remains contained at 4.7% year-on-year in December, the lowest level since February 2012.

Argentina was the weakest performer in December, falling by 8.1%. Investors took profits after the market rose by more than 20% in November. The sentiment in Buenos Aires was not helped by a wave of blackouts as the summer heat took its toll on the inadequate power infrastructure. The government, which had already imposed price freezes on the utility sector, announced further freezes on up to 200 goods and services.

Sam discussed a new position in energy producer, Afren. He believes that the company's assets in both Iraq and Nigeria are significantly undervalued by the market. In Iraq, he believes that the recovery factor being applied to the company's reserves is over-conservative and in Nigeria, he believes that the exploration programme that the company is embarking on looks extremely interesting.

The fund also reduced its positioning in Emaar Properties and sold out of First Gulf Bank and is investing this capital into the Abu Dhabi based property company Aldar.

They also took profits on two other strong performing stocks: Caribbean telecoms operator, Cable and Wireless Communications and Kyrgyzstan miner, Centerra. The fund increased its position in Americana, a Kuwaiti listed fast food chain which operates over 1,000 restaurants across the Middle East, North Africa and Central Asia.

As a result of the strong performance of a number of financials stocks over the last quarter of 2013, the weight of financials within the fund rose to 34% as at the end of December. This is a high level compared to where it has been historically. Sam expects this weighting to fall gradually as they continue to take profits in those stocks which have done well. A sharper decline in weightings in this sector will take place before June 2014, as they exit positions in financial heavy Qatar and UAE which are leaving the Frontier Index at the end of May 2014.

If I had one concern from our conversation it would be around the exiting of the Qatar and UAE (into Emerging Markets Status) and what impact this may have on the fund. UAE makes up around 13% of the fund and Qatar 9% and this is a large amount of stock movement.

In summary the fund has performed strongly in 2013 in line with the market. There are clearly opportunities and Sam believes these are still plentiful. However my concern remains around Qatar and UAE and the potential impact on the performance of the fund.

Fund performance

Performance since launch is shown below. Currently there is not a UK ETF which tracks the Frontier Market Index and therefore we have used the Emerging Market index as the comparison.

	2010	2011	2012	2013	2014	Since Launch
BlackRock Frontiers Investment Trust (launch 17/12/2010)	0.47%	-31.24%	15.87%	45.86%	0.66%	5.98% p.a.
iShares MSCI Emerging Markets (inc)	4.43%	-20.53%	9.50%	-7.31%	-7.68%	-7.16% p.a.

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

For investors seeking to benefit from long term trends rather than seek short term fixes frontier markets offers that exposure however it is not without risk. Sam Vecht clearly is a seriously bright person when it comes to investing in these markets and has demonstrated that even when Emerging Markets are out of favour he can steer this fund forward. It is not currently part of portfolios however we would consider blending it with both emerging and Asian funds as part of the overall portfolio.

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