

**FUNDS & INV TRUSTS**

The case for frontier market funds

We mull the appeals of a niche investment universe

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By **Dave Baxter**

- As one frontier-minded fund looks to close, we assess the remaining options
- Appealing to some high-risk investors, frontier funds come with their own quirks

Small as it is, a recent proposal to wind up the **Jupiter Emerging & Frontier Income Trust (JEFI)** will mark the disappearance of a more differentiated holding for some portfolios. As its name suggests, the trust has offered emerging market exposure with some allocation to less developed 'frontier' markets, allowing investors to diversify beyond China's substantial presence in emerging and Asian markets. This helped the Jupiter trust's performance last year, when it delivered a share price total return of more than 10 per cent as Chinese stocks and emerging market indices sunk.

It's fair to say that frontier markets are a risky, niche proposition, and not for everyone. As Meera Hearnden, investment director at Parmenion, puts it: "I may have looked at frontier funds around 15 years ago, but soon realised that within a risk framework, these investments just don't stack up in terms of volatility and drawdowns". AJ Bell's Ryan Hughes argues that emerging markets alone are "sufficiently high risk", while Falco Financial Planning's Matthew Bird also tends to ignore frontier markets, in part because they make up less than 1 per cent of global listed equities.

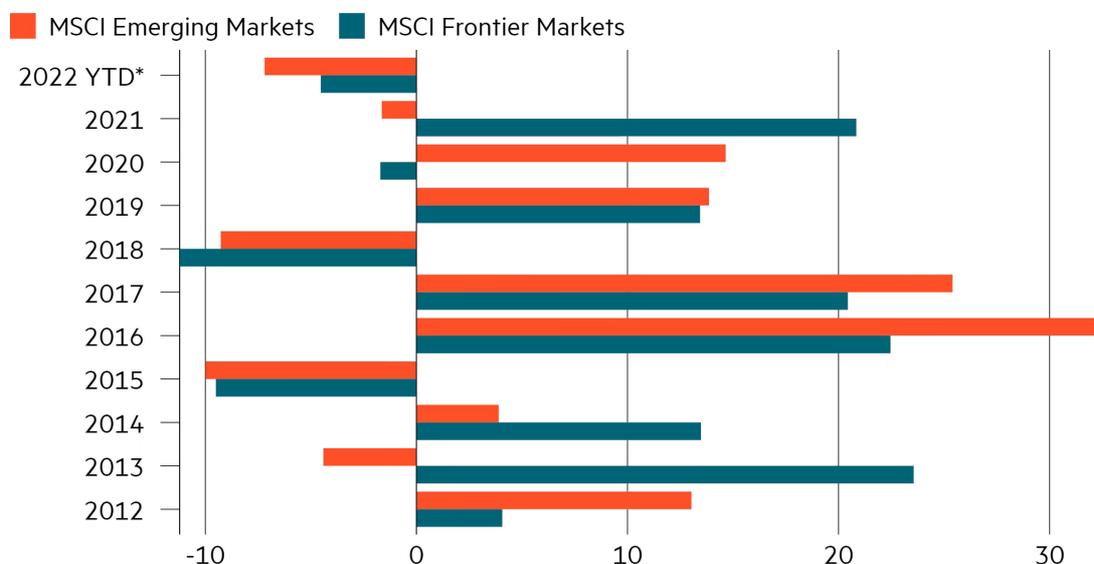
Nevertheless, a small allocation to frontier markets can be another option for investors who have a high risk appetite and see the appeal of younger markets with their own secular growth story. As our chart shows, frontiers can at times power ahead when their 'emerging' counterparts struggle. That said, the funds available come with their own idiosyncracies.

Vietnam looms large

As mentioned, frontier markets have been a bright spot in a difficult time for their more established peers. Last year, when a sharp sell-off in Chinese equities hurt the performance of the MSCI Emerging Markets index, its frontier equivalent performed nearly as strongly as the MSCI World index in sterling terms.

FRONTIER MARKETS VERSUS EM

Sterling total return (%)



*As of 21/02/22

Source: FE

This partly reflects the fact that the MSCI Frontiers index has a big weighting to Vietnam, a market that has done well on the back of an export boom and a growing middle class, among other factors. It made up 30.1 per cent of the index at the end of March, with other markets such as Morocco, Bahrain, Iceland and Romania also featuring significantly, albeit at much lower weightings.

Vietnam is certainly the dominant part of the frontier story for now: the single-country investment trusts operating in frontier markets (by MSCI classification) all focus on Vietnam. All three, **Vietnam Enterprise Investments (VEIL)**, **VietNam Holding (VNH)** and **Vietnam Opportunity (VOF)**, have delivered big net asset value (NAV) and share price returns, both in recent months and years, with VietNam Holding leading the charge on both fronts of late. The fund had just 25 holdings at the end of March, with a focus on industrialisation, domestic consumption and urbanisation. The biggest holding, making up around a tenth of the fund, was in **FPT Corporation (VN:FPT)**, an information technology service provider. The fund's biggest 10 positions made up nearly two-thirds of assets.

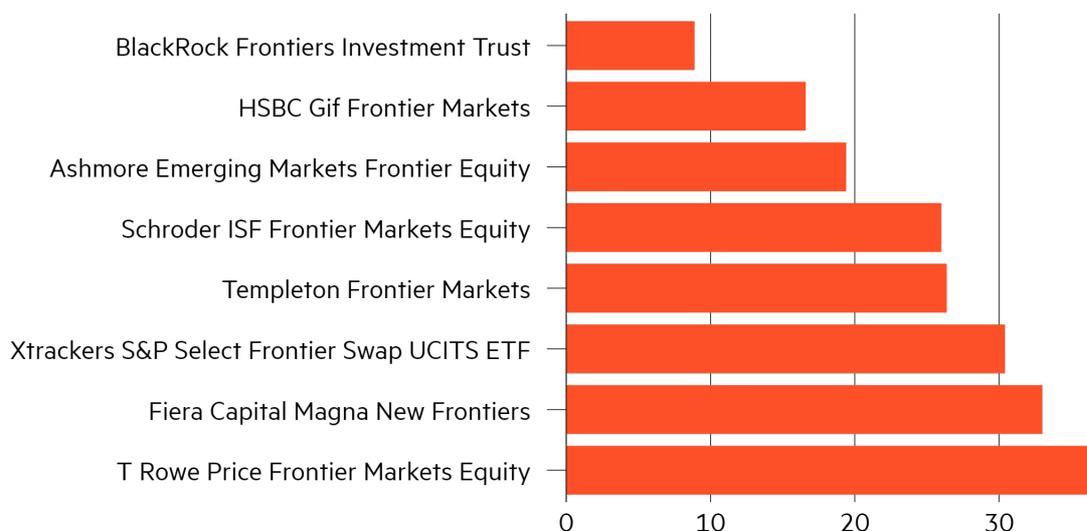
All three funds take a similarly concentrated approach, and unsurprisingly share some holdings such as FPT – although Vietnam Opportunity has tended to have a greater focus on unlisted companies. It’s notable that all three have seen their shares trade on chunky discounts to NAV despite strong returns – potentially providing a slight valuation buffer if the shine does come off the market.

Other options

High levels of stock concentration is a common issue in frontier markets investing, but funds can get around this in part by their use of definitions. **BlackRock Frontiers Investment Trust (BRFI)**, probably the best known product in the market and a name to repeatedly appear in the IC’s [annual list](#) of top active funds, can invest in any country which is neither part of the MSCI World index of developed markets, nor one of the eight largest countries by market capitalisation in the MSCI Emerging Markets index. That wording allows it to invest in the likes of Saudi Arabia and Indonesia, the trust’s top two country allocations as of earlier this year, both of which are classified as emerging markets by MSCI. This has allowed the trust to diversify beyond Vietnam, which made up 8.9 per cent of assets at the end of February. But as our chart shows, many frontier funds remain heavily exposed to the country.

RECENT VIETNAM EXPOSURES IN FRONTIER FUNDS

Allocation (%)



HSBC, Schrodgers and Templeton figures from end Feb. All others from end March.
Source: Fund factsheets

The BlackRock trust tends to offer a juicy yield, even if the team doesn’t target income, and the portfolio fared well on a total return basis in 2021 following a few years to forget. Elsewhere, GDIM investment director Tom Sparke favours **T Rowe Price Frontier Markets Equity (LU1079768849)**, saying that it offers “a diverse and high-quality mix of frontier opportunities”. The fund had 55 holdings at the end of March, and as our chart shows Vietnam made up 36.8 per cent of the portfolio.

In theory, frontier market investing lends itself well to an active approach, given that such markets should be illiquid and under researched. Yet Hughes says he would favour a passive approach here. "That feels counterintuitive given the potential inefficiency in frontier markets but given the very disparate nature of the countries and economies, I’d suggest it might be quite difficult for managers to call the market correctly on a consistent basis," he explains.

Unfortunately, the options available to retail investors are limited. One option available is the **Xtrackers S&P Select Frontier Swap UCITS ETF (XSFR)**, which had nearly a third of its assets in Vietnam at the end of March, with just under a fifth in Argentina and smaller allocations to Panama and Nigeria. The exchange trade fund has just 40 holdings.

Investors can also turn to those generalist emerging market funds that do dip a toe in the frontiers space. On this front Sparke notes: “Another option which catches the eye is the **Redwheel Global Emerging Markets fund (LU1324052809)**, which holds Zambia, Chile, Argentina and DR Congo as its top relative exposure weights. It is focused on growth and has produced some impressive results.”