

## Matthews Asia Perspective

### Q&A: Frontier Markets Present Untapped Potential



**Robert Harvey**  
Portfolio Manager  
Matthews Asia

*In this Q&A, Matthews Asia Portfolio Manager Robert Harvey discusses his current views on investing in frontier markets.*

#### **What is the current outlook for frontier markets?**

It's important to remember that not all frontier markets are created equal. Some countries have better demographics, better positioning regionally or globally and better political systems, infrastructure and legal framework. A deficiency in any of these areas is a challenge, but opportunities arise when you see positive change. In my view, Asian frontier and smaller emerging markets overall have been out of favor for a while and valuations are now attractive, especially when compared with their growth potential.

#### **When are frontier markets most attractive for investment?**

Frontier markets are often attractive to investors as they include countries or economies that are underdeveloped. This means they have the potential to grow, although this potential often is not yet realized. Frontier markets are usually most attractive to invest in when they are most out of favor. Pessimism means you can often buy attractive shares in companies at low prices. When investors become pessimistic, when media reports are largely negative, that is the time to invest in my opinion.

#### **What is the difference between frontier markets and emerging markets?**

There is no real difference between the two. At a basic level they are definitions created by benchmark providers. If you compare Sri Lanka (a frontier market) with India (an emerging market), for example, you will see Sri Lanka is much more developed by most economic metrics. For 2018, India had per-capita income of approximately US\$2,000, for instance, while Sri Lanka had per-capita income of around US\$4,200. Broadly speaking, the definitions are a convenient suggestion or indication of how underdeveloped a country might be.

#### **What is the typical profile of a frontier market investor?**

Frontier markets offer huge potential, but it is a complex segment. Investors must have time on their side. Complexity in frontier markets comes from many areas: domestic politics, global commodity prices; domestic economies; foreign exchange movements and domestic business cycles. Their small relative size can also result in a magnified impact on stock prices by changes in investor sentiment. These markets are mostly not suitable for investors who have a shorter time horizon. I think frontier markets are also more suited to investors who are looking for low correlations against developed market indices and who are looking for lower overall volatility. That being said, the complexity of these markets requires a good active manager who understands these complex markets and can discover opportunities for investors.

#### **What are the risks that frontier markets investors should assess before entering a market?**

Risks include high oil prices that can materially impact emerging and frontier markets, but the impact differs by country. In the Middle East, high oil prices are a

big positive and can help boost both the external accounts and the investment and spending within a country and the region. High oil prices are a negative for oil-importing countries such as Sri Lanka and Pakistan. High oil prices can result in higher import bills, a weaker currency and ultimately higher inflation and interest rates. Therefore, we believe investors should have a long-term time horizon and be prepared to endure volatility. Try not to invest when frontier markets are making news. Just because a market moves up or down, it is not a reason to sell it—only sell if the fundamentals change.

### Can you share your investing strategy for frontier markets?

Our approach to emerging and frontier markets is no different than how we look at Asia's developed markets. We use on-the-ground, bottom-up fundamental analysis to select stocks with a long-term time horizon, mainly focused on the growing consumer demand in these underdeveloped countries. We believe in on-the-ground research and meeting management teams face to face.

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*Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.*

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