



Frontier Markets

Dear Reader,

Welcome to the latest installment of my regular e-letter. Well news continues to be mixed. The strength of corporate profits has been very encouraging. Around 80% of US companies that have reported so far have beaten analyst expectations for the first quarter - the best performance in 17 years. A similar trend is being repeated globally with strong corporate data coming from Japan, Asia ex-Japan and Europe also. Of course it's not all good but finally a rescue package for Greece has been agreed by fellow EU member states and the IMF. The resolve to support Greece should, I hope improve sentiment towards the much larger and more important EU economy of Spain.

In this edition I write about two very different types of investments **Frontier markets and life settlements.**

Trendspotting - Frontier Markets

In mid-2008 the Russian market was tanking. By October 2008 the main RTS index had lost 80% of its value. It looked like the Eastern Bloc emerging market party was well and truly over.

Well, not quite. From that October, I was telling investors that at 80% down, this was a fantastic buying opportunity.

Russia's oil, gas and other natural resources had not suddenly disappeared, nor had the currency been crushed or the country defaulted on its debt. At 80% down, all it would take was a move back from 20% to 40% of its previous value for an investor to double their money.

It seemed a no-brainer to me, and over the last 18 months I was proved to be right, and then some.

The reason I share this is not to sound my own trumpet, but to demonstrate that, spotting a trend early based on a sound understanding of underlying fundamentals is very profitable.

With that in mind, let's look at funds centred on what the investment community terms

Frontier Markets. It might sound a bit Wild West, but in reality these funds are simply invested in a sub-set of the wider Emerging Market countries that I so firmly believe in for future and sustained growth.

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The typical Frontier Market is an open and developing economy, blessed with favourable demographics and often natural resource wealth, yet too small and illiquid to be classed in the larger, and safer sounding, Emerging Market bracket.

By this classification, EU member state Estonia is a Frontier Market, as is its fellow EU member Bulgaria.

So too is the natural resource rich Kazakhstan, the oil states of Nigeria, Kuwait and Qatar, the next Asian tiger, Vietnam, and the sleeping giant of South America, Argentina.

In 2009, as the global financial crisis bit, these frontier markets fell further than their more established emerging market cousins, owing to a combination of low liquidity, political risk and greater susceptibility to external macroeconomic shocks.

Indeed, half of the frontier markets in the table are at 50% below 2007/8 highs. This would strongly suggest that there is much room for recovery.

MSCI Frontier Markets Index – constituents				
Americas	Central & Eastern Europe & CIS	Africa	Middle East	Asia
Argentina	Bulgaria	Kenya	Bahrain	Pakistan
Trinidad & Tobago	Croatia	Mauritius	Jordan	Sri Lanka
	Estonia	Nigeria	Kuwait	Vietnam
	Kazakhstan	Tunisia	Lebanon	
	Lithuania		Oman	
	Romania		Qatar	
	Serbia		UAE	
	Slovenia			
	Ukraine			

Source: MSCI Barra

Of the above, the Black Sea region is of particular interest, with Kazakhstan looking a future star, given its enormous natural resources - oil, gas, minerals and metals and metals – and its extremely low relative valuations.

Just a decade ago, China and India were seen as exotic, even foolhardy investments. Now they are essential parts of many an established portfolio.

Africa is also looking increasingly attractive to long-term investors seeking value. With everything from diamonds to oil, copper to coal, people and land, Africa's huge natural resource wealth has helped the continent weather the global recession remarkably well, and record positive GDP growth last year.

Economic growth across all Frontier Markets is lifting living standards and leading to expansion of infrastructure and rising consumption. As such there are abundant opportunities for investments in construction, transportation, banking and finance, and finance, and telecommunications. Furthermore, Frontier Markets have demonstrated low correlation with developed and emerging markets, and therefore, exposure to such markets can help reduce overall portfolio volatility.

And yet, investing in Frontier Market funds is not without risk. For fund managers liquidity is a serious issue, as is the aforementioned political stability risk. Currency issues are also to be watched closely.

Investors should understand that they may well experience significant price volatility in any given period. A medium to long term view should be taken. Switches to defensive asset classes should be happen when the fundamentals indicate that the economic cycle is heading towards the contraction phase in key global economies.

So when investing in these markets, if you are not an experienced investor with plenty of time to monitor the underlying macro economic fundamentals you should invest with an experienced and qualified financial advisor. If you don't it could go badly wrong.

But, that's the potential downside. When considering the upside potential it is imperative to remember that just a decade ago, China and India were seen as exotic, even foolhardy investments. Now for many investors they represent an essential part of their portfolios.

Today's established Emerging Market heavyweights were yesterday's Frontier Markets. There is a clear trend here and it is not inconceivable that in the not too distant future we may view investing in Vietnam, Argentina, Nigeria and Kazakhstan in the same way as we do the BRIC countries today.

Correction

In the previous edition there was an editing error. The result was the following sentence, which of course does not make sense.

"Like many emerging markets there are currency issues - the Real is appreciating fast, putting pressure on exporters, making imports cheaper and leading to inflationary pressures that the Central Bank must keep a lid on through increasing interest rates, which would have a negative impact on the equity market."

It should have read.

"Like many emerging markets there are currency issues - the Real is appreciating fast, putting pressure on exporters, making imports cheaper . However the overriding concern for authorities is the threat of the economy overheating and leading to inflationary pressures that the Central Bank must

keep a lid on through increasing interest rates, which would have a negative impact on the equity market."

Apologies for any confusion.

Life Settlement Funds - the certainties of life: Death, taxes and solid returns

Many people that I meet are seeking an investment that delivers constant and stable returns, whatever the global economic situation.

With that in mind I'd like to introduce Life Settlement Funds, an investment that has performed consistently over recent years, even regardless of recent turmoil in other major markets.

A Life Settlement Fund is invested in US life insurance policies that are no longer needed by the policy as they have what the insurance companies euphemistically term 'impaired life expectancy'.

In layman's terms, this tends to mean the holders are old, and usually have a terminal illness. They have decided that their insurance payout is more use to them and their family whilst they are still alive.

A Life Settlement Fund is invested in US life insurance policies that are no longer needed by the holders. Typically, the holder sells the policy as they have what the insurance companies euphemistically term 'impaired life expectancy'.

In layman's terms, this tends to mean the holders are old, and usually have a terminal illness. They have decided that their insurance payout is more use to them and their family whilst they are still alive.

A great-grandfather, looking at a million dollar insurance payout upon his death, may instead choose to receive a cash payout while he is alive. Often his protection needs have changed; his wife may have passed away. Maybe she is alive, their adult children are financial secure and they both would prefer the cash now. This could be for a holiday of a lifetime or some other richly deserved indulgence. Or even to cover medical expenses.

Life Settlement gives such policyholders the chance to sell their policies on an open, regulated market for a fair discount to the sum assured, and to enjoy the cash benefits whilst they are still alive.

The policyholder is offered a settlement lower than the full payout, but higher than the cash-in value. In short, everybody wins: the policyholder receives fair market value, the buyer (usually an investment fund) becomes the owner of the policy and pays all the remaining premiums and when the policyholder dies receives the full 'face value' of the policy.

The US life insurance market is estimated to have total insurance coverage of approximately US\$21 trillion and the value of policies purchased by the Life

Settlements industry is thought to be in the region of US\$12 billion annually. This is a large, regulated and profitable industry.

And the reason this is a sound investment is simple, as famously, nothing is certain but death and taxes.

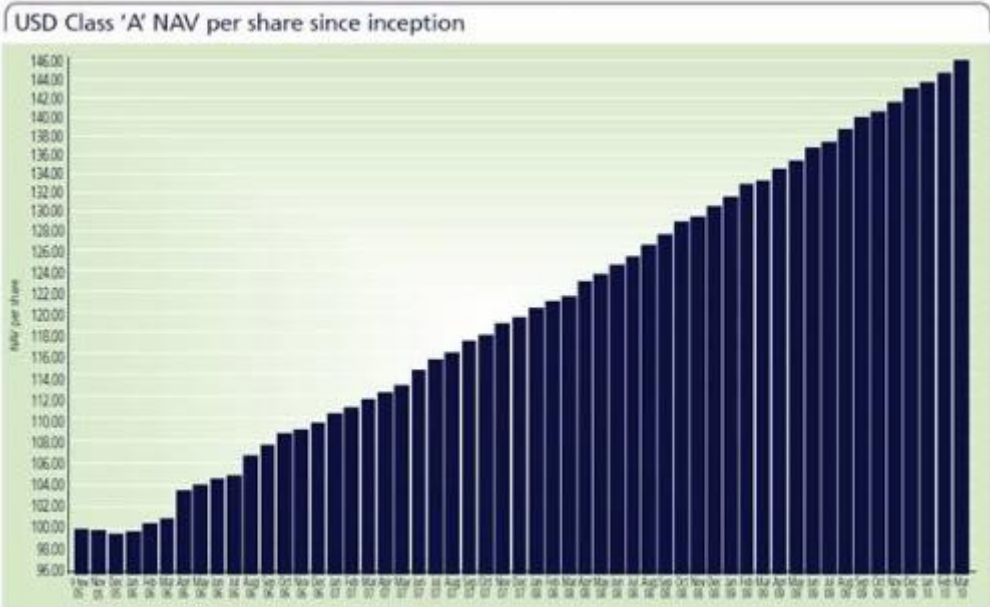
This being true, such funds offer an easy way to balance an investment portfolio as their performance has shown no correlation to traditional asset classes such as equities, bonds, gold and other precious metals or commercial property.

Life Settlement fund performance has shown no correlation to traditional asset classes such as equities, bonds, gold or commercial property

One such fund is the EEA Life Settlements Fund, listed on the Channel Islands Stock Exchange (CISX). According to its own literature, the fund has total sums assured of US\$1.3 billion and has had 104 maturities notified since launch in November 2005, which is a solid track record.

It is invested in policies spread over 92 US Life Companies, and aims to generate 9% and over yearly return. A glance at the fund's chart below shows that this performance is consistently attained.

Yet, as with all investments there are risks that should be noted, and in the case of Life Settlement funds, the investment is aimed at those with a medium to long-term view.



Performance from Jan 2006 to Jan 2010

The more specific risks with this fund type are that returns can be adversely affected by the underlying policyholders living longer than expected.

Also, funds can be relatively illiquid - they are reliant on policies maturing, and, or trading policies on an as yet, illiquid secondary market.

And there is also counterparty risk in respect of the solvency of the underlying insurance companies - i.e. the biggest risk is if the life insurers go bust.

But, again looking at the EEA fund chart, we can see that during the recent downturn - the deepest and most brutal global financial crisis since the Great Depression - this fund's returns did not even wobble.

Banks and brokerages may go to the wall, equities and currencies may collapse, bonds flat line and the bottom may fall out of the pork belly and soy bean markets, but the life insurance business, and thus Life Settlement funds, keeps chugging along, delivering safe, stable returns year in, year out, regardless.

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All the best,
Richard Holmes



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