

Frontier Stocks Beat World as Dubai, Vietnam Growth Top Fed (2)
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(Updates share prices throughout.)

By Michael Patterson and Weiyi Lim

June 12 (Bloomberg) -- The world's least-developed markets are proving the most resilient to the three-week selloff that has erased \$1.9 trillion of global equity value. While the MSCI All-Country World Index of shares in advanced and emerging nations has lost 4.2 percent since May 22 amid speculation the Federal Reserve will pare monetary stimulus, the MSCI Frontier Markets Index returned 0.5 percent including dividends. Thirteen of the 15 top-performing stock gauges are in frontier countries, where the mean market value of \$49 billion compares with almost \$19.5 trillion in the U.S. Fewer links to international capital markets have shielded smaller nations from a retreat that dragged down 52 of 72 equity indexes tracked by Bloomberg since May 22. Stocks in frontier markets also got a boost from the transfer of power between civilian governments in Pakistan and a rebound in Dubai real estate. Advance Emerging Capital and Morgan Stanley Investment Management are betting on more gains.

"Frontier equities can continue to outperform emerging markets equities, and should be much less impacted by the Fed," Tim Drinkall, a money manager at Morgan Stanley Investment Management, wrote in a June 7 e-mail. His firm oversees about \$341 billion worldwide.

Shares in Dubai, one of seven sheikhdoms in the United Arab Emirates, also rallied on prospects the country would be upgraded from frontier status at MSCI Inc. The U.A.E. and Qatar will be raised to emerging-market status, effective May 2014, MSCI said in a statement late yesterday. The benchmark DFM General Index has surged 48 percent in 2013, the second-best performer among 94 gauges tracked by Bloomberg.

Top Performers

Drinkall, whose \$83 million Frontier Emerging Markets Portfolio beat 99 percent of peers tracked by Bloomberg during the past 12 months with a 40 percent gain, said he favors Nigeria because of its economic growth prospects and Pakistan on the nation's improving political stability. His fund held shares of Lagos-based Dangote Cement Plc and Islamabad-based Oil & Gas Development Co. as of April 30, Morgan Stanley's website shows. Dubai Financial Market, operator of the emirate's bourse, surged 47 percent since May 22, the top gain in the MSCI

Frontier Index, as local equity trading volumes soared. The stock extended the rally today after the U.A.E. secured the upgrade at MSCI. Dangote Cement, Nigeria's biggest company by market value, and Lagos-based United Bank for Africa Plc were also among the top 10 advancers with gains of at least 12 percent.

MSCI cited Qatar's efforts to increase limits on foreign ownership in raising its classification for the \$141 billion stock exchange.

Drawing Investments

Qatar could draw investment of more than \$430 million while the U.A.E., which has bourses in Dubai and Abu Dhabi, sees flows of \$370 million after the change, HSBC Holdings Plc said in a report dated May 31.

The MSCI frontier markets index rose 0.1 percent to 560.36 as of 2 p.m. in London, bringing its rally this year to 14 percent. The gauge advanced for seven straight weeks through June 7, the longest stretch of gains in more than a year, and closed at a 25-month high of 562.78 on June 5. The MSCI All-Country index has increased 7.1 percent this year.

The Standard & Poor's 500 Index declined 2.6 percent and the Hang Seng China Enterprises Index retreated 10 percent since May 22, when Fed Chairman Ben S. Bernanke said in response to questions following Congressional testimony that policy makers could consider reducing stimulus if there were evidence in the U.S. of a sustained improvement in growth. Data showing a contraction in Chinese manufacturing has also weighed on global shares as the expansion in the world's second-biggest economy slows.

More Interest

"Most frontier markets march to the beat of their own drum," Sean Wilson, the chief investment officer at LR Global Partners, which oversees about \$200 million, said in a June 7 phone interview from Hanoi. "We've seen a step up in interest in the space."

Frontier countries have avoided the retreat in world equities because local developments are a bigger driver for their domestic markets and cheaper valuations have supported the stocks, according to Samir Shah, an investment manager at Advance Emerging Capital in London.

It's also more difficult to buy and sell stocks in the least developed markets. A total 8.6 billion shares in the MSCI Frontier Markets Index changed hands last month, compared with 1.52 trillion shares in the MSCI Emerging Markets Index,

according to data compiled by Bloomberg.

The MSCI frontier index has a 90-day correlation of 0.34 with the MSCI World Index of developed-nation shares. That compares with a reading of 0.6 between the MSCI emerging gauge and the MSCI World Index.

Funds Flow

While foreign investors have sold more than \$1 billion of shares from both Thailand and Indonesia since May 22, the outflow from Vietnam was \$26 million and Dubai recorded withdrawals of less than \$13 million, according to exchange data compiled by Bloomberg.

The frontier gauge has a forward price-to-earnings ratio of 11, versus 13 for the MSCI All-Country index, according to data compiled by Bloomberg and MSCI Inc. The frontier gauge's 3.9 percent dividend yield compares with 2.6 percent for the All-Country measure.

While valuations in frontier markets are still low relative to global equities, they're becoming more expensive versus history. The frontier index's forward price-to-earnings ratio is the highest since April 2011 and it's 12 percent above the three-year average level of 9.6, data compiled by Bloomberg show.

Not Sheltered

Declines in frontier-nation stocks during the global financial crisis in 2008 suggest they aren't completely sheltered from trends in global capital markets, said Thomas Vester Nielsen, a money manager at Lloyd George Management in London. The MSCI Frontier gauge fell 55 percent in 2008, versus a 44 percent drop in the All-Country index.

While Nielsen says he can't predict whether global markets will prove as volatile this year as they were in 2008, the possibility of short-term losses means frontier-market investors should have a longer term view.

"If we see a very significant global selloff, frontier markets will be impacted," said Nielsen, whose \$235 million LG Frontier Markets Fund has returned 51 percent during the past 12 months, according to data compiled by Bloomberg. "It's important that you go into frontier markets with open eyes."

In some of the top-performing frontier markets this year, accelerating economic growth and investor-friendly government policies are fueling gains. Frontier economies are set to expand an average 3.4 percent this year, versus 3.3 percent for the world economy, estimates from the Washington-based International Monetary Fund show.

Keep Growing

“Irrespective of what central bankers in the developed world do, frontier markets look set to continue growing,” Advanced Emerging Capital’s Shah, who helps oversee about \$750 million, said in a June 6 e-mail.

The Nigerian Stock Exchange All-Share Index has climbed 6.8 percent since May 22 and closed at the highest level in almost five years on June 10. The gauge has gained 41 percent this year, boosted by a 61 percent gain in Dangote Cement. Nigeria’s economy, which expanded at a 6.3 percent pace last year, is on track to grow 7.2 percent in 2013, according to the IMF.

The rally in frontier markets “is still part of the overarching preference investors have for local growth stocks,” Andy Brown, a London-based money manager at Aberdeen Asset Management, which oversees about \$322 billion worldwide, said in a June 10 e-mail. The firm has overweight positions in Nigeria, Kenya and Sri Lanka.

Vietnam, Dubai

Vietnam’s VN Index has increased 3.6 percent since May 22, extending its gain this year to 25 percent. The nation’s shares have rallied amid slowing inflation, government plans to remove banks’ bad debts and ease foreign ownership restrictions on stocks, and a proposal to amend the constitution to remove language stipulating a “leading role” for state-owned companies.

“Vietnam has bright prospects,” Jeff Gill, a money manager at City of London Investment Management Co., which oversees about \$3.7 billion, said in an e-mail on June 8.

Dubai’s DFM General Index has advanced 3.3 percent since May 22. The average sale price of mid-range villas in Dubai soared 47 percent in the year to May and mid-range apartment prices advanced 32 percent, according to data compiled by Cluttons LLC. Emaar Properties PJSC, developer of the world’s largest tower, has jumped 55 percent in 2013.

Insulated Markets

“The economy has improved and that is driving the equity markets,” Montasser Khelifi, a senior manager of global markets at Quantum Investment Bank Ltd. in Dubai, said in a June 9 phone interview.

Pakistan’s Karachi Stock Exchange 100 Index has risen 5.5 percent since May 22 and is up 32 percent this year. Nawaz Sharif took office as Pakistan’s prime minister this month after

May elections that marked the first time a civilian government completed its term and transferred power to a successor. Sharif, whose family owns steel and sugar mills, has pledged to boost the economy by addressing chronic power outages. Oil & Gas Development, Pakistan's biggest company by market value, has gained 7.9 percent since May 22 and Karachi-based Lucky Cement Ltd. increased 5.1 percent.

"There are some countries and sectors that are more insulated than others," said Jonathan Binder, the chief investment officer at Consilium Investment Management, which oversees about \$275 million in Fort Lauderdale, Florida. "A cement producer in Pakistan really is not that correlated in economic terms to what the Fed is doing."

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