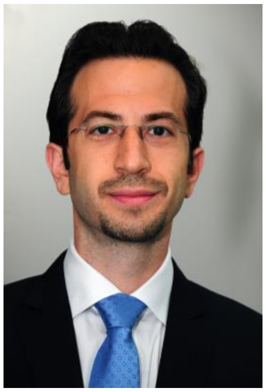
# One-on-one interview: Frontier Markets equity

**October 2019**

**Key takeaways:**

- We remain positive on the asset class given continued growth and development trends in Frontier countries
- Egypt remains one of our preferred markets due to favourable economic developments supporting local opportunities
- Ongoing trade tensions between the US and China appear to be stimulating a shift in manufacturing to Frontier countries such as Vietnam




**Ramzi Sidani**

Lead Portfolio Manager

**Jennifer Passmoor**

Co-Portfolio Manager


HSBC Global Asset Management

## Egypt is the largest overweight position in the fund. How has this contributed to performance?

We continue to have high conviction in Egypt. The country has been our top contributor YTD through August.

However, we did book some gains this year when certain companies approached our fair value. Our total allocation to Egypt (excluding Centamin, which has significant operations outside of Egypt) has been reduced since the beginning of the year through June..

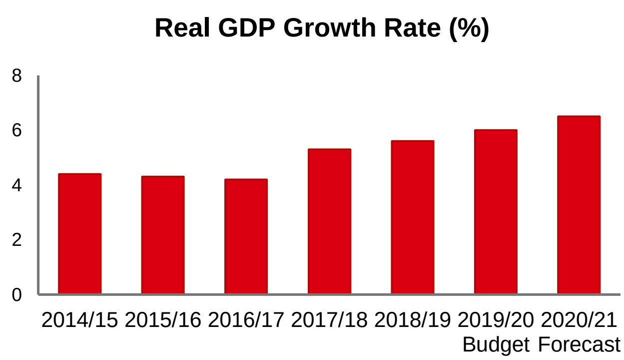
While the net difference slight, this doesn't take into consideration the strong performance throughout the year. Taking this into account, the reduction was much higher.

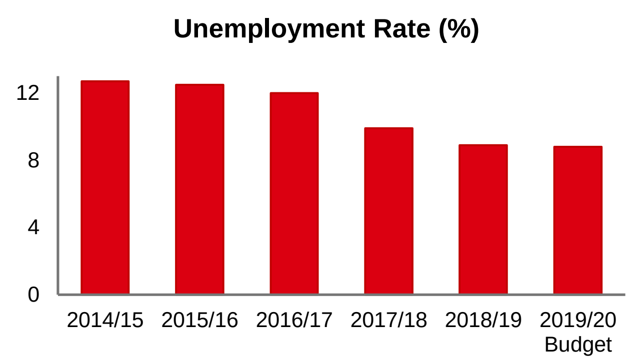
## Why are we still positive on Egypt?

Our view on Egypt is very much driven by both top-down and bottom-up analysis. The macro picture is a very important driver of our conviction.

Recently, we met with the Finance minister who presented the budget for 2019/20 and the improvements that took place in 2018/2019. In particular, the minister highlighted the structural improvements the Egyptian economy has gone through over the past couple years.

An important note is that in August, Egypt received its last IMF payment of $2bn. The IMF has now issued a statement that Egypt successfully implemented its energy reform program, achieving the first-time milestone of energy price liberalization. Prices are now in-line with local costs and are subject to monthly indexation.




**Past performance is no guarantee of future results.** Source: HSBC Global Asset Management, Bloomberg as at August 31, 2019.

Real GDP growth is at its highest level over the past five years, and unemployment is comfortably sitting below 10%. This reflects positively on consumer spending. We have seen this in the results of our Juhayna holding (Egypt's largest dairy company), where volumes continue growing at double digit rates while the company has pushed price increases.

The fiscal deficit continues to be high at 8.2%, but has been brought down from 11.4% two years ago. Most importantly, the country has, for the first time in the past five years, achieved a primary surplus of 2%.

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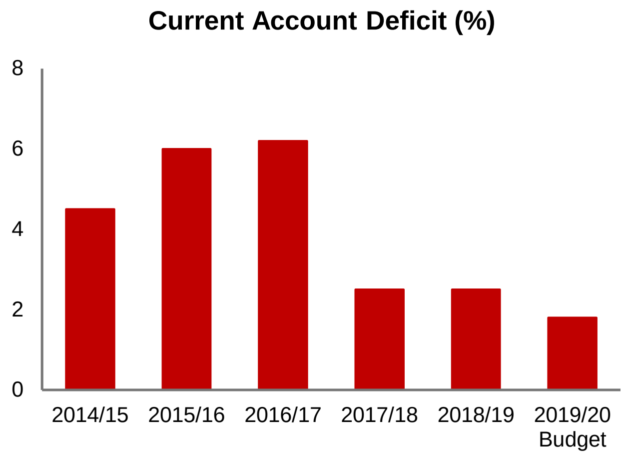


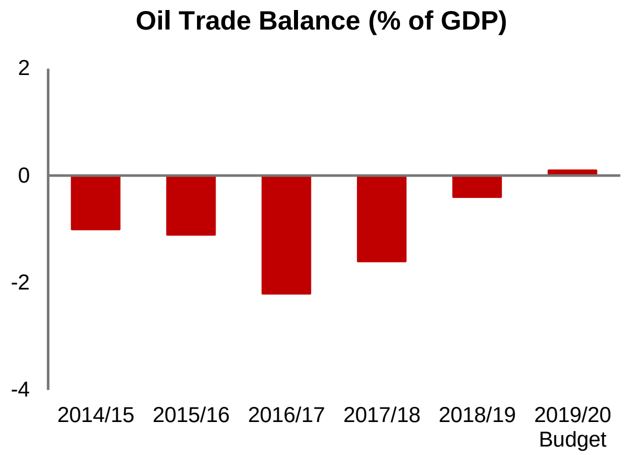


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Egypt still suffers from a current account deficit. However, it is currently at a manageable level of 2.5%. More importantly, for the first time ever, Egypt has seen its oil trade balance turn positive after they lifted all subsidies on energy prices and increased gas production, resulting in a reduction in their oil consumption.

Net international reserves stand at 7.9 months of import cover as of June 2019, compared to 3.7x in June 2016 and 6.4x in June 2017. Foreign holdings of T-bills have been increasing, representing 12.3% of total government papers as of the end of June compared to 9.0% in December 2018. All of this has led to a more than 7% appreciation in the local currency YTD.

Inflation in July dropped below 9% even after implementing the final round of fuel price increases. This is a very big achievement as there are no planned major inflation shocks on the horizon after achieving full liberalization of prices (fuel, transport, electricity, etc.). With inflation ending this year below 10%, the Central Bank has resumed its easing policy by cutting interest rates in August by 150bps, with expectations of further cuts in September.

We believe this is the last piece of the puzzle in our investment case given that investments and consumer spending have not yet fully recovered due to the high interest rate environment.

We are invested in Banks in Egypt and expect loan growth should accelerate to above 20% next year if interest rates go back to pre-IMF program levels or about 11%. Also, the Fed cutting and Turkey aggressively reducing interest rates will make it easier for Egypt to follow suit.

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## Can you explain the recent surprise outcome of the Argentinian presidential primary elections and how has it impacted the fund?

Argentina's primary elections were held on Sunday, August 11th and the outcome was very different than what markets were expecting. Consensus and polls on Friday the 9th were both expecting a 3-4% difference in favour of Alberto Fernandez/Cristina Kirchner over the incumbent president Macri. Thus, the market was expecting the primary results to lead to a head-to-head election on October 27th resulting in a second and final round on the 24th of November. These expectations were influenced by the improvement in Macri's ratings over the past 4-5 months, driven by FX stability and declining inflation.

Actual primary results showed a very different outcome, with Alberto Fernandez leading by 15.6%, implying that he could very well secure an easy win in the October elections.

Kirchner, who will be running as VP, is obviously associated with an era of capital controls, subsidies and a very negative relationship towards foreign investors. Alberto Fernandez, running for president, is at this stage surrounded by question marks given that he was a cabinet chief of Cristina Kirchner in 2007 & 2008, but then stepped down after opposing how the government was dealing with the financial crisis at the time.

Policies are expected to be more moderate under Fernandez compared to Kirchner's presidency, however it's very hard to say by how much at this stage. His campaign speeches mention that interest rates are too high and that the government is maintaining the Peso at artificially high levels. Also, some of his advisors call for some sort of capital controls. We don't know how much of this is campaign arm wrestling vs. actual future policies.

Also, the market is not sure who will be calling the shots in the future: will it be Kirchner or the actual president?

Within our Frontier Markets strategy we have been actively reducing our Argentina holdings since June. Our average absolute Argentina weight in June was at 6.78%, and we reduced it to just over 4.3% by August 9th, or pre-primary election. It's important to mention that we have been reducing our weight while the Argentine market was rising, thus locking in our gains. This puts Argentina today as a positive contributor to YTD performance. We have continued reducing our exposure to the country and today's total absolute weight stands at 1.4%. Another key point is that one of our current holdings is domiciled in Argentina but derives less than 5% of revenues from the domestic market. Thus, its valuation wasn't materially impacted by the primaries shock.

**Past performance is no guarantee of future results.** Source: HSBC Global Asset Management, Bloomberg as at August 31, 2019.
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## Have the recent trade tensions impacted Frontier Markets?

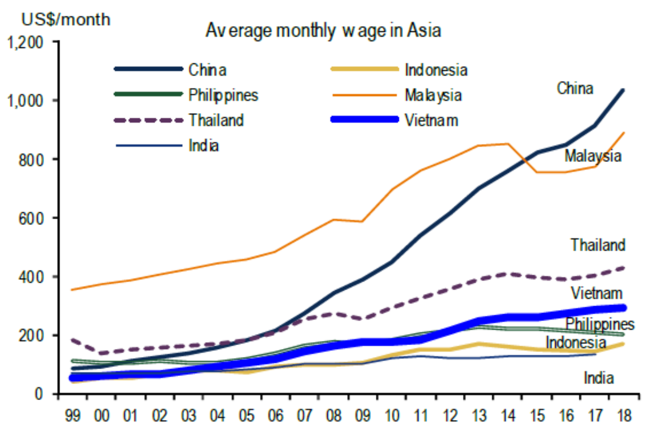
Trade tensions have had far reaching impacts and Frontier Markets have not been immune. However, they have not been effected to the same extent. Frontier economies are driven by domestic forces and less so by global factors, thus resulting in low intra-country correlations within the asset class and minimizing volatility.

We see opportunity from Sino-US trade tensions, with Vietnam being one of the main winners.

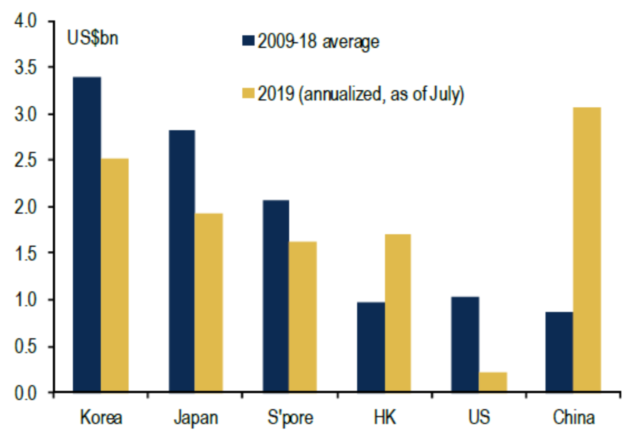
## Vietnam

In recent years there has been an ongoing supply-chain shift from China to lower cost nations such as Vietnam and the Philippines, and we feel that Sino-US trade tensions may catalyze this move. Manufacturers are looking to diversify their footprint in the region, and US tariffs on Chinese imports has encouraged companies to act.

Vietnam has many appealing factors for manufacturers that set it apart from other Asian peers, with a combination of lower average wages, a stable inflationary environment, multiple Free Trade Agreements, a strong banking sector, and tax incentives to encourage the building of manufacturing plants in the country. Judging by its ability to attract foreign direct investment (FDI) recently, the country seems to be the location of choice. FDI has increased amid the recent trade tensions, with FDI from China reaching $1.8bn in July, surpassing total FDI from China for all of last year.




Source: BofA Merrill Lynch Global Research, CEIC, August 31, 2019. Philippines' monthly wages are an estimation based on Minimum Daily Wages. Malaysia's monthly wages refer to average monthly wages in the Manufacturing sector. India's monthly wages are based on monthly earnings in cotton textile mills.




Source: BofA Merrill Lynch Global Research, General Statistics Office of Vietnam, August 31, 2019.

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## Key Risks:

**Risk Considerations**. There is no assurance that a portfolio will achieve its investment objective or will work under all market conditions. The value of investments may go down as well as up and you may not get back the amount originally invested. Portfolios may be subject to certain additional risks, which should be considered carefully along with their investment objectives and fees.

- **Equity** investments fluctuate in value based on changes to an individual company's financial condition and overall market conditions.
- **Foreign and emerging markets**. Investments in foreign markets involve risks such as currency rate fluctuations, potential differences in accounting and taxation policies, as well as possible political, economic, and market risks. These risks are heightened for investments in emerging markets which are also subject to greater illiquidity and volatility than developed foreign markets.
- **Frontier markets** generally have smaller economies or less developed capital markets than traditional emerging markets, and therefore investing in frontier markets can magnify the risks of investing in emerging markets.
- **Derivative instruments**. Derivatives can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on performance.
- **Non-diversification** occurs when portfolio assets are invested in fewer securities, industries, currencies or countries than in diversified investment portfolios, Non-diversification increases risk because each investment has a greater effect on portfolio performance and can also be affected by single economic, political or regulatory occurrences.
- **Geographic concentration** occurs when a portfolio concentrates its investments in one country or region. Portfolio performance is expected to be closely tied to the social, political, and economic conditions in that country or region, and may therefore be more volatile than the performance of more geographically diversified funds.
- **Commodity-related investments**. Exposure to commodities markets, including investments in companies in commodity-related industries, may subject a fund to greater volatility than investments in traditional securities. The value of commodity-related investments may be affected by overall market movements and factors specific to a particular industry or commodity.

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