COURTIERS Research Note

Category 1: For Public Release

COURTIERS

MAXIMISING THE WEALTH YOU CREATED

To: All Advisers; RMC

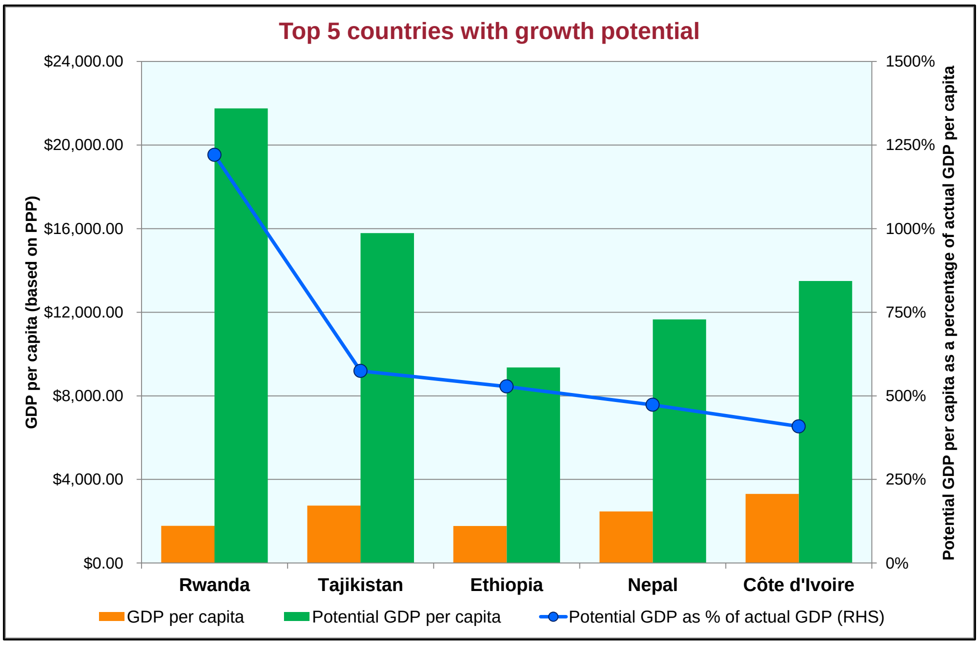
Author: James Timpson

Date: 31st May 2016

Subject: Developing Countries Review

For the last five years our analysis of the World Economic Forum's Global Competitiveness Index has highlighted Rwanda as a country with significant potential for growth. However, lack of investability remains a common problem with many emerging countries, so we've sought out some developing countries slightly further up the scale.

Every year the World Economic Forum (WEF) publishes its Global Competitiveness Report (GCR). The cornerstone of the report is the Global Competitiveness Index (GCI), which assigns each country a score based on many factors including infrastructure, education, market efficiency and business sophistication. As expected, the more developed countries dominate the top of the list while the least developed countries are at the bottom. As part of our own analysis we regress the GCI scores against gross domestic product (GDP) per capita (based on purchasing power parity, or PPP[1]) and use the resulting equation to estimate each country's *potential* GDP per capita based on its GCI score. If a country has a high GCI score relative to its GDP per capita, then theoretically that country's growth potential is strong. We've ranked the countries based on potential GDP per capita as a percentage of actual GDP per capita, and the top five are shown in the following chart.



Source: WEF, International Monetary Fund & COURTIERS

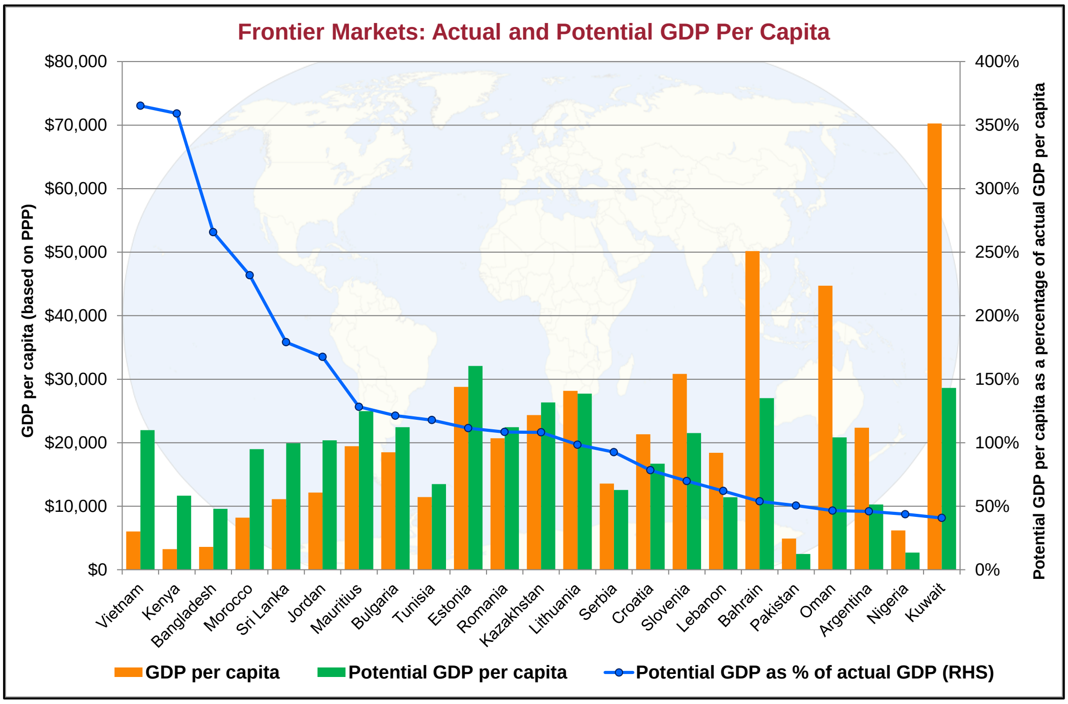
---

[1] Gross domestic product per capita is the value of all complete goods and services produced within a country in a given year, divided by the average population in that year. Each country's GDP per capita is converted to US dollars using purchasing power parity, which adjusts the exchange rate to account for differences in inflation and cost of living.

Rwanda, which is ranked 58th out of 140 in the GCI finds itself at the top of our growth potential list with a potential GDP per capita equivalent to 1,220% of its actual GDP per capita. This indicates significant potential for growth but the barriers to entry are high due to the lack of an investable market. The Rwanda Stock Exchange is open for only three hours a day and consists of just seven stocks. Trading volumes are very low, with most stocks not being traded at all on a given day, resulting in zero price movement. The corporate bond market is even more barren, with just two issues listed at the time of writing.

Second on our list is Tajikistan, whose potential GDP per capita is equivalent to 574% of its actual GDP. Tajikistan is home to the Central Asian Stock Exchange (CASE), which was established in April 2015 as a unique platform for organised securities trading. One of the main objectives of CASE is the formation of a transparent and reliable investment environment for both local and foreign investors, with the ultimate aim of fostering economic development. This is a positive sign for investors looking to broaden their horizons to the less developed areas of central Asia, but at the moment it is limited by its size – the GCR ranks it 120th out of the 140 countries in the report for market size. Like Rwanda, it is not currently a feasible investment.

The rest of the top five consists of Ethiopia, Nepal and the Ivory Coast, all of which are similarly difficult to directly invest in. So what about the countries which are recognised as investable? The MSCI Frontier Markets index tracks the performance of developing markets which are too small to be considered emerging markets. It currently tracks 158 companies in 23 different countries, including the likes of Croatia, Kenya and Pakistan. The chart below shows how each of the countries within the Frontier Markets index performed in our regression analysis.



Source: WEF, International Monetary Fund & COURTIERS

There are two Frontier Markets which stand out above the rest. The first is Vietnam, which came eighth in our list with a potential GDP per capita equivalent to 365% of its actual GDP per capita. Vietnam was one of twelve nations which participated in the Trans-Pacific Partnership free-trade agreement, which was finalized last year. One of Vietnam's key strengths is its imports and exports, which equate to 87.9% and 86.7% of its GDP respectively (compared to 29.9% and 28.6% in the UK). While poverty has declined significantly, one of the biggest challenges faced by Vietnam is creating enough jobs to meet the labour force, which is growing by more than one million people every year. Against the other 139 countries in the GCI, Vietnam ranks highly for gross national savings, domestic and foreign market size and the ratio of women in the labour force compared to men. However it ranks below 100th in several ethical-related factors including ethical behaviour of firms, strength of auditing and reporting standards and protection of minority shareholders' interests.

Kenya, which is ranked 99th in the GCI, is not far behind Vietnam in our analysis, finishing tenth and exhibiting a potential GDP per capita equivalent to 359% of its actual GDP per capita. Kenya acts as the hub of the East African economy, and its real GDP growth has averaged around 5% over the last few years. The country is heavily reliant on agriculture, with 80% of its population working at least part time in the sector. Kenya's key strengths lie within the efficiency of its labour market and the development of its financial market. Despite being a developing market, Kenya holds its own when it comes to the GCI's innovation sub-section, ranking 33rd out of 140 for company spending on research and development and 37th for government procurement of advanced technological products. However, corruption remains a significant issue, and Kenya comes last in the 'business costs of terrorism' category.

In terms of the two countries' respective equity markets, the MSCI Vietnam (USD) index has outperformed the MSCI Frontier Markets (USD) index over the last twelve months with a return of -4.13% versus -12.73%, while the MSCI Kenya (USD) index has underperformed with a return of -16.16%. However over five years Kenya has strongly outperformed its fellow frontier markets with an annualised return of +14.48% versus +1.37%, while Vietnam has lagged behind with an annual return of -4.23%.

It is clear that these two Frontier Markets exhibit both positive and negative aspects. Compared to the likes of Rwanda and Tajikistan, they are fairly easy to invest in due to the range of Frontier Market products available, but as with all non-developed countries the risks are significant. The COURTIERS funds currently have minimal exposure to both Emerging and Frontier Markets, but Vietnam and Kenya are two we will keep an eye on.

James Timpson BSc (Hons), IMC
Trainee Analyst