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Mattias Martinsson is Chief Investment Officer and partner of Tundra Fonder AB, a Swedish asset manager specialising in frontier markets. Martinsson will be in Switzerland at the beginning of May, on the 8th and 9th May in Geneva and on the 10th and 11th in Zurich. In this two-part interview with MarketPlus, he explains what is particular about Frontier Markets and the peculiarity of Tundra Fonder in this regard.

What do you expect from your journey to Switzerland?

«I've been travelling to Switzerland for the last two years, a couple of times every year, but at that time when the interest in Frontier markets was very low. People were afraid. Now we're actually seeing something has been happening. Normally I would go for two days, this time I'm going for four days. I don't know if that will lead to more investments but the interest has been increasing, and I think it will be interesting to see how investors feel about our markets. For us I would say it's the same dare, we try to come every quarter to Switzerland, in good times or bad times, to either get an update or for new investors to have us explain our markets and we will continue to do that».

Getting back to frontier markets, what factors influence the most the trend in frontier markets?

«I would say the risks are mostly political and economic, the companies tend to manage their way around these risks but the political shifts in these often younger states are less stable than in developed markets, so the political risks are bigger for foreign investors, and you have a lot of swings along the way, due to political risks.

Certain economies are more sensitive than many bigger economies. Take Pakistan for example: they are very dependent on energy importing, they import 67% of their oil. In 2008, there was a big rise in oil price, Pakistan suffered immensely from that and from the financial crisis. If you take a market like Nigeria, debt to GDP is less than around 15 per cent of GDP, but they are extremely dependent on oil and energy price, because oil is the main revenue source.

If you take a market like Sri Lanka they have a relatively high debt to GDP ratio, of around 75%. That's significantly lower than the average in Europe, but by frontier markets standard it is at the higher end and as a result the country is more sensitive to higher interest rates.

The good thing is that many of these countries have very specific risks which are not general risks for all of them: for example, when we launched our Vietnam fund in May 2014, on our second day Vietnamese and Chinese ships were fighting outside the East China Sea so the market fell 6%. That obviously did not affect Pakistan, Nigeria or any other markets.

That's again the good thing: if you take them as single countries you would say they might be too risky, but if you put them together and you're able to diversify these risks, then you get a risk profile that is not too far from a Global developed markets equity fund».

How do you estimate the political risk in your day-to-day job?

«First of all, we are a big team, with 11 investment professionals, two people specifically are working on environmental, social and governance risk (ESG), the rest are traditional financial analysts or portfolio managers. On bigger markets, like Pakistan for example, we have six people on the ground. We have our own people but also work very much with local brokers, we almost do all our trading with locals on the markets where we work. This gives additional input and being one of the larger investors in these markets means that we can find good information.

That can be compared to the traditional frontier fund markets where you invest in 25 markets with a team of maybe 2-3 people. I don't believe in that».

In a financial context more and more crowded of funds, both active and ETFs, what is the role of the active fund management, especially in the particular markets you choose to enter?

«We can show that our Pakistan fund, since we launched it in October 2011, has outperformed the MSCI Pakistan (dividends reinvested) index by approximately 80%, the frontier fund has outperformed its benchmark by approximately 30% over 4 years. I think that's the only answer, these comparisons are obviously net of full fees and costs. As an active fund manager you can't only say that you're active, you need to be able to show it, to prove it. I don't think we can prove more than what we have done that there is a role for active funds.

There are also some technical aspects that you should consider for ETFs for example: in emerging frontier markets the trading costs are normally higher than in the developed markets, so if you take a market like Nigeria for example, commissions to get in and out of the Nigerian stock exchange is 2.5%, so if you have an ETF focusing on Nigeria and you have a sudden rush of investors going in and the next day they're going out again, that will create a lot of costs for the fund. That is why if you take ETFs, even the good ones must underperform their benchmark, maybe 1%, sometimes 2%, in worst cases it's a couple of percent more, just because of trading costs».

Do you think your products are for private or high net worth individuals, or can they fit well in the portfolio of a less affluent individual? In your opinion, which is the optimal percentage of the total asset allocation?

«We made the structure of our funds so that they are available to anyone, that means that all our funds are daily traded, which means the same price for selling and buying. There is no minimum investment.

Our idea was to open these markets and provide quality management of funds in less developed markets like Vietnam, Pakistan, Bangladesh, etc. We didn't want any obstacles to that, today 70% of our investors are retail, it used to be 100%. 30% is institutions, now, and that share is increasing.

We don't have special treatment for more affluent investors, we provide a quality that is easy to access, fund rules which are easy to understand and a transparent structure you can rely on, which is supervised by the Swedish Financial Authority, you will recognise the fund rules from any other funds».

What is the temporal horizon of an investment in your funds?

«We normally say 5 years, in order to be able to invest, and if you were unfortunate enough to go through an initial down cycle in the equity market, eventually you will come out decently on the other side. Five years you're able to survive a downturn in the global equity market and it would give you a fair chance of a decent return at the end anyway».

What would be your first suggestion to a new client, maybe someone new to this world?

«As an investor, you first need to believe in the fact that the developing countries will grow faster than the developed world. If you look at the OECD's statistics, they show that for year 2000 developing countries made up 40% of the world economy, and the OECD countries made up 60%. In 2030 it will be the opposite. This is something everyone understands. We have 1 billion people living in the developed world and 6 billion people in the developing. Which pole of the economy will be bigger, eventually?

That said, I believe that anyone who has a willingness and believes in that theme, who for example has 10% of the assets in India, should consider that it has a population six times bigger than Pakistan, but India is trading at 20 times earnings and Pakistan at 10 times. Pakistan is about to enter emerging markets and become eligible for bigger investors. Why don't you have 2% in Pakistan if you dare to have 10% in India? I personally have all my investments in the developing countries because I believe that in the long term I can live with the higher risk, but I would still say that anyone who believes that the developing countries will continue to outperform the developed markets should have some investment in these countries in their portfolio. The share is up to them, for myself it's 100%.

For our Fund, the average annual return since we launched the fund has been around 16%, and volatility is lower than the Stockholm Stock Exchange. It outperformed MSCI Emerging Markets Net index by 30% since we launched. I think that's a fantastic first way to dip your toes in. It will never give you 100% a year because you'll always have a bad market and a good market, over time we are trying to achieve a higher return than the developed market but at a reasonable risk».

What do you think of social media in your field?

«We are very active on social media: on our Facebook page we try to comment on any market movement of over 1%. At Easter, during the two days' holidays, all our funds were going down between 1.5 and 2.5% and we were commenting on that, so that our clients are aware that the funds were moving negatively. A big rally in Pakistan, or a verdict in a political case would be commented on.

We try to be transparent, even if it's bad news. I think that people are fine with our markets moving sometimes a little bit more drastically than other markets, I think they accept that but they need to know about it, you don't want to be surprised that at the end of the month your fund is suddenly down 10% and no one told you about it. We try to keep the information in between as well: most people react and they are fine, saying Ok, now I know, I'm not scared anymore, I know the reason. That's an aspect of making people as comfortable as they can be in our markets, at least they know what happens».

Do you think the developments in technology, energy and such will affect the frontier markets in a big way?

«Many of these markets used to be not very developed and now they are developing and growing faster, that means they are adopting the new technology rather than the old technology. In these markets there is an explosion in mobile payment, in Kenya for example the biggest payment provider is a mobile one. The same is true for Bangladesh: it's a fantastic story, instead of setting up a new bank account you can use your cell phone.

We should not underestimate the ability for information to flow: compared to 20 years ago, people become aware of what is happening around them much sooner than before and I think that applies in many ways, from the political perspective to the information on products, new ideas. Technology helps these countries that didn't have a very developed infrastructure and now they're billing it in a good way.

In the energy side, there's a fantastic development going on. In the world, from an environmental perspective people are afraid that these 6 billion people will suddenly start to grow like us in the West. Unlike Germany, the chosen form of energy might not be coal, or oil, or some dirty kind of energy. I was in Lahore one month ago and we were there to evaluate some solar energy investments. The interesting thing about it is that the price the average corporate would pay is around 11 cents per kw/hour, but the new solar plants are investable at between 6/7 cents. Oil and electricity generation plants would require the oil price to go down to 20 dollars if they were to compete with that. The whole solar revolution we're very optimistic on, cannot replace everything but the efficiency that we are seeing and the costs reduction mean that it's a viable alternative for many corporates, and then it will have an impact and it will happen. Hopefully these countries' growth will not be as dirty as in the Western world based on coal and oil».

Is there any moral component for investing in these countries?

«We actually have two analysts that work with ESG, Environmental Social (meaning workers' conditions, forced labour, child labour) Governance (corruption, tax evasion). In addition to those two analysts, who are communicating with all our portfolio holdings, we also have a consultant specializing in sustainability, Sustainalytics, that screens all our funds for non-violations of human rights, of UN global compact.

Our own people are auditing their work, and can gather information on their own. Being on the ground, like we are in Pakistan and Vietnam, simplifies the information gathering and makes it easier to have an ongoing communication with the companies.

All our funds have a sustainability rating. Our experience from that work has improved our investment process further and as a result we decided to introduce ESG screenings for all our other funds. In our website we publish reports on the ongoing work as well as thematic reports. It is worth a read».

Why did you choose the name Tundra for your company?

«Tundra is across the globe, it's an area that separates the developed from the undeveloped, and the name also fits well with our Russian legacy, my partner Johan Elmquist and I both have our background from Russia. We move in those areas that are not yet developed, but are on the frontier of being developed and I think that's where we can add value».