August 2016 Monthly Comment published 31 August 2PM CDT

A stroke of a pen in Kenya one week ago began turning our once promising August into a mild disappointment. We estimate we will lose 0%-1% for the month, having been up nearly 2% when August 24 began. President Kenyatta unexpectedly signed an ill-drafted interest rate cap law that day that could—in our opinion—severely dent Kenyan banking system profitability and cause macroeconomic stress. The law caps interest rates at four percentage points above a central bank base rate, and requires banks to pay 70% of this base rate on deposits. Two prior attempts at similar legislation in past years never became law, and we, and the markets, assumed Kenyatta would swat away this populist measure. Instead, perhaps with his eye on next year's election, Kenyatta signed the law even as he detailed its shortcomings in his signing statement. For the month, we lost 16% in Kenya, costing us about 1.2 percentage points of performance overall.

It is unclear if the base rate in the law is the current central bank rate of 10.5%, the Kenyan Banks' Reference Rate of 8.9%, or a new third rate that the central bank can define. Also unspecified is whether the law is prospective or retroactive and whether the rule applies only to Kenyan shilling loans or also to foreign currency loans. Using the central bank base rate of 10.5%, the maximum Kenyan shilling interest rate on a loan would be 14.5%, regardless of the borrower's credit quality. Savers would receive 7.35% interest on their deposits. If implemented as such, we would expect lending to dry up, with loans mainly available for blue chip corporates. Personal lending might be restricted to payroll-deduction loans. Small business lending could come to a sudden stop if banks prefer to invest in government debt. On the same day Kenyatta capped rates at an assumed 14.5%, his government issued 10-year debt with a 15.04% coupon. On August 30, Bloomberg's yield curve for Kenyan government debt showed a one-year rate of 11.88%, in which Kenyan banks can invest risk-free. On the savings side, we would expect some products to disappear, and banks to promote non-interest bearing current (checking) accounts through rules that make savings accounts less usable. Fee increases are likely on loans and deposits, although the central bank must approve these and banks may delay new fees to avoid political scapegoating.

We tend normally to not worry too much about interest spreads and fee levels. We assume that banks have many profitability levers, and if one becomes constrained, they can make it up elsewhere. In this case, however, even if we assume Kenyan banks offset half of the net interest margin (NIM) compression this law begets, our models still show significant profitability declines. For example, an analysis we did of three banks shows that return on ending equity (ROE) will decline by 8-9 percentage points for each from 2015 to our 2017 forecast, reducing ROE from the low to mid-20s to the mid-teens. Our intrinsic value estimates for these three banks fell 26%-47% as a result.

Kenya's central bank opposed the law, yet will draft the missing details. Thus, it's possible that the final implementation will not be as draconian as it appears at face value. It's also possible that Kenyan banks will adapt and prosper in a new reality of a still reasonable 7% interest spread and mid-teens ROE. These levels may spur more lending growth in the long run. In the short run, however, risks for equity investors have increased significantly with so many unknowns, including the impact of a possible lending freeze on economic growth. We have cut our Kenyan banking exposure sharply, from 4.6% of our portfolio in July to 0.7% now, due to the intrinsic value declines. Our overall Kenya equities weight is 3%-4%, excluding cash.

Frontaura Global Frontier Fund

Fund Objective & Investment Strategy

Bloomberg Tickers: FRGLFRO US, FRGLFRC KY

Investing exclusively in publicly traded companies in frontier markets, provide investors with a net return series that over multiple years exceeds that of the major global developed and emerging equity indices.

We seek to exploit pricing inefficiencies in frontier equity markets. Our investment approach uses both top-down country factors and bottom-up company factors. At the country level, we examine sovereign risk and calculate country scores that measure currency vulnerability. At the company level, we model each company's discounted cash flow using our proprietary valuation tool that accounts for expected exchange rate changes and fading rates of return on invested capital and profit growth as time passes. Ultimately, we aim to own solid businesses at attractive prices in stable or improving countries.

Performance through August 2016[1]

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging	MSCI Frontier
2011 Q1	2%	6%	3%	2%	- 5%
2011 Q2	- 1%	0%	2%	- 1%	0%
2011 Q3	- 10%	- 14%	- 19%	- 23%	- 12%
2011 Q4	- 6%	12%	3%	4%	- 2%
2012 Q1	6%	13%	11%	14%	6%
2012 Q2	- 3%	- 3%	- 7%	- 9%	- 7%
2012 Q3	5%	6%	7%	8%	7%
2012 Q4	9%	0%	7%	6%	3%
2013 Q1	10%	11%	5%	- 2%	8%
2013 Q2	5%	3%	- 1%	- 8%	3%
2013 Q3	1%	5%	12%	6%	6%
2013 Q4	7%	11%	6%	2%	7%
2014 Q1	- 1%	2%	1%	0%	7%
2014 Q2	4%	5%	4%	7%	12%
2014 Q3	1%	1%	- 6%	- 3%	2%
2014 Q4	- 7%	5%	- 4%	- 5%	- 12%
2015 Q1	- 3%	1%	5%	2%	- 3%
2015 Q2	3%	0%	1%	1%	0%
2015 Q3	- 6%	- 6%	- 10%	- 18%	- 11%
2015 Q4	1%	7%	5%	1%	- 1%
2016 Q1	- 1%	1%	- 3%	6%	- 1%
2016 Q2	4%	2%	- 1%	1%	0%
2016 Q3	1%	4%	5%	8%	1%
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009	46%	26%	32%	79%	12%
2010	37%	15%	8%	19%	24%
2011	- 15%	2%	- 12%	- 18%	- 19%
2012	18%	16%	17%	18%	9%
2013	26%	32%	23%	- 3%	26%
2014	- 3%	14%	- 5%	- 2%	7%
2015	- 5%	1%	- 1%	- 15%	- 14%
2016	4%	8%	1%	15%	0%
ITD CAGR	6.7%	6.2%	- 1.0%	- 2.1%	- 4.4%

Holdings Summary[2]

Country	Holding
Sri Lanka	10%
Pakistan	8%
USA (cash only)	7%
Vietnam	7%
Papua New Guinea	6%
Nigeria	6%
Kenya	6%
Bangladesh	5%
Tanzania	5%
Rwanda	4%
Georgia	3%
Cambodia	3%
Romania	3%
Argentina	3%
Serbia	3%
Lebanon	3%
Kuwait	3%
Ghana	2%
Oman	2%
Macedonia	2%
Ecuador	2%
Montenegro	1%
Botswana	1%
Peru	1%
Uganda	1%
Qatar	1%
Mozambique	1%
Others	1%

Region	Holding
Sub-Saharan Africa	27%
South Asia	23%
Southeast Asia	16%
Eastern Europe	9%
Middle East / North Africa	8%
USA (cash only)	7%
Latin America & Caribbean	5%
Eurasia	4%

Sector	Holding
Financials	44%
Cash	13%
Consumer Discretionary	11%
Consumer Staples	10%
Utilities	8%
Materials	7%
Energy	4%
Industrials	3%
Others	1%

Portfolio Statistics[2]

Portfolio Price to LTM Earnings	6.8
Portfolio Price to Book	1.1
Portfolio LTM Dividend Yield	6.2%
Return on Ending Equity	24.4%
Positions	49
Countries	29
Average Market Cap	$693m
Median Market Cap	$412m
Portfolio Turnover (LTM)	41%
Portfolio Turnover (ITD)	29%
Standard Deviation (ITD)	14%
Beta to S&P 500 (ITD)	0.51
Assets Under Management	$119m

Terms / Service Providers

Management Fee	2%	Attorney	Foley & Lardner LLP
Performance Fee	20% with high-water mark	Auditor	RSM McGladrey, Inc.
Subscriptions	Monthly. New investor minimum $1,000,000. Additional subscription minimum $10,000.	Fund Administrator	Michael J. Liccar & Co.
Redemptions	Quarterly with three-month notice. No lock-up. Restrictions may apply.[2]	Global Custodian	Bank of New York Mellon

1 Frontaura returns are actual returns, net of all fees, through 31 August 2016 with a subject-to-change estimate for the most recent month, for an investor joining the fund at inception, making no further contributions, and making no withdrawals. Investors joining on other dates, making additional contributions, or making withdrawals may have different returns. ITD returns commence 1 November 2007. Index returns are on a total return basis, net of any withholding tax for a US investor, through 30 August 2016, as final index values for the current month are not available at time of publication.

Click this link for an explanation of the indices we show: http://http://www.frontauracapital.com/disclosures/Frontaura_Disclosures_as_of_2015_09_30.pdf

2 Click this link for an explanation of our holdings and portfolio statistics and our redemption provisions: http://http://www.frontauracapital.com/disclosures/Frontaura_Disclosures_as_of_2015_09_30.pdf

Disclaimer

This document does not constitute an offer to sell, or a solicitation of an offer to buy, membership interests in Frontaura Global Frontier Fund LLC or shares in Frontaura Global Frontier Fund Offshore Limited. We will not make such offer or solicitation prior to the delivery of an offering memorandum, an operating agreement or articles of association, a subscription booklet, and other materials relating to the matters herein. Before making an investment decision, we advise potential investors to read these materials carefully and to consult with their tax, legal, and financial advisors. Frontaura accepts subscriptions from accredited investors only, and we typically require you to prove your accredited investor status. We have compiled this information from sources we believe to be reliable, but we cannot guarantee its accuracy. We present our opinions without warranty as of the publication date. We may change our opinions at any time. Past results are no guarantee of future performance.

FRONTAURA

180 North Stetson Avenue, Suite 1935 Chicago, Illinois 60601 USA T +1 312 777 1500 F +1 312 268 5004 info@frontauracapital.com www.frontauracapital.com