Quarterly Letter – 2008 Q3

"The time of maximum pessimism is the best time to buy." -John Templeton

"Be fearful when others are greedy. Be greedy when others are fearful." -Warren Buffett

Only in hindsight can we determine the time of maximum pessimism with any certainty. But with the VIX, a measure of US market volatility and a proxy for the level of fear in the market, hitting never before seen levels day after day, it is accurate to say that things are pretty darn pessimistic in the developed world in October 2008. The degree to which the global financial crisis and equity market selloff affects frontier markets varies by country and region. In some cases, the effect is greater than in the US; in others, it is barely noticeable. Our portfolio fortunately contains more of the latter than the former, with most markets in between.

The overall result is that our fund continued to perform better than major international equity indices in the third quarter, but unlike prior quarters, the results were not satisfactory as we lost 10.6%. By comparison, total returns in the MSCI EAFE Index and the MSCI Emerging Market (EM) Index were -21% and -27%, respectively. The S&P 500 Index did slightly better than we did with only an 8% loss, although it still lags Frontaura significantly for the year. Table 1 on the next page shows our returns versus these indices for three periods: Q3, 2008 to date, and since inception.

Losses have continued in the first half of October, with our performance continuing to be both poor absolutely but good relatively. Through October 16, we estimate we are down an additional 11% in October. Global indices, however, again have more significant losses than this. The S&P 500, EAFE, and EM indices have total returns of -19%, -22%, and -27%, respectively, October 1 through October 16. Obviously, with current volatility, these returns change daily or even hourly.

We are disappointed with our results, although we do expect numbers like ours from time to time, given the inherent volatility of equity markets and of a concentrated portfolio. We take some comfort from our relative returns, although we would quickly add that relative returns do not put food on the table. Importantly, going forward, we do see a number of positives that we'll discuss in this letter:

- Valuations continue to be outstanding
- Our portfolio companies continue to grow earnings
- Inflation—our biggest fear for frontier countries—has begun to decline

Actions speak louder than words. We each made additional personal contributions to our fund in Q3 and we plan to do so again in Q4.

It is always difficult to step up and buy when fear rules the day. To date, recent bravery has been met with immediately lower prices. Nevertheless, we are gingerly buying stocks for the fund and we have increased our personal investment in the fund because we see value and opportunity. Stocks that have little connection to global events are trading at prices we never expected to see earlier this year when frontier markets were advancing and confidence was high. Prices may get cheaper still and we cannot predict when a turn will occur. But it will.

We are optimists who believe the world is getting better through globalization, with a middle class emerging throughout the world. While this evolutionary process will always be one of three steps forward, two steps back, we believe the long-term trendline is upward.

Table 1
Frontaura Global Frontier Fund LLC
Performance through September 30, 2008

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging
2008 Q3	-10.6%	-8.4%	-20.6%	-27.0%
2008 year to date	-3.7%	-19.3%	-29.3%	-35.5%
Inception (November 2007) to date	-1.9%	-23.2%	-33.1%	-39.9%

Frontaura returns are actual returns, net of all fees, for an investor joining the fund at inception and making no further contributions. Investors joining on other dates or making additional contributions may have different returns. Index returns are on a total return basis, net of any withholding tax.

Portfolio Review and Outlook

At quarter end, we held 25 stocks in 14 countries. Cash grew from 1% last quarter to 11% on September 30 due to investor inflows, some position reductions as we reassessed risk, and a sale when one holding traded significantly above our estimate of intrinsic value. With cash to deploy and bargains popping up around the world, the number of positions we hold may increase in the near term, even though our long-term objective remains to hold only 20-25 companies in 10 or more countries.

Valuations for our portfolio continue to be outstanding. At September 30, our portfolio PE was 7.6 with a weighted average dividend yield of 6.4%. In October, each number has improved by nearly a point as of this writing. While the price declines in some developed and emerging countries—not the US, though—are severe enough to approach these valuation levels, there are two important differences. First, our portfolio has a weighted average return on ending equity that's an eye-popping 42%. Second, growth continues. We estimate that our portfolio's weighted average percentage profit growth in the current fiscal year is in the low double digits.

In other words, whereas some companies in the developed and emerging equity markets trade at low valuations because the outlook is poor and earnings are declining, our portfolio is just plain cheap relative to the earnings power of the companies in it.

During the quarter, we visited Angola, Cote d'Ivoire, Croatia, the Philippines, Senegal, and Vietnam. We added Vietnam to the portfolio for the first time. We also added new positions in Egypt, Sri Lanka, and Zambia, where we already held other positions. These additions resulted from earlier trips taken in August 2007, October 2007, and January 2008 as stocks we have been watching dropped below our estimate of intrinsic value. The companies we have added are consumer related, as either mobile phone operators or providers of consumer staples. In contrast to stagnant incomes and high debt levels of developed world consumers, incomes of frontier consumers are rising with little household debt, and we seek consumer exposure where we can find value.

There has been widespread fear within the investment community that higher food and energy prices in emerging and frontier countries will restrict consumer spending on necessities. Overall, we think the revenue impact on companies we follow has been less than expected. Where we have noticed inflation the most is in a rising level of operating expenses that have reduced profit margins.

Table 2
Frontaura Global Frontier Fund LLC
Portfolio Statistics
September 30, 2008

Portfolio Price to Earnings	7.6
Portfolio Price to Book	1.6
Portfolio Dividend Yield	6.4%
Weighted Average Return of Ending Equity	42.0%

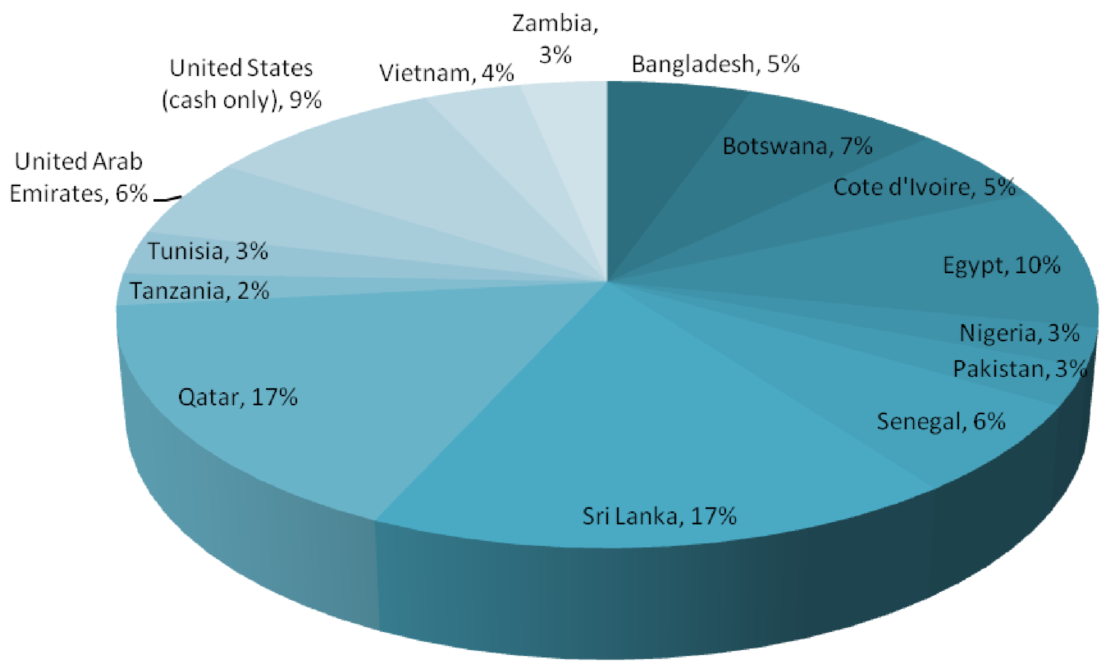
Earnings and dividends are the most recent 12 months of reported actuals
Portfolio PE and PB are the harmonic means of all positions, weighted by position size
Portfolio dividend yield and ROEE are the means of all positions, weighted by position size

We now think the inflation picture is more encouraging than when we highlighted inflation as a major risk in the last two quarterly letters. There are two reasons for optimism. First, countries will soon lap the beginning of the pronounced inflation spike that began in the first half of this year. Thus, if prices are unchanged or even continue to increase modestly, the rate of inflation will decline. We have seen this in the monthly inflation figures for August and September in several countries, as year-over-year inflation rates, while still high, are down slightly from their peak. The magnitude of this decline is still small enough that we might normally be uncertain if it would last, if not for a second factor: commodities prices are in free fall. Having nearly reached $150 in July, oil fell below $70 per barrel in October. Basic foods such as wheat and corn have seen drops of over 50% from their highs. It appears now that the inflation spike that was so painful to our universe may not be long lasting enough to cause permanent damage. Several frontier central banks have responded to recent disinflation by beginning to cut interest rates that they ratcheted up earlier this year.

This has an important implication for equity pricing. Higher inflation hurts equity valuations in numerous ways through higher interest rates. Higher rates draw investor funds away from stocks; they increase the cost of equity, lowering PEs; and they lower earnings directly for companies with debt. Higher inflation also means proportionally higher working capital, lowering returns on invested capital. The prospect of lower inflation implies the reverse, all favorable for frontier market equities.

We do not invest directly in minerals or resource companies, so our companies do not have direct exposure to the negative side of falling commodities prices. There could be indirect effects at the macro level, since many frontier countries are commodities producers. If we do a simple binary analysis at the country level, we think at least 60% of our portfolio is better off, not worse, with lower commodities prices.

Chart 1
Frontaura Global Frontier Fund LLC
Country Mix
September 30, 2008



Q3 Attribution

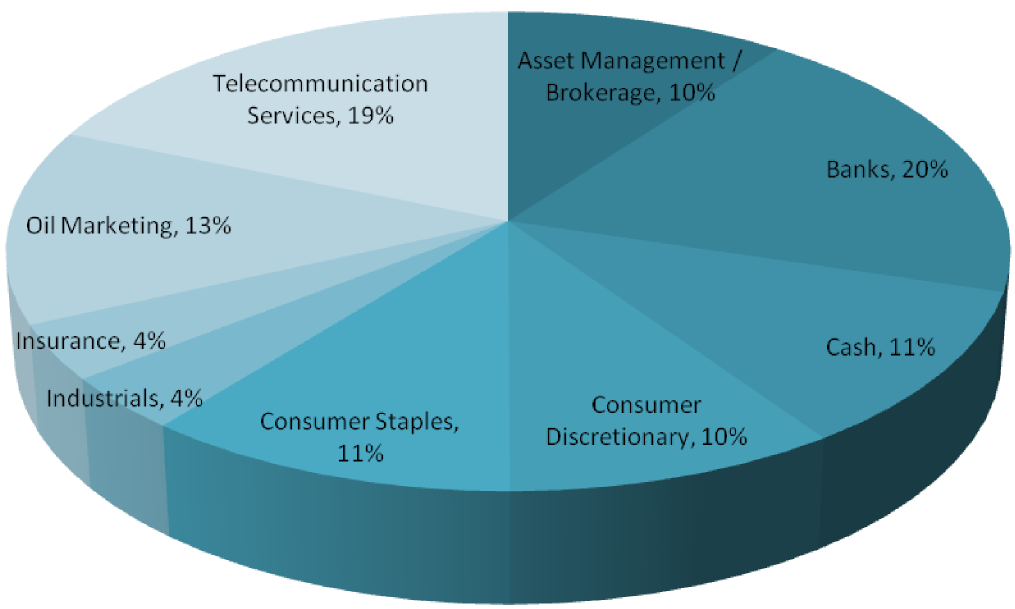
In our Q1 letter, we warned the US dollar would not decline forever, and when it reversed our fund like any international fund with foreign currency exposure would face a new headwind. That occurred in Q3, costing us about two-and-one-half percentage points of performance as our local currency return was around -8%[1].

Looking at significant winning and losing sectors and geographies, we lost money in telecommunications and all of our financial sectors, while we made money in consumer

[1] As we have previously explained we intentionally do not hedge currencies for both a philosophical reason and a practical one. Philosophically, over long periods of time currency movements tend to even out with currency hedging cost and effort representing a deadweight loss to portfolio returns. Practically, we cannot hedge most currencies in our markets anyway (and where it may be possible, it's sure to be prohibitively expensive and time consuming, with the introduction of counterparty risk). We could hedge a few of our currencies indirectly through global currency proxies they correlate to. To date we have not done that, preferring to devote all of our time toward researching and managing stocks.

discretionary. In dollar terms, Qatar, Senegal, and Egypt accounted for over 80% of our losses in the quarter, each contributing relatively equally. In percentage terms, our top three losers were Pakistan, Senegal, and Nigeria. Fortunately, Pakistan and Nigeria began the quarter with only with 4% of the portfolio allocated to each of them. Bangladesh was our biggest country winner during the quarter, and we did take profit there. Charts 1 and 2 show our country and industry mix at quarter end.

Chart 2
Frontaura Global Frontier Fund LLC
Industry Mix
September 30, 2008



It is worth reiterating points we've made previously on Qatar and our financial holdings, in light of concern over falling energy prices and the financial crisis. Qatar is one of our largest country holdings at 17% of the portfolio. The country, now the richest in the world on a per capita basis, has the world's third largest natural gas reserves, which are largely unexploited. Only Russia and Iran have greater reserves, making Qatar the world's preferred friendly provider. Production will begin to ramp up in the next few years, with much of the supply already sold in long-term contracts. Importantly, the country does not rely on high energy prices. A graph in a recent Wall Street Journal article[2] illustrated this point by showing the per-barrel oil price to maintain financial stability in 2008 in OPEC countries. Venezuela topped the chart at over $90 a barrel, Iran was over $50[3], as was Saudi Arabia. Qatar, meanwhile, was under $10. Qatar also was the only country whose break-even price dropped from 2000 to 2008. We don't own any resource companies in Qatar, preferring companies with broad exposure to the economy.

Financials, mainly banks, comprise over 50% of available market capitalization in many frontier countries. We remain well underweight banks, with 20% of our portfolio invested here at quarter end. Our underweighting has more to do with our concern that inflation may compress net interest margins and increase non-performing loans than concern that frontier banks have the toxic assets present in the developed world. Our observation is that the less developed a country is, the more conservative its lending standards tend to be, especially with regard to mortgages, if they even exist at all. The frontier countries that are most exposed to the financial crises—Ukraine and Kazakhstan come to mind, along with possibly parts of Eastern Europe—have higher per capita GDPs within the frontier universe, and we do not hold any positions in these countries at present.

Risks

In our Q1 letter we identified the most significant risks we thought our fund faced. Most of those have come true at least in part, so here we present a new set of risks that are on our mind.

A severe global recession could affect frontier countries. Economic linkages between frontier countries and the global economy are low, but still they do exist. The greater the severity of a global recession, the less isolated the frontier world will be. Nevertheless, the underlying economic outlook for frontier markets is much better than the developed world.

Foreign portfolio outflows could continue to affect frontier stock market returns. Unlike developed and emerging markets, frontier markets tend to be dominated by local retail investors, an attribute that explains why our concentrated fund has less volatility than the S&P500 to date (because each country's volatility is largely independent of each other due to different investor bases). This is also why the fund is less correlated to global equity markets than most equity assets classes are (because global investors are in the minority in frontier markets whereas they are the majority everywhere else). This is not to say that foreign investors are not present in frontier markets. They are, and even as the minority, if they decide to exit markets in mass as they did and are doing in September and October, prices will fall. From a longer-term perspective, we see this risk as more of an opportunity, allowing us to buy companies we still feel good about at prices below what we would otherwise pay.

The indirect effects of falling commodities prices are likely to affect some of our countries. As we said earlier in the letter, falling commodities prices are a net positive for

[2] *The Wall Street Journal*, "Oil's Drop Squeezes Producers," 10 October 2008, page A3.
[3] An implication of this being that Chavez must adopt more sensible economic policies if he is to remain in power, while Iran's leadership may face similar pressure if oil prices keep falling.

our portfolio as they lessen the risk we have most feared this year—inflation. This is true even in some of our countries that are rich in commodities. Still, it would be imprudent to expect no knock-on effects, even if overall we have positioned ourselves well for lower commodities prices. Nevertheless, we have no investments in resources, minerals, or other commodities producers, something unusual for an emerging or frontier fund.

Local market crises exist in frontier countries. Several countries with small positions in our portfolio—Nigeria, Pakistan, and Vietnam—are having their own market crises due to local country factors. We view Nigeria's selloff after as simply the inevitable bear market after a long bull run, but we acknowledge falling oil prices could dampen the country's outlook. Vietnam is dealing with the aftermath of its own stock market bubble[4], and we entered the market recently, seeing sufficient value with the market nearly 70% off its high, even if the fundamentals, and perhaps the stock market itself, have not yet bottomed. But we thought sufficient value was present in Pakistan[5], and we got it wrong, identifying the issues correctly, but misjudging the timing and magnitude of the problems badly.

Intense mobile phone competition. As previously discussed[6], we have devoted a significant percentage of our portfolio to mobile phone service providers that we see as a consumer play on the rise of a middle class in frontier markets. In less than a decade, these companies have developed some of the strongest brands in their countries—often rivaling Coke for example—and we think they have a lock on consumer discretionary income. We have increased our allocation during Q3 as stock prices of these operators have fallen, often due to inflation fears. We expect inflation to abate, and we think these companies will continue to grab a significant portion of consumers' wallet. As with any significant allocation—now 19% of our portfolio, but spread across different companies and countries—if something systemic goes wrong with these operators, then our returns could suffer. For example, if competition intensifies, returns on invested capital could decline through either higher capital expenditure spending requirements or lower profitability. Or if debt markets shut down completely, even to these most desirable businesses with their stable and predictable cash flow, they might have difficulty continuing to expand their networks.

Conclusion

These are frustrating times for investors, yet these are also the times that form the basis for future bull markets. In the most difficult of times, we have demonstrated significant relative outperformance versus global equity markets and we look forward to a return to absolute performance. No one likes losing money, but the losses have occurred already, while future returns are a function of present valuation and future prospects. Each of these look favorable to us. We encourage you to consider seriously investing with Frontaura or increasing your current investment for November 1, December 1, or at the beginning of the year.

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[4] See Frontaura Observer #9 for a discussion.
[5] See Frontaura Observer #6 for a discussion.
[6] See Frontaura Observer #2 and *Dow Jones News Retrieval*, "Tip Sheet: Frontaura Fund's Fact-Finding Missions Pay Off," 7 July 2008.

Please contact us if you would like any materials, such as our investment presentation, legal documents, or Frontaura Observer trip report newsletters, or if you would like access to our web site, that also contains all of these materials.

Regards,

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Appendix

Table 3 Frontaura Global Frontier Fund LLC Inception (November 1, 2007) to September 30, 2008 Performance				
Period	**Frontaura**	**S&P 500**	**MSCI EAFE**	**MSCI Emerging**
Nov-07	0.4%	-4.2%	-3.3%	-7.1%
Dec-07	1.6%	-0.7%	-2.3%	0.4%
Jan-08	0.7%	-6.0%	-9.2%	-12.5%
Feb-08	0.6%	-3.2%	1.4%	7.4%
Mar-08	-0.1%	-0.4%	-1.0%	-5.3%
Apr-08	3.4%	4.9%	5.4%	8.1%
May-08	3.9%	1.3%	1.0%	1.9%
Jun-08	-1.0%	-8.4%	-8.2%	-10.0%
Jul-08	-0.8%	-0.8%	-3.2%	-3.8%
Aug-08	-2.2%	1.4%	-4.1%	-8.0%
Sep-08	-7.9%	-8.9%	-14.5%	-17.5%
2008 Q1	1.2%	-9.4%	-8.8%	-11.0%
2008 Q2	6.3%	-2.7%	-2.3%	-0.9%
2008 Q3	-10.6%	-8.4%	-20.6%	-27.0%
2008 year to date	-3.7%	-19.3%	-29.3%	-35.5%
Inception to date	-1.9%	-23.2%	-33.1%	-39.9%
Annualized standard deviation since inception	10.8%	11.6%	13.1%	17.7%
Frontaura returns are actual returns, net of all fees, for an investor joining the fund at inception and making no further contributions. Investors joining on other dates or making additional contributions may have different returns. Index returns are on a total return basis, net of any withholding tax.				