Quarterly Letter – 2009 Q2

Frontaura gained 28% in Q2, paring our loss since our November 2007 inception to 8%. It was a robust quarter everywhere in global equities, although other indices are still down about 40% since our inception date, as we show in Table 1.

Table 1
Frontaura Global Frontier Fund LLC
Performance[1]
30 June 2009

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging	MSCI Frontier
2009 Q1	- 2%	- 11%	- 14%	1%	- 17%
2009 Q2	28%	16%	25%	35%	35%
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009 Year to Date	26%	3%	8%	36%	11%
Inception to Date	- 8%	- 38%	- 42%	- 41%	- 47%

As evidence of the broad-based nature of the rally, we made money in Q2 in nearly 90% of the stocks we held and in 13 out of 14 countries. In only three countries were our gains less than 19%. Our largest gains were in Zambia, up 45%; Cote d'Ivoire, up 41%; Qatar, up 35%; and Vietnam and Nigeria, up 30% each. All regions advanced similarly with Middle East/North Africa up 31%, Southeast Asia up 26%, sub-Saharan Africa up 26%, and South Asia up 21%. Twenty-six of our 28-percentage-point advance was due to gains in local prices while the remaining two percentage points resulted from currency gains as the US dollar weakened. We held 24 positions in 14 countries at quarter end as shown in Table 2.

[1] Returns commence 1 November 2007. Frontaura returns are 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 in US dollars on a total return basis, net of any withholding tax.

Table 2
Frontaura Global Frontier Fund LLC
Portfolio Mix
30 June 2009

Country	Holding
Qatar	19%
Sri Lanka	14%
Zambia	11%
United Arab Emirates	10%
Vietnam	10%
Cote d'Ivoire	7%
Senegal	5%
Philippines	5%
USA (cash only)	4%
Botswana	3%
Egypt	3%
Pakistan	3%
Nigeria	3%
Bangladesh	2%
Tanzania	2%

Industry	Holding
Banks	24%
Consumer Staples	17%
Diversified	15%
Consumer Discretionary	12%
Telecommunication Services	10%
Cash	8%
Oil Marketing	7%
Industrials	3%
Asset Management/Brokerage	2%
Insurance	2%

All Good Things Must End or The Pause that Refreshes?

As we began writing this letter, it appeared the global rally had ended or at least paused as the S&P 500 had dropped four consecutive weeks through July 10. This week's action, though, raises the question of whether this was just the pause that refreshes, with the US and many other markets advancing back toward their June peaks. Timing the market is not what we aim to do, nor should you want that attribute from a frontier markets manager, given the inherent liquidity and trading cost challenges of this asset class. What we are good at, we think anyway, is having a strong sense of what a business is worth and paying an appropriate price, or ideally at times an inappropriately low price, for shares in that business. We think we have also demonstrated that we are reasonably good at sensing and avoiding situations, at either a country or company level, that have an above average chance of significant loss of capital, due to either too high valuations or too-good-to-be-true fundamentals[2] that will inevitably fall short of expectations. Our orientation toward

[2] A corollary is that we avoid situations where the fundamentals are too complicated for us to understand with any certainty how events might play out. There are too many alternative countries and companies available to waste time and capital on unclear situations.

investing in quality businesses for the long term means that whenever the global market rally ends—and inevitably it will—we will not find the prospect of somewhat lower prices and valuations unwelcome. Nevertheless, we continue to see good value in our holdings, with the June 30 portfolio trailing PE at 6.8, the portfolio price/book at 1.2, and the weighted average trailing dividend yield at 8.3%. The weighted average return on ending equity of the companies we hold is 33.1%[3].

Developed World Delevers; Developing World Grows

We have discussed the global economy and how it pertains to our markets in detail in each of our last two quarterly letters. Not enough time has passed for our views to be proven right or proven wrong, nor have we changed our opinion. Thus, after a quick summary here, we'll move on, making this a shorter letter than recent versions. Our guarded view on the global economy is:

> *We think the United States and much of the world is experiencing a once in several generations debt deleveraging. By definition, this will be slow and painful. Economic recovery will not occur as rapidly or be as robust as in other post-World War II recessions, in our opinion[4].*

Having said this, we're more wary about economic prospects for the developed world, where Frontaura does not invest, than we are about the emerging and frontier world where we do invest. Simply put, the growth prospects, financial system health, fiscal balances, and demographics are more favorable outside of the developed world. There are caveats of course, as we have stated in prior letters. First, parts of the frontier world such as Eastern Europe where we have not invested are in as bad a shape as anywhere, clearly in what we would call a depression. We continue to worry about global contagion effects if Latvia, or one of the other Eastern Europe countries with a fixed exchange rate to the euro, devalues its currency. Second, while still doing relatively well, mainly frontier economies are small and could become vulnerable over time to an extended, deep downturn in the developed world. See our last two quarterly letters for a longer discussion.

The Only Country in the World He'd Invest In

The biggest news story in our universe in Q2 was the end of civil war in Sri Lanka. We invested in Sri Lanka in January 2008 because valuations were low and because we thought the civil war that began in 1983 was destined to end within a few years as the government

[3] Portfolio valuation metrics use the most recent 12 months of reported fundamental data as of 30 June 2009. Portfolio PE and price/book are the harmonic means of all positions, weighted by position size. Portfolio dividend yield and return on ending equity are the means of all positions, weighted by position size.

[4] "The Aftermath of Financial Crises" by Carmen M. Reinhart & Kenneth S. Rogoff is the best paper we have read to support this empirically. They find that on an average peak-to-trough basis, real housing prices decline 35% over six years; equity prices collapse 55% over three and one-half years; unemployment rises 7 percentage points over four years; output falls 9%; and government debt rises 86%. This paper is available in various forms on the internet. Most recently it was published in the May 2009 American Economic Review. Earlier the National Bureau of Economic Research issued it as Working Paper 14656 in January 2009, and an earlier 19 December 2008 draft is also available for free on the internet. This early draft influenced us significantly and we were remiss in not citing their research in our prior quarterly letters. The article is short, readable, depressing, and we highly recommend it. Longer, but also of interest, is "Banking Crises: An Equal Opportunity Menace" by the same authors, NBER Working Paper 14587, December 2008.

finally demonstrated it had the willpower to win. By this we mean the government showed it was willing to spend the money necessary, suffer the casualties necessary, and ignore the well-meaning but shortsighted calls for a ceasefire from the global community that ultimately prolonged the conflict by giving the opposition Tamil Tigers time to rearm. Total victory was the only outcome the government wanted, and it achieved that in May, later than the end of 2008 date it promised, but frankly earlier than we expected. Although the global downturn will likely mask it in the numbers, we expect the end of the war to boost Sri Lanka's economic growth and the amount of foreign direct investment it receives, relative to if the conflict continued. As the war ended, global investor Jim Rogers said that if he weren't giving an interview at the time, he'd be on a plane to Sri Lanka to check out the "wonderful opportunities" the country offered. In early July, he said stocks in Sri Lanka were the only equities in the world he would consider buying at the moment[5].

One of the companies in which we own in Sri Lanka is Hatton National Bank, the second largest non-government owned bank in the country. Its 178 branches give it a strong geographical presence throughout the island and it has already announced plans to open three new branches in territory that the Tamil Tigers formerly controlled. A few years ago, the Tamils controlled up to one-third of the island. Hatton has both voting and non-voting shares with a combined market cap of $216 million in US dollars. We own the non-voting shares as they trade at a 57% discount to the voting, with the right to vote being the only distinction between the share classes. At quarter end, the non-voting shares traded at a trailing PE of 4.3, with a price/book of 0.5, and a dividend yield of 7.8%. Even with this modest valuation, the shares have a total return of 69% in local currency this year or 68% in US dollars.

Thank You, Al Thanis

We wrote in our last quarterly letter about Qatari government initiatives to support their country's development and proactively eliminate potential issues in the banking and financial system well before problems materialized. This continued in Q2 as the government purchased portions of real estate investments and real estate loan books from the banking sector. This is the third major government initiative since last fall to help their banking system (they previously injected equity into the banks and bought out the banks' stock market portfolio). With this degree of intervention, one might assume the banks were weak and the banking system on the verge of collapse. In fact, the opposite is true. Banks in Qatar are well capitalized by global standards with low levels of non-performing loans. We own Commercial Bank of Qatar. At June 30, its ratio of tangible equity to tangible assets was 17.8%, while its non-performing loans were 1.5% of gross loans. At quarter end, it traded at a trailing PE of 6.8, with a price/book of 1.4 and an 11.1% dividend yield.

Internal News

We noted some positive changes for Frontaura in our June monthly comment, namely that we secured a sizable institutional investor who would nearly double our assets as of July 1, that we had an MBA intern working with us this summer, and that we would soon be looking

[5] See Bloomberg interviews on May 21 and July 6 for these comments.

to hire a recent college graduate to help with administrative, back office, and some analytical work. Several readers responded with good suggestions for our administrative hire. Our decision to hire someone stemmed from our observation that—unlike any year we can recall—most of this year's college graduates were graduating without a job, even if they were at the top of their class. Further, traditional fallback positions ("I'll just work at Starbucks until I find something") might not even be available. So being good value investors, we sensed an opportunity that would be good for us and good for the person we employ. While no one may have all of these attributes, our ideal profile is a recent liberal arts graduate with strong initiative, excellent writing skills, strong quantitative ability, experience living overseas, foreign language fluency, and interest in investing. If you know someone appropriate, have him or her send us a resume, as we will begin looking at candidates in the coming weeks.

Adding our first institutional investor is a significant milestone for us. This could help secure other institutional investors, as there is often a desire among institutions to see other institutions represented on a fund's investor roster. We built Frontaura by raising money from 30 high net worth investors. Typically, these are people we'd known for 10-20 years, most of whom work in the investments business, with many of them managing funds, such as US equities, private equity, or venture capital. While we will continue to raise money from individuals, unfortunately SEC rules limit the total number of investors that our type of fund can have. This will require us to raise our minimum investment beyond $100,000. We aren't setting a hard date yet for doing this, preferring to see what new investor additions look like on a month-to-month basis, but we do want to let everyone know that a change is coming soon. We will continue to accept $100,000 investors for August 1. Please see our monthly comments for updates on when our investment minimum will change.

The large institutional contribution did significantly raise our cash position, briefly to over 50% at the beginning of July. While we could invest nearly all of the cash right away, we will be more deliberate in how we spend it. Having some extra cash on hand is not a bad thing after several months of strong performance. Bargains do remain, but they are not of the magnitude and the availability that they were one quarter ago. The volatility of our markets fortunately does mean that new opportunities tend to present themselves with some frequency. We expect our cash position to follow a similar pattern to what it did at our inception, when for our first three months, cash was 35%, 23%, and 28%, respectively, of assets before reducing to a normal level (significant inflows occurred at the beginning of months one and three).

Conclusion

Q2 will be a hard act to follow but regardless of what the rest of the year may bring, we think we have prepared Frontaura to persevere and prosper in a global economy that is likely to remain uncertain for some time. We are stewards of your money and we will protect your capital as best we can while positioning the portfolio for capital appreciation in good companies available at good valuations. We thank you for being our client, or for those who are watching us, we would welcome you joining our fund.

Regards,

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Table 3
Frontaura Global Frontier Fund LLC
Monthly Performance
30 June 2009

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	ITD
2007											0.4%	1.6%	2.0%	2.0%
2008	0.7%	0.6%	-0.1%	3.4%	3.9%	-1.0%	-0.8%	-2.2%	-7.9%	-17.5%	-10.7%	1.4%	-28.1%	-26.7%
2009	-2.0%	-0.4%	0.7%	7.7%	14.4%	4.1%							26.1%	-7.6%

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