Quarterly Letter – 2009 Q3

The Frontaura Global Frontier Fund gained a further 17% in Q3, following our 28% rise in Q2. Clearly, the year is turning out very differently from what one might have expected at the end of Q1. We are now up 48% for the year, and 9% since our November 2007 inception that coincided with the peak in global markets. While all equities have performed well this year, we've done better than most areas other than emerging markets. Since inception, though, we remain 37-50 percentage points ahead of the reference indices we cite as proxies for the US, non-US developed world, emerging markets, and frontier markets. We summarize these performance statistics in Figure 1. Importantly, we have now made money for over 90% of our clients, who have joined us at different times with different levels of initial and ongoing contributions.

Figure 1
Frontaura Global Frontier Fund LLC
Performance[1]
30 September 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%
2009 Q3	17%	16%	19%	21%	11%
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009 Year to Date	48%	19%	29%	64%	24%
Inception to Date	+ 9%	- 29%	- 31%	- 28%	- 41%

[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.

Similar to Q2, the ongoing rally in Q3 was broad-based, although not quite to the degree of the prior quarter. At quarter end, we held 26 positions in 15 countries[2], dropping Bangladesh and adding Iraq and Zimbabwe when compared to Q2. We lost money in only five positions and three countries in the quarter. Ten of our 15 countries had double-digit percentage gains, with the United Arab Emirates, up 47%, the Philippines, up 45%, and Sri Lanka, up 33%, leading the way. We lost 3% or less in Nigeria, Cote d'Ivoire, and Tanzania, our three worst markets in Q3. Given these performance drags in sub-Saharan Africa, it was our lowest performing region, up only 11%. Our three other regions all had larger and similar gains, led by Southeast Asia, up 32%, South Asia, up 31%, and Middle East/North Africa, up 27%. Sub-Saharan Africa has tended to lag world markets over the past two years, both on the way up, then down, and now up again. Occasionally, we still see a stock there near its 52-week lows, something now elusive elsewhere in the world. Not coincidentally, a disproportionate percentage of our buys tended to be in the sub-Saharan African region in Q3, especially in August and September. Figure 2 on the next page shows the quarter-end mix by country and industry. The weakening US dollar added two percentage points to our Q3 performance, similar to Q2. We gained 15% in local currency.

Company Highlights

A new position in the portfolio in Q3 is Letshego, a for-profit microlender in Botswana with a presence throughout a number of southern and eastern African countries. We first visited Letshego over two and one-half years ago, but never held the stock until July, generally viewing it as too expensive. Letshego makes consumer loans to government employees with repayments debited directly from their customers' payroll. This limits non-performing loans to roughly 2%. We re-engaged with the company in March as the valuation had come down considerably, due to a falling stock price and rising earnings. Follow-up research throughout Q2 convinced us that the company's funding model and credit risk controls had and would hold up through the worst of the global crisis (although we still expect that one day they may shift their business model to begin taking deposits). Further, we monitored Botswana's monthly diamond exports—diamonds are roughly one-third of the country's economy—until we began to see activity resume following the end of 2008 temporary closure of the diamond mines to wind down excess inventory due to the global crisis. We first bought Letshego in July near its 52-week low at a PE of 7. By quarter end, we gained 29%, pushing the PE to 9. But in October Letshego announced a 42% EPS gain on 48% loan growth for the July half year, dropping the PE back to 8, despite a further 9% gain in the local price.

Following up on the two companies we cited in last quarter's letter, both performed well for us this quarter. Hatton National Bank (Non-Voting) in Sri Lanka gained 68% in Q3, yet still trades at a PE of 6 and price/book of 0.8, as of September 30. We made 29% on our

[2] We count our basket of Iraqi stocks as one position. We hold four Iraq stocks at the end of Q3, but expect this number to double or more in Q4. As we discussed in Frontaura Observer #16, Iraq—unlike our other country holdings—is a macro bet, and accordingly we seek to hold a basket of stocks rather than select only one or a few companies per country as we normally do. The lack of detailed information on Iraqi companies also lends itself to a basket approach.

Commercial Bank of Qatar holdings in Q3, yet it continues to have a trailing dividend yield of 9% at quarter end.

Figure 2
Frontaura Global Frontier Fund LLC
Portfolio Mix and Statistics
30 September 2009

Country	Holding
USA (cash only)	16%
Qatar	15%
United Arab Emirates	12%
Vietnam	11%
Zambia	9%
Sri Lanka	9%
Botswana	6%
Senegal	6%
Cote d'Ivoire	5%
Egypt	3%
Pakistan	3%
Tanzania	2%
Zimbabwe	2%
Philippines	2%
Iraq	1%
Nigeria	1%

Industry	Holding
Banks	21%
Cash	17%
Diversified	16%
Consumer Discretionary	13%
Consumer Staples	12%
Telecommunication Services	8%
Specialty Finance	5%
Oil Marketing	3%
Industrials	2%
Asset Management/Brokerage	1%
Insurance	1%

Portfolio Statistics	
Portfolio Price to Earnings	9.2
Portfolio Price to Book	1.4
Portfolio Dividend Yield	6.1%
Return on Ending Equity	27.3%

What Now?

From the March lows, global markets have rallied strongly for over seven months, benefiting us all, but making the question of "What now?" a reasonable one to ask. One of our clients asked our view on equities throughout the world recently, to include all countries, not just the frontier universe. We summarize our response below, but before we do, we need to explain how and why we think about such things. First, we acknowledge that predicting near-term market movements can be a quixotic endeavor (although an interesting one nonetheless), and one that we try to not let interfere too much with how we manage Frontaura for the long run. Therefore, while we make some near-term predictions below, you should not and we do not take these too seriously, because all short-term market predictions involve a high degree of guesswork. Longer-term predictions, say covering a span of at least seven years, can be more insightful, presuming the predictor grounds their forecasts in knowledge of historical valuations, profit margins, and return on capital levels. These variables may deviate from the norm in the short run, but they revert to the mean over longer periods, making them excellent predictors of a market's or a company's long-term return potential. Second, one might ask why we even think about the US or the developed world, since they are far outside our frontier universe. While we enjoy that our countries are less integrated with the world economy, they certainly are not disconnected completely, as the last year has shown. Events and investors in the developed world did affect—to varying degrees—the economies and the stock markets in our universe. Moreover, global corporate competition does not respect the dividing lines that investors so often draw. Third, our views on countries outside our frontier universe are necessarily high level. Other than the US, we don't have a detailed view on valuation within the developed and emerging world, other than to say they appear cheaper than the US (and starting valuation is the single most important determinate of future long-term returns within a country). Instead, we base our views more on the macro outlooks for countries, comparing their fiscal, monetary, and demographic metrics to the countries we analyze within our universe. Finally, many of our readers are outside the US and often inquire how the US economic and market outlook compares to their home country.

We think numerous data points make it clear that the US recession ended around June or July, and a halting recovery is underway. With the S&P 500 finishing Q3 at 1057, and creeping toward 1100 in late October, we see the US market as somewhat overvalued from a long-term cyclically adjusted perspective, but that's not to say that it cannot go higher—and our best guess is that it probably will. The S&P 500 at 1200 over the next six months is possible, and even 1300 while not probable, can't be ruled out, especially if earnings, GDP, or employment show positive surprises over the next quarter or two[3]. Everyone expects a slow recovery and while we agree with that generally, there's always the possibility of upside risk, especially with a weak dollar helping exporters. We think near-term US market corrections are likely to be modest, say 10% at most. There's a lot of cash still on the sidelines that missed the rally and we think it will likely begin to pile in if the S&P drops 5% or more. That's our sanguine view through early next year.

Beyond that, we see little upside in the US, possibly for years. The US fiscal outlook is horrible. Trillion-dollar deficits stretch to the horizon. Economic growth beyond the next

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[3] The case for these levels on the S&P 500 is easy to make. Assume the S&P 500's operating earnings are $75 in 2010 and assume a 16 PE and you get a 1200 S&P price. Alternatively, use only a $65 earnings estimate, but couple it with a 20 multiple, and you have a 1300 price target. The case against this analysis is more subtle, arguing that historical comparisons should use reported versus operating earnings and trailing versus forward PEs. Most important, and least understood we think, is that US profit margins are still above normal and ultimately are likely to mean revert at some point next decade, putting downward pressure on future earnings. Most bulls miss or ignore this point, we believe.

few quarters faces a stiff headwind of government stimulus expiring, taxes going up in 2011, regulation increasing, and unfavorable demographics. Further, this was not a normal recession but a once in several generations debt deleveraging and it will take years for US households to repair their aggregate balance sheet. Consumer spending will likely be subdued throughout this process. We think the US will be a trading market through the first part of the next decade. The US market is closer to a sell than a buy, but for the next few months, we expect things will be okay. Nevertheless, if the US were in our frontier universe, we would not invest in it, using the criteria we do to evaluate countries. Valuation levels are not attractive enough and the fiscal outlook is too poor and too uncertain. Faced with this in our frontier world, we would simply skip a country and go on to the next idea.

As for outside the US, we see most other developed markets more or less in the same position as the US, better in some areas (their fiscal balances not as bad), worse in other areas (demographics). Some countries have worse debt/GDP levels than US (Japan, Italy), while others are better (Germany). In the best shape are non-Japan Asia and commodity countries such as Canada and Australia.

At some point in the next few years we think there's a reasonable chance, perhaps around 50%, of a serious bear market resuming in the US and possibly other parts of the developed world. We can see a number of potential catalysts such as:

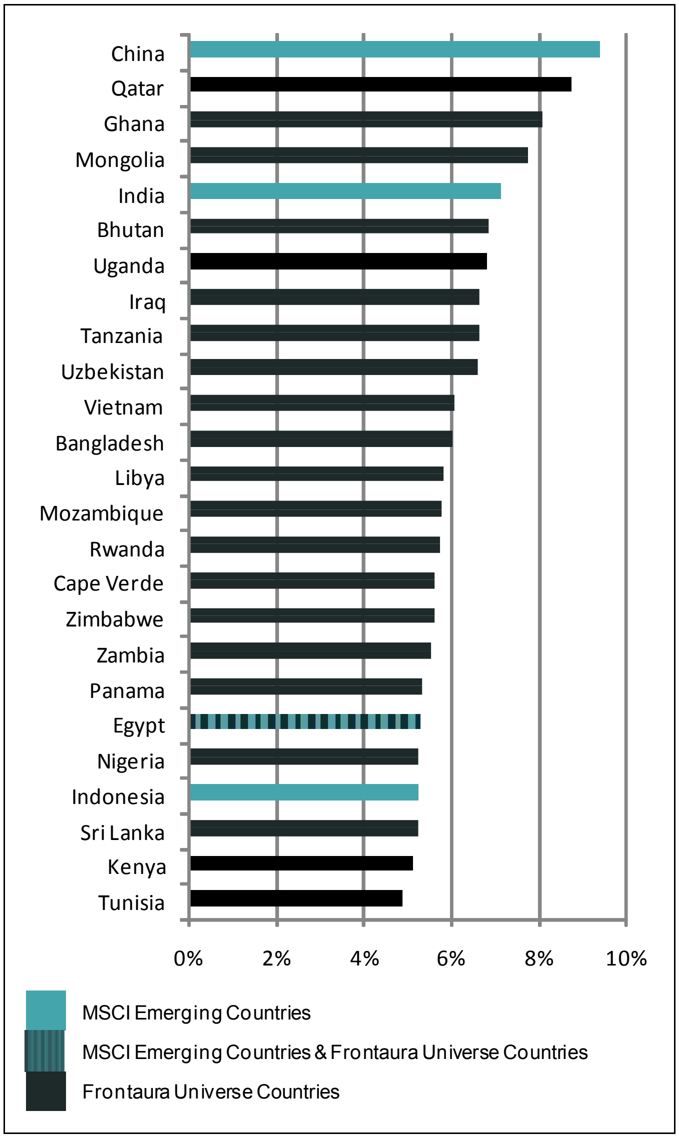
- Consensus recognition at some point in 2010 that we are in for a long, hard slog for reasons cited in prior paragraphs.
- US tax increases causing a double dip recession in 2011.
- The first year of the next presidential term (2013) being the catalyst for the US to take the medicine to address its structural deficit, leading to more tax increases and actual spending cuts.
- A second shoe dropping in this current global crisis, possibly in Europe, with the leading suspects being a) Spanish banks with hidden real estate problems; b) Latvia devaluation unleashing devaluation contagion throughout Eastern Europe causing the collapse of a major (take your pick) Swedish, Austrian, French, Greek, or Italian bank; or c) commercial real estate in general.
- A monetary policy mistake, either (most likely) keeping rates too low for too long or (less likely) raising rates prematurely. The former risks a repeat of 2003-2008 (asset bubbles, overleveraging, and a general good time until the music comes to a Lehman-like screeching halt), with the additional longer-term risk of high inflation. The latter risks a deflationary spiral a la Japan.

Most likely, the catalyst causing our would-be US bear market will be something not on this list, with the timing being different than we expect. Markets seldom conform to your predictions. The issue is the US is in a weak starting position, so any number of items could become the catalyst that knocks the market for a loop.

Extending beyond developed markets, we would frame the issue as follows. In the short run, we assume the markets act similar to US but with a higher beta, emerging markets ironically having a higher beta than frontier markets because they are more integrated with the developed world. Of course, any US bear market will affect all global markets, especially initially. We note though that emerging markets bottomed quicker than the US

(November 2008 versus March 2009) and have recovered more rapidly, as investors distinguish between the differing outlooks for the developed and the non-developed world.

Figure 3
Frontaura Global Frontier Fund LLC
The MSCI Emerging Markets Index
Contains Only 4 of the 25 Growing Fastest Countries
2009-2014 CAGR[4]



[4] Source: Frontaura Capital calculations using IMF World Economic Outlook GDP projections for 2009-2014, as of October 2009. We eliminate countries without stock markets from this list. Of the 25 fastest growing countries, none are developed markets, and only four are emerging markets, as MSCI defines them. On the other hand, 22 of the 25 fastest-growing countries with stock markets are in the Frontaura universe. Over half of the countries where we currently invest appear on this list.

Now let's take our preferred longer term, seven years or more, perspective. There are three ways you earn a return from equity investments:

1. Earnings growth
2. Dividend yield
3. PE changes (up or down)

Frontier markets have the fastest growing economies as Figure 3 shows, the highest dividend yields, and the lowest starting PEs among the four geographic equity classes (US, non-US developed, emerging, and frontier). For example, with regard to valuation, our portfolio at quarter end had a trailing PE of 9.2 on reported earnings with a 6.1% dividend yield—levels more attractive than you will find elsewhere in the world. We assess emerging markets to be second best overall on the attributes of growth, yield, and valuation, although their gains this year have made emerging markets more of a growth-only story than a growth and good value story. Within developed markets, we think there is a good macro case for Australia, Canada, Hong Kong, New Zealand, and Singapore. We think the other developed markets—Europe, Japan, and the US—face a steep uphill climb on fiscal and demographic issues[5], while valuation presents a further challenge for the US.

We acknowledge that our discussion of the negative here ignores many positives that will occur. Technological innovation will create companies and job next decade in areas we cannot imagine today. The US tends to be an innovation leader; further, the US more so than other major developed countries has a demonstrated ability to reinvent itself and overcome significant challenges.

One could dismiss our analysis as the Wall Street tendency to talk your book. But our book is frontier markets because we chose to start a firm to invest in frontier markets two years ago to take advantage of the growth, yield, and valuation superiority frontier markets offered. Moreover, the informational inefficiency of frontier markets rewards research and stock picking to a greater degree than other markets. The last two years have been eventful in ways unimaginable, but the superior frontier attributes remain. We welcome opinions of our readers, especially those who think we have our outlook wrong.

Management Company News

Q3 saw several key business milestones for Frontaura. They include:

- **First institutional investor joins fund.** Our assets nearly doubled in July with our first institutional investor. Three other high net worth individuals joined in Q3 while two existing investors increased their investment in Frontaura. We had 33 clients at quarter end. Together with performance, the assets in the fund have now tripled since March. Our management company is now profitable.

[5] The US is best placed to solve the demographic issue. Its birth rate has not fallen below replacement rate and it traditionally, though not always, is receptive to immigration. Japan's demographic challenges (oldest population, too low birth rate, opposition to immigration), on the other hand, are formidable.

- **Personnel expands beyond founders.** We made our first permanent hire in Q3, as Eric Dahl joins us in October. Eric is a June 2009 graduate from Northwestern University with a double major in International Studies and English Literature. Eric is proficient in French (the native language of 10% of our portfolio companies), studied abroad in Europe, and made the Dean's List consistently. Earlier in Q3, we bade farewell to Katie Advena, an MBA summer intern from the Tuck School at Dartmouth, as she returned for her final year of business school.
- **Offshore fund to launch in 2010.** We will launch an offshore feeder fund into the present Frontaura Global Frontier Fund to allow non-US investors to invest more easily in us. The offshore fund is in response to numerous requests from potential clients for such a product. We will continue to manage only one pool of money and existing or potential US investors will not notice any difference because of the offshore feeder. We endeavor to have the offshore fund operational as early as possible in 2010, possibly in January.
- **Minimum new investment increasing to $250,000 in 2010.** November 2009 (deadline Friday, October 30, 2009) and December 2009 (deadline Monday, November 30, 2009) will be the last two months where we accept new investors at the $100,000 level. This is a change we'd prefer not to make, but SEC regulations limit how many investors we can have, and a higher minimum is necessary to manage our remaining slots. This change does not affect existing investors, who can remain below the new minimum. Potential investors interested in joining for less than $250,000 will need to complete paperwork and wire money by the aforementioned deadline dates.
- **Some expenses permanently waived.** We will not charge research and travel expenses to the fund in 2010 and beyond as previously planned. Background: in the original offering memorandum, we waived all fund expenses through the end of 2008, and last year we extended that waiver through 2009. Of the expenses that were to begin in 2010, we have decided to not charge research and travel expenses. The expenses that we will charge in 2010 generally are the expenses common to nearly all funds—e.g. fees for auditors, custodians, lawyers, tax preparers, and third-party administrators.
- **Frontaura in the media.** CNBC was with us in Iraq in early October and recently featured our trip. You can watch the story by clicking the link below. Twice in September, Dow Jones quoted us in stories on President Uribe's possible third term in Colombia. Contact us if you would like to see these stories.
- **Observers chronicle trips to West Africa, Zimbabwe, and Iraq.** We published two Frontaura Observers during Q3, describing earlier trips to Cote d'Ivoire, Ghana, and Nigeria (Frontaura Observer #14) and Zimbabwe (Frontaura Observer #15). In October, Frontaura Observer #16 discussed our Iraq trip. Also in Q3, we traveled to Panama, Colombia, Venezuela, and Trinidad and Tobago.

Link to CNBC story on Frontaura Iraq trip:
http://www.cnbc.com/id/15840232?video=1300361285&play=1

Conclusion

In our last two monthly comments for August and September, we cautioned that some of our recent gains came on low volume and could be retraced in future periods. To some degree, this may be happening in October. Obviously, the global market rally will not continue forever, nor will we continue to post double-digit percentage gains every quarter. Equity markets globally are back to normal, in our opinion. Within our frontier universe, obvious bargains are occasionally present, but you cannot trip over them everywhere as you could for most of the past year. Nevertheless, the outlook for frontier markets remains superior to those of the US, developed markets, and emerging markets on attributes of economic and earnings growth, dividend yield, and current valuation. Since these are the three components that comprise returns from equity investments, we remain confident we have the fund positioned to deliver satisfactory returns to our investors. We thank you for being our client.

Regards,

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Figure 4
Frontaura Global Frontier Fund LLC
Monthly Performance
30 September 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%	1.4%	4.7%	10.6%				48.0%	8.5%

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.