Quarterly Letter – 2010 Q3

Figure 1
Frontaura Global Frontier Fund LLC
Performance[1]
30 September 2010

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging	MSCI Frontier
2010 Q1	10%	5%	1%	2%	11%
2010 Q2	5%	-11%	- 14%	- 8%	- 10%
2010 Q3	9%	11%	16%	18%	14%
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009	46%	26%	32%	79%	12%
2010	26%	4%	1%	11%	15%
Inception to Date	35%	- 21%	- 29%	- 14%	- 39%
ITD CAGR	10.9%	- 7.9%	- 11.0%	- 5.0%	- 15.6%

Frontaura gained 9% in Q3, bringing our year-to-date gain to 26%. As we show in Figure 1, the various global indices that tended to have double-digit losses in Q2 rebounded with double-digit gains in Q3. One quarter ago, we wrote, "should global indices sustain a rally from their Q2 losses, it will be difficult for us to keep pace, since we did not experience these losses." That is what happened in Q3. To the extent global markets continue their near-term bullishness throughout Q4, we may lag again, given how much catching up these markets still have to do versus our year-to-date and inception-to-date pace. Nevertheless, over a longer cycle where markets move down as well as up, we continue to feel well positioned given our trailing reported portfolio valuation metrics: PE 8.1, price/book 1.4,

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

and dividend yield 5.6%.[2] In short, our stocks trade at roughly one-half the level of the global market for the same amount of earnings.

Winning by Losing Less

We've written before how our fund has a low beta to the global indices we cite.[3] Here's another way to look at this dynamic, without invoking modern portfolio theory statistics that can sometimes be of dubious value. We now have 35 months of returns. During our history, the MSCI Frontier Markets Index has 17 up months and 18 down months. During the up months, the MSCI Frontier outperformed us 11 times, while we bested it 6 times. Overall its average up-month performance was +5.4% while ours was +4.5%. However, in the 18 down months, we won 18 to 0. Every time the MSCI Frontier dropped in a month, we dropped less (or gained). The MSCI Frontier average down-month result was -7.1%, while ours was -2.3%. The results are similar for other indices. The MSCI Emerging Markets Index beat us 14-4 when it is up, but we beat it 16-1 when it is down. MSCI EAFE bested us 11-4 when it was up, while we did better 18-2 when it dropped. Our best relative performance when an index is up came against the S&P 500 where we tied 9-9. When it dropped, we did better 15-2. On a cumulative total return basis, we have outperformed all of these indices by 49-74 percentage points.

Emerging Bubble, Inflation Trouble?

From December 2009 through early June 2010, the euro was the major currency the world hated the most. Since then the US dollar has retaken this inglorious title. US Fed Chairman Bernanke has fanned the flames of dollar disgust by announcing a likely second round of quantitative easing, known as QE2, or if you like simpler phrases, printing money. With US demand slack amidst consumer deleveraging and state and local government austerity, we, like many commentators, wonder if the ultimate beneficiary of such money printing will not be the intended target. We see it as quite possible that instead of general price inflation, asset price inflation will result. Moreover, this asset price inflation may result not in the US or other developed countries, but in emerging markets. In other words, emerging market stocks could boom. Actually, we would argue that this might have already begun. All of this is speculation, and it doesn't really affect how we invest, but it's something to be aware of in terms of your own expectations. An emerging market boom will likely affect the most liquid emerging market stocks first, before trickling down to less liquid emerging stocks and the most liquid frontier market stocks. Less liquid frontier market stocks, which make up a significant portion of our portfolio (because we believe they offer the best values in the world right now), will be the last area to benefit. Therefore, this is another reason why relative performance could be challenging for us in the months ahead, before a late cycle effect boosts our frontier stocks also.

This lag effect was observable in 2007-2009. Global stocks peaked in October 2007, but frontier stocks kept advancing through May 2008. Global stocks then bottomed in March

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[2] The portfolio dividend yield we quote is always the weighted average for the companies we hold, as this is directly comparable to the dividend yield of an index. The actual yield on our fund is less because we hold some cash.
[3] Using monthly total returns from November 2007 through September 2010, our betas to the corresponding indices are S&P 500 0.62, MSCI EAFE 0.50, MSCI Emerging Markets 0.45, and MSCI Frontier Markets 0.55.

2009, yet we were still able to buy a number of frontier market stocks at their lows in Q2 and Q3 of 2009.

Figure 2
Frontaura Global Frontier Fund LLC
Portfolio Mix and Statistics[4]
30 September 2010

Country	Holding
Qatar	17%
Zambia	7%
Cote d'Ivoire	7%
Sri Lanka	7%
Pakistan	7%
Serbia	7%
Tanzania	6%
Senegal	6%
Egypt	5%
Nigeria	4%
Botswana	4%
Zimbabwe	3%
Colombia	3%
Cyprus	3%
Ghana	3%
Iraq	3%
United States (cash only)	2%
Montenegro	2%
Uganda	1%
Philippines	1%
Macedonia	1%

Industry	Holding
Banks	38%
Consumer Staples	14%
Telecommunication Services	11%
Diversified	10%
Industrials	7%
Insurance	4%
Specialty Finance	4%
Cash	4%
Asset Management/Brokerage	3%
Consumer Discretionary	2%
Oil Marketing	2%
Materials	1%

Portfolio Statistics	
Portfolio Price to Earnings	8.1
Portfolio Price to Book	1.4
Portfolio Dividend Yield	5.6%
Return on Ending Equity	25.6%

Other asset classes, such as commodities, could also see a money-printing price lift. The danger of this is that it could create food and energy price inflation. The emerging and frontier world is more sensitive to this type of inflation than the developed world, as the less developed the country is, the larger the food and energy part of the inflation basket tends to be. Rampant inflation in 2008 was one factor, among many, causing an emerging market stock price collapse in 2008 even before Lehman went under. Inflation in our universe is much lower than in 2008, when it was in the 20%-30% range in several countries, and sporadic food riots broke out around the globe. Nevertheless, we worry

[4] Portfolio valuation statistics use the most recent 12 months of reported fundamental data as of 30 September 2010. Portfolio PE and PB 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. The yield on Frontaura Global Frontier Fund is less than our portfolio dividend yield due to cash held and withholding taxes.

about rising inflation. So far this year, our worries have generally been for naught, but inflation does seem to be ticking up slightly in a few countries we watch, so this risk remains present.

Portfolio Highlights

Throughout this section, we show our standard tables of statistics. We won't comment on each table as they explain themselves more efficiently than we could with additional words. The portfolio did not change significantly during the quarter. As Figure 3 indicates, excluding our US cash balance, only three countries had their weighting change by more than one percentage point during the quarter. We sold two positions, OK Zimbabwe and Unilever Cote d'Ivoire, for the reasons we discussed last quarter.[5] We used our OK Zimbabwe proceeds to double our position in Dairibord, the country's leading dairy, as it has demonstrated better and more reliable financial performance. Its stock did well in the quarter, as represented by Zimbabwe's 34% quarterly gain that we show in Figure 5. In fairness, we'll acknowledge that OK Zimbabwe's stock also performed well after we sold it. We consider it overvalued, however. We added one new position in the quarter, but we'll refrain from discussing it as we hope to buy more. In addition, the size of stake we have been able to buy is insignificant and it's unclear if we'll be able to buy more at the price we want.

Figure 3
Frontaura Global Frontier Fund LLC
Significant Quarterly Country Mix Changes[6]
30 September 2010

Country	Percentage Point Change	Explanation[7]
Qatar	+3	One large top-up purchase; 23% country return
Serbia	+2	Ongoing buying of 4 PE stock
Tanzania	+2	Ongoing buying of 4 PE stock
United States (cash only)	-7	Purchases in excess of cash inflows

Most of our Q3 buying occurred in Nigeria, Serbia, Qatar, and Tanzania. All of the buys in these countries were adding to existing positions, although we would distinguish the Qatar buy as different from the rest. It was an example of the benefit of illiquidity and having a bid in the market—at a discount—most of the time. A seller who wanted out NOW hit our bid and we were able to top up a position at a discount price. We would describe our role at times as a market maker in the stocks we own. If someone wants to sell a stock we own, we usually stand ready to buy, but at a price of our choosing. This is a reason why at

[5] The OK Zimbabwe sale occurred in early July before we published the Q2 letter, so we mentioned it in that letter. Nearly the entire Unilever Cote d'Ivoire sale occurred in Q2, so again we mentioned it in that letter. We sold the immaterial remaining portion in Q3.
[6] We show countries whose weighting has changed by two percentage points or more. Total may not add to 0 due to rounding and exclusion of countries changing by less than two percentage points.
[7] Any valuation statistics we show are as of quarter end.

times, we like to have a little extra cash on hand—it can result in improved performance through discounted buys, rather than being a drag on performance as commonly perceived.[8]

Figure 4
Frontaura Global Frontier Fund LLC
Portfolio Concentration[9]
30 September 2010

			Change from Prior Quarter	
	Companies	Countries	Companies	Countries
Positions	32	21	-1	0
Top 5	28%	46%	+3	+1
Top 10	51%	73%	+3	+4
Top 20	82%	97%	-3	+7

The purchases in the other three countries occurred as we added to some of the positions trading at the biggest discounts in our portfolio. During a research trip, we talked with another portfolio manager who said to us that he was not a big fan of buying more when the price of a stock falls. Well, we are. We love it when a stock that we already own a full position in falls in price, allowing us to buy even more of it. A question investors ask us is how, working in Chicago, we can keep up with everything that markets around the world know. Actually, we've found that—driven by local retail investors—most of what our markets "know" is nothing more than rumors and trading noise that are best ignored. We're not always going to be right of course, but by placing our biggest bets on the stocks we believe to be most undervalued, we build a margin of safety when we are wrong. Often we can trace the trading noise to a temporary oversupply of stock for sale, where the seller is exiting the stock for non-fundamental reasons. Examples we've seen include hedge funds that don't specialize in frontier markets selling their frontier holdings to meet investor redemptions in 2008 and 2009; international financial institutions such as regional development banks selling a sizable position after many years of ownership; and prominent individuals selling stakes due to personal financial issues such as margin calls. While others stand aside until the selling ends, we step up and willingly purchase at ever-lower prices. We built large positions in some of our big winners in the past—such as Indochina Capital Vietnam (ICV) and Kingdom Hotel Investments (KHI)—during supply overhangs. We expect some of the positions we have built recently to become future big winners for us. Never mind that presently they are a performance drag—so were ICV and KHI while the supply overhang was present. We have no idea when the turnaround will occur—it could be within a few months or it could take several years. We are in no hurry because if the price drops

[8] Our quarter-end cash position dropped from 11% in Q2 to 4% in Q3 because bargains were available and we knew that we had a significant amount of new cash inflows occurring in October, equal to 10% of September 30 ending net assets. October ending cash, therefore, will likely increase from the September level.
[9] We do not include the United States in our country count and percentage totals as we hold only cash there. Change from Prior Quarter represents the change in the number of positions and the change in percentage points for the top 5, 10, and 20 positions.

further, we can buy even more. We don't believe in waiting for a catalyst, because by the time the catalyst presents itself, the stock could have moved up 25% or 50% and there may no longer be any supply available.

The stocks we bought during the quarter were mainly banks, because of their low valuations: either their trailing PE is 4 or their price/book is around 0.5, or both. As we mentioned in our September comment, at 38%, we have more in banks than we ideally want, but stock exchanges don't oblige you by making available bargain stocks in the exact proportions to your preferred portfolio mix. Bargains occur randomly and we scoop them up when they are present, within some overall position and country constraints. Despite the high mix in banks, we are still probably underweight them relative to our universe, as banks are often over 50% of the market cap of a given country. Further, our bank exposure is mitigated by the simple business models of the banks we select—generally deposit takers and loan makers and little else—and their relatively low assets/equity leverage.

Figure 5
Frontaura Global Frontier Fund LLC
5 Best and Worst Performing Countries
2010 Q3

5 Best Countries			5 Worst Countries		
Country	Frontaura Return	MSCI Return [10]	Country	Frontaura Return	MSCI Return
Sri Lanka	36%	55%	Macedonia	-9%	--
Zimbabwe	34%	--	Nigeria	-8%	-9%
Qatar	23%	10%	Iraq	-7%	--
Ghana	18%	3%	Vietnam	-6%	-9%
Egypt	18%	11%	Tanzania	+1%	--

We continued to trim Sri Lanka in Q3. We gained 36% there in Q1, 35% in Q2, and 36% in Q3, and all of this after strong gains in 2009. Its weight at 7% on September 30 was the same as on June 30 as its performance kept pace with our sales. October cash inflows have knocked its weight down to 6% and this could fall further by year-end if additional inflows occur, assuming prices remain constant with no additional sales. As we have thought for some time, this market appears toppy to us, and a sharp fall is possible. On the other hand, it could continue to confound us with strong performance—picking a market top is nearly impossible; markets can go on stronger and longer than you ever expect. We aren't trying to pick the top—we are comfortable with our remaining holdings—but we have definite prices at which we are sellers (this has been the case ever since we began trimming

[10] MSCI country indices stated on a total return basis with dividends net of any withholding tax. We show "--" if MSCI does not have an index for a given country.

in Q2). The market's rise has been so rapid that many of our sales are short-term gains for tax purposes. We do not like this, but we decided that selling because of a too-high price is a lesser sin than assuming the too-high price would continue long enough to allow our gains to become long term.

Management Company News

Global market volatility from late April through August did slow our inflows to our fund some, but ending net assets still grew 20% during the quarter, with roughly equal contributions from performance and inflows. Two investors joined us during Q3, and another three joining October 1 brought our outside investor count to 57. Our 3(c)(1) count is even higher, though, at 89 through October 1. This means we can only add 11 additional investors on a net basis, and new investors have already spoken for a couple of these slots. While we are not yet at this point, we may possibly need to raise our minimum beyond $1 million as our available number of slots decline further.

Figure 6
Frontaura Global Frontier Fund LLC
Monthly Performance[11]
30 September 2010

	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%	-1.4%	-0.2%	0.2%	46.0%	7.0%
2010	-0.9%	4.2%	6.6%	4.5%	-1.2%	1.9%	3.4%	0.7%	4.7%				26.3%	35.2%

We visited the following countries in Q3: Armenia, Azerbaijan, Cote d'Ivoire (actually October 1), Georgia, Ghana, Kosovo, Nigeria, Turkmenistan, Uzbekistan, and Vietnam. In the first week of August, both *Barron's* and *The Wall Street Journal* quoted us, the *Barron's* article being a cover story on African investing.

One of our associates, Eric Dahl, spent three weeks in Kosovo as part of the Kosovo-America Emerging Leaders Program that the US State Department sponsored. Eric was one of 13 individuals to participate in this business exchange program exploring economic development in Kosovo and fostering business ties between the US and Kosovo.

The most significant change for the management company was the addition of a fourth person in August. Tom Egbert joined us as a research analyst after graduating in 2009

[11] Frontaura returns are net of all fees, 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. Index returns are in US dollars on a total return basis, net of any withholding tax.

summa cum laude from Wheaton College with a BA in Economics. Tom spent a year at the London School of Economics and has passed the CFA Level II examination. Having already worked several finance internships, Tom hit the ground running, and has increased our research throughput noticeably.

Regards,

Nick Padgett, CFA
Stephen Mack
Managing Directors
Frontaura Capital LLC
180 North Stetson Avenue, Suite 1935
Chicago, Illinois 60601 USA
+1 312 265 6882
info@frontauracapital.com