Quarterly Letter – 2011 Q1

Q1 had it all. Strongmen overthrown in multiple countries; civil unrest throughout the Middle East; multiple severe earthquakes in the developed world; a tsunami; a nuclear disaster; an oil price spike; rising food prices and inflation fears; interest rate increases around the globe; Portugal on the verge of needing a bailout and the US government on the verge of shutting down; Ireland's banks being bailed out yet again; an emerging markets and frontier markets selloff; multiple stock markets closed for extended periods, and more. We gained 1.6%.

Now here's a great example of the chaos theory coming to life—the proverbial butterfly flapping its wings causing a hurricane halfway around the world. Who among us foresaw that a policewoman harassing an unlicensed vegetable peddler in a dusty, rural town in Tunisia would lead to the US wading into a third war in the Middle East championed by anti-war candidate and Nobel Peace Prize-winner President Obama as Commander-in-Chief? Or that the US would be following the lead of France, lately the leading proponent of interventionism in the world, with French troops engaged actively in two civil wars in Africa? We have to say this is all as unlikely as say Virginia Commonwealth and Butler meeting in the Final Four of the NCAA basketball tournament.[1] Oh, wait, that happened too.

This quarter gave plenty of ammunition for bulls and bears alike. The bull case is that if markets can absorb all of this bad news and still make gains, then the global bull market is well intact. Indeed, developed markets reversed nearly all of their mid-February to mid-March selloff, finishing the quarter with gains. On a total returns basis, the S&P 500 rose 6%, while MSCI EAFE advanced 3%. MSCI Emerging started poorly, but rallied strongly late in the quarter to gain 2%. The bear case is that markets are deluding themselves, ignoring warning signs all around, just as they did in the years leading into 2008. In the bear's eyes, only MSCI Frontier, where much of the political risk emanated from, got it right. It dropped 5% in Q1.

We have mixed feelings about our Q1 performance. Considering the political risk exposure we had in Cote d'Ivoire and Egypt, coming out slightly positive feels like an accomplishment. However, considering how well some of our countries performed, only being a bit above break-even feels like a wasted opportunity. Figure 4 in the Appendix illustrates this. We gained 50% in Zambia, 36% in Tanzania, 29% in both Bulgaria and Zimbabwe, and 28% in Iraq. Double-digit gains in Serbia (17%), Macedonia (14%), and Jordan (11%) seem pedestrian after viewing the top five gainers. But on the downside we had a 71% impairment in Cote d'Ivoire and a 33% loss in Egypt. The Philippines (-12%), Vietnam (-7%), and Nigeria (-6%), rounded out our worst five countries. The benefit of country diversification in the frontier market asset class—which features low correlation between countries—has perhaps never been as clear as Q1's example.

[1] For our non-US readers, the NCAA basketball tournament is one of the major sporting, social, and betting events of the year in the US, where over three weeks beginning in March, 68 college teams play a single-elimination tournament until one winner emerges. Part of the appeal to the general public is in trying to pick the winner of each game through the final before the tournament begins. Out of some 5.9 million such entries that individuals submitted to the sports site espn.com, only two correctly predicted all of the Final Four teams, namely because of the presence of two underdogs, Butler and Virginia Commonwealth, who pulled three and five upsets, respectively, to make it into the Final Four.

Last quarter's letter identified four risks we saw in 2011: inflation, political risk, global macro risk, and heavy frontier market inflows. We experienced all four to some degree in Q1. Right out of the gate, inflation and rising interest rate fears knocked back many emerging market countries' stock markets in early January. At the same time, heavy beginning-of-year frontier inflows caused upward gaps in pricing in Southeastern Europe, Iraq, and Tanzania. January trading was difficult in these markets, and often sloppy. Rising political risk mitigated the inflow issue by quarter end, but it could return now if markets rally further.

This trading experience crystallizes our thinking on a couple of points we have often made when talking with investors:

- **You can't reliably predict catalysts, either in terms of what they will be or when they will occur.** The markets of Southeastern Europe went up in Q1, for example, simply because enough investors finally noticed their low values. You could say the catalyst was frontier inflows or you could say it was the turn of the calendar page to a new year where these markets no longer were YTD laggards, but these are ex-post explanations, much like financial news writers attributing each day's market move to a specific news event (e.g. "Stocks fall on interest rate fears"). No one was offering these explanations beforehand. We believed markets such as those in Southeastern Europe were too lowly valued and should rise. We positioned ourselves accordingly in 2010, but we had no idea when any re-rating would occur. It all came rather more suddenly and against a worse global news backdrop than we would have expected.

- **If you aren't buying on the way down, you may be watching on the sidelines on the way up.** This is truer in frontier markets than other markets because of illiquidity. As we have written before, a supply overhang can push a frontier stock down for months, but once the overhang is gone, boom, it can recover all of the lost ground and then some on little volume in a short amount of time. Someone waiting for the stock to bottom because they fear "catching a falling knife" can be left wondering what happened when the stock doubles in a couple months without them being able to buy many shares. In frontier markets, the best time to buy has often passed once the stock bottoms.

So Q1 reinforced our contrarian bias, leading us to believe that we need to be even more contrarian in how we spend our research time and where we allocate the fund's investment dollars.

Cocoa and Ivory live together in perfect harmony?

It follows that if you can't predict upside catalysts reliably, that it's also hard also to predict downside catalysts. Some events are just unpredictable, while others are entirely predictable, but the exact timing and location are unknowable. Greece will default on its debt, but when? 2011, 2012, 2013, 2021—we're not sure. That Japan will have a severe earthquake is knowable, given that it sits in the Ring of Fire, but when? March 11, 2011 as it turns out. Now when will the Big One hit California? It will one day and we shouldn't be surprised when it does occur. That the leader of an African country may try to overstay his welcome should also not be a surprise, but where will this occur and when? In addition to the better covered events in North Africa, it happened also in Cote d'Ivoire in recent months.[2] We'd been to the country four times in the past three years, knew well its difficult recent past (a peace agreement ending the civil war was signed only in March 2007)[3], and came to the conclusion that—while many outcomes were possible—continued progress was more likely than a slide back to civil war, and that valuations did not fully reflect this. In February, it became clear we were wrong and we impaired our positions accordingly as discussed in our February comment. The situation as we write this is more hopeful, but it could still turn negative either in the very near term or further out. Even with Gbagbo captured now, Ouattara has quite a mess to clean up and one cannot assume he will govern successfully or that civil war has been averted forever.

We try to assess our actions by asking whether we made a process mistake, as opposed to just having a bad outcome occur. Let's say our view before November 2010 was correct, and the risk of Cote d'Ivoire backsliding into widespread violence was only one in four and markets were pricing in a higher level of risk. That violence did occur may not mean we were wrong, for given four similar situations, we expected one bad outcome and maybe we just got that one. On the other hand, it might have been wrong to own an Ivorian bank given that the inherently leveraged business model of any bank makes it more vulnerable to a negative shock. It's too early to do a full post-mortem on Cote d'Ivoire as the situation remains fluid, but we'll be thinking in these process terms as we write our year-end letter containing our annual list of mistakes made.

They're falling down like a domino

We think it's more likely than not (say a two-in-three chance) that Q1 political changes in Egypt make the country a fundamentally more attractive investment in the long term. Ironically, though, in the near term, Mubarak's departure has made the country less attractive. Post-Mubarak, the already high budget deficit will get worse due to higher social spending; the current account will become solidly negative due to less tourism; inflation is likely to be higher than it otherwise would have been due to the spending and to shortages of some goods; the currency has and will continue to be weaker; and foreign reserves have and will continue to decline, in part because the central bank is intervening to limit the speed of exchange rate depreciation. Further, it is possible that protests and strikes embed themselves too much in the culture. Too much populism or socialism could prevent political reforms from translating into economic improvements, from the perspective of a foreign investor.

As we said in last quarter's letter, the question for us in Egypt was not really who would succeed Mubarak, but rather would the cabinet retain the pro-business orientation it has had since 2004. That question was answered in the negative before Mubarak himself left, as he threw the cabinet under the bus in his unsuccessful attempt to cling to power. That was unfortunate. While their reforms benefited large businesses and their leaders to a greater degree than common persons, we still think it was better than not to have had the

[2] See our December 2010, February 2011, and March 2011 monthly comments.
[3] Frontaura Observer #7 that we published in June 2008 discusses this.

reforms. The Egyptian stock market rose 12-fold through the eight years ending 2010, yet wasn't particularly overvalued—so clearly something good was happening in the economy. Now one of the three pillars of our prior Egyptian investment thesis (a pro-economic reform government) is gone.[4]

The other two pillars remain. First, the country still has a large population with favorable demographics, although it has provided an excellent example of how a population bulge can be an explosive agent of change, for bad or for good. Second, the country's geographic advantage ought to be permanent. The Suez Canal continues to generate foreign currency reserves, while strong export potential remains due to a low-cost labor force (even after a round of double-digit percentage wage hikes) and the proximity to Europe and the rest of the Middle East and North Africa. Tourism is clearly damaged for now, but this is not new. Egypt seems to suffer a dramatic tourism falloff every few years either due to a global macro event or a local incident of violence. Eventually, tourism should come back.

Given that we think 1) the long-term more likely than not should become more positive and 2) generally you've got to be early when buying and you can't predict or time catalysts, why were we net sellers rather than net buyers in Egypt in Q1? Actually, depending on the price and the company, we had both buy and sell orders at different limit prices in the market. Egypt did not sell off as much as brokers expected when it re-opened on March 23 (possibly because the global market mood had improved), so our sells were executed while we bought very little. Our limit prices were based, as usual, on our assessment of a company's intrinsic value. These intrinsic values declined in Q1 for many, but not all, Egyptian companies we monitor, as we lowered our estimates for near-term earnings and free cash flow. Our long-term estimates were unchanged and in some cases we now project faster-than-normal catch-up growth in a year or two.

The course that Egypt follows between now and a hopefully better future has many possible routes, of differing difficulty and destination. We've assigned a risk premium to the country that we think is an appropriate middle case. If the country gets to a better place more easily than we expect, then our risk premium in hindsight will have been too high and our intrinsic values too low, and likely we will have missed an opportunity. Right now, only a short time since the stock market re-opening, it appears this could be the case. Alternatively, though, it's possible that other investors are focusing too much on the long-term potential and too little on the near-term challenges, and that's why market prices exceed our limits. Frankly, we don't know which scenario will prove correct in the long run. Fortunately, with a universe of 100 countries to choose from for our relatively concentrated portfolio, we don't have to correctly identify every opportunity that arises to perform well. We'll stick to our process, buying good companies when we can get them at prices equal to or less than what we think they are worth, and passing up opportunities that in our view don't have enough appreciation potential relative to their risk. Over time, this ought to continue working well enough for us to generate good returns for our clients.

[4] The new government says it will continue economic reforms and perhaps this is true or will become true with time. We prefer to assess actions rather than words, and think there is reason for concern so far. A populist witch hunt to persecute former ministers indiscriminately seems to top the government's reform agenda at present and we don't see this as helpful to moving the country forward.

Management Company News

In Q1, we attended investment conferences that allowed us to check in with numerous companies we hold or are watching, and also to see some companies for the first time. A conference in New York featured Pakistani companies, while a conference in London highlighted companies from throughout sub-Saharan Africa. Unfortunately, events in Egypt led to the cancelation of an annual Middle East North Africa conference there, but we had seen many of those companies in November in New York. Further, many Egyptian companies traveled to London for a late March conference. Finally, we attended a conference in the Ukraine and traveled to Macedonia and Serbia.

Our administrator emailed investor K-1s on March 4, similar timing to the prior two years.

To follow up briefly on our comments last quarter about assets under management, we remain open to new investors for May 1, and we evaluate whether to remain open each month. We're open until we are not, and we will announce when we are not in a future monthly comment or quarterly letter. As always, maintaining the ability to perform well in illiquid stocks and markets is what guides our decision on whether to continue to accept new investors.

We present our usual quarterly figures on performance, investment mix, and attribution in the Appendix that follows.

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

Appendix

Figure 1
Frontaura Global Frontier Fund LLC
Performance[5]
31 March 2011

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging	MSCI Frontier
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009	46%	26%	32%	79%	12%
2010	37%	15%	8%	19%	24%
2011 Q1	2%	6%	3%	2%	- 5%
Inception to Date	49%	- 8%	- 21%	- 6%	- 38%
ITD CAGR	12.4%	- 2.3%	- 6.8%	- 1.7%	- 12.9%

Figure 2
Frontaura Global Frontier Fund LLC
Monthly Performance
31 March 2011[5]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2007											0.4%	1.6%	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%
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%
2010	-0.9%	4.2%	6.6%	4.5%	-1.2%	1.9%	3.4%	0.7%	4.7%	3.5%	1.5%	3.3%	37.1%
2011	2.8%	-3.7%	2.7%										1.6%

---

[5] 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.

Figure 3
Frontaura Global Frontier Fund LLC
Portfolio Mix and Statistics[6]
31 March 2011

Holdings Summary

Country	Holding
USA (cash only)	15%
Pakistan	11%
Tanzania	9%
Qatar	9%
Vietnam	7%
Serbia	7%
Senegal	6%
Botswana	6%
Nigeria	5%
Iraq	4%
Zambia	4%
Cyprus	3%
Zimbabwe	3%
Bulgaria	3%
Ghana	2%
Sri Lanka	2%
Colombia	2%
Montenegro	1%
Cote d'Ivoire	1%
Others	2%

Industry	Holding
Banks	33%
Cash	16%
Consumer Staples	11%
Telecommunication Services	8%
Specialty Finance	6%
Industrials	6%
Consumer Discretionary	5%
Diversified	5%
Insurance	4%
Health Care	2%
Asset Management/Brokerage	2%
Oil Marketing	1%
Materials	1%

Portfolio Statistics

Portfolio Price to Earnings	8.4
Portfolio Price to Book	1.4
Portfolio Dividend Yield	5.2%
Return on Ending Equity	22.1%

[6] Portfolio valuation statistics use the most recent 12 months of reported fundamental data as of 31 March 2011. 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, withholding taxes, management fees, and operating expenses. At present we retain all income rather than distribute it.

Figure 4
Frontaura Global Frontier Fund LLC
5 Best and Worst Performing Countries
2011 Q1

5 Best Countries			5 Worst Countries		
Country	**Frontaura Return**	**MSCI Return**[7]	**Country**	**Frontaura Return**	**MSCI Return**
Zambia	50%	--	Cote d'Ivoire	-71%	--
Tanzania	36%	--	Egypt	-33%	-23%
Bulgaria	29%	36%	Philippines	-12%	-3%
Zimbabwe	29%	--	Vietnam	-7%	-6%
Iraq	28%	--	Nigeria	-6%	-2%

Figure 5
Frontaura Global Frontier Fund LLC
Significant Quarterly Country Mix Changes[8]
31 March 2011

Country	Percentage Point Change	Explanation
Vietnam	+4	Ongoing buying of new positions
Tanzania	+4	Appreciation; new position
Zambia	-2	Proportionally low buying relative to high cash inflows
Qatar	-4	Proportionally low buying relative to high cash inflows
Cote d'Ivoire	-5	No buying relative to high cash inflows; full impairment of one position; partial impairment of another
Egypt	-5	Exited two positions

[7] 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.
[8] 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. Also note that we do not show the United States as we only hold cash there. Our US weighting increased by 14 percentage points due to cash inflows.

Figure 6
Frontaura Global Frontier Fund LLC
Portfolio Concentration[9]
31 March 2011

			Change from Prior Quarter	
	Companies	Countries	Companies	Countries
Positions	41	23	+6	--
Top 5	31%	43%	+1	--
Top 10	46%	69%	-4	-2
Top 20	69%	84%	-12	-13

[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. The decrease in concentration of our top 20 positions and countries in Q1 results from the increase of US cash from 1% to 15% of the portfolio due to cash inflows.