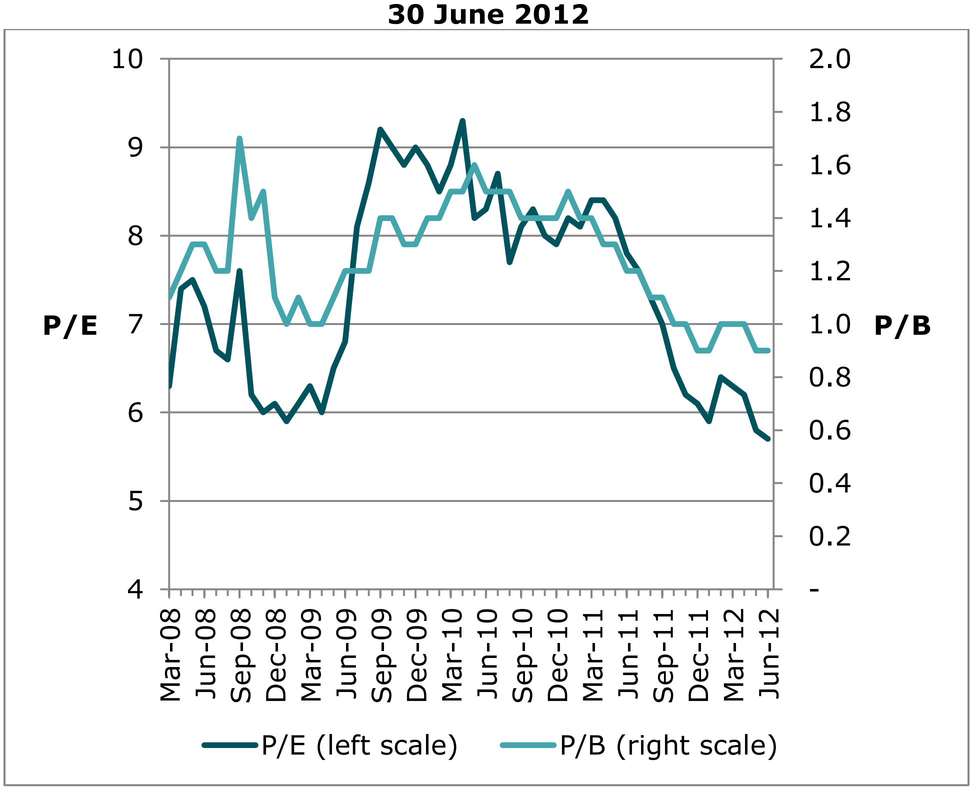
Quarterly Letter – 2012 Q2

Was That It?

In our May comment, we said, "The third annual mid-year euro debt scare really got going in May, making the month similar to May 2010 and August 2011 in terms of poor performance." Since this is a European crisis, let's look at the MSCI EAFE Index of non-U.S. developed markets (EAFE), the most European of the indices we commonly cite. It might surprise you that for EAFE, May 2012 was the worst month for total returns in the 2010-2012 period at –11.5%. But for the quarter as a whole, EAFE dropped only 7.1%, far less than losses in 2Q10 (-14.0%) and 3Q11 (-19.0%). So the quarter didn't feel nearly as bad as the month of May suggested it might. Entering Q3, a fair question to ask is whether that was it, or is worse to come?

Figure 1
Frontaura Global Frontier Fund LLC
Trailing P/E and P/B
Never Been Cheaper
30 June 2012



For Frontaura, May 2012 was our second worst month of the 2010-2012 period, at -4.4%, but the quarter was off a bit less at -3.4%. The MSCI Frontier Markets Index lost 6.7% for the quarter, while other indices such as the S&P 500 and MSCI Emerging Markets, fell 2.8% and 8.9%, respectively, on a total returns basis. Performance data for Frontaura and these indices appear in the Appendix in Figures 6 and 7, along with our usual tables.

As we often say, predicting near-term market performance is impossible, so we don't have a strong opinion on the question titling this letter. We do think that the valuation level of the companies we own has declined to where we worry less about global macro uncertainty. On a trailing PE basis, at 5.7, our portfolio has never been cheaper as Figure 1 shows.[1] We are not so cavalier as to think that our sub-6 PE cannot become a sub-5 PE or a sub-4 PE if a nasty global event were to occur. But if this happened, we think it would set the stage for even greater appreciation of our portfolio, much like a bad 2008 led to strong returns in 2009 and 2010 (we gained 44% cumulatively over these three years, despite losing 28% in the first year).

Figure 2
Frontaura Global Frontier Fund LLC
MSCI EAFE Index (White) and MSCI Frontier Markets Index (Green)
2010 – 1H 2012 Total Returns

[1] Here's some statistical trivia to set the record straight. We pay more attention to month-end PEs than intra-month PEs because we have a process at month-end to review and clean up any data issues. Readers with good memories may recall that we've written previously that briefly intra-month in November 2008 we had a 5.7 PE. When at the end of June 2012, we finished with a month-end PE of 5.7 for the first time, we went back and reviewed the November 2008 period. We now think that we did not have a 5.7 PE then, making the June 2012 month-end PE unequivocally the lowest we've ever had. The data issue back in November 2008 was that we were traveling when the 5.7 PE occurred in our daily portfolio reports. We entered a couple trades we made while traveling into our portfolio system a few days after the fact. Had we entered them in real-time, our calculated PE would not have dropped to 5.7 back then.

Figure 2 graphically shows total return performance during the three euro selloffs, for EAFE (white line) and for the MSCI Frontier Markets Index (FM, green line). Over the 30 months from 2010 through the first half of 2012, EAFE and FM are each nearly flat. EAFE performed worse during each of the three selloffs, but did about the same as FM over the entire period, primarily due to a lackluster recovery by FM between the second and third selloffs. Actually, one could say that FM's second selloff never really ended as it hit its lowest point of the entire period as recently as June 13, 2012. For FM, the second selloff began early, in late January 2011 with Middle East civil unrest and continued for a year until mid-January 2012. Then after a modest two-and-a-half month rally through March, FM fell again.

Figure 3 shows our performance versus FM during this period. We didn't experience much of the first selloff, dropping only 1% in May 2010 due to gains in Sri Lanka and elsewhere. We did experience the second and third selloffs, losing roughly three-quarters of what FM lost during these down periods. We attribute our lesser declines to our lower starting valuations.

Figure 3
Frontaura Global Frontier Fund LLC
MSCI Frontier Markets Index (Green) and Frontaura (Blue)
2010 – 1H 2012 Total Returns

Figure 4 presents the data from Figures 2 and 3 in tabular form, showing the percentage declines of EAFE, FM, and Frontaura during each of the three selloffs.[2] Of course, one cannot yet say with certainty that we have seen the final trough of the third selloff.

Figure 4
Frontaura Global Frontier Fund LLC
The Tale of Three Selloffs
30 June 2012

Index / Fund	EAFE			Frontier Markets			Frontaura		
Selloff	Peak	Trough	Total Rtn	Peak	Trough	Total Rtn	Peak	Trough	Total Rtn
1	15 Apr 2010	25 May 2010	-19.6%	12 Apr 2010	5 Jul 2010	-13.8%	30 Apr 2010	31 May 2010	-1.2%
2	2 May 2011	4 Oct 2011	-26.5%	26 Jan 2011	16 Jan 2012	-21.9%	31 Jan 2011	30 Nov 2011	-17.7%
3	19 Mar 2012	4 Jun 2012	-16.3%	30 Mar 2012	14 Jun 2012	-8.2%	30 Apr 2012	30 Jun 2012	-5.6%

A Quick Tour of the World

Last quarter, fatigued with discussing the various global macro factors that were affecting frontier investment returns and investor sentiment, we limited our macro thoughts to one stream of consciousness paragraph, presenting our opinions without necessarily supporting them. That felt so liberating, we'll do it again here now. The euro crisis remains far from over, despite the usual post-summit enthusiasm the markets demonstrated beginning June 29. Germany conceded less than perceived and Spain received less than believed at this summit. The probability that China could have a hard landing continues to increase (we say this having been China bulls for nearly 20 years). If this does happen, it could have investment implications for much of the world: negative for global growth in general and for commodity producing countries and currencies, but positive for commodity consuming countries, who might get a price break. The case that the commodities cycle may actually have ended back in 2008 is also getting harder to dismiss out of hand[3], although this summer's heat wave in the US corn and soybean belt has jacked up crop prices[4]. Further, it's always possible that global central bank policies eventually cause higher inflation (this would be at least a few years out) that gives a second wind to commodities. Weakening US economic data is what one should expect, we think, in an overly indebted world, with modestly good periods followed by modestly bad periods, giving each year a mediocre outcome. We are moderately surprised that Money Drop Ben has mostly grounded himself

[2] Since we only report NAV monthly, this comparison flatters us slightly (our peak-to-trough loss would be slightly more using daily NAVs), but it holds that we lost less than the MSCI Frontier Markets Index during each selloff.
[3] For the record, let us state that we consider gold to be a currency, and not a commodity.
[4] How hot has it been in Chicago this spring and summer? Well, consider this anecdote. Frontier markets countries tend to be in hot weather locations, and Chicago's weather reputation is for its winters not for its summers. But on Nick's last three trips, he's found the weather in his destination to be colder than in Chicago. These destinations have included sub-Saharan Africa and Singapore. Before his last flight departed Chicago, the outside temperature on the flight information display read 104 degrees (40 degrees Celsius). Not quite Dubai heat, but not good for US crop yields.

lately, but we suspect he'll fly high once more in the coming months, which could provide the usual boost, ultimately fleeting, to markets. "This is an election year, after all," his boss may remind him. Speaking of Mr. Obama, we suspect he would win re-election were it held today and he would lose the election were it held in 2013, as the economy slumps further. What will occur on November 6, the actual election date, depends on the rate of economic deceleration and how much magic remains in Mr. Bernanke's illusion-of-prosperity machine. Obama's fate may rest in the ability of Europe's political leaders to keep applying patches that allow the euro to stagger from one summit to the next. He may be getting worried.

Frontier Implications

Within frontier countries, disinflation generally has continued as we first signaled on page one of last year's Q2 letter, but it's not happening everywhere. It's too early to tell if the US heat wave will cause a third round of food price inflation (following price spikes in 2007/2008 and 2010/2011); a mitigating factor is that while corn and soybean prices are back to or beyond 2008 levels, other food staples such as rice and wheat are well below prior highs. While our portfolio has both commodity producing countries such as Nigeria, Qatar, and Iraq and commodity consuming countries like Vietnam and Pakistan, on balance we think lower commodity prices are better for our portfolio. Lower prices give commodities-poor countries a reprieve from the successive rounds of inflation, high current account deficits, and devaluing currencies they have endured in recent years. We did a simple study of our country exposure to two of the most important commodity groups: food and energy, which make up a significant portion of the inflation basket of most frontier countries. We looked at whether each country was a net exporter or a net importer of food and similarly whether they were a net exporter or a net importer of energy, which we defined as oil and natural gas. Of our 26 countries, 14 are a net exporter of at least one of these groups. Overall, though, food importers outnumbered food exporters 17 to 9 and energy importers outnumbered energy exporters 19 to 7. Frontier countries tend to either import both commodity groups or import one and export the other. Only 2 of 26 countries (Colombia and Cote d'Ivoire) are both food and energy net exporters.[5]

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[5] Net food exporters are Botswana, Bulgaria, Colombia, Cote d'Ivoire, Pakistan, Serbia, Ukraine, Vietnam, and Zambia. Net energy exporters are Colombia, Cote d'Ivoire, Iraq, Nigeria, Oman, Qatar, and the United Arab Emirates. The following countries are net importers of both food and energy: Cambodia, Cyprus, Estonia, Ghana, Jordan, Laos, Montenegro, Romania, Rwanda, Senegal, Tanzania, and Zimbabwe. Several countries have had recent oil or natural gas discoveries that could over time change their net energy status from an importer to an exporter. They include Cyprus, Ghana, and Tanzania. Note that we would call Zambia a commodity producing country because of its copper reserves, even though it is a net energy importer. Furthermore, neighboring Zimbabwe has significant mineral reserves, although recent economic and indigenization issues have reduced output to where we wouldn't call it a commodities country today, but it could be again in the future. Zimbabwe also was historically a net food exporter. Net energy classification based upon Frontaura calculations of oil and gas equivalents using oil and gas export and import data from CIA World Factbook: https://www.cia.gov/library/publications/the-world-factbook/index.html. Food export information from "Who are the Net Food Importing Countries?", The World Bank Development Research Group Trade Team, Policy Research Working Paper 4457, January 2008.

Quotable

"Spain is not Uganda," texted Spanish Prime Minister Mariano Rajoy during bailout negotiations last month. Well, no, it's certainly not. We have some fun with Mr. Rajoy's statement in Figure 5 in a shamelessly unbalanced way by presenting a few statistical facts.[6] We have invested in Uganda previously, but have no holdings there now.

Figure 5
Frontaura Global Frontier Fund LLC
Spain is not Uganda
A Selective and Unbalanced Review
30 June 2012

Item	Spain	Uganda
2012E Real GDP % change	-1.8%	4.2%
2012E Fiscal balance / GDP	-6.0%	-4.0%
2012E Gross government debt / GDP	79%	29%
Unemployment	24.2%	4.2%
Market cap, per capita, ($), current	9,059	20
Real rates	Negative	Positive
Currency peg or union	Yes	No

Lest our Uganda presentation cause you to think we see frontier countries only through rose-colored glasses, let us turn to Argentina, a country in which we have not invested. One hundred years ago, MSCI likely would have classified this country as developed, if MSCI had existed then. "As rich as an Argentine," was the saying from our great-grandparent's time. When a predecessor to MSCI did begin classifying developed countries in 1970, however, Argentina was not among them—a result of the country's gentle decline throughout the intervening decades. In 1988, Argentina debuted in MSCI's Emerging Markets Index and was the top performer, up 97%, in that index's inaugural year. In 2007, MSCI brought out its Frontier Market Index, and, disappointed not to be part of this new investment universe, Argentina promptly created some investor unfriendly policies such that MSCI demoted it from emerging to frontier in 2009. And just last month MSCI threatened to boot Argentina out of the frontier index altogether if it doesn't shape up. We can't help but root for this, as it would complete a rather remarkable journey for Argentina over the past century—from developed to emerging to frontier to uninvestable. Normally, as contrarians, we get excited when MSCI loses interest. MSCI's scorn is often a buying signal that everyone has given up, and so no significant selling remains. In Argentina's case, though, we will curb our enthusiasm. Steve visited the country in January and all of our biases against the country remained intact. Great place to visit; horrible place to run a business or to invest, was his conclusion after hearing more complaints from companies about government interference in their operations than on any trip he'd taken before. "No one in their right mind would invest in a country that expropriates investments," commented Mexican President Felipe Calderon, on April 17, 2012, after Argentina's nationalization of energy giant YPF, previously owned by Spanish firm Repsol. We agree.

[6] GDP, fiscal balance, government debt, unemployment (Spain) and population data from *International Monetary Fund (IMF) World Economic Outlook*, April 2012. Unemployment (Uganda) from Uganda Bureau of Statistics http://www.ubos.org/UNHS0910/unhs200910.pdf page 44. Market capitalization from Bloomberg 18 July 2012, and Uganda Securities Exchange www.use.or.ug. All other information or calculations by Frontaura.

Travel

In Q2, we visited Cambodia, Laos, Myanmar, Tanzania, Vietnam, and Zimbabwe. Upcoming trips include Singapore (Nick is there now and is available for meetings); London (last week of September); and New York City (Nick is speaking at a conference October 24). Possible investment trips in the second half of the year may include Egypt, Iraq, Lebanon, Sri Lanka and Palestine, among others.

Regards,

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Appendix

Figure 6
Frontaura Global Frontier Fund LLC
Performance[7]
30 June 2012

Period	Frontaura	S&P 500	MSCI EAFE	MSCI Emerging	MSCI Frontier
2012 Q1	6%	13%	11%	14%	6%
2012 Q2	- 3%	- 3%	- 7%	- 9%	- 7%
2008	- 28%	- 37%	- 43%	- 53%	- 54%
2009	46%	26%	32%	79%	12%
2010	37%	15%	8%	19%	24%
2011	-15%	2%	- 12%	- 18%	- 19%
2012	3%	9%	3%	4%	- 2%
Inception to Date	28%	- 2%	- 31%	- 22%	- 47%
ITD CAGR	5.5%	- 0.5%	- 7.7%	- 5.1%	- 12.8%

Figure 7
Frontaura Global Frontier Fund LLC
Monthly Performance
30 June 2012

	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%	-0.4%	1.0%	-1.7%	-2.4%	-4.0%	-3.9%	-1.6%	-4.9%	0.7%	-14.8%
2012	-0.5%	3.9%	2.6%	2.4%	-4.4%	-1.3%							2.5%

[7] 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 8
Frontaura Global Frontier Fund LLC
Portfolio Mix and Statistics[8]
30 June 2012

Holdings Summary

Country	Holding
Vietnam	16%
Tanzania	8%
Qatar	8%
Nigeria	7%
Zimbabwe	6%
Pakistan	5%
Estonia	5%
Iraq	5%
United Arab Emirates	4%
Serbia	4%
Cambodia	4%
Ukraine	4%
Senegal	3%
Botswana	3%
USA (cash only)	3%
Rwanda	2%
Romania	2%
Bulgaria	2%
Cyprus	1%
Laos	1%
Oman	1%
Colombia	1%
Cote d'Ivoire	1%
Ghana	1%
Others	1%

Industry	Holding
Banks	28%
Consumer Discretionary	16%
Industrials	16%
Consumer Staples	15%
Telecommunication Services	7%
Cash	4%
Insurance	3%
Specialty Finance	3%
Energy	3%
Materials	2%
Diversified	2%
Asset Management/Brokerage	1%

Portfolio Statistics

Portfolio Price to Earnings	5.7
Portfolio Price to Book	0.9
Portfolio Dividend Yield	5.7%
Return on Ending Equity	22.0%

[8] Portfolio valuation statistics use the most recent 12 months of reported fundamental data as of 30 June 2012. 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.

We hold most, but not all cash, in the United States. We also include in the US total any euros or other currencies we hold in countries outside of our investment universe. These other currency amounts often are immaterial. We include all other cash we hold outside the US in that country's total, regardless of currency. For example, Vietnam is a prefunding market, so we include our cash there in the Vietnam total, even though this cash typically is in US dollars.

Figure 9
Frontaura Global Frontier Fund LLC
5 Best and Worst Performing Countries
2012 Q2

5 Best Countries			5 Worst Countries		
Country	Frontaura Return	MSCI Return[9]	Country	Frontaura Return	MSCI Return
Pakistan	20%	-6%	Serbia	-23%	-24%
Laos	19%	--	Romania	-19%	-15%
Cambodia	15%	--	Ghana	-19%	-14%
Cote d'Ivoire	10%	--	Ukraine	-15%	-36%
Estonia	8%	-5%	Nigeria	-13%	4%

Figure 10
Frontaura Global Frontier Fund LLC
Significant Quarterly Country Mix Changes[10]
2012 Q2

Country	Percentage Point Change	Explanation
Cambodia	+4	Added to position; outperformance relative to fund
Ukraine	+4	Invested in country for first time
Zimbabwe	+2	New position; added to existing positions
Tanzania	- 2	Returned cash to US

[9] 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.
[10] 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. Note that we do not show the United States as we only hold cash there. See the Figure 8 footnote for a discussion of how we classify cash by country.

Figure 11
Frontaura Global Frontier Fund LLC
Portfolio Concentration[11]
30 June 2012

	Companies	Countries	Change from Prior Quarter Companies	Change from Prior Quarter Countries
Positions	52	26	+4	+1
Top 5	23%	45%	+1	- 2
Top 10	38%	69%	- 1	+1
Top 20	64%	93%	+2	+5
Top 20 + US (Cash)	67%	96%	- 4	- 2

[11] We do not include the US in our country count and most of the 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 Top 20 + US row does include the US cash percentage in the percentage totals. See the Figure 8 footnote for a discussion of how we classify cash by country.