Hunting for Deep Value in Frontier Markets

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Over the past few weeks, as U.S. equities have recovered the majority of their coronavirus crash losses, emerging market stocks have only become cheaper.

As investors have rushed to take cover in safer assets such as developed market debt, high-rated corporate debt and blue-chip developed markets stocks, emerging and frontier market equities have continued to trend lower.

Some of these markets are now trading at the lowest valuations seen in a decade, even though some of these economies have much brighter outlooks with better demographics than many of their developed peers.

As such, value investors might be able to find opportunities in these markets.

Not for the faint-hearted

I should note that frontier and emerging market investing is not for the faint-hearted. These markets are highly inefficient, which means there are plenty of bargains to be found. But as usual, buying what you don't understand can be a quick way to lose a lot of money in the stock market.

Some of these markets and the companies in them may look super cheap, but if you don't understand, it's probably best to stay away.

Undervalued markets

For investors that are willing to take on the risk, it may be worth taking a closer look at the Egyptian market, in my opinion.

Before the Covid-19 crisis, the Egyptian economy was projected to expand at 5.8% in 2020 and 6% in 2021. While the crisis will have a significant impact on the economy, forecasts suggest that Egypt will be one of the least impacted countries in the world.

One way to play the country's economic story is Commercial International Bank (CIB). This is the largest listed stock in Africa (excluding South Africa) with a market capitalisation of $5.8 billion.

The group's fundamentals are strong. Only 14% of Egyptians adults have a bank account, so the firm appears to have a considerable growth trajectory in front of it. The bank is well provisioned with an impairment coverage to non-performing loan ratio of more than 200% and a capital ratio of 26%, with a minimum capital requirement of 13%. A loan-to-deposit ratio of less than 40% only adds to the quality of this business. After recent declines, the bank, which has earned a 20% return on equity historically, is trading at around eight times earnings and a price-book ratio of 1.5.

Buying shares in the lender directly may be challenging for some investors. The VanEck Vectors Egypt Index ETF (EGPT) provides a way to get exposure to the bank as well as the rest of the Egyptian stock market. CIB is the ETF's largest holding, accounting for around 8% of assets under management. The total expense ratio is just under 1%, and the average price price-earnings ratio of stocks in the ETF's portfolio is 7.3. The price-book ratio is just under 1.0. There are 26 holdings in the portfolio overall.

Another frontier market that is generally overlooked is Nigeria. The most populous nation in Africa, Nigeria has similar economic fundamentals to Egypt. It has a young, growing population that is becoming increasingly wealthy.

This is not reflected in the valuations of publicly-traded Nigerian banks or indeed, any Nigerian stocks. The best way to invest in this market, from my view, could be via the Global X MSCI Nigeria ETF (NGE).

The ETF has $33 million of assets under management. The average market capitalisation of holdings is $1.6 billion, while the average price-earnings and price-book ratios are 4.5 and 0.6, respectively.

These metrics make the market one of the cheapest in the world. The largest holding, accounting for 13% of assets under management, is Dangote Cement Plc, which is managed by Africa's richest man, Aliko Dangote.