

STOCKS: INVESTORS EXPLORE THE FRONTIER MARKETS

Pros tell Bloomberg BusinessWeek where they're finding opportunities in smaller emerging nations like Argentina and Nigeria

This year the real action for risk-tolerant global investors is on the frontier.

The MSCI Barra Frontier Markets index tracks equities of 25 countries, including six in the Middle East that account for 55% of the index's total market capitalization. Year-to-date as of Apr. 12, the Frontier Markets index was up 13.66% compared with a 4.09% gain by the BRIC countries (Brazil, India, China, and Russia) in aggregate and a 5.25% increase for the emerging markets overall.

The distinction between emerging and frontier markets mostly concerns size and how far along they are in developing legal and regulatory systems, critical elements for international investors. The MSCI Barra global equity indexes use both objective and subjective criteria to admit countries to a given index, says Paul Herber, a co-manager of the \$44 million Accessor Frontier Markets Fund (FRONX). To qualify as an emerging market, an economy must have a certain number of companies that meet a minimum market-capitalization threshold and certain trading criteria. Also, the country's equity market must be open to a certain degree to foreign investors, and its legal framework must be stable.

Last year, Argentina and Pakistan were both downgraded from emerging to frontier markets by MSCI Barra. Argentina implemented capital controls that reduced the ability to convert foreign currencies into the local currency,

while Pakistan provided artificial supports to its stock market by restricting daily declines at the peak of the financial crisis. Both countries, however, have higher gross domestic product per capita than many emerging economies, says Herber.

DISCOUNTED VALUATIONS

Economic growth forecasts may be contributing to the bigger gains in frontier-market stocks than those in the more developed emerging markets so far in 2010. IHS Global Insight (IHS), a leading research and economic forecasting firm, predicts 3.5% GDP growth in the former group compared with 1.6% growth in the latter.

But the apparent preference for frontier markets this year is more likely due to discounted equity valuations. Frontier markets are trading around 10 times projected aggregate earnings for all the public companies in the 25 countries that make up the MSCI Frontier Markets index, while emerging markets are trading at 16 times expected earnings for 2010, according to Nathan Rowader, co-manager of the Accessor fund.

Given the huge rally that the largest, most liquid emerging markets experienced in 2009, it makes sense that frontier markets, which are smaller and still cheap relative to their more developed cousins, would benefit as liquidity spreads to smaller markets, says Nick Chamie, head of emerging-markets research at RBC Capital Markets in

Toronto. Recent gains in these markets may partly reflect the exaggerated impact that money flows have on prices in smaller markets with less liquidity, he adds.

Of the component indexes that make up the MSCI Frontier Markets index, the Africa index had the largest gains year-to-date as of Apr. 12—25.2% vs. 9.74% for the Latin America & Caribbean index, 8.32% for the Central & Eastern Europe & CIS index, and 6.95% for the Asia index.

NIGERIA LEADS AFRICA

The largest component of the MSCI Africa index is the Nigeria index, which is up almost 30% so far this year, according to Herber of the Accessor fund, who sees it as a microcosm of the frontier markets as a whole. Nigeria's political unrest—a prolonged illness has incapacitated President Umaru Yar'Adua—has increased the perception of risk associated with investing there and damped equity prices. Oil-rich Nigeria is expected to have 6.5% GDP growth in 2010, and yet the MSCI Nigeria index trades at nine times projected 2010 earnings, with a 3.5% dividend yield, says Herber. The combination of GDP growth forecasts and low valuations are being reflected in stock market appreciation this year, he adds.

A young, productive workforce; a large, growing consumer economy; and lots of foreign direct investment will eventually add up to a "virtuous cycle"

that allows large portions of the population to move up the economic scale in Nigeria and similar countries, says Herber. Improving infrastructure and advances made in the legal and regulatory systems are the kinds of development that will drive stock performance and growth across the frontier markets for the next 15 to 20 years, he says.

Herber and Rowader's Africa exposure is roughly 9% of the fund's assets, all of which is via total return swaps with various counterparties. Their biggest Nigerian holding is First Bank of Nigeria (FIRSTBAN:NL), which trades on the Lagos Stock Exchange. The stock is a play on the local economy's health and how fast the bank is able to expand its loan book and raise deposits. Like China and India before it, Nigeria probably needs to accrue many years of continued growth to be able to pull large numbers of people up into the middle class, says Herber. But once that happens, it will further perpetuate economic growth, he adds.

ARGENTINA OPPORTUNITIES

Herber and Rowader's Middle East exposure, the largest in the fund, isn't in oil companies, which are government-owned and not publicly traded. Instead, they focus on banks, property developers, and telecom providers—all driven by local consumer demand and the strength of the local economies. The most cost-effective way to get exposure to the Middle East markets, they've

found, is through a Deutsche Bank (DB) exchange-traded note that delivers the return of the MSCI Gulf Cooperation Council (MSCI GCC) index. Their fund was up 13.88% year-to-date as of Apr. 13.

Third Avenue Management in New York invests in frontier markets through a hedge fund whose value the company won't disclose because of regulatory restrictions. Amit Wadhwaney, the hedge fund's manager, looks for well-capitalized companies with strong corporate governance and trustworthy management that are "neglected, disliked, out of favor, and in turn present opportunities that are similarly depressed." Several are in Argentina, where economic turmoil and concerns about a populist government have weighed on asset prices.

One of Wadhwaney's top picks is IRSA Investments & Representations (IRS), which trades as an American Depositary Receipt on the New York Stock Exchange. As Argentina's largest real estate company, IRSA controls 65% of the country's largest shopping-center operators and has an option to buy its key rival, which controls another 30% of that market.

Besides its shopping-center assets, IRSA own three large hotels—including one at a popular ski resort—office buildings, large land reserves, and a nearly 12% stake in Banco Hipotecario, a traditional mortgage bank. Argentina's mortgage debt as a percentage of

people's income is among the lowest in South America, "so theoretically there is room for this to grow," says Wadhwaney. The stock was up 25% year-to-date as of Apr. 12. The stock trades at roughly 14.8 times projected earnings of 80¢ per share for fiscal year 2010, ending in June.

IMPACT OF GLOBAL ECONOMY

One of the selling points for frontier markets, says Rowader, is their low correlation to the global economy compared with China and the extent to which the individual companies within the countries are dependent on the local economies. That makes them fairly insulated from global events like weakness in the U.S. banking system or devaluation of the euro, he says.

Chamie at RBC Capital Markets disagrees. The significant pullback in oil and other commodity prices during the financial crisis and global recession had a dramatic impact on economies such as Argentina's and Nigeria's, and weakness in the global economy reduces tourism and money remittances from nationals to countries in Central America and the Caribbean, he says. Some of the Gulf states may have large enough cash reserves to provide protection from global cycles, he says, but overall, frontier economies are more vulnerable than some people would like to think

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Performance as of 6.30.10 Institutional Class

	Inception Date	1 Month	3 Months	1 Year	Gross Exp. Ratio (as of 9/1/08)	Incept to Date
Forward Frontier Markets Fund	1/29/08	-3.04%	-10.93%	-1.50%	1.96%	1.08%
MSCI Frontier Markets Index		-0.90%	-9.94%	0.43%		

The performance data quoted represents past performance, which does not guarantee future results. An investment's return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance data quoted. The Funds' performance information assumes reinvestment of all dividends. For performance most current to most recent month end, please contact www.forwardfunds.com.

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Definitions:

MSCI Barra is a leading provider of investment decision support tools to investment institutions worldwide. **MSCI Barra** products include the MSCI Frontier Markets Index. The MSCI Frontier **Market Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of frontier markets. As of June 2009 the MSCI Frontier consisted of 25 emerging market country indices.

The **CIS Index**, **MSCI Africa Index** and **MSCI Nigeria Index** are component indexes that make up the MSCI Frontier Markets index,

The **MSCI Gulf Cooperation Council (GCC) Index** is designed to provide pension plans, other investors, asset managers and consultants with an asset allocation and performance measurement framework for the equity markets of the GCC countries.

The **Gross Domestic Product (GDP)** is a basic measure of a country's overall economic output. It is the market value of all final goods and services made within the borders of a country in a year.

An **Exchange Traded Note or (ETN)** is a type of unsecured, unsubordinated debt security where returns are based upon the performance of a market index minus applicable fees, no period coupon payments are distributed and no principal protections exists.

An **American Depositary Receipt (or ADR)** represents ownership in the shares of a non-U.S. company that trades in U.S. financial markets.

Top Ten Portfolio Holdings as of 6.30.10
Forward Frontier Markets Fund

Vanguard Short-Term Bond ETF	22.46%
iShares Barclays Aggregate Bond Fund	8.72%
U.S. Treasury Notes , 2.375%, 09/30/14	6.88%
MSCI GCC Countries Ex-Saudi Arabia - Warrant (Expires 03/24/11)	6.46%
MSCI GCC Countries Ex-Saudi Arabia - Warrant (Expires 09/24/10)	4.04%
KazMunaiGas Exploration Production, GDR	2.55%
Market Vectors Vietnam ETF	2.28%
SOLIDERE, GDR	2.21%
Banco Macro SA, ADR	1.23%
Telecom Argentina SA, ADR	1.12%

Visit www.forwardfunds.com for a complete list of fund holdings.

There is no guarantee that the fund will meet its objective. The Forward Frontier Markets Fund is a non-diversified fund. An investor will indirectly bear the expenses of the fund's underlying investments. Investing involves risk, including possible loss of principal. In addition, the Fund's underlying investments (such as structured notes, derivatives, commodities and levered ETFs) will involve heightened risks related to liquidity, increased volatility, and unfavorable fluctuations in currency values. The underlying international and real estate investments will also be subject to economic or political instability in the US and other countries, credit risk and interest rate fluctuations. Investing in foreign securities, especially emerging and frontier markets, will involve additional risks, including social and political instability, liquidity, greater volatility and less regulation.

Investment Objective: The Forward Frontier Markets Fund seeks to provide capital growth.

Forward Management has managed the Frontier Markets Fund since it commenced investment operations on December 31, 2008. Forward Management was founded in 1997. An Investment Committee is primarily responsible for the management of the Frontier Markets Fund. The members of the Investment Committee are Nathan J. Rowader, Director of Investments, Jim O'Donnell, CFA, President of Forward Asset Management and Chief Administrative Officer of Forward Management, Paul Herber, CFA, Investment Officer, and Justin H. Roberge, Investment Analyst.

Nathan Rowader, Paul Herber and Justin Roberge are registered representatives of ALPS Distributors Inc.

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