Investing on the "Far Side of the Moon": Capturing Capital Market Inclusion Opportunity across MEASA (Middle East - Africa -South Asia)

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The MEASA Region:

- *45% of the world's population; median age below 23 years (leading future growth).*
- *18% of the world's GDP; likely to have achieved triple the developed world economic growth rate in 2017 and home to 7 out of the 10 fastest-growing economies in the world.*
- *6% share of MSCI combined global market capitalization.*
- *2% weighting in the MSCI ACW Index.*
- *A unique capital markets development opportunity as population and economic growth lead capital markets to grow, with likely market upgrades to emerging or frontier status and subsequent increase in market-cap weighted indexes.*
- *A simulated market-cap weighted MEASA index would have generated a 13.6% annualized return from January 2003 through September 2017 (versus 9.2% for the MSCI World Index).*
- *Efficient access to MEASA stock investments is difficult, but investors should seek opportunities to purchase stocks in the region as opportunities arise.*

Introduction and Executive Summary

The MEASA region forms a crescent of countries beginning with Bangladesh and India in the East, continuing through the Middle East and West Africa, and terminating with the South African nations. This grouping of countries has a long history of cultural, economic, and political advantages and achievements. One need only consider the energy riches of the Middle East, the mineral, agricultural, and fishery resources of Africa, or the large and educated population of India to understand the potential for the region.

The MEASA region covers 45% of the world's population, and, with an average age of 23 years, is expected to be the most rapidly growing. This growth, combined with increased labor and resource productivity will drive explosive economic growth. Already at 18% of global GDP, the MEASA GDP likely grew at triple the developed world economic growth rate in 2017, with 7 of the 10 fastest growing economies being in the region.

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At the same time, and despite the economic potential for the region, the regional capital markets are grossly under-represented in the major MSCI world equity indexes. Out of the total 83 countries in the region, only 7 are part of the MSCI Emerging Market ("EM") Index, 15 in the MSCI Frontier Market ("FM") Index, and 5 in the MSCI Standalone Market Indexes. Despite that the MEASA markets account for 6% of total global market capitalization and 18% of global GDP, the weighting in the MSCI ACW Index is only 2%. As its countries are upgraded to frontier or emerging status, we believe that interest in the region will explode, that the index weights of its stocks will multiply, and that significant excess returns will be available.

While a breathtaking economic potential exists, institutional investors do face significant barriers to effectively purchase stock at scale and in diversity from the region. Liquidity appears limited, and registration and custody arrangements are formidable. We describe this essentially as investing on the "far side of the moon," in that despite its conceptual appeal, it has remained difficult or impossible for many institutional investors from around the world to gain effective access to this region's opportunities. Yet, savvy investment managers are now developing innovative approaches to access MEASA region stocks. As these managers introduce broad-based fund products, the riches of the region will open to those institutions with a vision for what can be. Already, the performance of stocks in the region has exceeded broad global benchmarks by hundreds of basis points over the last fifteen years.

In summary, we believe that in many ways, the situation of the MEASA region today looks very much like the BRICs in the early 2000s.

Exhibit 1: MEASA Region Countries in Medium Blue, Tradable MEASA Countries in Dark Blue

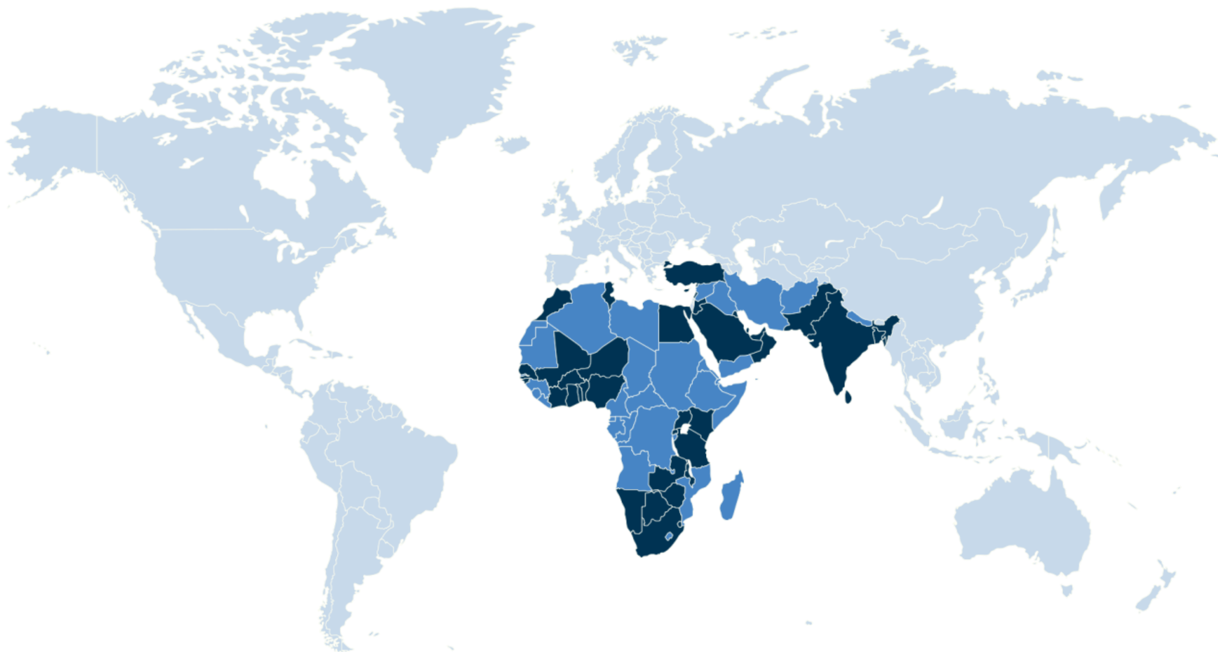
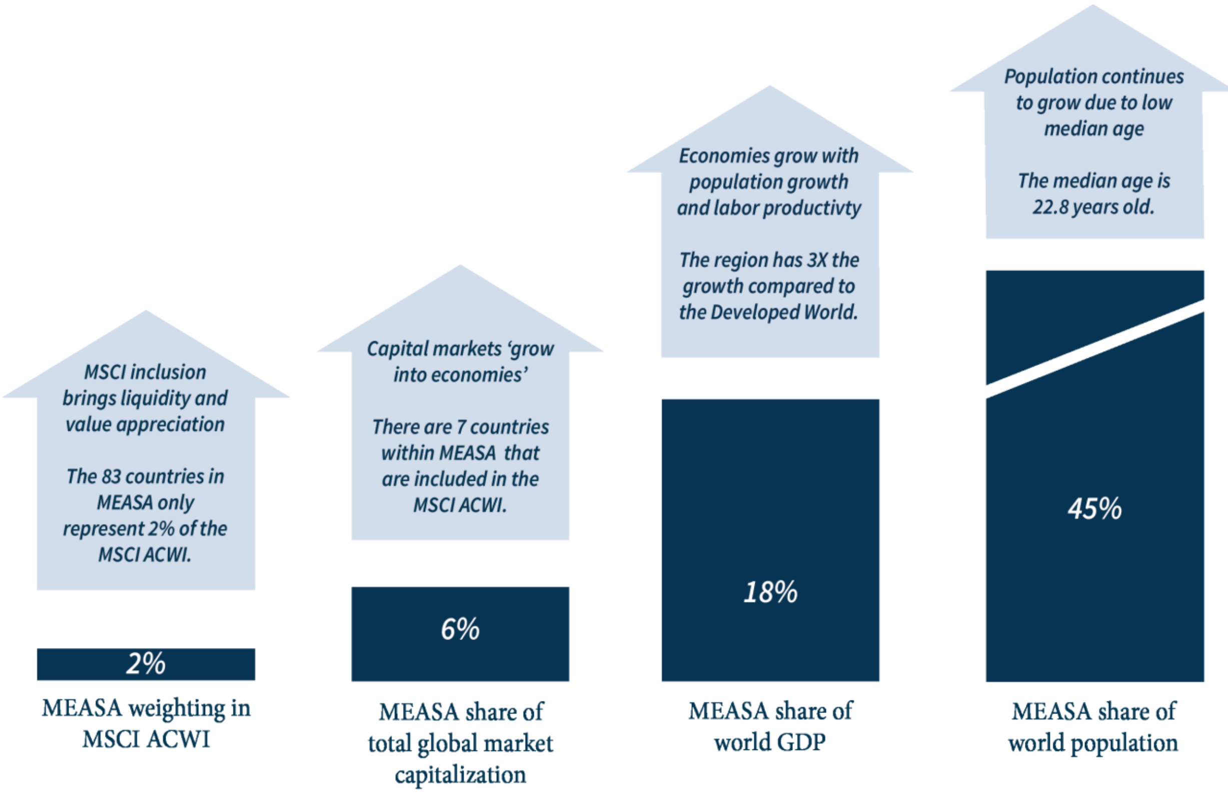


Exhibit 2: MEASA Capital Market Growth Story



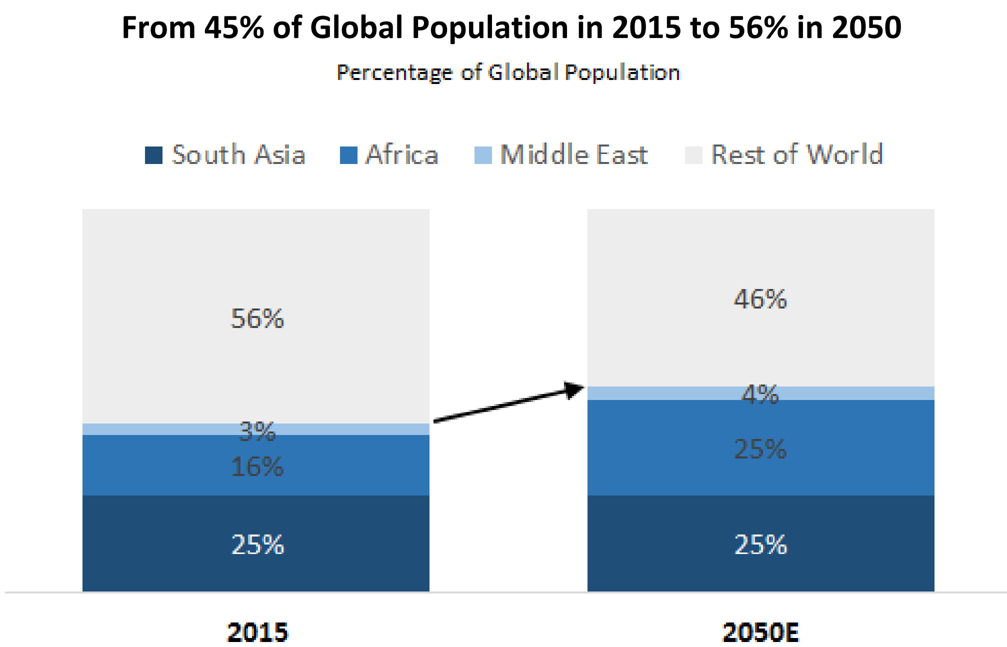
Source: UN, Population Division, 6/1/2017, International Monetary Fund, 6/1/2017. The World Bank, 5/22/2018, MSCI 6/1/2017, FactSet Database . GDP is based on Purchasing Power Parity (PPP) and is measured in international dollars. Percentages are approximated. Information is believed to be accurate, but may change without notice.

Population

At their core, people represent the potential for any region, and the MEASA region in particular is loaded with both a large number of people, and vast high quality human resources. These countries currently account for 45% of the world's population which is expected to grow to 54% by 2050 (see Exhibit 3). While the populations of the developed countries (such as the U.S., Japan, and Western Europe) are aging rapidly, the MEASA region population is relatively young and consists of a high and rising share of the working-age group. Exhibit 4 shows the median age in the MEASA region as 22.8 years, compared to 27.8 years for the traditional emerging countries, and 41.2 years for the developed countries.

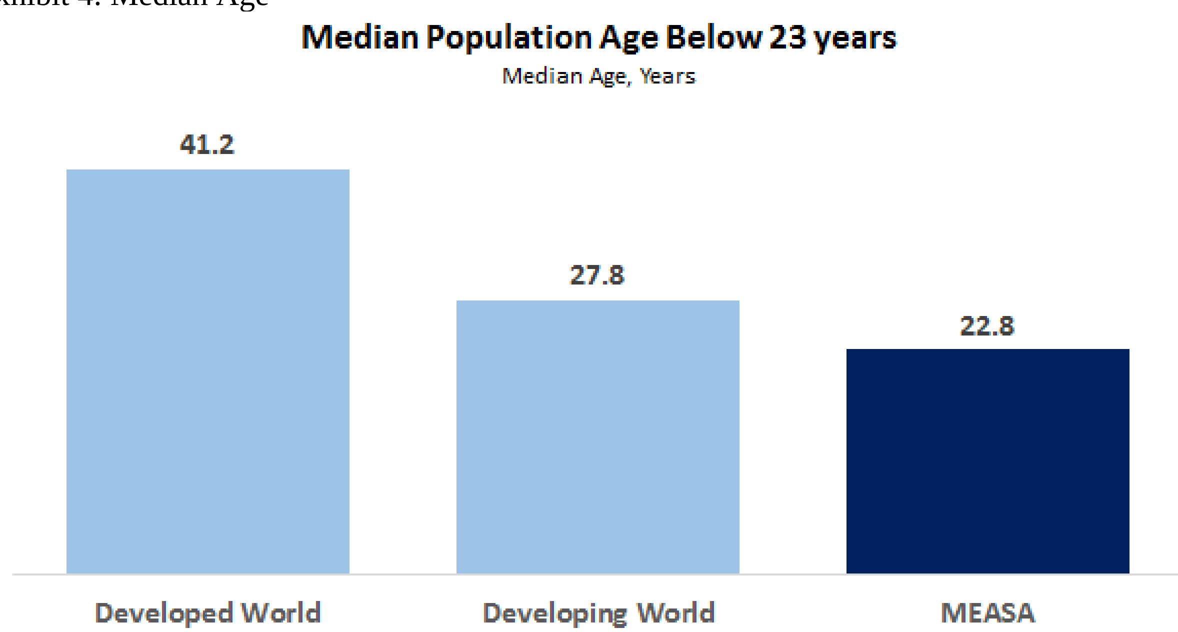
The situation in India is a prime example (see Exhibit 5). Two thirds of India's population is under the age of 35; giving the country a significant competitive edge with low labor costs. Many Indian people speak English, and have benefited from one of the most developed higher education systems in the world. This highly skilled work force makes India an attractive haven for multinational corporations looking to expand overseas. India's young population drives strong growth in consumer spending; having increased from $478 billion in 2010 to $957 billion in 2015. India is on path to becoming one of the world's largest consumer markets by 2025.

Exhibit 3: Share of Global Population



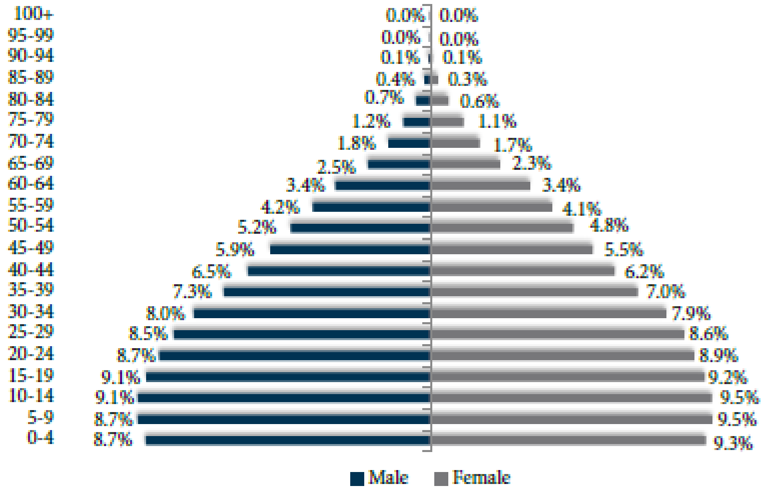
Source: UN, Population Division, 6/1/2017

Exhibit 4: Median Age



Source: UN, Population Division, 6/1/2017

Exhibit 5: 2015 India’s Population by Age Group



- #2 in the world for STEM graduates at 2.6 million
- 100% of 16-17 year olds express an interest in STEM topics with 76% considering a career in engineering
- Literacy rates have almost doubled in the last 30 years

Source: UN, Population Division, 6/1/2017
Source: 2016 World Economic Forum, Science, Technology, Engineering, Math
Source: Queen Elizabeth Prize for engineering, 2005
Source: UNESCO Institute for Statistics

Economic Position and Growth

The MEASA region currently accounts for 18% of the world’s GDP and is expected to be one of the fastest growing regions over the next several years. Combined MEASA region GDP is likely to have grown by 5.9% in 2017, compared to 1.8% for developed market (see Exhibit 6). 7 out of the 10 fastest-growing economies in the world come from this region (see Exhibit 7).

Not content to rest on their laurels, many MEASA countries are initiating economic reforms in an attempt to further boost their economies. For example, in the Middle East, the 2014-2015 slump in oil prices further compelled the GCC countries to adopt and/or accelerate reforms to diversify their economies away from hydrocarbon dependence. The recent IPO of a portion of the Abu Dhabi National Oil Company, and the upcoming massive Saudi Aramco IPO are two illustrations. These actions will not only provide funds for economic diversification, but will provide a liquid supply of Mideast equity securities. As another example, in India, Prime Minister Modi has liberalized and simplified the process for foreign investment in India. These kinds of actions show the possibilities.

We believe the situation for the MEASA region today is similar to the situation for the BRICs in the early 2000s (noting of course that India is included in both groups). For example, in 2001, the BRICs countries accounted for about 8% of the world's GDP on a current basis.[2] By 2015, the share had grown to almost 22%.[3] While it is impossible to predict the degree to which the MEASA region will reflect the performance of the BRIC's economies, these numbers illustrate the potential.

Exhibit 6: 2017 Likely Economic Growth

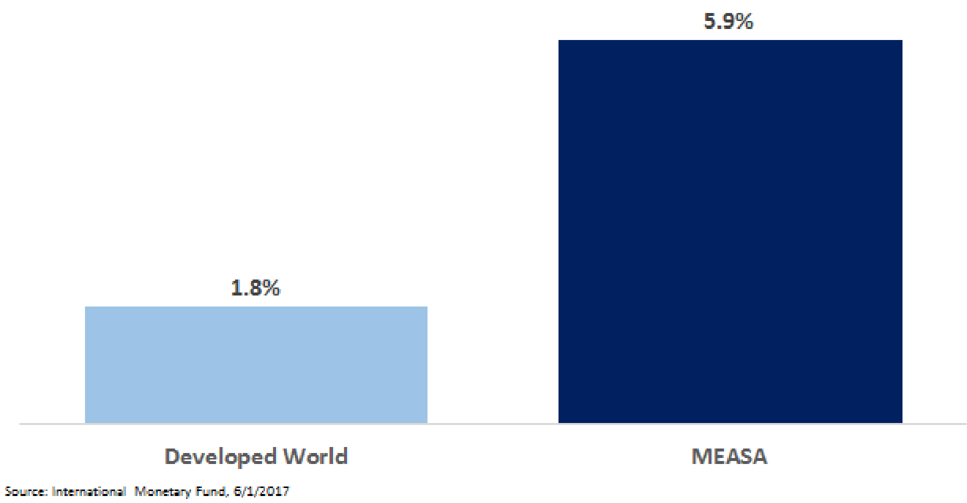


Exhibit 7: Top 10 Fastest Growing Economies (nominal annualized growth)

Country	2016F	2017F	2018F	2016 - 2018 GDP CAGR
Libya*	11.4%	64.1%	33.2%	34.5%
Sudan*	15.9%	22.7%	19.2%	19.2%
Iceland	19.4%	14.6%	12.0%	15.3%
Eritrea*	14.7%	13.1%	13.3%	13.7%
Central African Republic*	11.7%	11.9%	12.1%	11.9%
Myanmar	11.4%	9.1%	10.6%	10.4%
Djibouti*	9.7%	10.2%	10.2%	10.0%
Bangladesh*	10.3%	9.2%	9.4%	9.6%
Turkmenistan	0.4%	17.1%	11.4%	9.4%
Angola*	-6.9%	27.7%	9.8%	9.3%

* Countries within MEASA region

Source: International Monetary Fund, 6/1/2017

[2] Jim O'Neill, *Building Better Global Economic BRICs*, Goldman Sachs, Global Economic Paper No:66, November 30, 2001.

[3] World Bank, World Development Indicators Database, February 1, 2017, as cited by Robbie Gramer, "The Cable: Infographic: Here's How the Global GDP is Divided up," *FP*, February 24, 2017, http://foreignpolicy.com/2017/02/24/infographic-heres-how-the-global-gdp-is-divvied-up/, accessed on December 29, 2017.

Capital Markets Development; Index Representation

Despite the economic position and potential for the MEASA region, the index companies have yet to catch on. Though representing 18% of the world's GDP, the MEASA region companies only account for 6% of the market cap of the total for the MSCI ACWI Index constituents, and significantly, only account for 2% of the index weight. As these anomalies are corrected, we believe that investor interest in the region will explode, with subsequent positive effects on the region's equity returns. The difference in percentages (2% versus 11%) thus represents a significant 9% potential gap that is expected to narrow for the benefit of investors in these markets over time.

A similar situation existed for the BRICs stocks in the early 2000s. By what mechanism was the situation rectified and index weight increased, and what was the investment result? As the BRIC's countries gained in stature due to growth and economic reform, they were upgraded to "frontier and emerging" status by MSCI. Superior investment returns followed.

An MSCI index upgrade is typically a significant positive catalyst for a country's market. Upgrades tend to boost liquidity and portfolio inflows into the country as index oriented investors seek to rebalance. Also, some institutional investors are restricted to traditional developed and emerging markets. Market reclassification means that a new group of investors enter a market. MSCI classifies countries based on dozens of criteria including: openness to foreign ownership, ease of capital flow, and efficiency and stability of the market's operational framework. When conditions change, MSCI reclassifies markets. Typically, when a country's market approaches the criteria for a reclassification, MSCI places it on a watch list, gathers feedback from institutional investors, and finally announces a decision to reclassify the market. When the market is selected, MSCI specifies a date at which the reclassification will become effective - usually in about a year.

Exhibit 8: MSCI Classification of MEASA Countries

All MEASA Countries by GDP							
Africa					Middle East		South Asia
Nigeria	Cote d'ivorire	Mozambique	Niger	Guinea-Bissau	Turkey	Jordon	India
Algeria	Uganda	Zimbabwe	Mauritania	Seychelles	Saudi Arabia	Bahrain	Pakistan
South Africa	Zambia	Burkina Faso	Swaziland	Comoros	Egypt	Cyprus	Bangladesh
Morocco	Democratic Republic of the Congo	Chad	Togo	Sao Tome and Principe	United Arab Emirates	Syria	Sri Lanka
Angola	Senegal	Republic of Congo	Sierra Leone	Eritrea	Iraq	Georgia	Nepal
Ethiopia	Botswana	Namibia	Burundi	Libya	Qatar	Palestine	Afghanistan
Kenya	Mali	Mauritius	Lesotho	Mayotte	Kuwait	Armenia	Maldives
Tanzania	Madagascar	South Sudan	Liberia	Reunion	Oman		Bhutan
Tunisia	Gabon	Guinea	Cape Verde	Saint Helena	Azerbaijan		
Ghana	Equatorial Guinea	Benin	Gambia	Somalia	Lebanon		
Sudan		Rwanda	Djibouti	Western Sahara	Yemen		
Cameroon		Malawi	Central African Rep.				

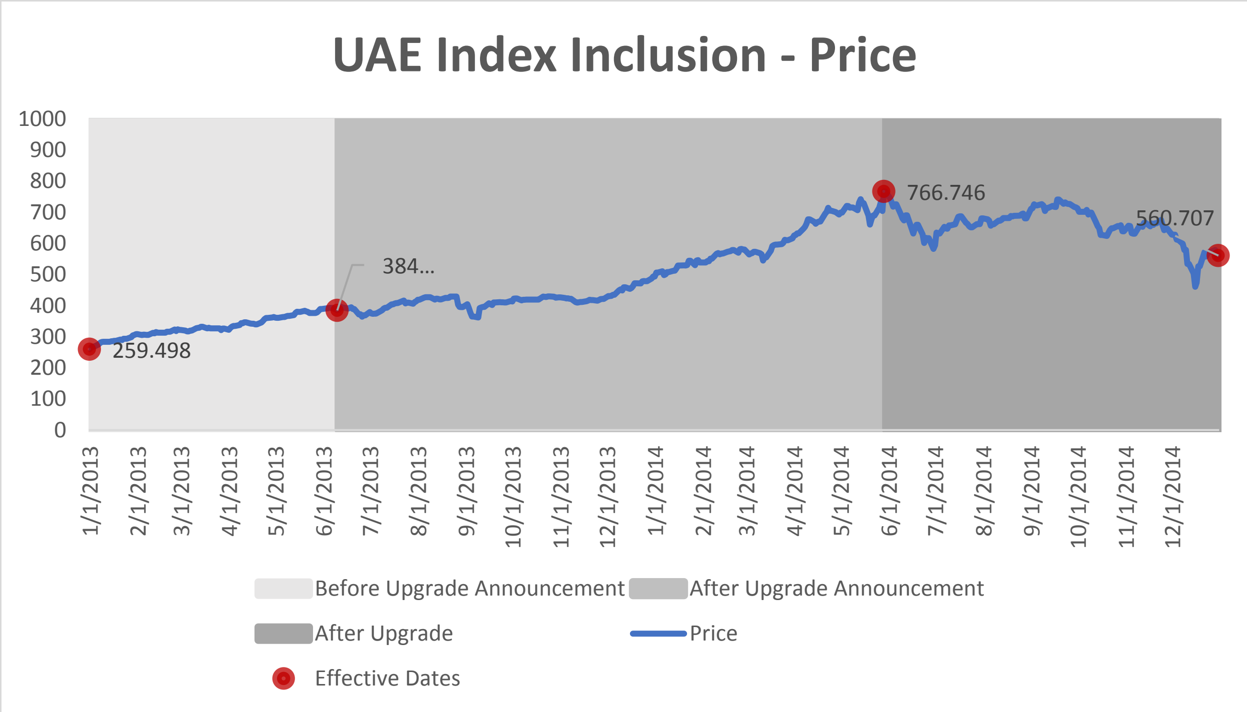
MEASA Investible Universe									
MSCI EM INDEX			MSCI FM INDEX			Other MEASA Countries	
Middle East	Africa	South Asia	Middle East	Africa	South Asia	Middle East	Africa
Egypt*	South Africa*	India*	Bahrain*	Kenya*	Bangladesh*	Cyprus*	Botswana*
Qatar		Pakistan*	Jordan*	Mauritius*	Sri Lanka*	Saudi Arabia*	Ghana*
Turkey*			Kuwait*	Morocco*			Malawi
United Arab Emirates*			Lebanon*	Nigeria*			Namibia*
			Oman*	Tunisia*			Rwanda
				WAEMU[1]			Swaziland
							Tanzania*
							Uganda
							Zambia
							Zimbabwe

*Represents countries the MEASA Strategy is registered in or for which registration is pending as of 05/31/2018.
[1] The West African Economic and Monetary Union (WAEMU) consists of the following countries: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo. Currently, the MSCI WAEMU Indices include securities classified in Burkina Faso, Côte d'Ivoire, and Senegal.
Source: MSCI, and McKinley Capital, retrieved May, 2018. Information is believed to be accurate, but may change without notice.

For most investors, the relevant dates are the announcement and effective dates for reclassification. Several MEASA region countries have already been "upgraded." As Exhibits 9 and 10 show, the UAE returned 99%, and trading volume increased by 473% between the time MSCI announced the UAE upgrade to emerging market status (May 31, 2013) until the time the upgrade was implemented (May 30, 2014). Similarly, Pakistan saw a 26% return and a 337% increase in trading volume between the MSCI upgrade announcement (June 14, 2016) and effective date (June 1, 2017) - Exhibits 11 and 12.

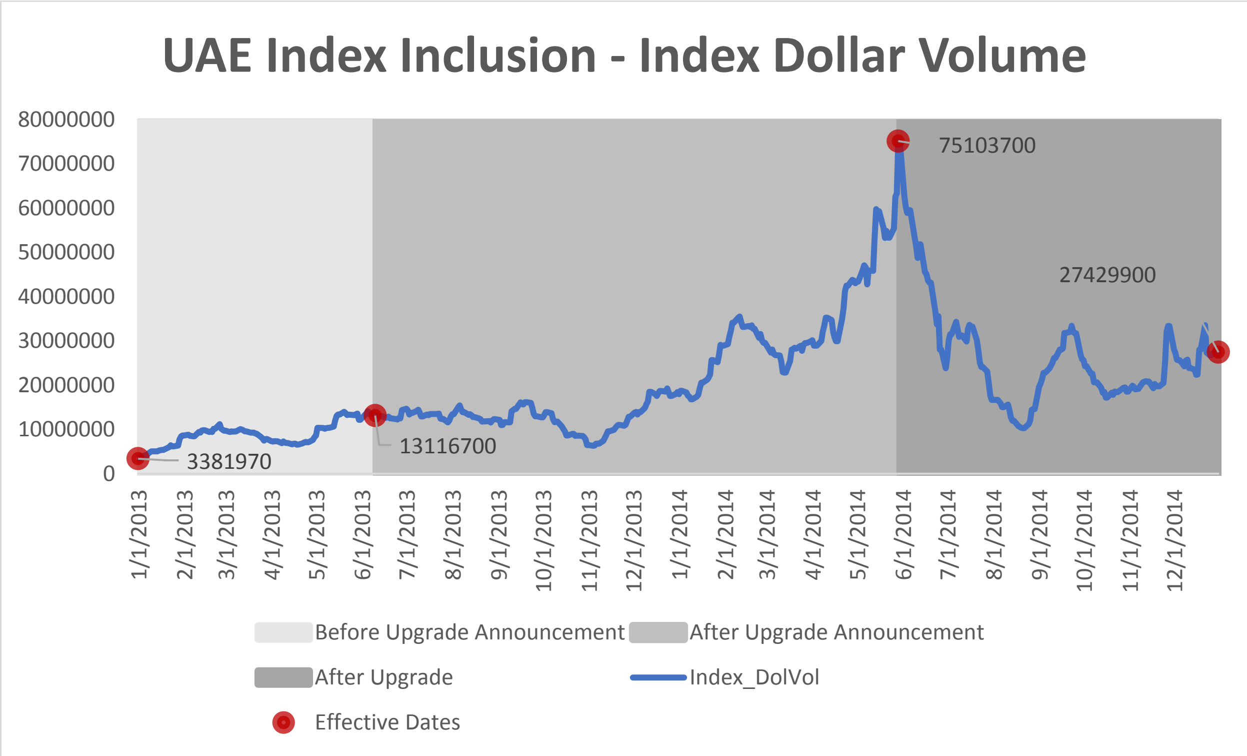
Active investors start including key names in their portfolios right after the announcement; even ahead of the effective date. Passive investors typically wait until the effective date to adjust their positions. We expect similar results from future MEASA region upgrades.

Exhibit 9: MSCI UAE Price



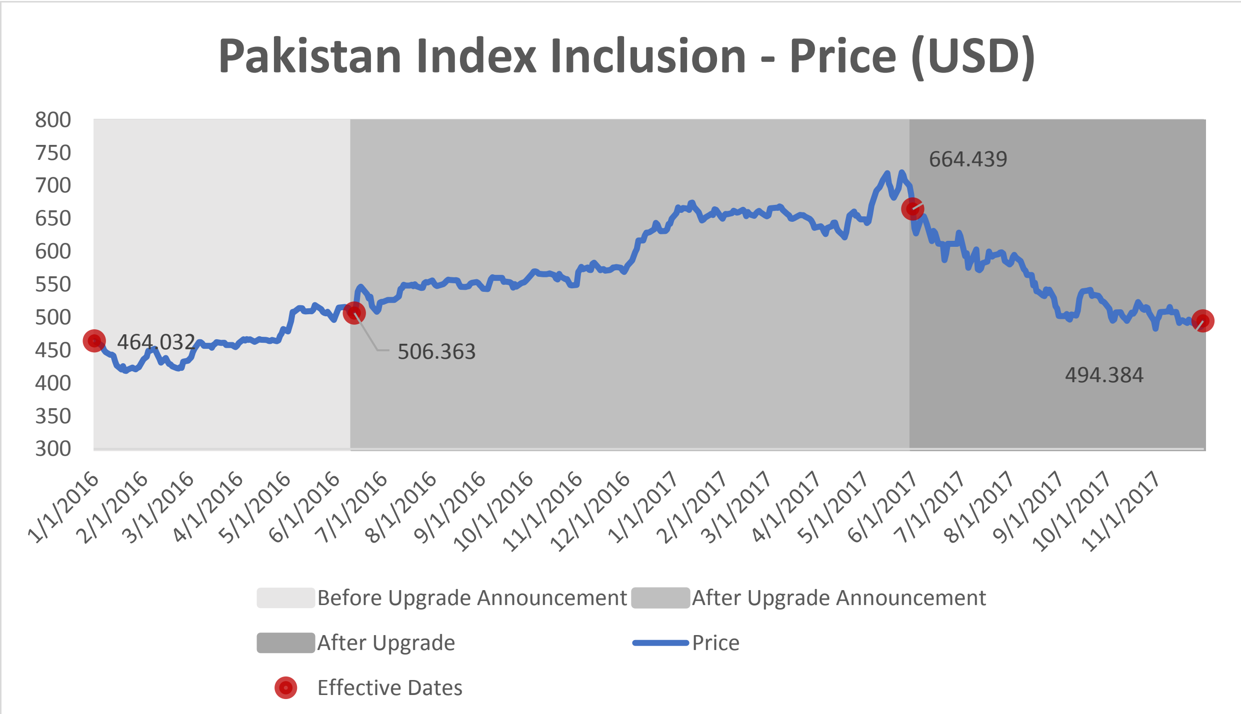
Source: MSCI, FactSet, 12/1/2017

Exhibit 10: MSCI UAE Index Dollar Volume



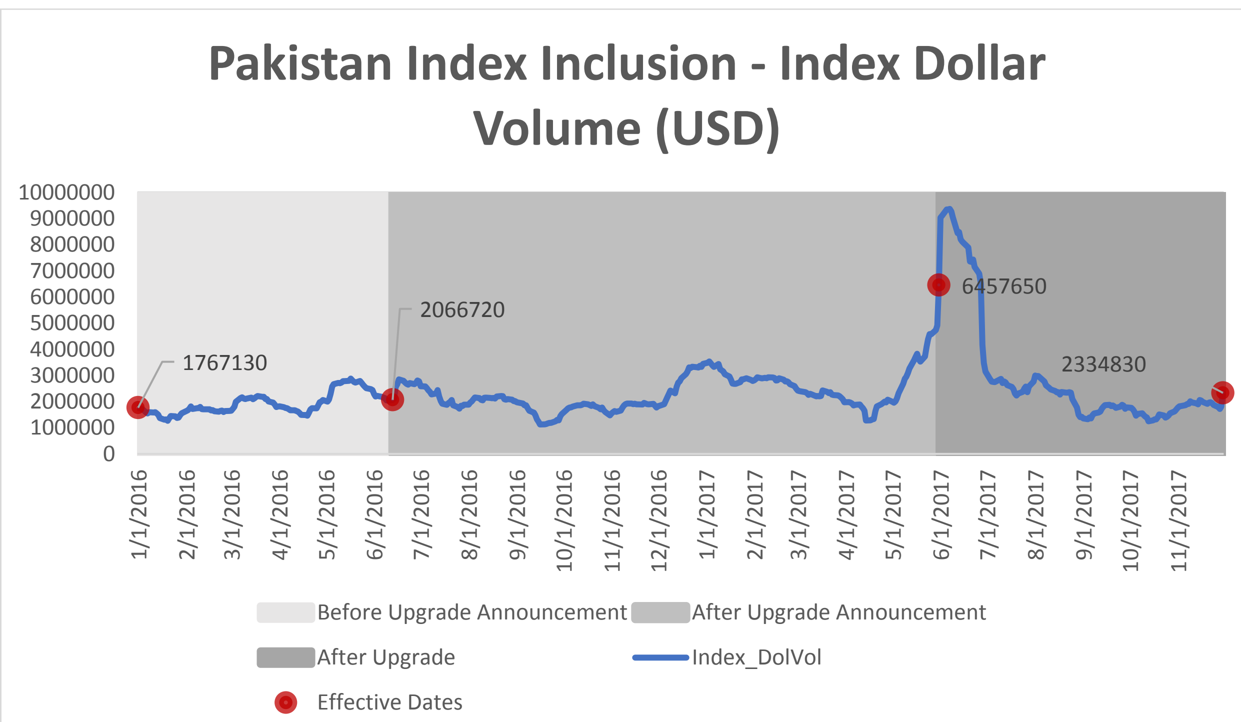
Source: MSCI, FactSet, 12/1/2017

Exhibit 11: MSCI Pakistan Price



Source: MSCI, FactSet, 12/1/2017

Exhibit 12: MSCI Pakistan Index Dollar Volume



Source: MSCI, FactSet, 12/1/2017.

Recent MEASA Equity Returns

The exceptional returns that we believe will be available in MEASA region investments have already been demonstrated to some degree. Exhibit 13 shows the returns of a simulated market-cap weighted MEASA equity index. This simulated MEASA index outperformed the MSCI World Index, the MSCI Emerging Index, and the MSCI Frontier Market indices from January 2003 through September 2017. The simulated MEASA index generated a 13.6% annualized return over that time period, compared with 9.2% for the MSCI World Index. Exhibit 13 shows that it also produced better Sharpe ratios, than the comparison MSCI indexes. We are firmly convinced that similar results are possible in the years ahead.

Exhibit 13: Simulation Risk Return Statistics (January 2003 – September 2017)

Index	Annualized Return (%)	Annualized Risk (%)	Sharpe Ratio
MEASA Simulated – Market Cap Weighted	13.64	24.59	0.51
MSCI Frontier Markets Index	8.57	23.57	0.31
MSCI Emerging Markets Index	12.36	23.16	0.48
MSCI World Index	9.22	16.06	0.50

Source: FactSet, Axioma, Zephyr StyleADVISOR, 12/1/2017. Analysis by McKinley Capital, 12/1/2017. The MEASA simulation is based on the returns of stocks with an average daily trading volume of $100,000 or more per day.

Conclusion

The rapidly growing MEASA region countries and their companies would seem to be burgeoning with attractive investment opportunities. Yet, we think of investing in this region as investing on the "far side of the moon!" This opinion is based on the perception of illiquidity and institutional barriers to investment. The situation today in the MEASA region countries seems similar to the situation in the BRICs countries in the early 2000s. As happened with the BRICs countries, the barriers to investing in the MEASA region are being removed as we write. Innovative investment advisors are set to offer mechanisms to access these markets. The rewards will go to those visionary investors who are able to first see the possibilities.

We thank Gregory Samorajski and Shierley Widjaja of McKinley Capital Management, LLC, and Peter Lejre, Senior Executive Officer of McKinley Middle East, LTD for their research, technical, and editorial assistance.

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