Aberdeen Frontier Markets

Long term growth opportunity

Aberdeen Frontier Markets Investment Company (AFMC) offers investors a diversified exposure to the superior growth prospects offered by frontier markets. Its managers believe that weak commodity and energy prices, as well as concerns over Chinese growth, have weighed heavily on the sector and the vast majority of investors are now underweight. A valuation gap has opened up, versus developed markets, but AFMC's managers see the potential for a strong recovery should a rebound in earnings growth start to emerge. In the meantime, they expect that investors will be able to benefit from an attractive yield. AFMC's board agrees that income is an increasing part of the rationale for investing in frontier markets and is introducing a semi-annual dividend.

Long-term capital growth from frontier markets

AFMC aims to generate long-term capital growth by investing predominantly in a diversified portfolio of funds and other investment products which derive their value from frontier markets. Investee funds may include closed-and open−ended funds, exchange traded funds, structured products and some direct equities.

Year ended	Share price total return (%)	NAV total return (%)	MSCI Frontier Markets TR.* (%)	MSCI Emerging Markets TR. (%)	MSCI World total return (%)
30/09/12	(5.3)	(1.2)	(2.7)	(3.1)	11.5
30/09/13	31.4	22.5	26.3	3.6	21.5
30/09/14	19.9	15.4	24.8	12.1	13.4
30/09/15	(18.3)	(17.2)	(15.3)	(16.5)	4.1
30/09/16	18.4	15.3	13.4	31.8	26.0

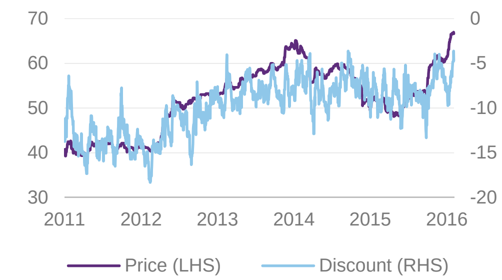
Source: Morningstar, Marten & Co. * Note AFMC does not have a formal benchmark. The MSCI Frontiers Index is used as the main comparator

Sector	Global Emerg. Mkts
Ticker	AFMC LN
Base currency	GBP
Price	65.5875p*
NAV	67.75p*
Premium/(discount)	(3.2%)*
Yield estimate**	3.0%

*Note: as at close 4 Nov. 2016. For current data click here.
**Note: based on proposed dividend of US¢ 1.2 per share.

Share price and discount

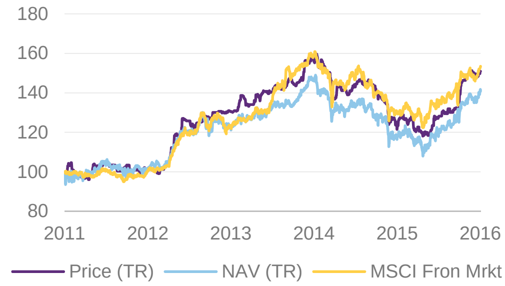
Time period 30/09/2011 to 02/11/2016



Source: Morningstar, Marten & Co

Performance over five years

Time period 30/09/2011 to 30/09/2016



Source: Morningstar, Marten & Co

Domicile	United Kingdom
Inception date	15 June 2007
Managers	Andy Lister Bernard Moody
Market cap (GBP)	111.0m
Shares outstanding	169.3m
Daily vol. (1-yr. avg.)	198k shares
Net gearing	(2.1%)

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Overview

One of two London-listed frontier markets funds.

Aberdeen Frontier Markets is one of two London-listed investment companies that are focused on frontier markets. AFMC invests, overwhelmingly, through funds (both closed and open ended) to gain access to locally based managers who are experts on specific markets or regions. This results in a superior level of diversification.

Significant outperformance since launch.

Since its launch in 2007, AFMC has provided significant outperformance of frontier, emerging and world markets but, during the last five years, frontier and emerging markets have faced various headwinds and have been somewhat out of favour with investors. The managers believe that, in many markets, monetary policy cycles are now easing and they see the potential for a strong return to form for frontier markets.

Opportunity to exit at NAV less costs.

AFMC offers shareholders the certainty of an opportunity to exit at NAV less cost at five-yearly intervals. In a move that should make it more attractive to investors, AFMC's board is introducing semi-annual dividend payments.

Market outlook

As evidenced by recent market disruptions and associated volatility, global markets are characterised by uncertainty, with polarised views on the direction of travel of the global economy and its various constituent parts (ranging from recession, to stagflation through to hyperinflation). There is little in the way of broad consensus, other than that interest rates would appear to be set to remain lower for longer and that further periods of volatility seem likely to prevail. As illustrated in Figures 1 and 2, global markets have, as a whole, had a good run during the last five years and they seem to have shrugged off concerns about China and Brexit earlier this year. Despite recent setbacks, global market valuations have recovered with trailing P/E ratios trading towards the top end of the five- year ranges (see Figure 2 below). This may sound a note of caution for some and gives some weight to the argument that concerned investors should be looking for assets less correlated with traditional equity markets.

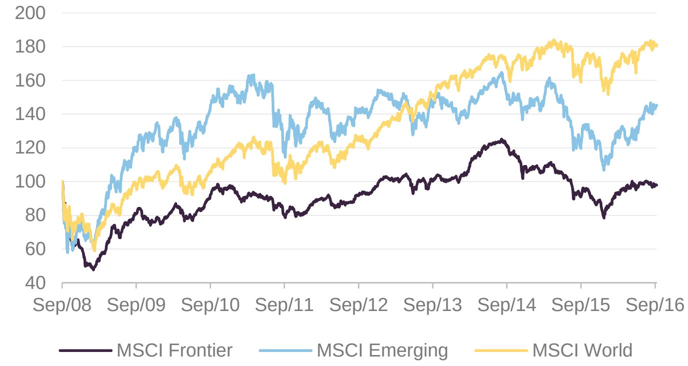
In comparison, emerging and frontier markets have made progress during the last five years but, reflecting both concerns over China as well as a perceived higher risk in an uncertain world, the advances of these markets have been significantly below that of more developed markets.

Furthermore, whilst developed and emerging market valuations are significantly above their five-year averages, frontier markets remain broadly inline. They also look attractive when set against fixed income securities.

An under-researched universe and lower liquidity are potential sources of opportunities.

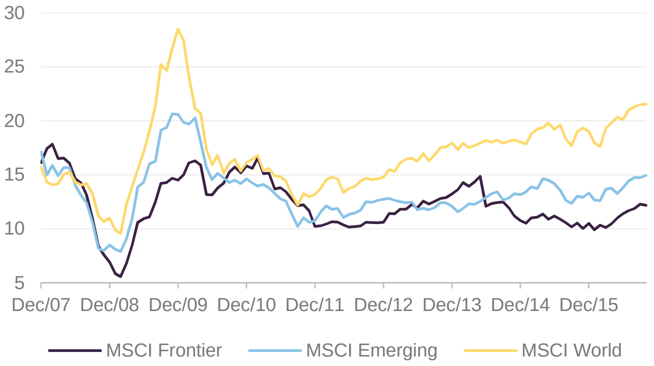
Frontier markets and, to a lesser extent, emerging markets tend to be less well-researched and less liquid parts of the market. In consequence, there is a greater likelihood of finding a mispriced security. Furthermore, whilst their equity markets are, to varying degrees, subject to the fund flows of international investors (frontier markets have seen continual outflows for the last two years), the underlying companies are operating in markets that are less integrated with the global economy. The performance of individual companies should be relatively uncorrelated with those of developed equity markets. However, it should be remembered that frontier markets have, by definition, less developed political and economic systems and so are more likely to be subject to country-specific risks. As such, a portfolio approach is warranted. Their lack of liquidity means that investment ideas may take time to come to fruition and so investors need to be prepared to take a long-term view. A final consideration is that information availability may be more restricted for frontier markets and whilst this may create opportunities for those who have the resources and expertise needed to identify them, we think that for many investors this is an ideal subcontract for a professional investment manager.

Figure 1: Market indices – 8-year performance rebased



Source: Bloomberg, Marten & Co.

Figure 2: Market indices – trailing P/E ratios*



Source: Thomson Reuters Datastream, Marten & Co. *Note: monthly data

Figure 2 shows trailing P/E ratios for frontier, emerging and developed markets during the last eight years (the longest time period for which data is available for all three indices).

In terms of valuations, the MSCI Frontiers Index is trading at a trailing P/E of 12.2x, which is 6.1% above its five-year average of 11.5x and therefore modestly above. However, the MSCI Emerging Markets Index has a trailing P/E of 14.9x (17.2% above its five-year average of 12.7x) and the MSCI World Index has a trailing P/E of 21.5x (24.3% above its five-year average of 17.3x). The suggests that frontier markets could be a relatively attractive way of gaining exposures to returns less correlated to global equity markets. A fund of fund approach, such as that offered by AFMC, has the additional benefit to investors of offering a discount on a discount. For example, AFMC is currently trading at a discount of 5.7%. However, where it is investing in closed-end funds, these frequently trade at a discount (the average discount on AFMC's closed-end fund holdings is in the region of 26.8% and these comprise approximately 27.3% of the portfolio). This gives a look-through discount, for AFMC, in the region of 16%.

Long-term structural growth opportunity

A key argument for investing in both frontier and emerging markets is that, in addition to offering returns that are less correlated with global markets (see Figure 3), investors are able to gain exposure to the structural growth offered by these countries as they develop and their economies grow. Figure 4 illustrates the GDP per capita of some of the key markets that AFMC has holdings in. These are, on average, significantly below those of the more developed markets, which gives significant potential for catch up. At Marten & Co, we believe there is very strong growth potential for frontier markets. We believe they will benefit from increasing globalisation and by adopting modern technology and leapfrogging outdated technology systems that in some instances are holding back more developed markets. The IMF's World Economic Outlook for October 2016 forecasts average annual growth for emerging markets for the period 2017-2021 of 4.9%. This is markedly above that for advanced economies, of 1.8%.

Figure 3: Correlation matrix of key AFMC frontier markets and indices

	MSCI Frontier	MSCI Emerging	MSCI World	Argentina	Nigeria	Pakistan	Romania	Vietnam
MSCI Frontier	1.00	0.72	0.75	0.51	0.64	0.45	0.70	0.46
MSCI Emerging	0.72	1.00	0.88	0.51	0.36	0.28	0.75	0.44
MSCI World	0.75	0.88	1.00	0.54	0.36	0.28	0.75	0.44
Argentina	0.51	0.51	0.54	1.00	0.13	0.28	0.38	0.14
Nigeria	0.64	0.36	0.35	0.13	1.00	0.28	0.38	0.14
Pakistan	0.44	0.28	0.25	0.17	0.28	1.00	0.28	0.14
Romania	0.70	0.75	0.79	0.39	0.38	0.28	1.00	0.37
Vietnam	0.46	0.44	0.47	0.17	0.14	0.14	0.37	1.00

Source: Bloomberg, Aberdeen Asset Management.

Figure 4: GDP per capita and estimated GDP growth for some of AFMC's larger frontier market allocations versus advanced economies

Heading	GDP per capita (US$)	Average growth rate 2017-2021 (%)
Nigeria	2,260	2.5
Kenya	1,522	6.4
Egypt	3,709	5.2
Vietnam	2,164	6.2
Pakistan	1,428	5.3
Argentina	12,425	3.0
Romania	9,439	3.4
Advanced economies	47,001	1.8
Emerging and developing economies	11,110	4.9

Source: IMF World Economic Outlook – October 2016, Marten & Co

Fund profile

Frontier markets focused fund of funds that invests through local managers. Further information is available at the company's website:

www.aberdeenfrontiermarkets.co.uk

Established in 2007, AFMC is a Guernsey-domiciled and AIM-listed investment company that invests in a diversified portfolio of funds with the aim of generating capital growth from frontier markets. AFMC typically holds 30-35 underlying funds, which give exposure to a greater number of underlying companies (more than 500). The fund's managers believe that pricing anomalies are generally more widely available in frontier markets, than in developed markets, as frontier markets (sometimes referred to as 'pre-emerging markets') have lower levels of liquidity and research.

Investing through local managers

AFMC typically invests in funds with locally based managers, as AFMC's managers believe that these are the best placed to identify and exploit such pricing anomalies. AFMC's managers follow a value-orientated investment strategy. They aim to deliver outperformance by selecting good managers in attractive markets and by benefitting from discount narrowing on closed-end fund holdings.

AFMC's portfolio is managed using a combination of top-down and bottom-up processes. The proportion of the portfolio invested in each component of frontier markets is determined on a top-down basis according to where the managers perceive the most attractive investment opportunities to be. Individual funds are then selected, bottom up, based on the managers' extensive fundamental research.

No formal benchmark

As discussed in the performance section on pages 14 and 15, AFMC does not have a formal benchmark. The MSCI Frontiers Index is used as the main comparator but the managers say the index is not representative of the underlying universe and so AFMC's portfolio is not constructed with reference to it. They comment that the index has a relatively short history, is concentrated and is subject to major changes in weightings when countries are reclassified and move in and out of the index. For example, when MSCI downgraded Argentina to a frontier market in 2009, it entered the index at a c 15% weighting. Similarly, when Pakistan is reclassified as an emerging market (scheduled for May 2017) its weighting, approximately 12% of the frontier index at present, will fall to zero. The managers also believe that, over the long term, superior returns and a lower level of volatility will be achieved by having a greater degree of diversification than is offered by the index.

AFMC also uses the MSCI Emerging Markets Index and the MSCI World Index as comparators.

Experienced management team

The company's managers, Andrew Lister and Bernard Moody, have been involved with the management of the company's portfolio since its launch (they have been the named fund managers since June 2014) and the majority of the team has worked together for more than 10 years.

Andrew and Bernard were previously employees of Advance Emerging Capital but moved across when Aberdeen Asset Management acquired that company in December 2015. Following the move, the investment manager was renamed Aberdeen Emerging Markets and the fund was renamed Aberdeen Frontier Markets (previously Advance Frontier Markets) in April 2016. AFMC's board was supportive of the transaction, citing that the management team remained intact but that the fund could benefit from Aberdeen's high profile, good reputation and significant additional resources available.

As at 4 November 2016, Andrew Lister had 98,318 AFMC shares and Bernard Moody had 22,250 shares. At the closing price of 65.5875p on 4 November 2016, these holdings are equivalent to investments of £64.5k and £14.6k respectively. We think this is positive as it helps to align the managers' interests with those of shareholders.

Now with income

Semi-annual dividend payments are being introduced.

As discussed in further detail on page 17, AFMC is introducing semi-annual dividend payments. This brings it into line with its closest peer and the board believes that the cash-generative nature of many frontier companies, and the dividends into which this can translate, is increasingly an important part of the rationale for investing in frontier markets. The first dividend, equivalent to US¢ 1.2 per share, is expected to be paid in December 2016. The company expects to publish the value of the sterling dividend in mid-November.

Strategy has room to grow

Increasing fund size should benefit shareholders through improving liquidity and lower ongoing charges.

In addition to AFMC, Andrew Lister and Bernard Moody also manage the open-ended Aberdeen Frontiers Opportunities Fund, using the same strategy, these have a combined AUM of approximately US$200m. AFMC's managers say that the underlying managers, through which they invest, are not at capacity and that, reflecting this, their own strategy has significant room to grow. They believe that the strategy could comfortably exceed US$500m without impacting on their ability to generate returns. We would welcome growth in the size of AFMC, as this should benefit all shareholders both by increasing liquidity and lower ongoing charges, by spreading the company's fixed costs over a wider asset base.

Managers' view

Long term structural growth opportunity

Higher growth expected from frontier markets than developed markets.

The managers believe that the rationale for investing in frontier markets is little changed from when AFMC was launched in 2007. In their view:

- Premium economic growth continues to be driven by long term trends in demographics and consumption.
- Frontier markets continue to be uncorrelated to each other and they believe the asset class is likely to deliver returns that are less volatile than investors expect.
- Frontier markets are less efficient and somewhat overlooked, as an asset class, which provides opportunities for active stock pickers to identify mispriced securities.

The managers do not necessarily expect frontier markets' superior growth to translate directly into stock market growth in any given year, but they do expect that companies exposed to these strong trends will outperform over the longer term.

One key change of the rationale for investing in frontier markets that has changed in recent years has been valuation (see Figure 2). Frontier, emerging and world markets have all de-rated since their highs of 2009 but whilst developed markets have recovered strongly, frontier and to a lesser extent emerging markets, have been left behind. As such, frontier markets have experienced a material de-rating, relative to world markets. Accompanying these low valuations, frontier markets also offer attractive dividend yields, which the managers believe reflects the unlevered and cash generative nature of many frontier corporates.

The managers believe that current valuations have been achieved through a combination of resilient earnings and stock market performance that has failed to keep pace with earnings performance. They think that this situation is unsustainable over the longer term and believe that, in a world where growth is muted (both corporate earnings and GDP) and income is scarce, investors will over time be willing to attach higher valuations to frontier assets than they are today.

The managers acknowledge that political and economic risk can often be higher than in less developed markets but they believe that this can be mitigated by having a diversified portfolio and by using local managers who have superior understanding of their investing environments. As such, AMFC's managers believe that its portfolio is extremely well positioned. They say that it is concentrated in well-structured funds, managed by talented stock pickers, in attractive markets.

Near term outlook improving

Macro issues are expected to drive the risk appetite for assets globally. The outlook for frontier markets is improving and they offer exceptional value relative to developed markets.

Taking a nearer-term view, the managers believe that, as evidenced by the market volatility and currency moves, following the UK referendum on EU membership, macro issues in developed markets will continue to drive the risk appetite for assets globally. Reflecting this, they expect global market volatility, including that of currencies, to continue. However, they say that, following what has been a difficult few years for emerging and frontier markets, the outlook for many is now improving and, following a period in which they have been out of favour, frontier markets now offer exceptional value relative to developed markets (see Figure 2 for an illustration).

Amongst other headwinds, weak demand for commodities and energy as well as worries around slowing Chinese growth has dampened enthusiasm for emerging, and frontier markets in general. Investors have also sought the safety of safe-haven currencies, which has also acted as a headwind. The managers believe that the markets have been unduly negative in their response to China and they say that, as China's growth has stabilised, volatility is receding. There are also signs that the outlooks for commodities and energy are improving as well. Reflecting these developments, AFMC's managers say that the cycles in many frontier markets are now easing and, aided by challenges in both the US and Europe, they believe that sentiment towards frontier markets is improving. This has led to the recent rally, but the managers say that this has done little to reverse the longer-term trend and that frontier markets have significant potential for catch up.

AFMC's managers believe that investors should be thinking about adding to their exposure to frontier markets.

Anecdotally, AFMC's managers believe that the vast majority of investors have an underweight exposure to both emerging and frontier markets (data from EPR Global shows outflows from frontier markets of US$2.4bn during 2015 and US$1.0bn during the first 8 months of 2016) and they believe that, with China potentially turning a corner and the various challenges facing investors in developed markets, the attractions of frontier markets are once again becoming apparent. They believe that for a sustained recovery, investors will need to see earnings growth and improvements in the return on equity but that, should this occur, investors could return to the asset class with strength.

Investment process

The investment process comprises top-down market selection with bottom-up fund selection.

Aberdeen Frontier Market's portfolio is managed using a combination of top-down and bottom-up processes. The proportion of the portfolio invested in each component of frontier markets is determined on a top-down basis according to where the managers perceive the most attractive investment opportunities to be. Individual funds are then selected, bottom up, based on the managers' extensive fundamental research.

Asset allocation

The managers' view of individual country allocations is informed by a combination of internal factors (country analysis, extensive country visits and analysis of fund flows) and external factors (the views of the managers of the underlying funds).

When conducting their internal country analysis, the managers focus on:

- Country quality: balance sheet, external and fiscal accounts and foreign exchange reserves
- Value: trailing and forward P/E, P/B and dividend yield
- Growth outlook: for both GDP and corporate earnings

- Potential for change: political, economic, social and demographics.

Looking at the eternal factors, principally the views of the best of breed managers from the underlying funds, AFMC's manager highlight that:

- The underlying managers are experts on their own country/region
- AFMC's managers are able to have regular meetings and discussions with the underlying managers to update on market prospects
- AFMC's managers have strong relationships with the underlying managers, as long term investors, allowing them to benefit from better quality discourse.
- AFMC's managers also make an allowance for home country biases.

Identifying best of breed fund managers

AFMC's managers believe that due diligence and on-the-ground research are key to identifying best of breed fund managers and the team undertakes more than 300 meetings with managers a year (AFMC's managers will not invest in a fund without first having met the manager and conducted their due diligence). The due diligence process focuses on qualitative factors, with AFMC's managers aiming to gain an understanding of the investment process, the depth and stability of the team and their style, motivations, strengths and weaknesses. Particular attention is given to:

- Manager experience and relevance to current strategy
- Alignment of interest between managers and investors
- Access to management both pre and post investment
- Having a common sense, repeatable and consistently applied investment process
- Evidence of extensive due diligence on underlying investments
- Competitive fee structure
- Liquidity terms consistent with the underlying portfolio
- Operational integrity
- Awareness of ESG issues.

In addition to the above, the managers also employ statistical analysis, using proprietary and third-party databases to verify their qualitative findings. Consideration is given to:

- Performance history
- Return characteristics
- Underlying portfolio characteristics
- Quality and consistency of returns relative to peers.

Portfolio construction and monitoring

All members of the team attend a quarterly asset allocation meeting at which AFMC's top-down asset allocation is reviewed in line with the process described previously. Any changes are considered in conjunction with bottom-up conclusions. Individual holdings are discussed and changes to holdings will typically result from ongoing due diligence, changes in discounts for closed-end funds and changes to the asset allocation view. The balance of products and styles is also considered within the portfolio.

Risk management and investment restrictions

A number of restrictions are in place with the aim of ensuring that there are appropriate levels of concentration at a holding level and sufficient diversification at the geographic level. Specific restrictions include:

- A maximum of 10% of net assets can be invested in a single holding
- AFMC will generally not maintain long-term positions that do not exceed 1% of net assets
- A 15% maximum exposure to a single country
- Maintaining a high degree of diversification (typically 20-40 investments)
- Maintaining a mix of styles (growth, value, large cap, small cap, etc.)
- Investing a proportion of assets in markets uncorrelated with frontier markets
- Generally, not allowing cash to exceed 5% of the portfolio
- Altering the balance between open-and closed-ended funds depending on market conditions – e.g. reducing exposure to closed-end funds when discounts are especially narrow to reduce the risk of being exposed to discount widening and increasing exposure when discounts are wide, with the aim of benefitting from discount narrowing.

Asset Allocation

As at 31 August 2016, AFMC had 34 underlying investments (an increase of two over six months). The majority of these holdings were fund positions; open ended funds accounted for 52.7%, closed end funds 27.3% and ETFs/structured notes 11.7%. AFMC also holds a handful of direct equity positions (7.4%), whilst cash (including look through to underlying holdings) accounted for 0.9%.

The managers will tend to opt for direct equity positions in markets where they struggle to find the exposure that they are looking for in a fund, but can find companies they like that they can invest in directly. Examples would be the markets of Morocco and the Lebanon. They hold one Moroccan stock - Maroc Telecom. The managers consider this to be one of the best-run companies in Morocco. It meets their investment criteria and provides exposure to Moroccan growth. In Lebanon, the managers have selected BLOM Bank. The managers consider this overwhelmingly to be the best managed company of the three that constitute the MSCI Lebanon Index. When selecting direct equities for AFMC's portfolio, the managers say that they are also able to draw on the experience and resources and Aberdeen's 20 strong emerging markets team.

Concentrating on quality

AFMC's managers have increased manager concentration during the last 18 months, focusing on those they believe to be the best quality.

In terms of portfolio developments, AFMC's managers say that they have been making a conscious effort to reduce the number of underlying management houses, during the last 18 months, by focusing on those that they believe are best quality. They say that increasing scale with a particular manager gives them the opportunity to push harder to reduce fees (they say that the average fee has been reducing and the weighted average fee is now 1.06%).

Asset allocation developments

Figure 5 illustrates how AFMC's allocations have changed during the six months to the end of August 2016. The exposure to Africa has been reduced, some of which is performance related (see page 15). The exposure to Asia has increased, which is partly performance driven but the mangers have also been reducing exposure to the Middle East in favour of Asia. Elsewhere changes have been relatively modest.

Figure 5: Geographic allocation as at 31 August 2016

Geography	Allocation 31 August 2016 (%)	Allocation 29 February 2015 (%)	Percentage point change
Nigeria	6.9	8.2	(1.3)
Kenya	3.2	5.3	(2.1)
Morocco	2.2	2.3	(0.1)
Egypt	2.0	1.5	0.5
Other Africa	4.7	6.5	(1.8)
Vietnam	15.6	14.5	1.1
Pakistan	15.1	13.9	1.2
Bangladesh	2.5	2.9	(0.4)
Kazakhstan	2.1	1.9	(0.2)
Other Asia	1.9	1.8	0.1
Qatar	2.4	2.6	(0.2)
Other Middle East	5.5	4.5	1.0
Argentina	9.8	10.5	(0.7)
Other Latin America	0.3	0.3	0.0
Romania	9.3	9.9	(0.6)
Turkey	2.7	0.0	2.7
Slovenia	2.1	2.2	(0.1)
Other Eastern Europe	4.8	7.5	(2.7)
Unspecified	1.9	0.5	1.4
Indirect cash	5.5	3.7	(1.8)
Portfolio cash	(0.4)	(0.6)	0.2
Total	100.0	100.0	0.0

Source: Aberdeen Asset Management, Marten & Co.

Pakistan

Although not illustrated in Figure 5, the allocation to Pakistan has also increased (from 13.9% to 15.1%). The managers are positive on the outlook for Pakistan following MSCI's decision to upgrade its status from frontier to emerging market. Markets have already responded positively to the news but the managers expect to see further good performance as index buyers look to purchase in advance of Pakistan's inclusion in the emerging markets index in April 2017.

Vietnam

Vietnam accounted for 15.6% of the portfolio at the end of August, representing AFMC's single largest country exposure. The managers retain a positive stance on Vietnam. They say that discounts remain attractive on closed end fund investments and the long term outlook for the market remains positive, supported by solid macroeconomic fundamentals and that there are good bottom up stock picking opportunities for underlying managers. Sentiment has been boosted by progress on relaxing foreign ownership limits on individual stocks.

Argentina

AFMC's 9.8% weighting to Argentina reflects the team's belief that, despite continuing economic challenges, the country is now being managed more sensibly and that corporates will benefit from pro-market policies over the coming years. Paradoxically, Argentina's substantial debt market in is included in emerging market debt indices but its equity market is still considered frontier. This may change though, as MSCI has flagged it as a potential candidate for future promotion to emerging market status given the removal of capital controls since President Macri took office in December 2015. The managers say that Argentinian equities are reasonably valued and AFMC gains access through a manager based in Buenos Aires with over two decades of experience investing in the country.

Romania

Romania is another market favoured by AFMC's managers (it had a weighting of 9.3% at the end of August). In the managers' view, the country offers an exceptionally stable political situation relative to other regional peers with strong growth prospects. The managers say that Romania's GDP growth was the fastest in the region in the second quarter of 2016, at 6% year-on-year, supported by fiscal easing, strong investment growth and an acceleration in domestic demand. AFMC's exposure is largely gained through its holding in Fondul Proprietatea, a USD2bn closed end fund, which currently trades on a discount of c30%. This is despite it regularly returning capital to shareholders via tender offers and dividends.

Figure 6: Top 10 holdings as at 31 August 2016

Holding	Asset class, manager, style, structure	Allocation 31 August 2016 (%)	Allocation 29 February 2015 (%)	Percentage point change
Fondul Proprietatea GDR	Romanian private and listed equities, Templeton AM, value, Romanian closed-end fund	8.6	8.2	0.4
East Capital Balkan Fund	Balkan equities, East Capital AM, value and growth, Swedish open-ended fund	8.3	8.2	0.1
VinaCapital Vietnam Opportunity	Vietnamese private and listed equities and property, VinaCapital AM, value and growth, Cayman closed-end fund	7.8	6.9	(0.6)
Tundra Pakistan Fund	Pakistani equities, Tundra Fonder AB, value and growth, Swedish open-ended fund	7.7	7.5	0.2
PXP Vietnam Emerging Equity Fund	Vietnamese equities, PXP Vietnam AM, undervalued growth, Cayman open-ended fund	7.1	6.3	0.8
Advance Copernico Argentina	Argentine equities, Copernico Capital Partners, Value, Cayman OEIC	7.0	7.6	(0.6)
SCM Africa Fund	African equities, Steyn Capital; quality and value, Mauritius OEIC	4.8	5.4	(0.6)
Sturgeon Central Asia Equities	Central Asian equities, Sturgeon Capital, value, Luxembourg SICAV	4.8	4.0	0.8
SC Africa Consumer Fund	African Consumer equities, Sustainable Capital, rules-based market value independent, Mauritius OEIC	4.2	5.7	(1.5)
MSCI Pakistan	Pakistani equities, Bank of America Merrill Lynch, index tracker, ETF	3.9	3.4	0.5
Total top 10 holdings		64.2	65.3	(0.9)

Source: Aberdeen Asset Management, Marten & Co.

Kuwait is a difficult frontier markets to access. It has a poor record of corporate governance.

Underweight exposure to Kuwait

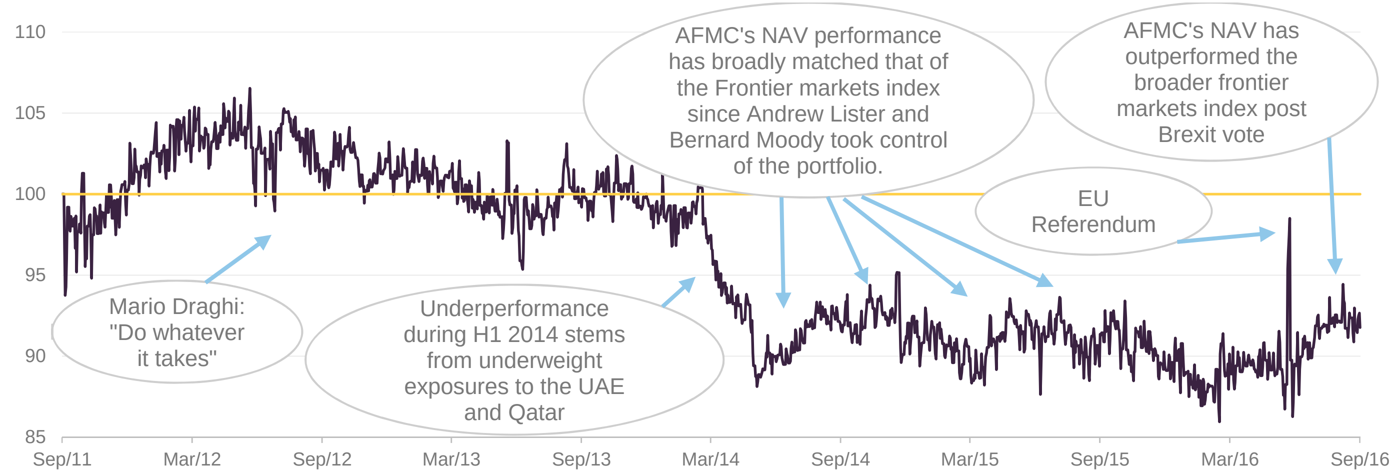
With an allocation of 1.0% as at 31 August 2016, AFMC has a marked underweight exposure to Kuwait (the index allocation is around 20%). AFMC's managers say that they have not been able to find a fund manager, operating in the region, that they can get comfortable with and, with such a thinly traded stock market and poor corporate governance record, it is difficult to gain exposure to companies that they like with adequate liquidity. However, they continue to review this on an ongoing basis.

Performance

Figure 7 provides an illustration of how AFMC's NAV has performed over the last five years relative to frontier markets (as represented by the MSCI Frontier Markets Index). It shows the trend has been one of underperformance versus frontier markets during the last five years. However, whilst informative, the relative performance of the MSCI Frontiers Index should be interpreted using a degree of caution (see page 7 for further discussion of why the frontier markets index is not used as a formal benchmark). Crucially, AFMC's managers do not consider the index to be truly representative of the underlying investment universe and AFMC's portfolio is not constructed with reference to it. The managers believe that the index is too concentrated and that greater diversification will lead to superior returns over the longer term. For example, approximately 20% of the index is invested in Kuwait, but this is a market which is very thin and overseas investors, in particular, have very limited access.

Looking at Figure 7, it can be seen that much of the underperformance occurred during the first half of 2014. This was prior to the current managers taking control of the portfolio but was also a period during which Qatar and the United Arab Emirates (significant underweights for AFMC) benefitted strongly in the run up to their promotion to emerging market status. From the announcement of their promotion in June 2013 and this taking place in May 2014 Qatar and the UAE rallied 88.3% and 39.7% respectively (in sterling equivalent terms), whilst the MSCI Frontier Markets Index increased by a more pedestrian 23.5% Whilst the UAE and Qatar comprised 33.7% of the index at their exit, AFMC's exposure was markedly lower at 7.4%. Both markets fell sharply the month after their promotion but AFMC's relative performance did not see any benefit from this. Indeed, had they had a full weighting, this position would have taken time to work out and AFMC would have likely seen a strong negative impact.

Figure 7: AFMC NAV/MSCI Frontier Markets Index – rebased to 100 since 30 September 2011



Source: Morningstar, Marten & Co.

AFMC's relative performance also suffered from overweight exposures to commodities and energy, which have struggled during the last five years, as well having an underweight exposure to Asia, whose frontier markets have been among the better performers.

Figure 8 illustrates that both AFMC's NAV and share price have outperformed global markets (as represented by the MSCI World Index), since AFMC's launch in 2007. It is also worth noting that both AFMC's NAV and share price total returns, whilst behind those of global and emerging markets, are ahead of the frontier markets index since the current management team have been in place. However, emerging markets and frontier markets have been very much out of favour during the last five years and have underperformed world markets by a substantial margin. As illustrated in Figure 8, this trend appears to have stabilised during the last six months.

Figure 8: Cumulative total return performance to 30 September 2016

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	Managers*	Since launch**
AFMC NAV	3.0	8.4	17.8	18.7	16.2	40.8	10.3	36.8
AFMC share price	0.4	8.4	18.0	23.6	15.8	50.9	12.9	18.0
MSCI Frontier Markets	3.4	5.7	14.4	18.2	25.6	53.4	9.1	18.0
MSCI Emerging Markets	2.2	12.3	21.7	36.7	23.9	41.7	29.0	68.9
MSCI World	1.4	8.0	17.6	30.6	50.3	113.9	43.2	107.9

Source: Morningstar, Marten & Co. * Note: Andrew Lister and Bernard Moody assumed responsibility for the management of AFMC's portfolio from 1 July 2014. **Note: The fund was launched on 15 June 2007.

Overweights to Vietnam and underweights to Nigeria and Kuwait made significant positive contributions.

Taking a closer look at AFMC's NAV performance, for the year to 30 September 2016, AFMC's managers say that outperformance was driven by both manager selection and asset allocation. AFMC's Vietnamese funds were strong performers (PXP Emerging Market Equity Fund, VinaCapital Vietnam Opportunity and Vietnam Holdings). Fondul Proprietatea of Romania was a notable detractor, which AFMC's managers attribute to its high energy exposure. Geographically, underweights exposures to Nigeria and Kuwait provided significant positive contributions as did overweights to Pakistan, Vietnam and Romania. In terms of detractors, an underweight exposure to Argentina, an off-index exposure to Saudi Arabia and an underweight to Morocco were negative, as were discounts which generally widened (Pakistan Holdings and Africa Opportunity Fund being notable examples).

Peer group comparison

Please visit QuotedData.com for a live comparison of AFMC and its Global Emerging Markets peer group.

AFMC is a member of the AIC's nine-member strong global emerging markets sector. However, of this peer group, only one other fund, BlackRock Frontiers, is focused primarily on frontier markets. The rest are focused primarily on emerging markets and so, whilst they are arguably the closest peers, they are not necessarily ideal comparators. Furthermore, there is quite a diverse range of fund sizes and investment styles and so broad-brush comparisons, made across the entire sector, are arguably of limited use.

As illustrated in Figure 9, over five years, AFMC's NAV total return performance ranks third amongst its peers and its three- and five-year returns are ahead of the sector averages. Over the shorter time periods, AFMC's NAV total returns have been modestly below those of the peer group averages although this arguably reflects the sector's bias towards emerging markets, rather than frontier markets. Year to date, emerging markets have experienced a more marked recovery than frontier markets. Looking at Figure 10, which illustrates the share price total return performances of the global emerging markets peer group, the pattern is similar. AFMC's return is greater than the sector average over the five-year period, is in line over three years and less over the shorter time frames, with the difference being noticeably wide over the one-year period.

Figure 9: Peer group NAV total return performance to 30 September 2016 (annualised for periods over one year)

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
Aberdeen Frontier	0.4	8.4	18.0	23.6	5.0	8.6
Aberdeen Emerging	5.1	11.7	21.1	32.5	5.9	4.3
Ashmore Global Opps	0.7	3.8	17.3	1.8	(7.8)	(12.2)
Ashmore Glbl Op USD	1.5	8.2	17.8	8.5	(4.9)	(10.5)
Blackrock Frontiers	3.2	10.7	23.4	30.0	8.8	15.5
Fundsmith Emerging	0.2	10.2	14.0	16.4		
Genesis Emerging	1.8	10.6	22.6	36.3	2.5	6.2
JPMorgan Emerging	1.7	11.0	22.8	35.9	9.0	8.4
JPMorgan Em. Inc.	3.8	20.3	30.1	43.0	4.9	8.5
Templeton Emerging	1.1	13.7	29.1	46.7	3.5	3.6
Utilico Emerging Mrkt.	(0.5)	8.5	17.9	35.9	9.8	12.5
AFMC rank	9	9	7	8	5	3
Sector arithmetic avg.	1.7	10.6	21.3	28.2	3.7	4.5

Source: Morningstar and Marten & Co.

Figure 10: Peer group share price total return performance to 30 September 2016 (annualised for periods over one year)

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
Aberdeen Frontier	1.8	5.7	16.9	17.7	4.6	6.8
Aberdeen Emerging	1.8	11.9	22.2	36.5	7.3	6.0
Ashmore Global Opps	(0.1)	(1.3)	(2.2)	4.2	(10.2)	(10.0)
Ashmore Glbl Op USD	0.8	3.3	10.2	22.9	(2.8)	(6.4)
Blackrock Frontiers	2.9	7.3	21.0	27.4	10.6	14.5
Fundsmith Emerging	0.8	5.6	14.4	20.0		
Genesis Emerging	1.3	8.2	19.9	35.0	6.6	7.4
JPMorgan Emerging	2.7	9.4	23.1	35.7	10.1	9.2
JPMorgan Em. Inc.	2.8	10.7	22.2	36.7	5.6	9.3
Templeton Emerging	4.1	13.9	29.6	49.2	5.4	5.3
Utilico Emerging Mrkt.	(1.1)	7.0	13.4	29.9	9.5	11.8
AFMC rank	5	8	7	10	8	6
Sector arithmetic avg.	1.6	7.4	17.3	28.6	4.7	5.4

Source: Morningstar, Marten & Co.

Whilst not the smallest fund in the peer group, AFMC's market cap is markedly below the sector average, but there is still reasonable liquidity in its shares; at current prices, the value of its one-year average daily volume of shares traded is £155.8k.

AFMC's smaller size also explains why its ongoing charges are at the top end of the range although it should be noted that AFMC's ongoing charges are not that much higher than some funds that are considerably bigger. Moreover, its ongoing charges are comparable to those of Blackrock Frontiers, which is its closest competitor.

AFMC's discount is tighter than that of the sector average, suggesting demand for its strategy although the discount has moved within a range of 3.6% to 13.3% during the last three years. In terms of gearing, AFMC's exposure, at both the gross and net level, is comparable to that of the peer group average.

Figure 11: Peer group comparison – size, fees, discount, yield, gearing as at 2 November 2016

	Market cap (£m)	Value of avg. daily volume* (£000s)	Ongoing charges (%)	Perf. fee	Discount (%)	Dividend yield (%)	Gross gearing	Net gearing
Aberdeen Frontier	112.8	155.8	1.7	Yes	(4.3)	3.0	102	97
Aberdeen Emerging	313.6	394.7	1.2	Yes	(12.1)	0.0	100	100
Ashmore Global Opps	43.5	86.6	0.5	Yes	(20.7)	0.0	100	82
Ashmore Glbl Op USD	43.5	17.6	0.5	Yes	(29.2)	0.0	100	82
Blackrock Frontiers	216.3	347.5	1.5	Yes	(1.0)	3.5	123	108
Fundsmith Emerging	249.6	435.6	1.7	No	2.7	0.0	100	100
Genesis Emerging	945.9	1,140.8	1.4	No	(11.6)	0.0	100	100
JPMorgan Emerging	1,047.6	1,297.1	1.2	No	(12.0)	1.1	102	101
JPMorgan Em. Inc.	363.6	719.8	1.2	No	(0.1)	3.9	106	103
Templeton Emerging	1,977.9	3,762.5	1.2	No	(13.7)	1.2	100	100
Utilico Emerging Mrkt.	487.6	120.5	1.1	Yes	(11.2)	2.8	120	118
AFMC rank	9	8	11		4	6	4	9
Sector arithmetic avg.	527.5	767.5	1.2		(10.3)	1.1	104.6	98.5

Source: Bloomberg, Morningstar and Marten & Co. * Note: value of average daily volume is calculated using the average daily number of shares traded to 2 November 2016 and closing prices as at 2 November 2016. All in sterling equivalent terms.

Initiating a semi-annual dividend

AFMC to initiate semi-annual dividend payments in June and December of each year.

On 14 June 2016, AFMC announced that, following consultation with major shareholders, it is its board's intention to introduce semi-annual dividend payments. Our expectation is that these will be structured as an interim payment in June with a final payment in December of each year.

Assuming that shareholders approve its payment at the forthcoming AGM on 12 December 2016, the first dividend is expected to be paid on 19 December and will be in respect of the second half of the financial year ended 30 June 2016. The initial dividend is to be US¢ 1.2 per share. However, whilst the dividend has been proposed as a US dollar amount, the dividend is to be paid in sterling and the sterling rate is to be announced in due course. Using an exchange rate of 1.2519, as at 4 November 2016, a US¢ 1.2 is equivalent to a dividend of 0.959p, which is a yield of 1.5% on the share price of 65.5875p.

Increasing marketability and moderating the discount

AFMC's board considers that the dividends are an increasingly important consideration for investing in frontier markets.

Reflecting AFMC's long-term capital growth objective, the company's dividend policy has historically been to not declare annual dividends. However, the board now considers that the cash-generative nature of many frontier companies, and the dividends into which this can translate, is increasingly an important part of the rationale for investing in frontier markets as an asset class. The board is also aware that this is an evolving practice elsewhere in the market and believes that initiating regular dividend payments should enhance the marketability of the company's shares and help to moderate discount volatility. We share these views. It is worth noting that, whilst not all of the funds in the global emerging markets peer group pay dividends, seven out of the 11 funds do and the introduction of a semi-annual dividend brings AFMC into line with its closest competitor, BlackRock Frontiers.

Base dividend will be set with reference to the look through yield

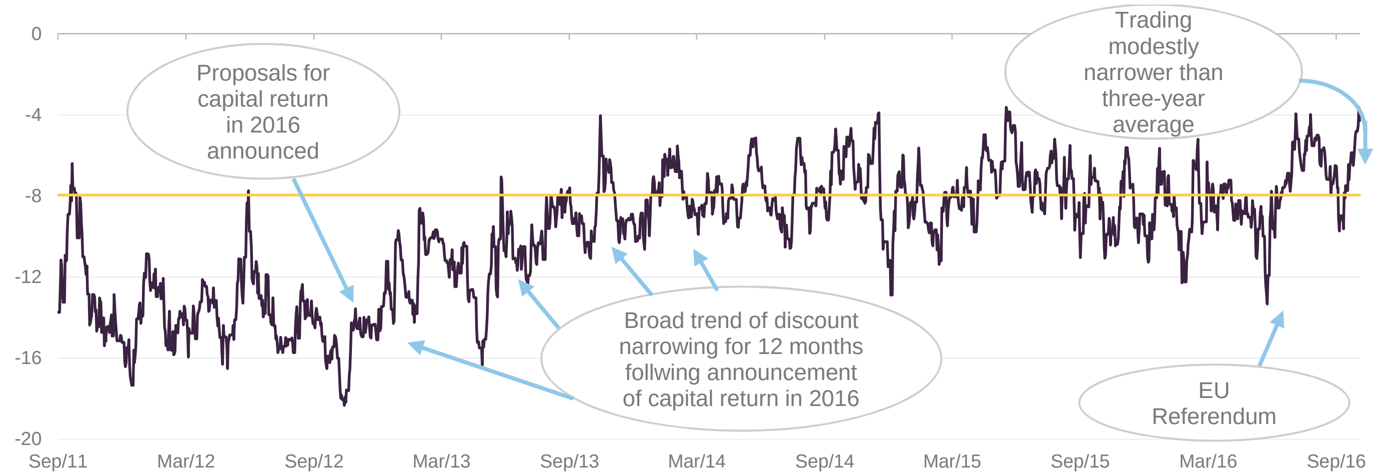
Dividend level to be set with reference to the manager's calculation of the yield on the underlying portfolio.

The company says that the base level of dividend will be set with reference to the Investment Manager's calculation of the yield on the underlying portfolio on a look-through basis, less relevant costs. The rationale behind this approach is that it will allow AFMC to offer a yield that is a better reflection of that available from frontier markets than if it purely relied on the cash income it receives.

This is because many of the underlying funds, in which AFMC invests, have 'accumulation share classes'. Under these, any income received is retained and rolled up into the capital value of these shares and, as a consequence, this underlying income is effectively hidden as capital within AFMC's own accounts. As such, whilst AFMC will likely be paying a significant proportion of its dividends from its capital account, the managers say that this is somewhat misleading as any payment from capital will largely reflect the otherwise 'hidden income'.

Premium/discount

Figure 12: Premium/(discount) over five years



Source: Morningstar, Marten & Co.

Five-yearly tender offers

With a view to controlling the discount to NAV, at which the company's shares trade, AFMC offers shareholders the opportunity, at five-yearly intervals, to exit the company at NAV less costs. The rationale behind the mechanism is that it allows AFMC's managers to take a longer-term view, which is consistent with investing in frontier markets, whilst giving investors the certainty of a periodic exit at close to NAV.

AFMC also has the authority to repurchase up to 14.99% of its issued share capital and to issue up to 20% of its issued share capital per annum. However, whilst AFMC's board has previously said that it will consider buying back shares if it considers it to be in shareholders' interests to do so, there is no formal discount target and the board has only just started to utilise it (despite these authorities being in place since the company's launch in 2007). AFMC's first repurchase of shares was made on 5 October 2016 and, since this time, a total of 200k shares (0.1% of issued share capital) have been repurchased. Given AFMC's size (a market cap of £111.0m as at 4 November 2016) and that the company also offers five-yearly tender offers, we expect that AFMC's board will continue to be judicious in their use of share repurchases.

As illustrated in Figure 12, following the announcement of the introduction of the tender offer in December 2012 (this was structured as a first tender in 2016 and then at five-yearly intervals thereafter) the discount followed a broad path of narrowing, albeit with considerable volatility, during the following twelve months. Thereafter the trend stabilised and, for the last three years, AFMC has traded within a range (a minimum of 3.6% and a maximum of 13.3%). The current discount of 3.2% is narrower than its three-year average of 7.9% and, if this narrow discount continues, the managers say they will seek to place any shares tendered and, if possible, expand the fund at the time of the tender offer. This would have the beneficial effect of increasing liquidity in AFMC's shares and lowering its ingoing charges ratio.

An improving outlook for frontier markets and the introduction of the semiannual dividend could both contribute to a narrowing of the discount.

Frontier and emerging markets have faced a number of headwinds in recent years, not least a slowing China and lower demand for energy and commodities, which has arguably dampened demand for such strategies. However, it seems that the outlook is gradually improving and it seems reasonable that this could stimulate demand for shares. A further consideration for AFMC is the introduction of its semi-annual dividend. The board believes that this will increase the marketability of the trust and, if correct, this could also contribute to a narrowing of the discount. They also believe that the movement of the management contract to Aberdeen, and the benefits this brings, should also improve the company's marketability and help in this regard. The managers highlight that they now have access to Aberdeen's 20 strong emerging markets equities team, AFMC also has access to Aberdeen savings scheme and, now AFMC has been renamed, they think it should also benefit from Aberdeen's strong brand recognition.

A further consideration is that the tender offer process will likely clear out any near term sellers and, bar any near term market disruptions, we believe this should have a positive impact on AFMC's share price.

Fees and costs

Base fee

Under the terms of its management agreement with Aberdeen Emerging Capital, AFMC pays a base management fee of 1.25% per annum of the lower of market capitalisation and NAV. This fee structure incentivises the manager to minimise the discount and, because AFMC has recently been trading at a discount (one-year average 8.1%), the manager's fee as a proportion of gross assets is lower (approximately 1.1%). The fee is calculated, and paid in arrears, on a monthly basis.

Performance fee

Under the terms of the management agreement, Aberdeen Emerging Capital is also entitled to a performance fee. However, since listing in 2007, AFMC has paid a performance fee for just one of its financial years (a performance fee of US$1.87m was paid in relation to the year ended 30 June 2014).

The performance fee, for a given reporting period, is equal to 12% of the amount by which the period end NAV per share exceeds AFMC's target NAV per share, multiplied by the weighted average number of shares during the period. The target NAV per share is defined as being the highest of:

- AFMC's high watermark. This is the NAV per ordinary share, after the deduction of the relevant performance fee, as at the end of the latest performance period in respect of which the manager was awarded a performance fee (currently US$1.0798 per share). The minimum high watermark is US$1.00 per share.
- The NAV per share at the start of the reporting period increased by a hurdle rate of 12%.

In addition to this, the performance fee, in respect of a particular reporting period, will not exceed 3% of the Company's total NAV, before the deduction of any performance fee, at the end of that reporting period.

Fees on underlying funds

Although AFMC has some direct investments, the majority of its underlying investments are in funds (52.7% open ended and 27.3% closed end as at 31 August 2016, see page 11 for more detail on asset allocation) and the managers of these funds will also charge fees. These fees will vary from fund to fund but AFMC's managers say that the weighted average fee is 1.06% per annum and that they believe the average all-in cost to be in the region of 1.25% per annum. However, Aberdeen has a scale advantage and will not only be able to access funds that are only open to institutional investors but, in many instances, will be able to access funds with a superior fee structure.

Company secretary and administration arrangements

Vistra Fund Services (Guernsey) Limited (Vistra) is appointed as administrator and secretary to AFMC. Vistra effectively receives a fee of £30k per annum for the secretarial services it provides. It also receives the fee for the administration services but this is passed through to the UK administration agent, PraxisIFM Fund Services (UK) Limited (PraxisIFM), to which Vistra has delegated the provision of administration services. PraxisIFM receives a monthly fee equal to one twelfth of 0.1% of the company's net assets subject to a maximum fee cap. For the year ended 30 June 2016, the fee cap was £125,000. Both Vistra and PraxisIFM's contracts of appointment are subject to six months' notice.

Allocation of fees and costs

Reflecting the board's expectation that future returns will predominantly be derived from capital, AFMC's management fee and finance costs are charged one-third to revenue and two-thirds to capital. All other fees are charged wholly to revenue with the exception of any performance fees, which are charged wholly to capital.

AFMC's ongoing charges, for the year ended 30 June 2016, were 1.67% (2015: 1.64%). As illustrated in Figure 11, AFMC's ongoing charges are at the top end of the range for its peer group, reflecting that its size is markedly below the sector average. However, AFMC's ongoing charges are not that much higher than some funds that are considerably bigger and are comparable to those of its closest competitor.

Capital structure and life

AFMC has one class of ordinary share in issue. These are listed on the AIM segment of the London Stock Exchange.

AFMC has a simple capital structure with one class of ordinary share in issue. Its ordinary shares are listed on the AIM segment of the London Stock Exchange and, as at 4 November 2016, there were 169,260,000 in issue with 200,000 held in treasury.

Borrowing via a revolving loan facility

AFMC is permitted to borrow and has a US$6m revolving loan facility, with Investec Bank Plc, for this purpose. Borrowings, for investment purposes, are limited to 10% of net assets, at the time of drawdown. The managers would normally expect gearing to be approximately 3% but would expect the fund to be close to fully invested on a look through basis. In addition to this, AFMC is permitted to use an overdraft, or another short-term borrowing facility, to meet its working capital needs. As at 30 September 2016, AFMC had gross gearing of 3.1% and net cash of 2.1%.

Life

AFMC has an indefinite life. Shareholders are given the opportunity to exit the company, at NAV less costs, at five-yearly intervals.

AFMC has an indefinite life. Previously shareholders were offered three-yearly continuation votes (the last of these was held at the company's AGM in 2014), but AFMC's board decided to replace this with a commitment to offer shareholders the opportunity to exit the trust at NAV less costs at five-yearly intervals (see page 18).

Financial calendar

The company's year-end is 30 June. The company's annual results are usually released in September (interims in February) and its AGMs are usually held in December of each year. As discussed on page 17, the company is introducing semi-annual dividend payments. It is anticipated that an interim dividend will be paid in June and a final dividend paid in December of each year.

Board

AFMC's board has been refreshed during the last 12 months.

The board comprises four non-executive directors, all of whom are deemed independent of the investment manager. The last 12 months have seen a significant refresh of the board with the retirement of Helen Green and Grant Wilson, both of whom had been directors since the company's launch in 2007; and the appointment of David Warr and Lynne Duquemin. Guernsey-based John Whittle, a director since 2012, replaced Grant Wilson as chairman. Richard Hotchkis is now the only director to have served on AFMC's board since launch.

The company's articles of association require that one third of the directors put themselves forward for re-election, on an annual basis, and that all directors automatically stand for election at the first AGM following their appointment. Richard Hotchkis is to offer himself for re-election, by rotation, at this year's AGM.

The average number of years of fees invested is relatively low, but reflects the recent refresh of the board. Richard Hotchkis, the longest-serving director, has two years of fees invested in the company, which is favourable in our view, as it helps to align a director's interests with those of shareholders.

Figure 13: Board member - length of service and shareholdings

Director	Position	Appointed	Length of service (years)	Annual director's fee (GBP)	Share-holding*	Years of fee invested*
John Whittle	Chairman	1 February 2012	4.8	35,000	11,000	0.2
David Warr	Chairman of the Audit Committee	9 September 2015	1.2	30,000	-	-
Lynne Duquemin	Director	18 February 2016	0.7	25,000	-	-
Richard Hotchkis	Director	25 April 2007	9.5	25,000	80,000	2.1

Source: Aberdeen Frontier Markets Investment Company, Bloomberg, Marten & Co. *Note: shareholdings as per most recent company announcements as at 2 November 2016. Years of fee invested based on AFMC ordinary share price of 65.5875p as at 4 November 2016.

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