

Frontier Markets and Emerging Small Countries: Elements of an Emerging Asset Class

WHAT ARE FRONTIER MARKETS?

Frontier markets represent the smaller countries that many consider to be a subset of emerging markets. As yet undiscovered by many investors, these markets have lower market capitalizations and less liquidity than more developed emerging markets. They include publicly listed companies across Asia, Africa, Europe, Latin America and the Middle East. Many companies in frontier markets have very limited analyst coverage and offer undiscovered investment opportunities.

Over the last 10 years, a number of indices have emerged to help investors define the frontier markets universe. The MSCI Frontier Markets Index is comprised of 25 countries, with six additional countries currently under consideration. The indices include large, mid and small cap companies. Many other countries have similar characteristics and are not included in frontier market indices. Table 1 below gives a partial list of the countries identified and/or visited by the International Equity Team at Wasatch Advisors, which the team defines as Frontier Markets/Emerging Small Countries.

Frontier markets include countries with large populations, favorable demographics with age distributions that skew younger than more developed economies, and a growing middle class. The gross domestic product (GDP) per capita of many frontier countries is much lower than traditional emerging markets — but growing at a very fast rate. Other frontier markets are found in oil-rich Middle East countries that have high GDPs per capita and smaller populations, but exhibit fewer aspects of the urbanization and emerging middle class trends seen in much of the frontier universe. (GDP data source: The World Bank. World Development Indicators, June 2011.)

Wasatch Advisors has chosen a fundamental investment strategy that will invest in frontier markets and smaller emerging market countries with similar economic characteristics. Wasatch believes that its bottom-up, research-intensive investment process is particularly compelling in this emerging asset class for two primary reasons:

- In Wasatch's opinion, higher GDP growth trends in these markets with the potential "demographic dividend" of young and growing populations are what Wasatch believes make these markets an especially attractive universe for stock investing.
- Wasatch's research indicates that market inefficiencies exist in an information asymmetry that derives from an under-covered stock universe with investment opportunities largely untapped by foreign investors.

Table 1—Frontier Markets/Emerging Small Countries

Index-listed Frontier Markets	Index-listed Frontier Markets (<i>continued</i>)	Non-Index-listed Frontier Markets	Emerging Small Countries
Argentina	Lithuania	Malawi	Mexico
Bahrain	Mauritius	Swaziland	Malaysia
Bangladesh	Namibia	Uganda	Indonesia
Botswana	Nigeria	Zimbabwe	Thailand
Bulgaria	Oman	Fiji	Chile
Colombia	Pakistan	Georgia	Poland
Cote d'Ivoire	Panama	Mongolia	Turkey
Croatia	Qatar	Nepal	Colombia
Cyprus	Romania	Uzbekistan	Philippines
Ecuador	Serbia	Armenia	Peru
Estonia	Slovakia	Bolivia	Czech Republic
Ghana	Slovenia	Cayman Islands	Egypt
Jamaica	Sri Lanka	Costa Rica	Hungary
Jordan	Trinidad and Tobago	El Salvador	Morocco
Kazakhstan	Tunisia	Guyana	
Kenya	Ukraine	Paraguay	
Kuwait	Vietnam	Uruguay	
Latvia	Zambia	Venezuela	
Lebanon		Saudi Arabia	

Note: Wasatch Advisors may include additional countries from frontier and other emerging markets as it defines them in the principal strategies section of the Wasatch Frontier Emerging Small Countries Fund prospectus.

Wasatch believes frontier markets and many smaller emerging market countries have investment characteristics and inefficiencies that today are totally different than the BRICs—Brazil, Russia, India and China—countries that have grown to become much more developed markets, which tend to dominate emerging market indices and investment managers’ strategies. In that sense, some frontier markets may be the next BRICs, and may offer the same kind of early investment opportunity that the BRIC countries did when that phrase was coined back in 2001.

While most frontier market countries face significant challenges, many of them may be more economically advanced, less volatile and less dependent on the state of the global economy than commonly perceived. Some countries are considered frontier markets simply because they are smaller, somewhat neglected and their securities are less liquid. Yet Wasatch believes that frontier countries will grow faster than the rest of the global economy by becoming more efficient, improving their infrastructure, and developing more robust regulatory and capital investing frameworks.

What kinds of publicly-listed companies are in the investable universe of frontier and small emerging markets? They range from consumer companies and retailers that cater to the nascent middle class of these countries to infrastructure, materials and financial companies. Many investors are also unaware of the frontier and emerging market listings for multinationals—in Africa and Asia for example—of companies like Unilever Ghana Ltd. and Pepsi-Cola Products Philippines, Inc.*

FACTORS DRIVING THE OPPORTUNITY

Wasatch believes equity investing in frontier market countries and the countries that are the smallest in the traditional emerging market indices represents what Wasatch sees as a vast opportunity for investors willing to do their homework and put boots on the ground. The investment opportunity is driven by the macroeconomic and demographic characteristics of many of these countries.

Frontier Market Countries have High GDP Growth Projections Compared to Developed Economies.

Nominal and real GDP growth rates estimated by the International Monetary Fund (IMF) for frontier markets are expected to be higher than the advanced economies of the U.S., Europe and Asia for many years.

Several economic studies of national growth rates have advanced evidence of a “convergence of income where a country with a low initial income relative to its own long-run (or steady-state) potential level of income will grow faster than a country that is already closer to its long-run potential level of income.”¹ In a 1997 Harvard Institute for International Development study that examined 25 years of Asia, Southeast Asia and South Asia growth data, the long-run levels of per capita income depended on two main kinds of variables: economic policies and economic structure. Wasatch believes that there are even more encouraging signs of open economic policies and structural change today in many of the frontier and smaller emerging markets where it performs company research.

Meanwhile, Wasatch’s research indicates that outsourcing and globalization trends continue to create jobs and drive growth toward frontier countries. There is every reason to expect these trends to continue as burdensome regulations and taxation within the developed world continue to escalate.

Historic and Projected GDP Growth



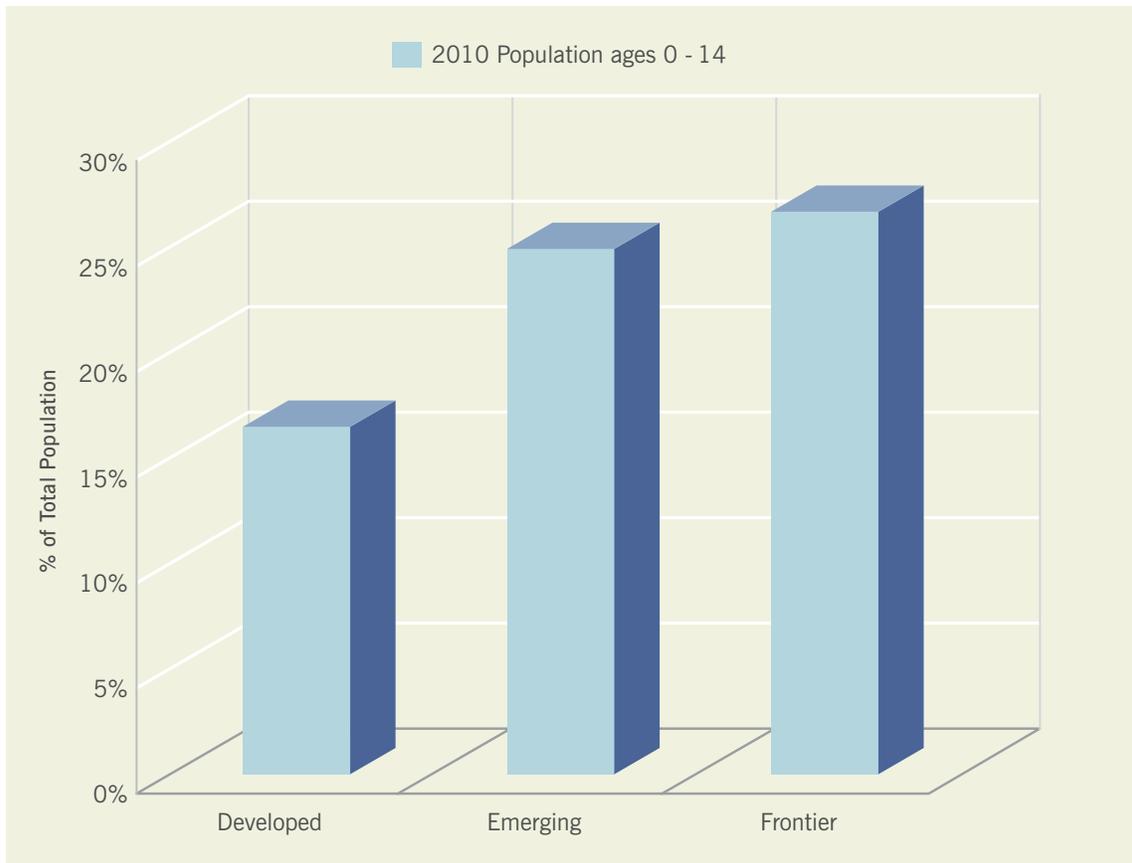
Source: International Monetary Fund, World Economic Outlook Database, September 2011.

Powerful Demographic Factors and Population Growth

Many frontier market countries have large populations and the favorable demographic of a younger population. Only 14% of the people in Japan and Italy are under age 15, whereas in Zambia, Tanzania and Bangladesh, this proportion of the population is much higher (46%, 43% and 36%, respectively).² As urbanization accelerates in these countries, domestic demand-oriented companies are expected to develop around a growing middle class. These factors bode well for finding companies with scalable business models that can target the large and growing populations in these countries.

The skew of frontier market populations toward a younger age supports other favorable elements. In contrast to many of the world’s more advanced economies, most frontier countries have a favorable ratio of their working population to their current or projected retirement population. Wasatch Advisors believes that trying to capture growth from companies poised to benefit from this “demographic dividend” is an attractive part of the thesis for investing in frontier markets.³

Younger Population



Source: The World Bank, December 15, 2011.

Liquidity and Foreign Investment Flow Trends have Historically Helped Drive Returns in Emerging Markets.

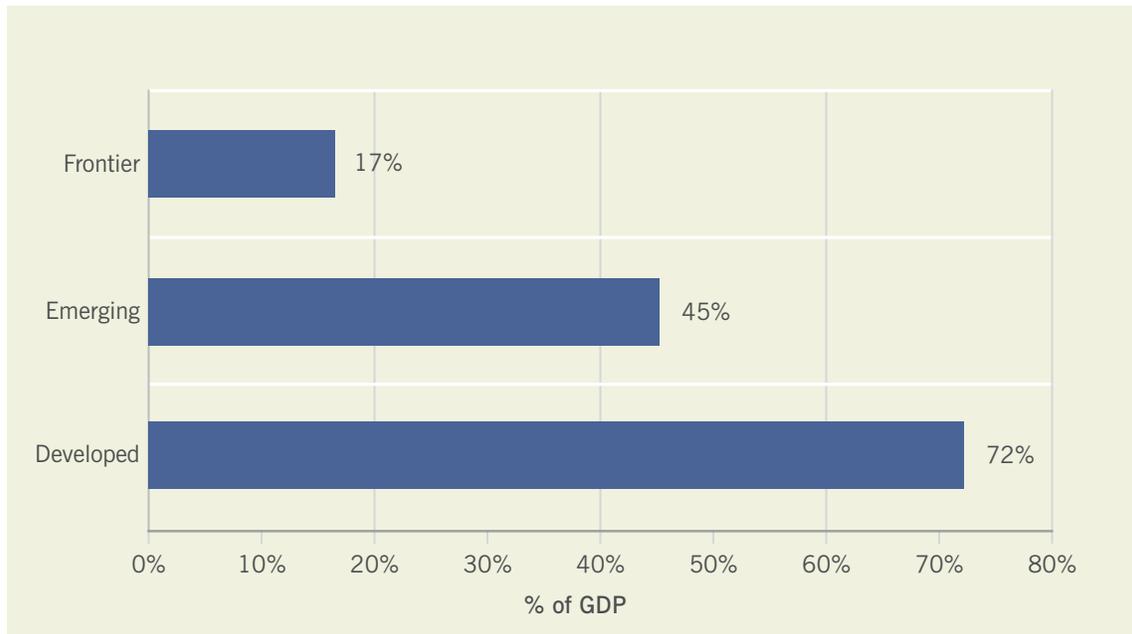
Frontier markets have a much lower average market capitalization compared to the respective country's GDP. IMF data (see chart below) show much smaller stock markets for frontier countries as a percentage of their GDP even compared to emerging markets.

Data from around the world indicate that a country's total market capitalization typically represents an increasing share of GDP as rising incomes and economic prosperity allow the financial structure of the country to develop. The result is that stock markets of smaller, neglected countries have the potential to grow much faster than their economies.

For example, in 1985, Mexico's equity market capitalization was 0.71% of GDP and was only accessible by foreigners through the Mexico Fund trading on the New York Stock Exchange. In 1995, this figure had risen to 20.53% of Mexico's GDP, and U.S. investors held about 19% percent of the market.⁴

In summary, the imbalance between the world's investment in frontier markets and these countries' share of world population and GDP is palpable. Today, frontier countries account for **21.6%** of the world's population, **6%** of its nominal GDP, and **only 3.1%** of world market capitalization.⁵

Average Market Capitalization of Publicly Listed Companies as a % of GDP



Source: IMF World Economic Outlook data, April 2011.

Frontier Markets have Historically Low Correlation of Returns to the Markets of the U.S. and other Advanced Economies.

Due to their low level of integration with more-developed world markets, frontier markets offer significant potential portfolio diversification benefits. Frontier markets remain largely local in character, driven mostly by the country’s own economic and political development. Additionally, primary drivers of growth differ significantly from country to country—a factor that results in lower correlations *between* the frontier countries themselves.

Correlation of Market Indices 5/31/2002 – 12/31/2011

	MSCI Frontier Markets Index	S&P 500 Index	MSCI Emerging Markets Index	MSCI EAFE Index
MSCI Frontier Markets	1.00			
S&P 500	0.49	1.00		
MSCI Emerging Markets	0.55	0.82	1.00	
MSCI EAFE	0.58	0.90	0.91	1.00

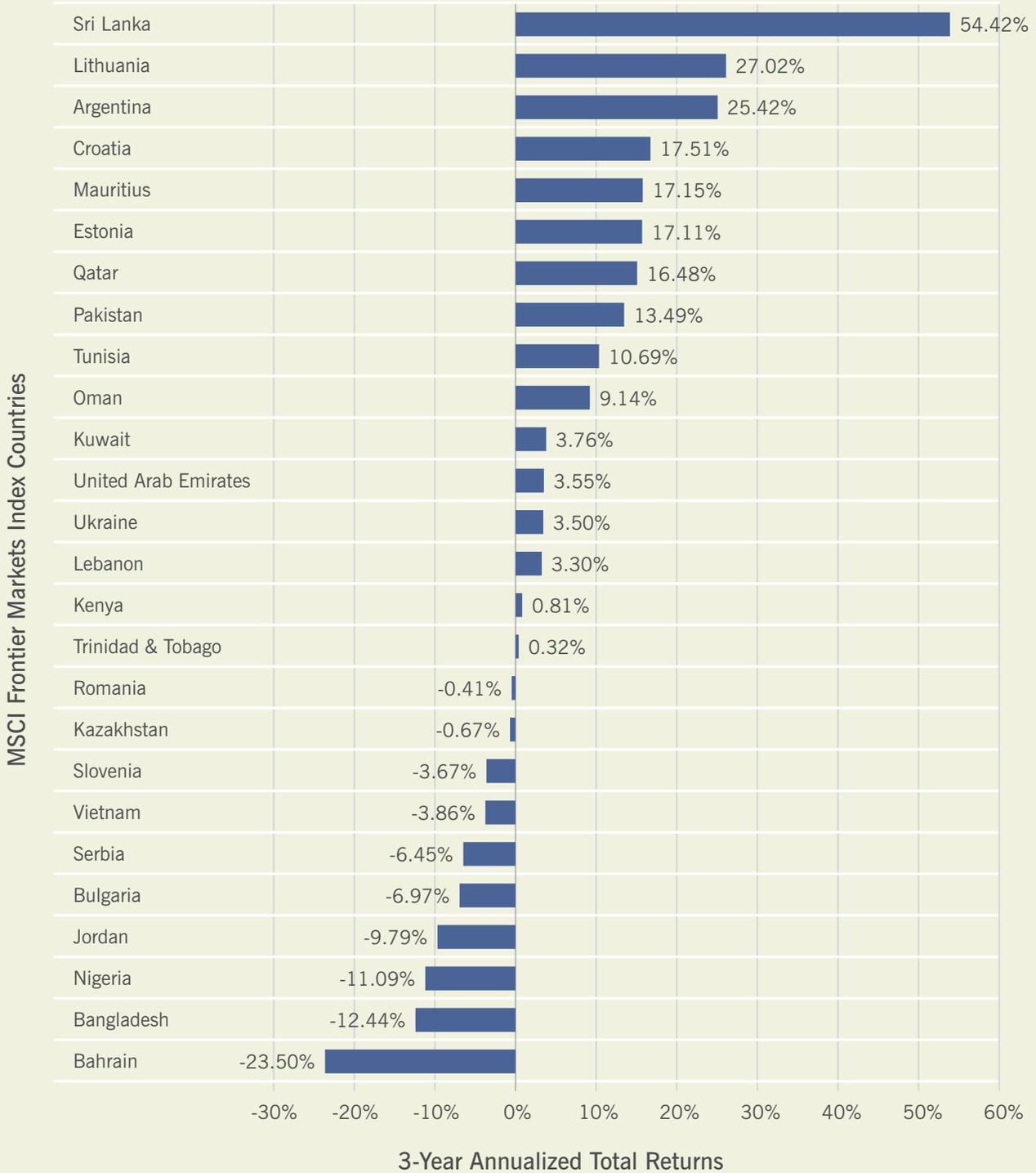
Source: Morningstar Direct. Monthly Return Correlation, \$USD, 5/31/02 - 12/31/11. Past performance is no guarantee of future results.

Just as with emerging market investments, an allocation to frontier and smaller emerging markets may have the same risk-return optimization effect for investors seeking to diversify their portfolios.

Note: Frontier markets do present significant country-specific risks, including possible political and social instability, and currency risk. Wasatch Advisors believes that a diversified portfolio of well-researched companies is the best way to invest in this riskier, emerging asset class. Although frontier market stocks are not without their risks, their potential for long-term growth is clear.

3-Year Annualized Total Return Performance

Based on the MSCI Frontier Markets Index Component Country Returns (in U.S. dollars)
12/31/2008 – 12/31/2011



Source: FactSet, MSCI. Past Performance is not indicative of future results.

WASATCH FRONTIER EMERGING SMALL COUNTRIES FUND (WAFMX)

Wasatch launched its frontier markets fund on January 31, 2012 as the Wasatch Frontier Emerging Small Countries Fund, led by portfolio manager Laura Geritz, CFA. The Fund is currently open to new investors but is expected to have limited capacity due to its specialized nature.

The Fund's investment objective is long-term growth of capital. The Fund invests primarily in the equity securities of companies of all market capitalizations that are tied economically to frontier markets and small emerging market countries. Wasatch expects a significant portion of the Fund's assets to be invested in the equity securities of companies with market capitalizations under US\$3 billion at the time of purchase.

Wasatch Advisors estimates that there are presently over 6,000 publicly listed companies in the investable universe it has defined for this Fund:

- “Frontier markets” include any country that is outside the Morgan Stanley Capital International (MSCI) All Country World Index, and also any country that is currently included in the Russell Frontier Index, the S&P Frontier Markets Broad Market Index (BMI), the MSCI Frontier Markets Index, or similar market indices, or any country that has similar characteristics regardless of its inclusion in an index.
- Wasatch considers a “small emerging market country” to be any country that individually constitutes no more than 7% of the MSCI Emerging Markets Index or the S&P Emerging Markets BMI.

The “Emerging Small Country” component chosen by Wasatch for this Fund expands the universe of investable companies in countries that, in many cases, have similar growth and economic characteristics as frontier index countries.

Wasatch believes that the best way to invest in inefficient markets, while avoiding index overweighting in sectors like financials and energy, is to thoroughly research, analyze and select companies that have outstanding potential for long-term growth.

A Word About Indices

Frontier market indices are available in various forms from MSCI, S&P and Russell. It should be noted that the MSCI and Russell indices include “ex-GCC” versions, meaning they exclude the several rich, oil-producing Middle East countries in the Gulf Cooperation Council (GCC). When GCC countries are included, the various cap-weighted frontier indices have Middle East components that dominate them as benchmarks, with weights ranging from approximately 40% to 60% depending on the index. Ex-GCC frontier indices are much more balanced among the five regions where most of the frontier market countries are found.

While Wasatch will ultimately track the Fund's performance against the traditional and “ex-GCC” frontier market indices, it expects to construct the portfolio based more on bottom-up company selection than on top-down country or sector weights. As a result, Wasatch does not anticipate that this strategy will result in energy and/or financial sector weights that are as large as the weights seen in either version of the frontier indices.

Wasatch Fundamental Strategy for Investing in Frontier and Smaller Emerging Markets

Wasatch portfolio manager Laura Geritz has identified the following factors that she finds desirable in prospective investments in frontier and small emerging markets:

- High-quality companies with strong financials (strong balance sheets and/or good cash flow generation)
- Companies with high return on equity (ROE), that can self-fund their future growth
- Companies that are market leaders or emerging leaders with sustainable competitive advantages
- Durable and predictable earnings growth (sustainable long-term growth)
- Dominant or potentially dominant companies with defensible brands and distribution as well as companies whose future growth is likely to be driven by domestic growth in frontier and emerging small countries. Preference for domestic, demand-oriented growth stocks.

THE WASATCH ADVANTAGE IN EMERGING MARKETS INVESTING

Wasatch was founded in 1975 as a Small Cap Growth investment boutique. The firm has spent 35 years developing unique expertise in the small and micro cap space. Wasatch launched its first international product in 2000, and has continued to build its international team over the past 11 years.

In October 2007, Wasatch launched the Wasatch Emerging Markets Small Cap Fund (WAEMX)—one of just a few actively managed funds focused specifically on small cap stocks in emerging markets. In typical fashion, the concept wasn't new—the Wasatch research team was already in these countries looking at small companies for other Wasatch funds.

Deep Due Diligence

To take full advantage of the opportunity and inefficiencies in the emerging markets small cap space, analysts have to be willing to roll up their sleeves and travel through the countries to gain a true understanding of the companies and their markets. A Wasatch cornerstone has always been the deep due diligence applied to each investment its teams make. The international team regularly travels the world, getting off the beaten path in emerging markets, and frequently meeting with management teams that mention just how rare it is for them to actually get a visit from an analyst.

Roger Edgley, CFA, Director of International Research, and Laura Geritz, lead portfolio manager of the Frontier Emerging Small Countries Fund, have visited companies in emerging and frontier markets around the world. They manage over US\$4 billion in international mandates at Wasatch. Countries visited for company research meetings include Vietnam, Ghana, Indonesia, Turkey, South Africa, Nigeria and Cambodia. The team believes that fundamental, on-the-ground research is the only way to discern the right investments in these markets.

Wasatch believes that its deep due diligence can better determine a company's growth potential, financial stability and management quality. The Wasatch heritage is "bottom-up," which means analyzing the investment potential of individual companies. The Wasatch Frontier Emerging Small Countries Fund will employ this same approach.

Cross-Team Collaboration

Another key element of Wasatch's approach is cross-team collaboration. Wasatch doesn't send one person to Indonesia to determine the best companies in that country. Wasatch sends a team to Indonesia with members of different backgrounds in order to get a more robust understanding of each company. This team gets together with analysts who have been trekking through other parts of the world, as well as the U.S. team, to compare companies from around the globe to help select emerging market investments that seem to have the best potential.

Roger Edgley, has over 20 years of international investing experience and has led the Wasatch International Equity Team for 10 years. A native of the United Kingdom, Roger has lived in Asia, Europe and the U.S. He is also the Director of International Research at Wasatch and a member of Wasatch Advisors' Board of Directors.



Roger Edgley, CFA
 Portfolio Manager
 Director of International Research

Laura Geritz, lead portfolio manager of the new Wasatch Frontier Emerging Small Countries Fund, joined the Wasatch international team in 2006 with a strong background in international and small cap investing. Roger and Laura are also co-managers of the Wasatch Emerging Markets Small Cap Fund.



Laura Geritz, CFA
 Portfolio Manager

Wasatch's international investing team includes nine portfolio managers and analysts, each dedicated to the hands-on research process that the firm employs in managing its mutual funds and institutional separate accounts.

Wasatch Advisors, Inc. is the investment advisor for the Wasatch family of no-load mutual funds (www.wasatchfunds.com). Total assets under management as of December 31, 2011 were \$10.2 billion.

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RISKS

In addition to the risks of investing in foreign securities in general, the risks of investing in the securities of companies domiciled in frontier and emerging market countries include increased political or social instability, economies based on only a few industries, unstable currencies, runaway inflation, highly volatile securities markets, unpredictable shifts in policies relating to foreign investments, lack of protection for investors against parties that fail to complete transactions, and the potential for government seizure of assets or nationalization of companies.

Investing in small cap funds will be more volatile and loss of principal could be greater than investing in large cap funds.

Being non-diversified, the Wasatch Frontier Emerging Small Countries Fund can invest a larger portion of its assets in the stocks of a limited number of companies than a diversified fund. Non-diversification increases the risk of loss to the Fund if the values of these securities decline.

An investor should consider investment objectives, risks, charges, and expenses carefully before investing.

To obtain a prospectus containing this and other information visit www.wasatchfunds.com or call 800.551.1700.

Please read it carefully before investing.

The investment objective of the Wasatch Frontier Emerging Small Countries Fund and Wasatch Emerging Markets Small Cap Fund is long-term growth of capital.

Information in this report regarding market or economic trends or the factors influencing historical or future performance reflects the opinions of management as of the date of this report. These statements should not be relied upon for any other purpose. Past performance is no guarantee of future results, and there is no guarantee that the market forecasts discussed will be realized.

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**Portfolio holdings are subject to change at any time. References to individual companies should not be construed as recommendations to buy or sell shares of those companies. Wasatch analysts closely monitor the companies held in Wasatch funds. If a company's underlying fundamentals or valuation measures change, Wasatch will reevaluate its position and may sell part or all of its holdings. As of February 21, 2012, the Wasatch Frontier Emerging Small Countries Fund held 0.63% and 1.05% of its assets in Unilever Ghana Ltd. and Pepsi-Cola Products Philippines, Inc., respectively. Fund holdings are subject to change at any time. Current and future holdings are subject to risk.*

¹Radelet, Steven, Sachs, Jeffrey, and Lee, Jong-Wha, *Economic Growth in Asia*, Harvard University, Harvard Institute for International Development, July 1997, pp. 3-6.

²World Development Indicators, The World Bank, 2007.

³Bloom, David E., Canning, David, and Sevilla, Jaypee, *The Demographic Dividend: A New Perspective on the Economic Consequences of Population Change*, RAND, 2003, p. 39.

⁴Bekaert, Geert, *Emerging Equity Markets and Market Integration*, National Bureau of Economic Research, NBER Reporter, Winter 1999/2000.

⁵Speidell, Lawrence, *Frontier Market Equity Investing: Finding the Winners of the Future*, CFA Research Foundation of CFA Institute, ISBN 978-1-934667-36-1, May 13, 2011.

DEFINITIONS

Correlation indicates the strength and direction of a linear relationship between two investments. The value will range between -1 and 1. A value of 1 indicates perfect positive dependency and -1 indicates perfect negative dependency between the two investments.

Earnings growth is a measure of growth in a company's earnings per share from one year to the next.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders annually.

Return on equity (ROE) is the amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

The MSCI Emerging Markets, MSCI Frontier Markets, and S&P Frontier BMI ex-GCC indices are free float-adjusted market capitalization indices designed to measure equity market performance in the global emerging markets.

The MSCI EAFE (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

The MSCI ACWI (All Country World Index) is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets.

The S&P 500 Index represents 500 of the United States' largest stocks from a broad variety of industries.

You cannot invest directly in these or any indices.

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