What's beyond the emerging markets?

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Investors look at 'Frontier Markets' for gains, acquisition opportunities. In focus: Nigerian banks.

With developed markets foundering amid poor returns, worsening government balance sheets and greying demographics, there's a lot of focus at the annual Canadian hedge fund industry gathering on emerging markets.

But for some, even emerging markets aren't far enough out on the risk curve.

That's where the so-called frontier markets come in. Mexico? So 20 years ago. Even Latin America is too well-known and well-trodden for Alison Graham, the chief investment officer of Voltan Capital Management.

Instead, she looks at 60 countries ranging from the Republic of Georgia to Cambodia to to Bangladesh to Botswana.

One theme she's following is Chinese investment. China doesn't qualify as a frontier market, but the country is buying up natural resource deposits in countries she watches.

"We're seeing that all over Africa," she said at the World Alternative Investment Summit Canada in Niagara Falls. The advantage of trying to find companies that will benefit from those Chinese investments is much the same thesis that investors have when looking for Canadian plays that might get a lift from a Chinese buyer: "Those capital flows aren't subject to the monthly or even yearly vagaries of what's going on in the Chinese markets."

Even Nigerian banks are on her radar as a top pick, as part of her goal of looking for "places where things are changing but the market hasn't recognized it yet."

When it comes to Nigeria's banks, "for decades, they were everything you expected Nigerian banks to be," she said. They were corrupt, they had bad lending standards, and generally were companies to avoid.

But since the financial crisis, Nigeria has undertaken serious reforms. So serious that 10 of 24 major bank CEOs are in jail, she said. What's' more, the stress tests the government undertook were more critical than those of the European Union, said Ms. Graham, and there's new legislation that limits risks such as lending to insiders and concentration of loan books.

And after all that, they trade "at the cheapest valuations anywhere in emerging markets" even as the local economy has started growing and lending is on the rise..

Other picks include Cambodia, which some have called the "new Vietnam" and Iraq, which Ms. Graham thinks is on the cusp of an oil boom.

For those that can't stomach life on the frontier, other presenters at the conference pointed to some areas that while still a little hairy at least qualify as emerging.

Charles Blitzer of the International Finance Corp., a part of the the World Bank Group, suggested that investors who like turnarounds should focus on central and Eastern Europe, where many companies are dealing with stretched balance sheets and are good turnaround candidates for private equity funds.

What about China, the emerging market that everyone is talking about?

One risk to watch there is the shadow banking system that arose in the country to fund public works projects at the local levels, said Joseph diCenso, an economist from the International Monetary Fund.

Lower levels of government in China aren't allowed to borrow directly from banks, so a system of institutionalized middlemen arose. They did the borrowing on behalf of cities and states looking to build bridges, waterworks and the like.

However, most of those projects aren't going to produce enough cash to service the loans, which could lead to trouble for banks or eventual nationalization of the loans, estimated to be worth about 20 per cent of China's GDP. The risk is "manageable" in the words of Mr. DiCenso, but still, something to watch.