



## A Supportive Environment for Vietnam's Stock Markets

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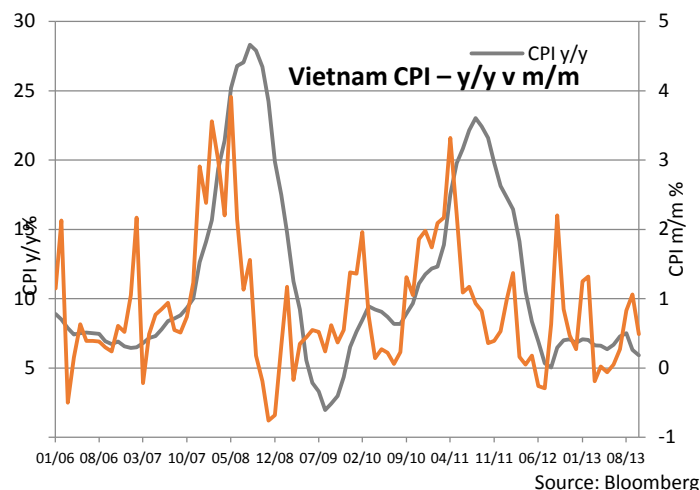
### Vietnam's new-era of macroeconomic stability driving investment

A new era of economic and policy stability has created a benign and improving macroeconomic environment in Vietnam, and is driving significant changes in the country. Investor recognition of these advances is largely responsible for the outperformance of Vietnam's stock markets relative to regional bourses and frontier peers over the last two years or so. Having learnt a number of lessons, the hard way, through the global financial crisis and on into 2011 Vietnam is now three years into a new stage of its development.

In February 2011 there was a sea-change in monetary policy as the country's leaders shifted focus from two decades of 'growth above everything' by introducing a platform of measures designed to promote long-term economic stability. Over the preceding decade GDP growth had averaged 7% annually, but with dramatic inflationary and trade deficit pressures on the currency precipitating three-year boom-bust cycles (CPI peaked at 28.3% y/y in August 2008 and at 23.0% y/y in August 2011) there was understandably little confidence in the currency or, indeed, in the ability of the government to regulate the economy. The high interest rate regime introduced as an important tool of monetary tightening had the desired effect in stabilising the currency and taming inflation by curtailing the excessive credit growth that had been a main cause of inflationary pressures, but did not come without collateral damage including a slowing of GDP growth and a dramatic increase in non-performing loans which essentially crippled the banking system.

### Steady and sustainable growth

Things have improved since, driven by a number of factors. GDP growth is beginning to accelerate and looks to be once again sustainable at higher levels. While 5.1% growth in 2012 and 5.4% for 2013 felt rather anaemic compared to the robust 7% average achieved over the previous decade, the mild pick-up in the second half of last year can reasonably be expected to continue into 2014, returning close to the mean by the end of 2016. Booming exports together with strong foreign direct investment and overseas remittances helped Vietnam, in 2013, to post its largest ever trade and current account surplus, after the first trade surplus in 20 years in 2012. These changes have meant domestic confidence in the economy has returned and the Vietnamese dong has been the most stable currency in Asia (excluding the hard-pegged HKD and RMB) for almost three years.





## **Building Southeast Asia's new manufacturing hub**

Vietnam has a large, young and well-educated population (90m people, 60% below 35; literacy rate > 95%) with a historic focus on low-value, low-cost manufacturing and agricultural production. Vietnam is the number one global exporter of rice ahead of Thailand, number two in coffee after Brazil and number three in natural rubber among other soft commodities and is also an exporter of crude oil.

Foreign Direct Investment into higher value-added manufacturing, in particular into the electronics sector, a new driver of export growth is driving a renewed leap in export growth (2013 exports +15.4% to US\$131 billion). In 2012 tech-giant Samsung assembled roughly one quarter of their global smart phone production in Vietnam and in 2013 doubled their investment. At the same time Samsung is encouraging suppliers to tool up and open shop in Vietnam, and the company expects to export US\$24 billion of product from Vietnam in 2014. Intel's largest microchip assembly and testing facility sits on the outskirts of Ho Chi Minh City and Foxconn is building a US\$5 billion plant in the North of the country near the border with China. With labour costs roughly one-third of those in neighbouring China, Vietnam is attracting many new entrants; Japanese, South Korean, Taiwanese and Singaporean companies have traditionally been the dominant investors, with the US now catching up fast.

## **Transforming the state-owned enterprises**

The Government's commitment to resolving the problem of non-performing loans and reducing inefficiencies at state-owned enterprises (SOEs) appear to have become the main priority. The Vietnam Asset Management Company (VAMC) brought into operation in July 2013 has begun the task of resolving bad loans. The relatively slow progress to date has hampered economic growth but the recent bond issues by the VAMC should act to restore confidence in the Government's determination to follow through with its plans.

Whilst the SOE sector remains a bloated part of the economy, the Government has released a specific list of 432 SOEs that must be equitised and subsequently privatised in the 2015 - 2017 period. A great many of these companies will be listed on the two local bourses and private, including foreign, stakeholders and management will catalyse more efficient operation, leading to an overall improvement in the use of capital and investment in Vietnam. Over the long-term the resultant increase in breadth and scale of the markets as these new investment options emerge should encourage further local and foreign inflows and drive the market higher.

## **Excitement being reflected in the equity market**

As 2014 starts to unfold, the outlook for the Viet Nam Index (VNI) will continue to be influenced by global market conditions and investor risk appetite, as well as the effectiveness of the Government's policies to revive bank lending. However a more stable macroeconomic environment and a sustainable move from deficit to surplus several years ahead of expectations is at the core of an increasingly optimistic outlook. This will assist the Government in the pursuit of its objective of keeping inflation and the currency stable for considerably longer than the recent three-year boom-bust cycles. Coupled with relatively strong foreign inflows, possibly seeking a haven from recent emerging markets turmoil, but also in recognition of the long-term attractions of Vietnam, the Index is now trading at levels not seen since October 2009, although the index is still over 60% below 2007 highs in US dollar terms.

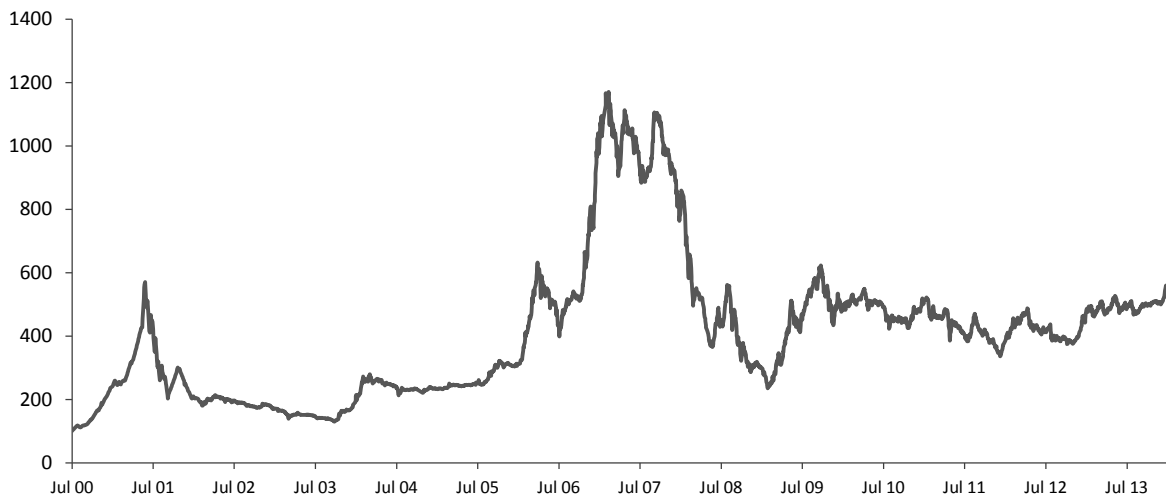


Figure 2. Viet Nam Index (VNI)

This multi-year high in the VNI has been achieved via solid gains in 2012 (up 18.9% in USD), 2013 (up 20.6% in USD) and year-to-date (up 17.3% in USD for the first quarter of 2014). Valuations remain attractive, with the VNI trading at 13x 2014 earnings compared to 18x in the Philippines and 13x in Thailand, and still at the lower end of the historic trading range of 8-35x. Outside of the larger capitalisation stocks, particularly those whose valuations are distorted by ETF inflows, the valuation proposition improves further.

### Relaxation of foreign ownership limits

There are impending structural changes which are likely to add further impetus to the index's rally once confirmed. The two Vietnamese exchanges currently have quite stringent foreign ownership restrictions for listed equities. Foreigners are limited to owning a maximum of 49% of listed companies with the exception of banks, where the limit is 30%. Proposals to increase these limits to 60% for non-sensitive sectors and to 49% for banks are apparently currently in the final stages of consideration in the office of the Prime Minister. As one might expect the companies that are most appealing to fundamental investors are at their foreign limits and a foreigner can only buy those shares from another foreigner who is willing to sell, usually at a premium to the price at which the stock is currently trading between domestic investors. The market is expecting these changes in the very near term, and once confirmed increased access should have a positive impact on the price of many stocks. It is already possible for foreigners to own 100% of a non-public company in non-sensitive sectors in Vietnam, and it makes little sense for the ownership rules for public companies to be more restrictive than those for non-public companies, particularly if it is government policy to develop the capital markets.

### Formation of a domestic institutional investor base

Foreign investors currently represent roughly 10 to 15% of daily market turnover on the Ho Chi Minh City Stock Exchange (and substantially less on the Hanoi exchange), which obviously implies that 85 to 90% of turnover is sourced from domestic investors. In the historic absence of domestic institutional investors one can conclude that the dominant forces in the Vietnam market are prop books and retail investors, which has never been a recipe for low volatility. Over the past few months the market has seen the legal framework put in place for the creation of the first domestic mutual funds, exchange traded funds and pension funds and this gradual development of a domestic institutional investor base - hopefully with a somewhat longer investment horizon than currently exists - in combination with the extension and encouragement of foreign participation are key to the market beginning to mature.



## Equity market opportunity

Vietnam is now, in our opinion, in an investment 'sweet-spot' as a new era of economic stability has resulted in a benign and improving macro environment supported in the short-term by impending relaxation of the foreign-ownership limits, and in the medium-term by recapitalisation of the banking sector and a resumption of the equitisation to privatisation process of SOEs. In the long-term the resultant increase in breadth and scale of the market will encourage future interest and the upward momentum is creating a rare market opportunity as the country and its capital markets continue along the development path.

*Kevin co-founded PXP Vietnam Asset Management in 2002. He is responsible for investment policy and strategy and is the Portfolio Manager for the funds. He has more than 28 year's investment experience. Kevin spent a decade in Hong Kong from 1985 to 1995 initially as an investment analyst and then as a specialist manager and trader of proprietary funds in emerging equity and equity derivatives markets in South East Asia. During that period, among other things, he established the Hong Kong equity derivatives business of Baring Securities and Deutsche Morgan Grenfell. On returning to the United Kingdom in 1995, Kevin worked for Dresdner Kleinwort Benson, where he was involved in Latin American and South East Asian sales trading, and then for Bear Stearns International, where he traded closed-end funds in global emerging markets. Later he established the Global Emerging Markets and Japan Investment Company activity of ABN Amro in London.*

*PXP Vietnam Asset Management is a Vietnam focused listed-equity specialist investment manager based in Ho Chi Minh City, Vietnam. PXP is dedicated to achieving superior long-term returns in both closed-end PXP Vietnam Fund and open-ended Vietnam Emerging Equity Fund. For more information please visit [www.pxpam.com](http://www.pxpam.com).*