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# Vietnamese equities: From vulnerability to opportunity

*Vietnamese equities outperformed most other Asian and global stock markets in 2017 only to change that order and become one of the worse performing markets in 2018 year-to-date.*

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**THE RECENT DEVELOPMENTS IN VIETNAM'S CAPITAL MARKETS** need to be seen from both a domestic and an international perspective. Last year EM (Emerging Markets) outperformed (DM) Developed Markets by a very wide margin and within Emerging Markets Vietnam was one of the star performers globally.

Year-to-date 2018, however the trend of last year has not only changed but reversed and some of last year's best performing markets are now among the worst performing stock markets globally.

Global equities primary indices have now turned negative and dispersion of equity market returns are widening. A feedback loop is taking hold across financial markets as the emerging-market sell-off intensifies, helping to support the U.S. dollar and causing re-financing risk in emerging markets like Brazil and Turkey to rise sharply.

A stable macro economy and strong fundamentals however make many analysts and fund managers to continue to stay bullish about the Vietnam equity market longer-term. The domestic economy continues to accelerate, with Fitch Ratings forecasting expansion of 6.7% in 2018. Vietnam's government has helped fuel growth by focusing on containing debt and reforming state-owned enterprises.

Among foreign risks, exchange rates and the USD/VND rate in particular may determine whether or not the stock correction in the VN Index has run its course.

So far this year all the world's worst performing markets, The Philippines and Turkey have had both sharply declining currencies and equity markets.

Even after ignoring external factors such as broader based Emerging Market weakness, some investors are concerned that Vietnamese equities' valuations are getting expensive. They are trading at 17.86 times estimated earnings for 2018. The investable universe of 355 VN stocks trades at a BF (Blended forward) P/E (price-earnings ratio) of 11x (times). Oil & Gas with 20.7x is the most expensive sector followed by Health Care with 20.1x. Consumer Services 16.4x and consumer goods 14x. Technology 12.8x, Financials 12.6x and Telecommunications 11.8x. Industrials and Utilities 7.7x and Basic Materials as the cheapest sector of the Vietnamese equity market trades at 4.2x.

Total return of the investable universe of 355 VN stocks is now -5.5%. Telecommunications sector with 6.1% return is the best performing sector and the only sector that is still positive in the Vietnamese stock market. Technology sector with -14% is the worst performing sector. Too many investors have betted that tech stocks only can go up so that tech companies stocks became a "crowded trade".

Financial and Bank sector stocks are in line with the broad market and are mostly flat to 0% return year-to-date. Utility sector is down -2% followed by Oil and Gas with -3.8% and Consumer services with -5.4%. Basic Materials and Industrials -7.9% and consumer goods -8% and Health Care sector stocks -13.4%.

Among many analysts the consensus view now is that the party may have ended for Vietnamese large caps, but there's value to be found in small cap stocks.

High valuations of Vietnamese stocks are a legitimate concern, but that might well be limited to the top 12 to 14 index heavyweights. Some analysts see value from mid- to small-cap stocks, which are trading at 9.5 times trailing PE and a dividend yield of 7 per cent.

**A STABLE MACRO ECONOMY AND STRONG FUNDAMENTALS HOWEVER MAKE MANY ANALYSTS AND FUND MANAGERS TO CONTINUE TO STAY BULLISH ABOUT THE VIETNAM EQUITY MARKET LONGER-TERM.**

Investors are increasingly beginning to question whether Vietnam's stock market can replicate the 48% growth registered last year after it lost 12 per cent in April - its worst monthly performance this year - despite a roaring economy and a growing IPO market.

Vietnam's rapidly growing economy played an important role in the stock market boom of last year. According to the Asian Development Bank's latest outlook report, Vietnam is expected to achieve 7.1% and 6.8% economic growth in 2018 and 2019, respectively.

Economists expect a gradual moderation in the headline rate of growth in the coming years, this will largely be due to an increasing drag from net exports. This trend will not necessarily represent a weakening of the economy, as it will be partly the result of strong imports to feed domestic consumer and investment demand.

Because of the Vietnam macro story, the valuations of the top 12-14 index heavyweights got to unrealistic levels nine months before the April correction.

The growth expectations for these blue chip companies are not supported by their earnings multiples. But apart from the 12-14 large caps which drove up the Ho Chi Minh VN Index, the broader market has not participated as much in this rally.

The gradual shift of manufacturing into Vietnam from other countries such as China has fueled growth of foreign direct investment over the last three years to record levels.

FDI disbursement reached a record high of USD17.5 billion in 2017. For the first quarter of 2018, FDI disbursement was up 9% year-on-year.

The World Bank expects Vietnam's middle class, which accounts for 13% of the 95 million population to grow to 26% by 2026. All these positive macroeconomic factors bode well for mid- and small-cap Vietnamese stocks.

Even after the recent Vietnam equity market slump that dragged average trailing 12-months P/E ratios down to the mid-teens from more than 20 times, there are buying opportunities, thanks to the "goldilocks" economy that the country is enjoying.

Given the backdrop of globally weakening emerging markets and after significant gains on Vietnam large cap stocks, the temptation to lock in some profit was too great for many local and foreign investors alike.

Vietnam market has decoupled from the rest of the world's emerging markets recently, rising even when the rhetoric of trade war tensions between U.S. and China escalated and almost all other markets fell. To some international investors, this looked too out of sync and they have decided to take profit.

Some margin calls have begun at Vietnamese stock brokers as a result of recent volatility, prompting local investors to consolidate positions as well as to reduce exposure in expectation of an increase in margin collateral requirements.

Despite some recent softness, Vietnam is still among the world's fastest rising equity markets this year and is quickly throwing off its reputation as a "frontier market".

Importantly, there are strong signs that it is becoming a hub for more significant, strategic investors. Overall, this bodes well for the government's broader privatization efforts, which have picked up over the past six months.

A short-term concern for foreign investors is that Vietnam may not meet its 2018 Privatization target. Only 5 of 85 state companies government plans to privatize this year have share sales as of May 25, according to finance ministry statement. There is a risk the government may fail to meet its privatization target this year because process is "too slow" at companies.

Main momentum for Vietnamese economic growth, including coal mining, crude oil production and remit-

tances, are not sustainable. Vietnam Export growth relies on foreign companies; Samsung Electronics 2017 shipments totaled USD53.3b, or 25% of Vietnam's exports last year but so far in 2018 value-added manufacturing, production is declining according to Vietnam National Assembly Economic Committee.

The United States economy is in a very late-stage expansion and Vietnam's export sector could be negatively affected by a business-cycle downturn in the US (Vietnam's largest export market).

The VN stock market average trailing 12-months PE ratios down to the mid-teens from more than 20 times, there are buying opportunities, thanks to the "goldilocks" economy that the country is enjoying. This is due to the linkage of valuation and willingness of international investors to pay for growth.

When you look at emerging markets as an asset class, the sensitivity and the vulnerability to a stronger U.S. dollar and to higher bond yields is lower now than it was in the past.

But it's definitely there, and it's something that an investor has to think about in the scheme of investing. We are potentially moving into a reversal of a very weak U.S. dollar - the environment we've had for 18 months, I think that there is a reasonable chance that you'll have a little bit of a hiccup as a result of it in emerging equity markets around the world.

The problem in emerging markets and a stock market like Vietnam, I think is that people tend to get excited when it does well, and then they get utterly depressed when it does badly.

And therefore exactly the opposite way which you invest in it, which is you should buy it when valuations are good and things are not good. And when everybody is very excited (read: last year's all-time record top in 2017), it's probably a little late to the party.

I think right now you have to be a little bit more careful, which is why I would not put a full allocation into Vietnamese equities yet. I would put only half and buy in tranches. There are growing calls for Vietnam to be included in the MSCI Emerging Markets Index. After all, even Argentina, which is seeking another IMF rescue bailout, is on the watch list for an upgrade. And Vietnam has better stock market liquidity than the Philippines, which is already included in the index.

Expectations that Vietnam may soon make the MSCI classification was one the reasons why its stock market became Asia's best-performing last year.

In the final analysis, Vietnam is one equity market globally where strategic investors may want to buy the current market weakness, not sell the weakness in the VN-Index. ■