Investing in Growth & Seeking Value in one of Asia's Most Dynamic Economies – Vietnam

On April 28, Hubbis held a virtual thought leadership event that focused on the rise of investment opportunities in Vietnam. Partnering Hubbis for the event was sole sponsor AQUIS Capital from Zurich.

SPEAKERS

Mario Timpanaro
Fund Manager - Lumen Vietnam Fund
AQUIS Capital

Mario joined AQUIS Capital in July 2020, where he is responsible for the Emerging Markets. Before he worked for Vogt Asset Management AG and CBR Investment AG, where he played a key role in the launch of the Lumen Vietnam Fund, which he continues to manage with great success as the responsible portfolio manager. Under his leadership, the Lumen Vietnam Fund was the first Vietnam focused equity long-only fund worldwide to receive the UCITS label (2013). Since then, the fund has been the first to invest according to ESG criteria. Mario also worked at Würth Finance in 2006 where he worked as a portfolio manager in the treasury and risk division. He started his career 1987 as market maker for Japanese convertible bonds and warrants for Bank Julius Bär in Zurich. 1992 he was appointed by the Board of Directors of Bank Julius Baer to set up the derivatives department. After the commercial education at KV Zurich Business School, he attended INSEAD in Fontainebleau (Paris) to expand his knowledge in derivatives. He is an educated and passionate chartist, as this helps him recognise the important trends in the international financial markets at a very early stage.

Vuong Van Anh
Chief Investment Officer
Vietnam Holding Asset Management

Van Anh joined VNHAM Hanoi in November 2007 as Financial Controller. In early 2010 she relocated to Ho Chi Minh City as Investment Analyst and main ESG integration process coordinator. Her strong financial background includes four years' experience as Senior Auditor for PricewaterhouseCoopers (Vietnam) and more than seven years in investment roles within VNHAM. Van Anh was promoted to Investment Manager in December 2011, to Senior Investment Manager in June 2014 and Chief Investment Officer in June 2018. Van Anh holds a BA in economics from Hanoi Foreign Trade University and an executive MBA from the Singapore Management University. She is member of the Association of Chartered Certified Accountants (UK).

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Setting the Scene

The presenters explained that Vietnam is a country on a formidable growth path, and that, albeit from a modest base, Vietnam is becoming an increasingly important country for inward portfolio investment by both leading asset management entities and also private investors. The likely upgrade in coming years from frontier market status to inclusion in the MSCI EM indices will help draw in more foreign money, which today represents less than 8% of the market.

Accessing the right investments and the right research and information requires specialists, such as the Lumen Vietnam Fund.

The fundamentals look very positive, the presenters told delegates. Vietnam is home to more than 100 million people – the 15th largest population in the world – and its people are young, educated, and eager to work and succeed. These highly appealing demographics are proving a magnet for the growing number of global and international companies moving to Vietnam in recent years and bringing with them both large amounts of FDI, as well as ever increasing levels of technology and expertise.

With low labour costs (far below those in China), with improving infrastructure, and dynamic development policies, Vietnam is quickly becoming the new workshop for the world as a manufacturing hub for goods ranging from furniture and footwear to home appliances and mobile phones.

This inward shift of manufacturing accelerated during the global pandemic, as international companies have sought to further diversify their production beyond China. But the trend is constant even should the pandemic fully abate, as costs and labour availability present such a compelling story for decision-makers.

The country's middle class of some 33 million people is expanding rapidly thanks to new work opportunities and rapid urbanisation, creating ever-growing demand across all consumer sectors: from property and construction materials to technology to consumer goods and services. As the economies grows and diversifies apace, so too the capital markets are expanding and the range of investment opportunities growing all the time.

To briefly summarise some of the key appeals highlighted by experts, the country has robust political stability with broad support for the one-party system. Education is good an improving with a literacy rate of 95%. Technology adoption is high and rising. The internet economy is growing at almost 30% compound annually. Renewable energy is sharply on the rise, and key export sectors include Smartphones & Accessories, Textiles & Footwear, Computers & Electrical Products and Machinery & Equipment.

Using its expertise to offer investors access to Vietnam' equity market, the managers of the Lumen Vietnam Fund UCITS strategy have built a fund of USD 240 million today. It launched roughly a decade ago in 2012 and the investments are selected with a bottom-up approach in listed companies in Vietnam, with the stated aim to achieve consistent long-term capital appreciation.

The presenters explained that they choose their sector weightings at plus or minus the market weightings, and that a core portion of the portfolio consists of small to medium size listed companies that demonstrate attractive growth characteristics and potential, aligned also to tactical allocation to selected large cap stocks that the managers consider undervalued. The fund's managers are also very proud of their strict ESG investment criteria, which they first introduced back in 2013.

Armed with an excellent slide presentation, Lumen Vietnam Fund manager Mario Timpanaro and Vuong Van Anh, Chief Investment Officer at Vietnam Holding Asset Management offered delegates their insights to Vietnam and to their fund.

They explained that while both Mario and AQUIS are based in Zurich and control the Lumen Vietnam Fund, great expertise on the ground is provided by Vuong Van Anh's team of analysts and experts at Vietnam Holding Asset Management, which is itself 100% owned by AQUIS.

Lumen Vietnam Fund - Managed in Zurich with on-the-ground expertise & analysis in Vietnam

"I am the Fund Manager, based at AQUIS in Zurich, and we are proud of our independent team on the ground in Vietnam," Mario told delegates. "Lumen Vietnam Fund is the first [Vietnam-focused] UCITS fund worldwide, having launched in November 2013. Vuong Van Anh and her team are on the ground in Vietnam and provide our expert research and analysis from there. I helped launch the fund back in 2012, we have AUM of USD240 million today. We have a long track record of successful returns, and I should note that we are also proud of our ESG credentials, which we introduced in 2013 in the very early stages of ESG's global involvement in the investment process."

The Lumen Vietnam Fund investment philosophy in brief

Mario continued: "The key factors determining stock selection include sector leaders with clear competitive barriers; strong balance sheets and free cash flow generation; above average EPS growth confirmed by the proprietary investment model; best management teams compared to sector peers; and sound ESG practices with room to engage and improve; and the stocks must be listed. There are limits of 10% per individual company, and 30% per sector.

We like to have a good view of the performance and outlook, so we meet the companies we invest in three to five times a year, sending in our analysts who specialise in different sectors. It is vitally important that the management teams can sail into headwinds and come out on top. At the end, we also layer in ESG considerations and end up with some 100 investible stocks. There are currently 35 stocks in the portfolio.

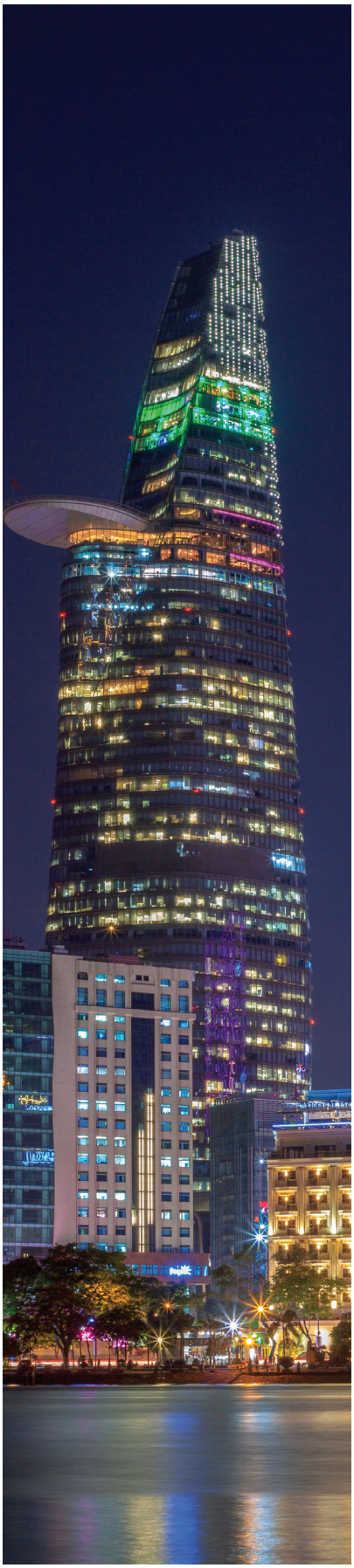
The investment process is a mix between top down and the bottom up. We are targeting EPS growth of 15% to 25% in the ensuing three to five years. In brief, we have fundamental analysis, we check their numbers against the peer group, and as I am a passionate chartist, we use the charts to help us find the right moments to buy or to disinvest.

Vietnam has a very low correlation to the major well-known equity indices around the world. And in the past three years, Vietnam has become even less correlated. This means that the fund will sit well within a diversified portfolio. With little or no correlation to other well-known markets, Vietnam should be a perfect satellite holding in a larger portfolio for investors seeking low correlation with a higher return.

We are long only, we do not employ any derivatives, we only invest and trade. On a long-term basis, the Lumen Vietnam Fund has consistently outperformed investable ETFs by a considerable margin. We have the longest track record among the Vietnam UCITS funds. We are also the best performing UCITS fund in the last 3 years."

Vuong Van Anh reviews the key sector weightings and valuation parameters:

Vuong Van Anh offered her insights: "We are broadly diversified amongst nine sectors of the Vietnamese economy, with financials the largest



at 28.3%, real estate next at 20.3%, Industrials 11.8%, and then the rest is split between Consumer Discretionary (8.4%), Information Technology (7.1%), Materials (6.6%), Consumer Staples (6.5%), Energy (4.3%), Utilities (2.3%) and we have net cash of 4.3%. All those figures are dated March 31, 2022.

We digress from the indices when we see logic in doing so. Accordingly, for example, there is a roughly 35% weighting for financials in the broader market here in Vietnam, and real estate is around 25%, we are underweight both currently, but we can overweight or underweight at any one point in time. Most of the time we underweight these two big sectors compared to the index and reserve the remaining weightings for other sectors where we believe we can find some hidden gems.

For example, we recently invested in the largest deep-sea port of Vietnam, we also increased the weighting of a logistics company that benefits from the e-commerce growth that is projected at between 30% and 40% per annum for the next five years.

We like consumer staples with the recovery in consumption and retail sales in Vietnam in the post pandemic period. Information technology is also a sector that we will gradually overweight as a sector of the future. And this year, we are significantly overweight the energy and utility sectors as well as the sectors as consumption rises sharply, and also as they have certain defensive elements against the rising interest rate and inflation environment in Vietnam.

While we are somewhat underweight financials, we do certainly like the sector. The banking industry in Vietnam has gone through a very severe restructuring period in the last seven to 10 years, clearing a lot of debt and cross-shareholdings into the state-owned enterprises.

Banks are coming from a low base for earnings, and many of them will start to have double digit credit growth that is in line with the economic growth. Secondly, they will start to have fee income, bancassurance commission fees, and many of them are going through digitalisation. In insurance, the life insurance penetration in Vietnam is less than 10%, and there is huge potential.

We are also slightly underweight real estate, but we also like the sector. The real estate market is enjoying rapid growth in the middle class and their incomes. That is propelling activity in the mid-market segment and affordable housing. There is huge shortage of supply. There is massive urbanisation as people move to the cities and regions where the most dynamic economic activity is taking place.

We also like industrials, especially where there is a wave of manufacturing relocating into Vietnam. That will support urbanisation and diversification, as more industrial parks emerge, bringing with them more hospitals, housing, education and all sorts of services and facilities.

In terms of categorisation into large, mid, and small cap is on the right-hand side chart, we have less large cap holdings compared to the index, with a 38% exposure compared to 60% in the index. So, we have more room to allocate to mid-caps and smaller cap stocks. We actively re-balance on a continuous basis nearly every quarter.

We have a total forecast growth in EPS of 26.8% for our current

portfolio, and we trade in total at around 13 times forward earnings for 2022 and around 11x for 2023. We are therefore trading at below the normal historical range, which is forward PE of 13x to 14.5x and looking at this and comparing with the regional markets, we see a local discount and we see great potential for the Vietnam market as well as for the Lumen Vietnam fund.

We change our forecasts every quarter when there are certain big events, or developments in macro factors, globally, regionally, or domestically, so our analysts will make their continuous revisions and monitor the earnings forecast of the companies in their coverage.

We are gradually seeing improving transparency and disclosures, with the drive to obtain better information from the companies, as well as better dialogue and more engagement. We are very much involved in those initiatives and company engagement is central to our mission, and as we said, we visit companies three to five times a year whenever possible."

Mario Timpanaro on the anticipated upgrade from frontier market to EM status

Mario explained: "Most people expect that within three years Vietnam will be upgraded from frontier to EM status. Vietnam should then have a weight of around 4% to 6% in the MSCI Asia index.

I shall expand somewhat on this possible upgrade, which I personally believe will actually take place within one or two years. That will result in major inflows from those funds who cover EM investments. We think inflows as a result will increase by USD6-8 billion, and that is quite conservative. Moreover, Vietnam is already a large listed market, with daily trading twice the size already of Qatar, Poland, and Turkey combined.

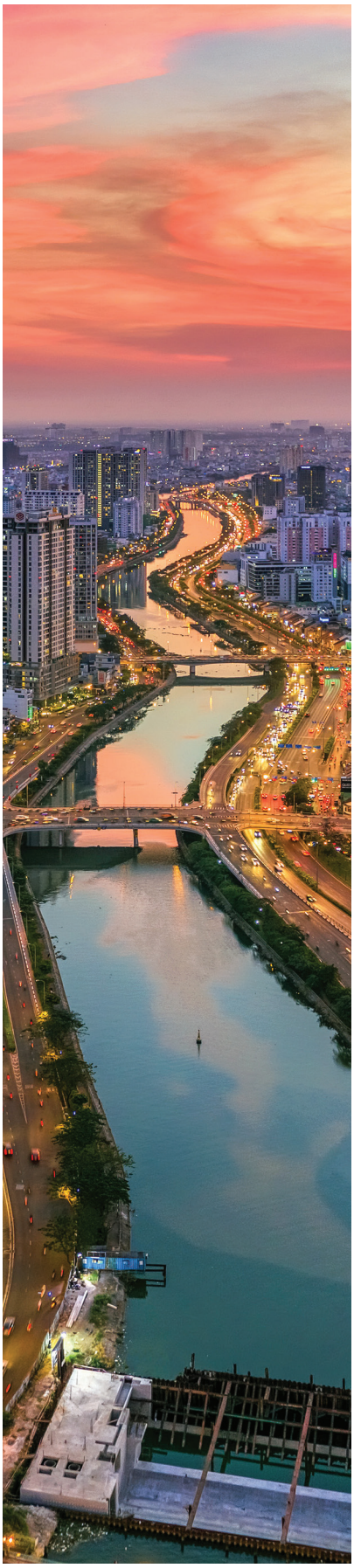
Trading volumes here of roughly USD1.2 billion daily are already significant, driven mostly by domestic investors. Foreigners account for only roughly 7% to 8% of the total market, and the liquidity in the market is high locally despite only 5% of the Vietnamese population owning any shares at all.

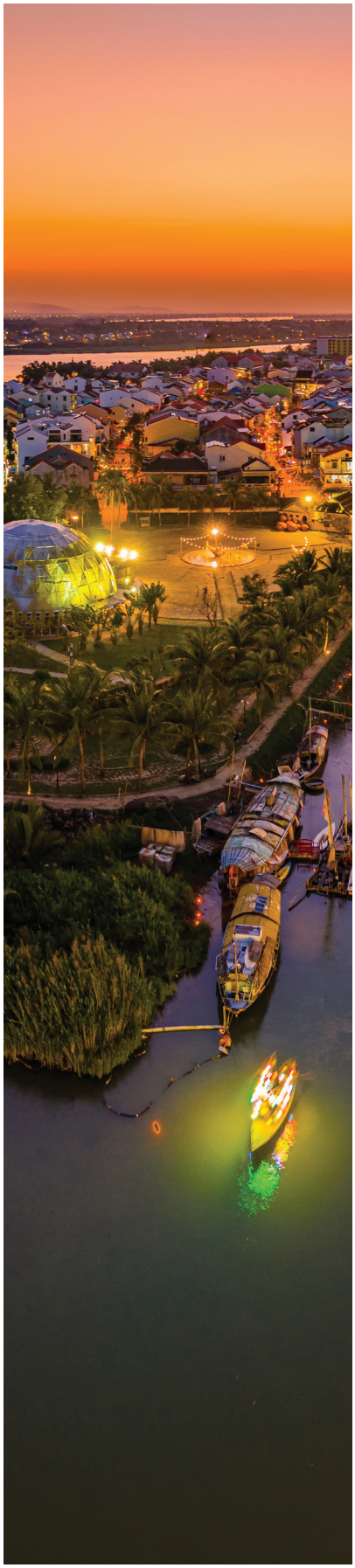
I should add that the high volatility driven by a lot of domestic retail trading activity is also a challenge at times, although it is an opportunity for professional investors as well, at least those who understand the behaviour of retail investors, who have a generally very short investment timeline. Vietnam probably needs another three to five years for the retail investors to become more educated on valuations and longer-term investment."

GDP numbers, government policy and the currency outlook all look encouraging

Mario explained: "The government's stimulus package projects their total investment of USD120 billion over the next five years until 2025, to renew the infrastructure, airports, ports, highways, cities and so forth. That means Vietnam is planning for an estimated 4% GDP stimulus package in 2022-2023, which might add a further 1% GDP growth per annum.

Vietnam's GDP was resilient during the worst of the pandemic. Then we saw in the last quarter 2021 that GDP grew by 5.29%, and in Q1 of 2022 another 5.03%, which shows that the dynamism of this market.





Inflation is modest, it will run around 3.5% to 4.5% this year, due to the higher oil price and gas prices, by our estimates. But that is not really very high for Vietnam, which has a historical 10-year average annual inflation rate of 3.8%. As of April 1, the government cut the tax on diesel and benzene from 50% to 25%, to reduce the impact on people's finances in general.

The Vietnamese Dong is a very strong currency, the most stable currency against the US Dollar, even though it is not pegged on the Dollar, it's actually in a basket of currencies of the most important trading partners.

The National Bank of Vietnam has USD110 billion of foreign reserve, which is equivalent to 34% of the GDP. That derives mostly from the FDI. National debt is less than 45% of GDP. Only 38% of the total national debt is in US dollars.

Vietnam's FDI is a success story. FDI has risen due to the reallocation of manufacturing from China to Vietnam. We estimate that for 2022 alone, nearly USD23 billion of new FDI will come in, with 26% coming from Singapore, 18% from South Korea, 10% from China, 7% from Japan and then well diversified from many other countries. A lot of this is going into manufacturing, to products of a higher value such as mobile phones, tablets, and TVs, with leading names such as Samsung heading the list."

The economy diversifies and strengthens

Vuong Van Anh reported: "Additionally, Vietnam in 2021 recorded a more than 25% growth in trade, both imports and exports. For this year, we also expect around 14% to 15% growth in both directions. More importantly, the trade surplus is expanding quite well, which helps to replenish the foreign reserves for Vietnam.

We see stronger growth in exports to the United States and other countries like the ASEAN bloc, as well as South Korea. This shows how good the manufacturing location is, as well as the benefits to Vietnam of the switch of production outside of China. Vietnam is one of the countries with a major advantage in having a huge border to China. Many companies from Europe side moved their production to Vietnam because it makes more sense.

In renewable energy, the government is working on the masterplan Number 8 on that, with an aim by 2045 of renewable energy totalling more than 35% of our needs. Coal-fired thermal plants will be cut back in the same time frame."

The positive data and encouraging outlook should translate to positive stock market momentum and earnings growth

Mario Timpanaro told delegates: "Valuations in the domestic market are appealing. Vietnam offers a discount compared to other countries such as Thailand, Malaysia, Indonesia, India, and others, despite EPS growth that is significantly higher for 2022.

And why does Vietnam trade at a discount to Asian markets? Well, the pending evolution from frontier market to MSCI EM status is part of the answer. To achieve that, the government will need to keep pushing through with reforms. The market is valued at around USD340 billion, so there is plenty of size and choice, but as I

explained earlier, the upgrade to EM will bring in new funds.

As to what is considered cheap or expensive, term deposits can achieve around 6% currently, and we consider anytime the equity market is traded at a trailing PE below 16.7x, it is considered cheap.

The historical valuation range over the last seven years since 2014, was 14.7x trailing earnings and 13.5x forward profits, and we can see from past activity that anytime the forward PE trades below 13x, the market will normally recover rapidly within one or two months. The market is now trading at around 10% to 15% lower than the historical average.

We also look at market flows, and we compare valuations to the regional peer group. In short, we have reasons to expect a re-rating for this market. The Vietnam stock market actually outperformed the regional markets in 2020 and 2021, delivering returns of 17% and 39% respectively in these two years.

For 2022 to date, the index has [by late April] declined by roughly 13%, partly as a result of the policy stance of the Vietnamese government relating to some dubious market activities by some parties in bonds, equities and real estate, actions which have negatively affected domestic sentiment.

For us, we believe that this is short term pain for the long-term gain because the enhanced and better regulations against any fraudulent or manipulative activities will improve the situation overall in Vietnam.

We certainly have room for greater transparency and increased company engagement, all of which are positives for the future. ESG-centricity will help achieve some of those goals. International best practices will come in increasingly.

As a result of the government action and the current situation, Vietnam trades now at only 12x the forecast 2022 PE, well below the 10-year average of 14.5x. We remain structurally positive on Vietnam for the long-term perspective. And we see this short-term dislocation in the market as a really good opportunity to reallocate some of the portfolio and put some new investment money to work.

Thus far, the inflows associated with the possible upgrade into emerging market status may be little more muted than expected. Actually, we have seen outflows in the last three years, since 2019 until now to the tune of one or two billion dollars equivalent.

We think this relates more to the strategic relocation of global funds rather than something relating to the fundamentals of Vietnam. We believe the upgrade to EM status will gradually draw new flows to Vietnam, including ETF trackers. We believe that the new inflows from the passive funds might be anywhere from a few billion to even around USD20 billion into Vietnam, combining both FTSE and MSCI tracking funds.

Life is returning to normal, auguring well for Vietnam

Vuong Van Anh reported briefly on the return to normality in Vietnam. "To update you on the key macro factors, we began to see foreign investors and travellers physically returning to Vietnam since the middle of March, and soon the government will not require visitors to do the Covid-19 testing prior to arrival. That means the government is targeting a return to normal life. Life is almost coming back to normal, it appears to be hectic and busy everywhere, like before. These are all very positive signs for the economy and for the markets here. ■