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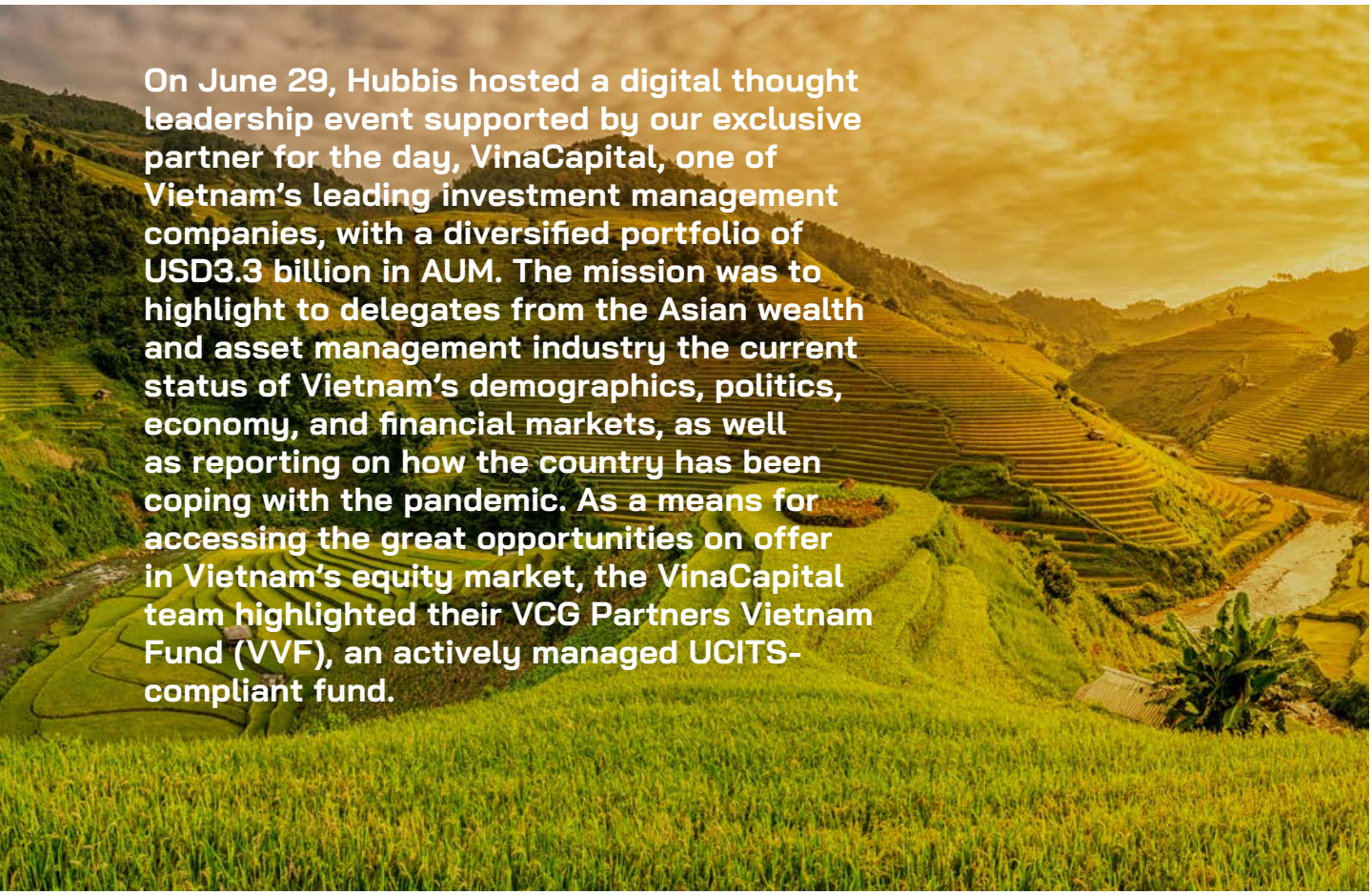
Vietnam's Equity Market and the Country's Compelling and Continuing Growth Story



On June 29, Hubbis hosted a digital thought leadership event supported by our exclusive partner for the day, VinaCapital, one of Vietnam's leading investment management companies, with a diversified portfolio of USD3.3 billion in AUM. The mission was to highlight to delegates from the Asian wealth and asset management industry the current status of Vietnam's demographics, politics, economy, and financial markets, as well as reporting on how the country has been coping with the pandemic. As a means for accessing the great opportunities on offer in Vietnam's equity market, the VinaCapital team highlighted their VCG Partners Vietnam Fund (VVF), an actively managed UCITS-compliant fund.

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THE WEBINAR ADDRESSED A NUMBER OF KEY QUESTIONS, INCLUDING:

- What is happening in Vietnam's economy, and what is the outlook?
- Does the government have the right controls in place for the pandemic?
- Which sectors of the economy are performing well, and which sectors will outperform?
- Why is FDI so high, and can that continue?
- How can foreign investors best access this fast-growing market? Where are the most attractive opportunities, and why?
- What is the outlook for corporate profits, valuations, and the broader financial markets?
- What sort of valuations prevail today and where do those sit relative to the past domestic highs and lows and relative to the region?
- When will Vietnam finally transition from a frontier to an emerging market, and what are the implications?
- Why will more foreign investment flow into the domestic financial markets?
- What investment opportunities are there locally other than stocks?
- What are the risks in Vietnam?
- Why is VinaCapital's actively managed VCG Partners Vietnam Fund an ideal entry point for private clients?

These and many other key issues were addressed by VinaCapital's two chosen experts: Thu Nguyen, CFA, Managing Director and Head of Investment, and Ismael Pili, Head of Research. Eric Levinson, Deputy Managing Director and Head of Business Development at VinaCapital, also co-hosted the event.

VinaCapital: an ideal conduit and partner through which to access Vietnam's dynamism

Eric Levinson, Deputy Managing Director and Head of Business Development at VinaCapital, co-hosted the event, first explaining to delegates that VinaCapital is an ideal partner through which foreign investors of all types can gain access to the immensely compelling story of Vietnam's economy and the expanding range of investment opportunities. He explained how the firm manages some USD3.3 billion of AUM and is one of the longest-established investment firms and largest firms in Vietnam, ranking first in private equity, real estate, energy, infrastructure and venture capital, second in equity investments, and third in fixed income.

Vietnam offers a great combination of dynamic demographics and entrepreneurial drive

Thu Nguyen, the VinaCapital Managing Director and Head of Investment, reported how Vietnam has a 97.6 million population, of whom 55 million are of working age, there is a 97% literacy rate, and people are highly industrious and entrepreneurial. Vietnam's economy has consistently ranked as one of the fastest-growing in the world, with a pre-pandemic five-year average growth rate of 6.8%. In 2020, when many countries saw their economies contract, Vietnam recorded GDP growth of 2.9%. This year, the economy is on track to register 5.6% growth in 1H this year; VinaCapital projects 5.8% for 2021 as a whole, and the government projects growth of 6.5% to 7% for the coming five years.

To date, the government has been managing the pandemic sensibly and efficiently

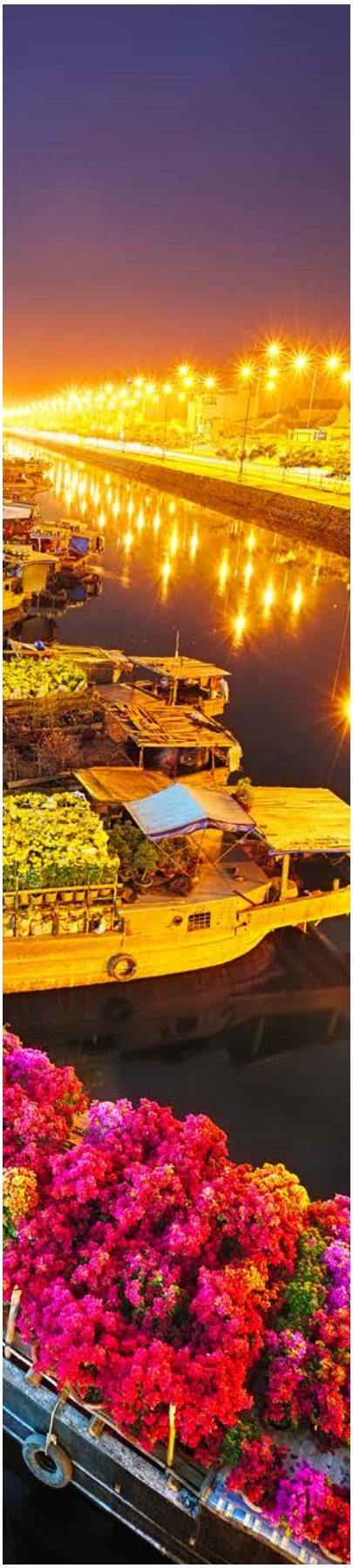
The government has managed the COVID-19 outbreaks well despite its limited resources, through rigorous contact tracing, strict social distancing, and other prevention measures, and there is a high degree of confidence locally and internationally in our ability to keep the pandemic under control. Vietnam's manufacturing output grew 2.6% m-o-m in May, and 0.3% in June, while the country's manufacturing output growth surged 11.6% y-o-y for the first 6 months of 2021.

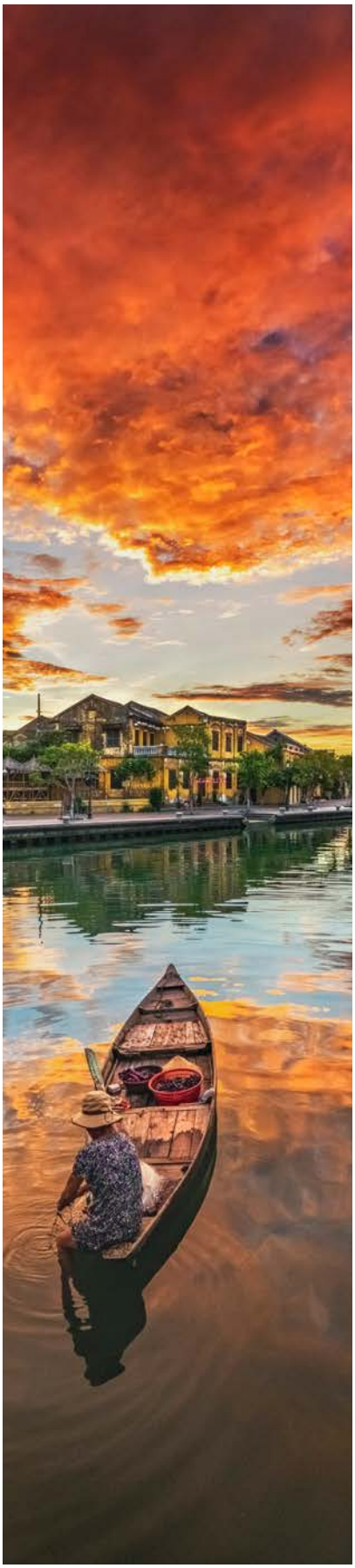
Vietnam has many advantages to help drive FDI, tourism and to power export growth

Not only are Vietnam's demographics outstanding, but the country enjoys an excellent strategic location with an immensely long coastline of nearly 3.300km that is very favourable for trade, tourism and FDI. The country is oil and electricity independent, and well-endowed with other natural resources, and is the world's number one exporter for pepper, number two in rice, coffee, and mobile phones, and number three in seafood and furniture. FDI growth averaged 11% in the eight years prior to COVID, while tourist arrivals also averaged 20% growth in the five years pre-COVID to reach a record 18 million international tourist arrivals in 2019.

A rapidly expanding middle class will lead to greater urbanisation and economic diversification

The percentage of the country's middle class is set to double





to 26% in the next five years, thanks to new work opportunities and rapid urbanisation, creating ever-growing demand for financial services, which has been remarkably robust, and across all consumer sectors, from property and construction materials to consumer goods and services. There is also a growing IT and technology industry. GDP per capita has increased consistently at a CAGR of almost 9%, which bodes very well for domestic consumption, which in turn is a major growth catalyst for Vietnam in the coming decades.

Vietnam is now at the inflexion point of over USD3.000 GDP per capita, which is comparable to China at around the year 2000. Today, the industrial sector is around 37% of the total Vietnam GDP, and the services sector around 39%. The upside is immense - take the car ownership ratio in Vietnam, which is at just 2.3%, while in Malaysia and Thailand the rate of ownership is already 20 times and 10 times that level, respectively.

Vietnam's advantages and political stability have resulted in a stable currency, controlled inflation, and a positive outlook

Political stability, robust FDI, rapid economic growth and diversification, a widening trade surplus, as well as foreign reserves over USD100 billion are all key elements underpinning the currency's stability. Inflation in Vietnam has peaked at 2.9% in the first six months and VinaCapital predicts the inflation rate to remain between 2% to 2.5% for rest of 2021.

Vietnam's economic transformation is being further propelled by high costs in China

While FDI is rising and will further propel strong export growth, there is an economic transformation story taking place, as the country is a major beneficiary of the production relocation out of China, the 'China plus One' strategy as it is known.

Low labour costs, a smart workforce, and an appealing tax are further drivers for growth

Labour costs are slightly lower than the Philippines, about half of Thailand, a third of Malaysia's, and 25% the levels in China. There are plentiful tax incentives for foreign investment and the workforce has proven itself able to adapt and upskill. Moving rapidly from an agrarian society, the FDI sector now accounts for over 70% of exports, and the country has become one of the top 20 exporters in the world with an average 12% growth in export balance in the last eight years, including 2020. Vietnam's exports grew by 29% y-o-y in the 6 months to end June, driven by 45% y-o-y growth in Vietnam's exports to the US. At the same time as the country is moving rapidly from farm to factory, from rural to urban, it is moving rapidly from analogue to digital, with the TMT sector powering ahead.

Logistics costs remain high, but therein also lies a great opportunity

On the negative side, infrastructure must develop rapidly, as logistics costs are now amongst the highest in Asia, at 16% of GDP, of which

56% is transport cost. But while this is a challenge, it could also be seen as an opportunity for private investors in infrastructure, or logistics companies with breakthrough technology or processes to help Vietnam overcome that hurdle.

With so many tailwinds, it is of little surprise that the domestic financial markets are powering ahead

In the first six months of 2021, Vietnam's stock market has hit new highs, driven by the strength of corporate earnings, as well as rising demand and liquidity. Even with these new highs, Vietnam is roughly 23% cheaper on a P/E basis than its previous 2018 high and equally cheaper versus most of its regional peers.

Vietnam's equity market offers a compelling case for investors at home and abroad

Ismael Pili, VinaCapital's Head of Research, reported that the Vietnam equity market is the best performing market in Asia, up 25% year to date by June 28, and that is on top of the 15% achieved in 2020, despite the pandemic.

Equity volumes are up sharply as liquidity and confidence surge higher

Volumes have risen significantly on the stock markets. The average daily turnover on the main HOSE, the Ho Chi Minh Stock Exchange, is averaging over USD800 million. That is far above the figure of USD271 million average volumes in 2020. Including Vietnam's two smaller exchanges (the Hanoi Stock Exchange and UPCoM), daily volumes are nearly USD1 billion, and in the ASEAN region, only Thailand is more actively traded at this time.

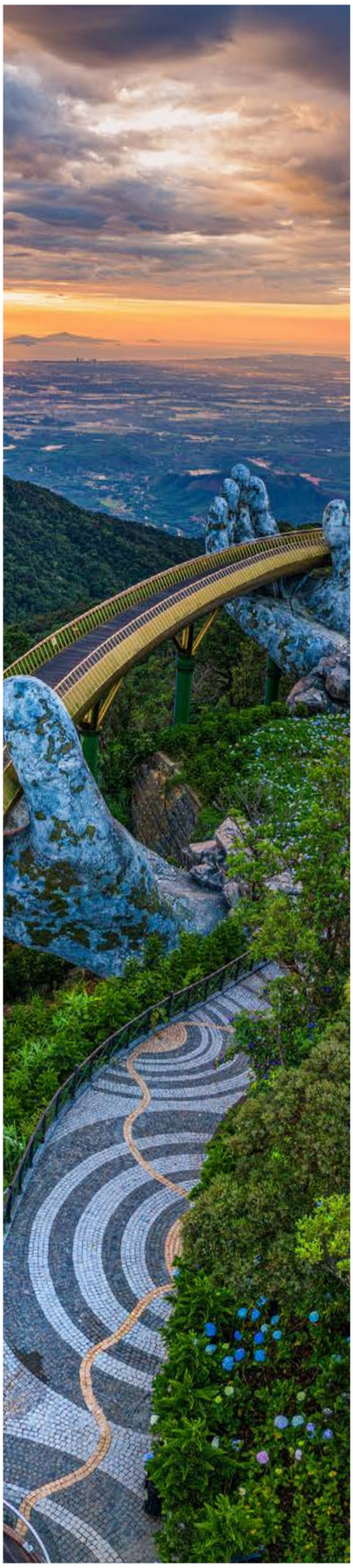
Valuations have risen sharply but are not racy compared to the 2018 high or to the region

The VN Index was trading at a reasonable 2021 forward P/E of 16.7x at the end of June, which was over a 5% discount to the average 2021 forward P/E of ASEAN emerging markets. Although at an all-time high on high liquidity, it is well off the 21.6x peak seen in March 2018. Demand is also much more broad-based today.

Earnings are buoyant. EPS growth estimates have risen from 18% at the start of 2021 to about 31% growth currently. Looking ahead, VinaCapital thinks there is scope for consensus estimates to actually rise, led by the banks, real estate and materials, albeit at a somewhat slower pace relative to the first half.

The banks are performing well and driving the index forward

Financials, which are represented mostly by the banks, account for 34% of the index weightings and was among the best-performing sectors that have contributed the most to the VN Index's gain. Financial stocks have advanced 43% YTD (by June 28) on outstanding first-quarter earnings as well as expected strong growth in the full year 2021. The importance of financials is not unusual because that's something we see in a lot of emerging markets. The financial sector here includes the banks, brokers and insurance, but the banks account for 32% of the 34% financial sector market weightings currently.



Other key sectors are helping drive equities higher

Real estate at 25% of the index and the consumer discretionary segments at 12% of the weighting combined with financials at 34% mean those three sectors account for over 70% of the total market weightings. It is the size of the financial sector combined with the nearly 42% uplift in the financial sector valuations that have helped drive the index up by roughly 25% this year.

By end-June, the real estate sector had risen 29% and consumer discretionary nearly 25%. The materials sector, at 8.8% of the index, represented by mainly steel companies, is up almost 43% ytd, driven by a stellar earnings outlook on the back of strong global and domestic demand. Information technology is actually the best performer ytd, rising nearly 62% although it is very small, at just 1.5% of the market.

VinaCapital offers investors outstanding access to the many opportunities available

To access these great opportunities, VinaCapital has a passive solution to the market exposure through its ETF VN100, but Thu Nguyen reported that the discerning foreign investor should really head to the actively managed VCG Partners Vietnam Fund, better known as VVF. The VVF fund's Class A NAV per share has increased 37% year-to-date, significantly outperforming the VN Index.

VVF is, by the way, a UCITs fund that was launched in 2015 and has achieved an annualised return of 15% per annum since inception, which is an outperformance of 2.1% per annum versus the benchmark VN Index. The fund employs a GARP or growth at a reasonable price strategy. With bottom-up stock picking, VinaCapital has been able to assemble a portfolio that is 16% cheaper than the market, trading at just about 14x forward P/E while the market is trading at about a 16.7x forward P/E.

At the same time, Thu reported that the portfolio of companies also is expected to deliver a strong earnings growth of 55% this year, which is a significantly higher than the 31% average earnings growth of the broader market. The fund takes an index-agnostic approach, allowing them great flexibility in stock and sector picking, resulting in a high active share of 62%.

In a frontier market, it is vital to keep the fingers on the corporate pulse

As with other frontier markets, the quality of corporate governance in Vietnam is not always the best. The managers work very hard to understand the business culture, management and practices of their portfolio companies. On average, the fund's investment team has about 160 to 180 meetings with companies throughout the country for information checks, site visits, business updates and strategy discussions with management teams. The research team headed by Ismael covers 87% of the stock market by market capitalisation. There is considerable anticipation that the market will become classified by MSCI as an EM within the foreseeable future, although the exact timing remains unclear. When it does move to EM status, this will power considerably greater foreign investment as international funds weight up accordingly.

The outlook for equities in Vietnam remains encouraging and the compelling story continues

Overall, as a team, VinaCapital continues to strongly believe in stocks in the domestic market. While Ismael said they wouldn't be surprised to see a few wobbles along the way, as is natural in any market, especially a frontier market, they believe the outlook for the economy and equity markets remains remarkably positive. ■