

An emerging market that shone in a difficult year

Vietnam has been one of Asia's most promising markets for a long time. Now it is shaking off the global coronavirus crisis looking better than ever, says Cris Sholto Heaton

The list of countries that managed to grow their economies last year is an unusually short one, which makes Vietnam stand out. Its GDP growth rate of 2.9% was low by historical standards – it typically manages 6%-7% – but still put it ahead of every other major economy in Asia and looks remarkable given the damage that the coronavirus pandemic inflicted on the world. Even at the peak of the crisis in the second quarter of the year, Vietnam just about eked out positive growth and has recovered quickly.

Many MoneyWeek readers will be familiar with the reasons to be bullish about Vietnam's prospects – we've written about it a lot over the years. A large population (97 million), helpful demographics (average age of 32), decent education levels, rising urbanisation and industrialisation, and a manufacturing sector that has increased its share of global exports by more than any other country over the past decade – together this suggests great potential for sustainable long-term growth. In key respects, Vietnam resembles South Korea or Taiwan – which made a spectacular success of economic development – much more closely than some of its Southeast Asian neighbours that have not yet managed to rise so far.

Its performance over the past year has solidified that impression. Three things went especially well for Vietnam in 2020. The first will hopefully be irrelevant once the coronavirus pandemic passes, but is encouraging for the country's governance. The second is extremely promising for the evolution of the economy – it's the main reason to believe that Vietnam still has superior prospects to any other comparable emerging economy. And the third bodes well for the stockmarket's long-term progress – although this remains a high-risk market and investors need to expect some ups and downs along the way.

Coping well with Covid-19

Vietnam's immediate strength is that the impact of coronavirus has been fairly small and controlled compared to most of the world. So far, it's had around 2,500 reported cases and 35 deaths. As in every country, there will be some unreported cases, but Vietnam's statistics look pretty reliable – if there were large numbers of deaths that had not been recorded, it would be obvious.

This is not down to luck. All the specialist investors in Vietnam that I spoke to for this article – Dominic Scriven of Dragon Capital, Andy Ho and Khanh Vu of VinaCapital and Craig Martin of Dynam Capital – give a great deal of credit to how quickly the government acted once the first signs emerged that Sars-CoV-2 was going to be a threat. Vietnam is a country with a history of novel disease outbreaks – the first high-profile case of Sars was detected there in 2003 (although the virus had again arisen in China), followed by human cases of H5N1 avian flu virus (which prior to Sars-CoV-2 was considered one of the biggest risks for a global pandemic) – and was unusually well prepared. As the scale of the problem became clear, it introduced a quarantine system with different levels of isolation for those who had

been infected and exposed, and largely closed its borders to travel. Even now, only people travelling for humanitarian reasons and those with critical technical expertise are allowed to fly into the country.

Whether this response is the full explanation for Vietnam's success is an open question. There are still many mysteries about this pandemic: it is hard to understand why almost every single Asian country has done comparatively well in keeping Covid-19 in check compared to Europe and the Americas, regardless of its demographics, the quality of its healthcare system and the specific measures it took (from extreme authoritarianism in China to a relatively open economy and society in Japan).

Nonetheless, it is clear that the government took quick, decisive and consistent action, and that people in the country responded well to this. That's not solely because Vietnam is an authoritarian system that can exert a lot of control (although it is) or because people didn't want to risk catching the disease or being caught up in quarantine (although they obviously didn't), but because Vietnam is a fairly cohesive society that puts a lot of emphasis on working together for the collective interests. This crisis has been a very good illustration of the strengths that it can bring to other goals such as economic development.

Growing exports and infrastructure

The ability to keep the pandemic in check and keep most of the economy open most of the time is a crucial part of why Vietnam did well in 2020 – but it's not the whole story. Longer term, the more important factor is the way that the Vietnamese export sector is benefiting from companies moving some of their manufacturing and sourcing away from China to other destinations. This trend has been under way for many years, initially driven by lower labour costs in Vietnam and then by the trade war between China and the US during Donald Trump's presidency, which made it increasingly prudent for multinational firms to diversify their suppliers.

Vietnam is not the only beneficiary – the size of the Chinese export-manufacturing sector compared to anywhere else in the world would have made it impossible for one country to absorb much of the shift. But it has done exceptionally well in moving up the manufacturing value chain, advancing from textiles in the mid-2000s to sophisticated electronics today, with factories now making flagship products for firms such as Apple and Samsung.

Relatively good education and skill levels in the workforce and government policies to attract foreign direct investment (FDI) are a key part of this – but that's been true for a long time. In the past, infrastructure has been one of the biggest shortcomings – speaking to investors a decade ago, one of the biggest and most consistent complaints was Vietnam's failure to deliver the level of investment and planning that made China so attractive for foreign manufacturers. Today, everybody agrees that the outlook is much more encouraging. The government plans to invest \$120bn in projects such as roads,

“The government acted quickly when it became clear Covid-19 was a threat”



Vietnam was one of the few countries with much to celebrate in 2020

railways and airports over the next five years – as much as it spent in the whole of the past decade.

A record-breaking boom in stocks

So if government policy and economic progress last year were good, what of the stockmarket? Vietnam scores three out of three: despite some foreign investors pulling money out of the market, as they did from all emerging economies, the benchmark index rose by 18% in 2020. That's due to strong demand from domestic retail investors, many of whom are investing in the stockmarket for the first time. Tens of thousands of new trading accounts are being opened every month. Trading volumes have soared to the point where they often outstrip the capacity of Ho Chi Minh Stock Exchange's systems, which are 20 years old and need to be upgraded.

To anybody who has been following Vietnam for a while, this may sound uncomfortably familiar. The last time a Vietnamese stockmarket boom captured the attention of international investors was back in 2006-2008 when the index soared, plummeted and then remained largely stagnant for several years. It finally passed the peak of that bubble a decade later, at least in nominal terms – but for foreign buyers, a much weaker currency means that their investments would be well below the peak (the Vietnamese dong is down by more than 30% against the dollar over that time).

One has to wonder whether the same boom and bust could be set to happen again – but fund managers who were invested through the last cycle are more sanguine. All the investors I spoke are keen to

emphasise that the wider macroeconomic environment today is much healthier than it was back then.

A decade ago, policymakers ignored high and rising inflation and held interest rates down to try to promote growth. The result was a massive bubble in both stocks and real estate. This and other high-profile follies – such as allowing state-owned conglomerates to pursue debt-fuelled growth into a mystifying range of unrelated industries in the hope of building national champions – created a massive bad-debt problem in the banking system that took several years to clear up.

Although growth continued, the result was something of a crisis, hence the frequent currency devaluations. Today, policymaking seems much better – interest rates of 4% are slightly above inflation – and the country's finances are more robust. Vietnam now runs a trade surplus compared to a very large deficit at the end of the 2000s. Its foreign exchange reserves amount to around four months of imports, compared to a few weeks at the peak of the crisis.

Not only does the economy look a lot more secure – which is crucial for currency stability – the market looks fairly cheap considering its growth potential: the index trades on 18 times last year's earnings and 15 times forecast earnings for this year. That doesn't mean that this boom can't turn into another bubble – the history of high-growth emerging markets suggests that at some point it will, whether that's now many years in the future – but it doesn't seem to be there yet.

“The market looks cheap considering its growth potential”

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Why this market that deserves more attention

Although we always refer to Vietnam as an emerging market, the compilers of stockmarket indices such as MSCI, S&P Dow Jones and FTSE Russell class it as a frontier market, one tier down. This is due to technical restrictions on access – limits on how much of a company foreign investors can hold and the requirement to pre-fund trades (effectively put your money up front rather than pay when the trade settles two days later) – rather than economic or market factors. Economically, Vietnam is already wealthier and more advanced than a typical frontier market peer, while its stockmarket is broader and more liquid than some countries that are well established in the emerging market indices, such as the Philippines.

This technical-sounding point has an important implication for investors. The average emerging market fund has little or no exposure to Vietnam – it's out of their benchmark and the manager may not even be permitted to invest there. So anybody who wants to buy into this market will generally need to make a deliberate decision to do so through a dedicated Vietnam fund, rather than expecting to do so through a general emerging markets or Asia fund.

At this stage, an index-tracking exchange traded fund (ETF) probably isn't the way to go, even if they are cheaper than managed funds. ETFs are often the best starting point for investing and frequently outperform most actively managed funds even in emerging markets (fund managers frequently claim that active management has an in-built advantage in emerging markets because these markets are supposedly less efficient – but this is rarely borne out by the results). However, Vietnam is a tricky market for trackers, because a combination of the foreign ownership limits and the lower liquidity of all but the largest companies puts some significant constraints on which stocks are accessible enough to be included in the indices the ETFs track. So you end up owning a lot of large companies that investors who know the market well don't like much, which is why they haven't hit their foreign ownership limits.



Industrialisation has transformed the economy

There are two main ETFs tracking Vietnam – the db x-trackers FTSE Vietnam, which has a London listing, and VanEck Vectors Vietnam, which is US listed and no longer appears to be available to UK investors (due to the Mifid II restrictions on UK investors buying foreign funds that came in during 2018). If you look at the long-term performance of these funds, you can see the problem at work – they track their own indices closely enough, but these constrained indices lag the wider market.

This should change eventually. If Vietnam makes the necessary reforms (allowing foreigners to hold non-voting shares above the ownership limit and introducing a central counterparty for trades), these would allow it to be added to emerging market indices – almost certainly bringing a flood of foreign buying – and also make index tracking easier. But for now, the best way to invest remains an investment trust or closed-end fund, which don't need to worry so much about the liquidity of the shares they hold. We look at the three main choices in the box below.

“The average emerging market fund has little or no exposure to Vietnam”

Three ways to invest in Vietnam

During the last Vietnam boom, there was a flood of specialist funds listing on the London Stock Exchange. This has now shrunk to three remaining trusts: Dragon Capital's **Vietnam Enterprise Investments (LSE: VEIL)**, VinaCapital's **Vietnam Opportunity Fund (LSE: VOF)** and Dynam Capital's **Vietnam Holding (LSE: VNH)**.

You'll notice these funds tend to hold many of the same key investments, albeit the amount they have in each varies quite significantly. For example, steelmaker Hoa Phat (a play on construction, real estate and infrastructure) is 17.5% of VOF's listed portfolio, 12% of VEIL and 8.7% of VNH. This shows the limits of the Vietnamese market: while it is relatively large and diverse for its size with around 1,500 listed companies, the number that are investable remains much lower. There are maybe 100-150 candidates in terms of liquidity and governance, say managers, and a far smaller amount are liquid enough that a fund could buy or sell a big position on the exchange without affecting the price. But this doesn't mean that all three trusts are following exactly the same investment approach – in fact, their strategies are quite distinct, even if certain major themes (urbanisation, industrialisation,

infrastructure, consumption growth and so on) are largely shared between them.

The largest fund is Vietnam Enterprise Investments, with £1.3bn in assets. VEIL is predominantly invested in listed equities – it limits less liquid assets to a maximum of 15% of net asset value and these are usually privatisations or other investments in companies that are headed for an initial public offering in the near future.

So I'd see VEIL as a play on listed equities, and mostly on medium and larger companies by local standards. It typically trades at the smallest discount to net asset value (NAV) for this reason. The current discount is 12.7%, the NAV per share grew by 131% over the five years to December 2020 in US dollar terms (compared to a total return for the VN index of 109%) and the ongoing charge last year was 2.2%.

Vietnam Opportunity Fund is also a large fund (around £700m in assets). About 70% of its portfolio is in listed equities, with most of the rest in unlisted equities and private equity, so this offers investors the chance to get access to companies at an earlier stage.

Trusts that hold a larger share of unlisted assets often trade at wider discounts (investors can be less certain

about the value of the portfolio), but sometimes reverses during booms (investors get more excited about the upside potential of the portfolio). That's what we see with VOF. It sometimes trades at a greater discount than VEIL, but in the last year this has shrunk and the discount currently is on 11.2%. Unlike the other two funds, VOF pays a dividend and currently yields 2%. Five-year NAV returns were 111% (allowing for reinvested dividends) and ongoing charges last year were 1.7%.

Vietnam Holding is a smaller fund, with assets of around £100m. It focuses on listed equities, but with slightly more of a bias towards medium-sized companies and a more concentrated portfolio. The fund trades on a wider discount – currently 17% – and the five-year performance is much weaker (NAV returns of 43%), but this reflects a troubled patch around 2017-2018. However, the trust has undergone significant changes since then: the board was replaced, governance strengthened, and the management contract transferred to Dynam Capital, a new company owned by Craig Martin and long-term manager Vu Quang Thinh. If it delivers better returns in future, the discount should continue narrowing. Ongoing charges were 3.1%.