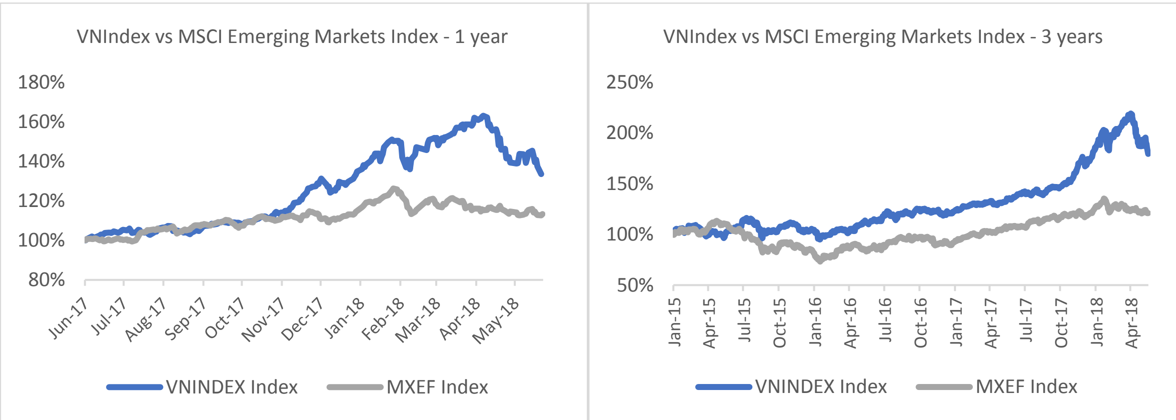
May 23, 2018

- The Vietnam Index (VN Index) fell below 1,000 points, erasing all its gains for the calendar year.
- After gaining 22% over the first quarter and peaking at 1,204 in early April led by large-cap stocks, the decline over the past six weeks has been a result of profit taking across the board, with the same large-cap stocks weighing on the decrease.
- Emerging market (EM) risk-off, a stronger US dollar, rising local interest rates, and inflationary fears from higher oil prices have contributed to the turn in sentiment and market sell-off.
- Nevertheless, market fundamentals remain, with strong earnings growth and long-term economic growth driven by resilient consumer confidence – the current market correction poses an opportunity for selective buying.

Following the one-direction increase in 2017, in which the VN Index increased almost 50% and earned itself the status of one of the best performing markets globally, this calendar year has seen a return of volatility. After reaching an all-time high of 1,204.3 points in April, yesterday the index closed at 985.9 points, the level at which it opened 2018. Across the board, all sectors including banking, consumer, resources, real estate, and industrial stocks have declined, with many of the largest gainers for the year contributing most to the fall.

The recent correction perhaps stemmed from a bout of profit taking led by institutional investors, while domestic investors have had to deal with the threat of possible increases in margin collateral requirements and began offloading positions in April and May. The recent market correction has not yet triggered widescale margin calls, but should the market decline further, we may see this commence.

At its peak in April, the market was trading at a price-to-earnings (P/E) ratio of over 22 times; today it has retracted to 18.5 times, bringing it back in line with regional peers. Importantly, the market continues to outperform the MSCI Emerging Markets Index (MSCI EM) over the past one and three years.



Source: Bloomberg

Exacerbated by concerns over a US-China trade war, and a general outflow from emerging markets by global allocators thanks to a stronger US dollar (USD) and higher US-long term rates (10-year bond yields peaked at 3.1%), we have seen Vietnam pulled into this maelstrom and consequently the overall market sell-off. Given the increasing degree of correlation to global markets, we summarise these factors and their possible impact below.

Vietnam's FX Rate

The Vietnam Dong has depreciated by less than 1% YTD versus 4-6% depreciations in Indonesia, India, and the Philippines. The recent, sharp upward move in the USD is unnerving EM investors and prompting capital outflows from emerging markets, particularly from those EMs that were previously the recipients of "carry trade" investment inflows, including Indonesia and India (Indonesian bond yields are about 4%pts above US bond yields, but Indonesia's currency depreciated by more than 4% YTD, wiping out a year's worth of "carry trade" investment income).

Vietnam's current account surplus, which averaged 3%/GDP over the last five years, and the SBV's crawling peg regime, which was instituted at the beginning of 2016, helped the central bank navigate the recent turbulence in EM FX markets. That turbulence was triggered by a circa 4% increase in the US Dollar (DXY) index from late April, stemming from the fact that speculators had accumulated the biggest short position against the value of the US Dollar in seven years, according to Goldman Sachs.

We believe foreign investor outflows from Vietnam's stock market could significantly accelerate if the DXY index were to quickly increase by another 2-4% to the 95-97 level, but the magnitude of speculators' short positions against the USD has apparently diminished by nearly 2/3 since mid-April, making it likely that the short squeeze in the DXY has nearly run its course for the time being.

Vietnam Interest Rates

Vietnam's interbank interest rates nudged up from 0.9% at the end of March to nearly 1.5% at present, and both 5Y, and 10Y Vietnam Government Bond (VGB) yields increased by about 50 bps to 3.5% and 4.5% respectively. This gradual deflation of Vietnam's VGB bubble is also fueling the current pessimistic stock market sentiment among local investors.

Global Oil Prices

The 20% YTD increase in global oil prices has been largely driven by geopolitical factors, but high oil prices look likely to persist for the rest of 2018, due to a growing supply and demand deficit, as well as a decline in global oil inventories to below the five-year average (which is widely considered to be the equilibrium level of oil inventories).

Market's Long-Term Prospects Remain Strong

In light of the above factors, the market drove down market valuation to a fairly reasonable P/E ratio of 18.5 times, which is in line with regional peers after reaching a peak of +22 times in early April. We think that the strong earnings growth of approximately 15% - 18%, as well as long-term economic growth driving by strong consumer confidence and economic outlook across sectors, especially banking and retail, will support the market in the long run.

Disclaimer