Ismael Pili
Head of Research

When America Sneezes

Global Equity Markets Continue to Take its Cue from the US. Three thematic baskets for Vietnam.

Overall Summary

- The phrase "when America sneezes, the world catches a cold" alludes to the notion that as a global leader, other nations tend to follow the US be it for good or bad. Notwithstanding the pun related to the pandemic, **equity market direction around the world has been influenced by sentiment on US equities**.

- With the worst of the pandemic likely behind us, central bank-supported **equity markets are unlikely to retest their lows**. While reopening momentum may well carry risk assets a bit higher over the near term, the tepid economic recovery and deep uncertainty over the virus outlook (notwithstanding the latest news of a possible vaccine) argue against a pivot to more risk-on positioning.

- Still, the presence, if not the threat, of liquidity has removed tail risk and driven markets higher. **Liquidity moves markets more than earnings**.

- In Asia, over the last month, consensus **estimates for FY20 EPS have finally started to come down** with MSCI AC ex-Japan (MXASJ) growth rates now down to ~2% vs ~15% EPS growth in Jan 2020. It is likely that we will see further earnings downgrades.

- In Vietnam, the bounce in global equity markets was not lost on the country, as the VN Index rose 28% from its March 24th low this year driven by retail investors, as **foreign institutional investors were largely net sellers**.

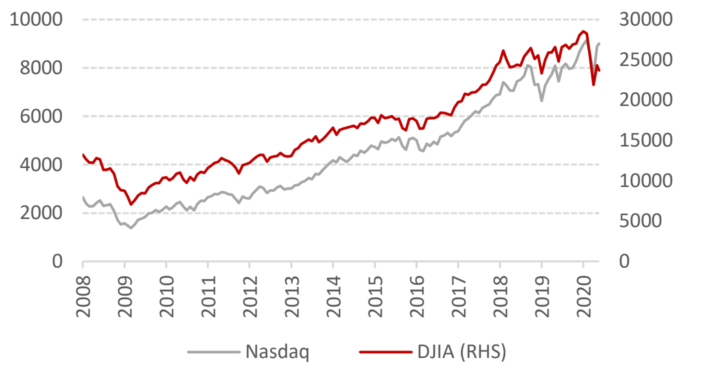
- For offshore equity investors, **Vietnam is an off-index bet** that comes at a time when the macro environment globally is volatile and febrile. The list of **why Vietnam could be peripheral for the next few months** is long, and the wall of worry to clamber over is high. However, when investors do come back, they will have a blend of quality blue chip stocks to consider. It is unlikely foreigners will buy sectors or try to rotate, but rather their **preference will be to make calls based on management and business quality**.

- The need for market access though may find banks, property, and consumers as the first port of call simply because of better accessibility (i.e., higher ADTV and/or FOL). We may, however, not be at this stage yet. Our preference can be lumped under **three thematic baskets**: **early stage recovery plays**, **infrastructure**, and '**defensibles**'. See inside for the specific sector plays.

US Equity Markets – Liquidity vs Fundamentals

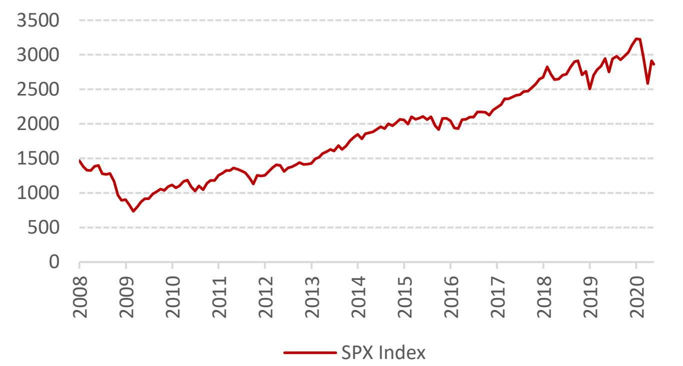
The direction of Vietnam's stock market, if not the world, is seemingly influenced by developments and sentiment in the US. With the worst of the pandemic likely behind us, central bank supported **equity markets are unlikely to retest their lows**. While reopening momentum may well carry risk assets a bit higher over the near term, **the tepid economic recovery and deep uncertainty over the virus outlook** (notwithstanding the latest news of a possible vaccine) **argue against a pivot to more risk-on positioning**. The divergence between markets and economic reality remains, and this gap continues to widen.

Nasdaq & Dow Jones Industrial Average



As of 18/5/2020 *Source: Bloomberg, VinaCapital*

S&P 500



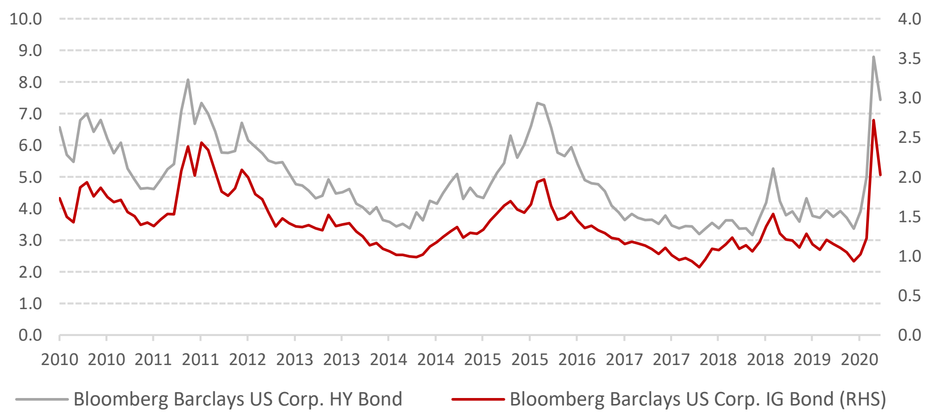
As of 18/5/2020 *Source: Bloomberg, VinaCapital*

Rising markets are being driven largely by **narrow dominance of tech stocks vs traditional old-economy stocks**, with Growth stocks (such as Tech) continuing to outperform Value stocks (financials, deep-cyclicals) in the US as well as in Asia in what seems to be a global trend.

The impact of liquidity vs fundamentals continue to play out, with several examples of this dynamic where **investors have been able to look through the disaster in the global economy because of liquidity** (and the expectation that there is more to come) as well as more fiscal stimulus. Case in point: US payrolls for April set post WWII records as non-farm payrolls fell by 20.5m in April and the US unemployment rate rose to 14.7% (surging from 4.4%) – yet the S&P 500 still rose by a risk-on 1.7% that day.

Besides real liquidity, the threat of liquidity has removed tail risk and driven markets higher. Though the Fed announced on April 9 its program to buy corporate bond ETFs as a strategy for stabilizing credit market functionality, not one dollar had been spent since that announcement until May 12 https://www.marketwatch.com/story/fed-kicks-off-its-buying-of-corporate-debt-etfs-2020-05-12. Yet IG bond spreads had rallied over 150bps even before the actual purchase. These programs have been a huge success not because of their efficacy, but how they were delivered.

High Yield Bond & Investment Grade Bond spread

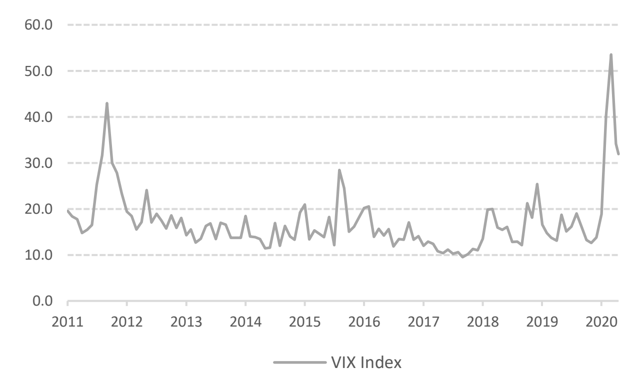


As of 18/5/2020 *Source: Bloomberg, VinaCapital*

As mentioned, it is looking more likely that the previous market troughs will not be revisited (unlike in the previous crises over the past century) under **the influence of lower rates** (discount factors are better from a valuation perspective), **the start of a growth recovery** (some of the trade data seem less dire than anticipated), and **extended policy support** (from a liquidity/fiscal perspective).

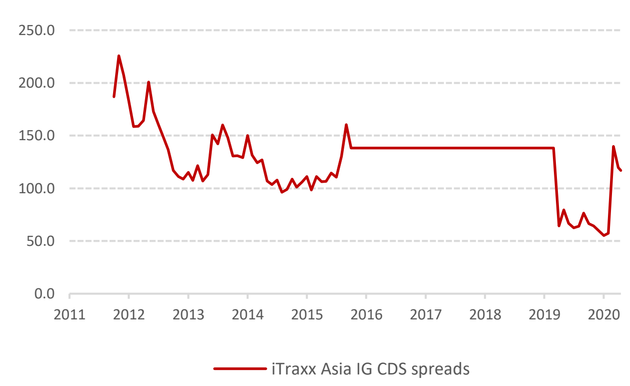
Other measures of equity risk sentiment such as **credit spreads and implied volatility have also normalized** further - credit spreads have tightened (the iTraxx Asia IG CDS has been flat since mid-April at around 115 and if equities hold, this level could see a tightening as the market normalizes completely down to below 80; meanwhile the VIX volatility index also fell below 30 for a bit - the first time the volatility index fell under this level since late February before the rout in global equities, and is now within 1 standard deviation of its pre-COVID outbreak average. If there is no second wave of infections and the expected R0 remains low and falling, then it is possible that this level is scaled back and equities rally.

VIX



As of 15/5/2020 *Source: Bloomberg, VinaCapital*

iTraxx Asia IG CDS Spreads



As of 15/5/2020 *Source: Bloomberg, VinaCapital*

Earnings haven't had much impact on sentiment either - US earnings season is starting to wind down, with most of the S&P 500 having reported first quarter results for 2020. In our last check (May 8), the running decline so far has been a net profit contraction of 13.6% yoy for the quarter; if those numbers hold, it will be the largest year-over-year decline since the third quarter of 2009 (which was -15.7%). The S&P 500 doesn't seem to be that fussed though and is now at levels it traded at in October last year just before the phase one deal was signed with China, while the NASDAQ is now in the black (+0.5% ytd) in 2020. A truly remarkable achievement in the face of something akin to an economic depression. As Stanley Druckenmiller of Duquesne has espoused, **liquidity moves markets more than earnings**.

US Indices – PER

(in x)	S&P 500	Nasdaq	DJIA
2019	21.2	33.5	20.1
2020E	22.8	32.7	21.6
2021E	17.7	24.2	16.2
2022E	15.2	20.3	14.0

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

US Indices – Net Profit Growth

(in %)	S&P 500	Nasdaq	DJIA
2019	0.9	2.4	(8.2)
2020E	(17.4)	3.1	(22.6)
2021E	28.4	34.9	33.1
2022E	16.4	19.4	15.9

As of 15/5/2020 *Source: Bloomberg, VinaCapital*

Asia Markets – North Asia May Fare Better

In Asia, over the last month, consensus estimates for FY20 EPS have finally started to come through with **MSCI AC ex-Japan (MXASJ) growth rates now down** to ~2% vs ~15% EPS growth in Jan 2020. It is likely that **we will see further earnings downgrades**, as the region is in the early stages of the reporting season (to date, only ~30% of MXASJ companies have reported 1Q20 earnings). However, **the downside for Asia ex-earnings should be cushioned somewhat by its much higher weighting in strong secular sectors (e.g. technology, software, semis)** – and within Asia, North Asia will likely fare better for these reasons.

Korea – EPS Growth

(in %)	2019	2020E	2021E	2022E
Consumer Discretionary	8.1	-17.1	49.2	10.4
Consumer Stables	-59.3	199.6	15.4	4.7
Finance	-3.4	-17.2	6.5	8.5
Industrial	-36.9	59.9	88.5	8.9
Information Technology	-84.7	187.9	65.4	19.0

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

Taiwan (TAIEX) – EPS Growth

(in %)	Mkt Wt	2019	2020E	2021E	2022E
Information Technology	51.6	-0.4	19.9	17.2	12.9
Financials	14.3	16.5	4.6	5.7	8.3
Materials	9.5	-30.7	-11.7	19.8	8.8
Consumer Discretionary	6.5	10.2	24.0	4.2	6.4
Industrials	5.3	-9.4	26.3	32.9	14.1

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

In Asia ex-Japan, NE Asia, Indonesia, and India are the markets that still maintain a positive EPS growth outlook. In Korea, investors still expect ~40% growth and in Taiwan, analysts are assuming ~6% growth (down from ~15%), as consensus continues to anticipate an earnings recovery in hardware & semis from a contraction in 2019 to ~20% in 2020. In China, consensus estimates decreased to ~15% currently, while in India, analysts finally accepted the inevitable, with EPS growth expectations down to ~14% vs hallucinating levels of 20%-30% in Jan-Feb 2020.

Asian Markets – PER

	2019	2020E	2021E	2022E
China	14.3	11.8	10.3	9.1
Hong Kong	11.2	10.6	9.1	8.1
India	25.1	16.3	12.9	11.8
Indonesia	18.9	12.8	11.0	9.9
Korea	21.7	14.0	9.8	8.7
Malaysia	17.8	16.8	15.0	13.9
Philippines	17.2	14.1	11.6	11.0
Singapore	12.5	13.5	11.9	10.2
Taiwan	19.5	16.7	14.6	13.0
Thailand	18.0	19.0	15.4	13.5
Vietnam	15.1	13.6	11.2	9.5

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

Asian Markets – Net Profit Growth

	2019	2020E	2021E	2022E
China	5.3	15.0	14.8	13.3
Hong Kong	-1.9	-13.5	16.1	12.3
India	22.7	13.8	26.3	9.3
Indonesia	15.2	7.0	16.4	10.8
Korea	-48.4	40.4	42.7	12.9
Malaysia	12.8	-4.9	11.5	8.2
Philippines	12.4	-12.9	20.9	5.5
Singapore	6.2	-25.6	13.8	16.6
Taiwan	-13.1	6.0	14.3	12.0
Thailand	-9.0	-20.9	23.0	14.4
Vietnam	7.2	-2.1	21.5	18.5

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

While analysts will continue to cut, **FY20 EPS have limited informational value**. Far more important is the steepness of recovery into 2021-22. What do numbers tell us? **MSCI AC ex Japan analysts are expecting a strong V-shaped recovery** (~20% net profit growth in 2021 followed by ~12% in 2022). Developed Market analysts are broadly in the same camp. Amongst individual markets, as always, India and Korea take the pole bullish position (up ~30%-40%), but estimates in every market assume rapid normalization. **A far more likely course will be a gradual and protracted recovery**, but as long as there is some recovery underway, with policy makers continuing to keep risk free rates low while containing volatilities & spreads, the markets' direction may be mainly about policy risks.

On that front, there are some building **risks** that are worth watching:

- **Further fiscal stimulus.** On macro fundamentals, while the US has cushioned the impact to disposable income with the various fiscal programs, these programs will roll off in 2Q. If we do not see the rebound the markets expects, then this will require the US government to agree to further fiscal stimulus, which could be harder to do (though the USD3tn relief package was passed by the US House, it is not expected to pass in the Senate with President Trump promising to veto the bill). Investors could then start to consider if we are at peak fiscal support.

- **A second COVID-19 bump.** A potential further complication is risks of a second wave of COVID-19 globally and the ongoing spread west of the virus in the US. We saw new cases in Korea just as they started opening, Germany saw the virus reproduction rate move to above 1, and China also saw the first case in Wuhan since April 3rd as well as an increase of cases in the north-eastern provinces of Jilin and Heilongjiang. Meanwhile, COVID-19 continues to spread west through the US, moving into states that have had little lockdown restrictions.
- **US-China tensions.** Saber rattling between the US/China will likely grow larger as we head into the US election season. A few weeks back, the risk of this eased as trade ministers in both countries exchanged a phone call and rhetoric was toned down, but this is no longer a partisan issue: a recent poll suggests that 66% of Americans have an unfavorable view of China. As the virus spreads into 'Trump country', risk to his approval rating may lead him to ratchet efforts to solidify his base. Since March 30, his approval ratings have declined by 2%, and there is likely more to go. We are due to get more data points on this topic via the US Treasury report on currencies, China's National People's Congress (22nd May), and the Commerce Department's HK Human Rights & Democracy Act (May 25th), all of which will likely be opportunities for both the Trump Administration and China to provide more clarity on the issue.
- **Rising EM indebtedness.** EM debt vulnerabilities have not gone away. Latin America remains a hot spot for activity and debt defaults, with Ecuador starting the restructuring process last week, but more relevant for EM are the growing constraints of further fiscal support as external debt obligations balloon.

Vietnam Riding the Wave

In Vietnam, the bounce in global equity markets was not lost on the country. The VNI rose 28% (as of May 20) from its March 24 low this year driven by retail investors, as foreign institutional investors were largely net sellers *(see table below, as of May 15)*. In our view, **international investors are taking money out of Vietnam** to meet redemptions – an easy choice as for most, **the market is an off-index bet that comes at a time when the macro environment globally is volatile and febrile**.

FOREIGN FLOW	($US bn)	($US mn)	($US mn)	($US mn)	($US mn)	($US mn)
	Mcap	**1D**	**1W**	**1M**	**3M**	**YTD**
Vietnam	123	-6	+80	-170	-702	-666
Total EM ASEAN	**1,125**	**-246**	**-923**	**-2,910**	**-10,240**	**-11,262**
Philippines	138	-13	-65	-243	-950	-1,084
Indonesia	352	-74	-278	-697	-1,726	-1,661
Malaysia	207	-77	-169	-669	-2,655	-2,751
Thailand	429	-83	-411	-1,301	-4,908	-5,766
Flow/Mkt Cap		%	%	%	%	%
Vietnam		-0.00	+0.06	-0.14	-0.57	-0.54

As seen globally, we are likely in the first phase of recovery (i.e., the period where governments are throwing money around in order **to prevent economic collapse and systemic risk**). The second crucial phase will be around **stimulating growth** (via cash, policy (reduce friction costs, tax deferments), and it seems we are still a long away from that. In the meantime, markets will remain vulnerable and taking risk may not be many foreign investors' inclination at the moment. We don't get the sense there is rotational buying among foreign investors, and **the key question is thus when and if FII come back**.

The list of why Vietnam could be peripheral for offshore equity investors for the next few months is long, and the wall of worry to clamber over is high:

- **MSCI upgrade** is a long way away;
- The **banking sector** has yet to see the impact of COVID-19;
- **Tourism** is not going to restart soon;
- **Manufacturing** will be held hostage to global demand;
- **Agriculture** will be afflicted by issues beyond the pandemic;
- The **reduction in FOL** by VPB will hamper confidence;
- Though government investment (i.e., infrastructure) will be there, borders being closed to travelers will **impede FDI flow**.
- Domestic consumption accounts for ~70% of GDP, but **weak consumer confidence** and **a contraction in disposable income** needs to be overcome.
- **GDP growth** forecasts may still look a little generous.
- Consensus estimates have come down, though we see **scope for further cuts** beyond the expected 2Q20 earnings trough (except for the banks). Undoubtedly, FY21E reflect a recovery scenario, though foreign investors grabbing that envisioned recovery may be premature.

Vietnam – PER

PER (x)	2019	2020E	2021E
Vietnam	15.1	13.4	11.0
Aviation	14.9	52.6	16.0
Banks	12.6	11.8	15.7
Consumer Staples	17.8	19.8	18.6
Consumer Discretionary	8.5	9.8	8.3
Industrial Parks	18.4	11.8	13.9
Oil & Gas	10.8	8.5	14.4
Port Logistics	14.2	12.0	10.4
Property Non VIC	12.2	12.1	10.4
Property VIC Family	28.1	33.8	25.8
Steel, Materials, Cyclicals	8.4	7.4	6.7
Tech, Telecom	50.4	28.2	32.0
Utilities	8.8	8.7	9.4

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

Vietnam – Net Profit Growth

Net Profit Growth (%)	2019	2020E	2021E
Vietnam	7.3	-2.6	21.4
Aviation	17.6	-63.5	218.3
Banks	28.7	2.0	-4.5
Consumer Staples	6.0	-9.9	7.5
Consumer Discretionary	15.1	-13.9	18.5
Industrial Parks	-5.5	58.4	-13.5
Oil & Gas	10.4	10.2	3.1
Port Logistics	-9.8	14.5	14.0
Property Non VIC	5.3	-0.4	18.9
Property VIC Family	73.5	-10.5	33.3
Steel, Materials, Cyclicals	-10.6	15.3	10.9
Tech, Telecom	6.5	24.8	22.7
Utilities	8.1	2.9	-0.4

As of 18/5/2020 *Source: Bloomberg, VinaCapital*

However, when investors do come back, they will have a blend of quality blue chip stocks to consider. It is unlikely foreigners will buy sectors or try to rotate, but rather their preference will be to **make calls based on management and business quality**. The need for market access though may find **banks, property, and consumers as the first port of call simply because of better accessibility**. We may, however, not be at this stage yet. Our preference can be lumped under **three thematic baskets**:

1. **Early stage domestic recovery plays:** as previously cited by our Research team, the lifting of the soft lockdown in Vietnam may have a positive impact on these sectors or companies:
   - **Banks** – generally less asset quality pressure on its borrowers. Those that had higher 'impactable' loans would benefit more.
   - **Property** – improved prospect for project launches.
   - **Consumer discretionary** – increased foot traffic.
   - **Aviation related** – more flight, more passenger traffic, more cargo.
   - **Brokers** – improved sentiment on company prospects, deals.
2. **Infrastructure**: the easy lever for Vietnam can pull to buoy economic growth would be on infrastructure spending. The Research team cites the following sectors on this theme:
   - **Construction Materials**
   - **Property**

- **Utilities**

Less direct or indirect plays could include:

- **Industrial Parks**
- **State-owned commercial banks**

3. ‘**Defensibles**’**:** these are companies with **industry leading franchises and businesses** that are posting **good returns and/or growth** that competitors may find difficult to supplant.

Disclaimer