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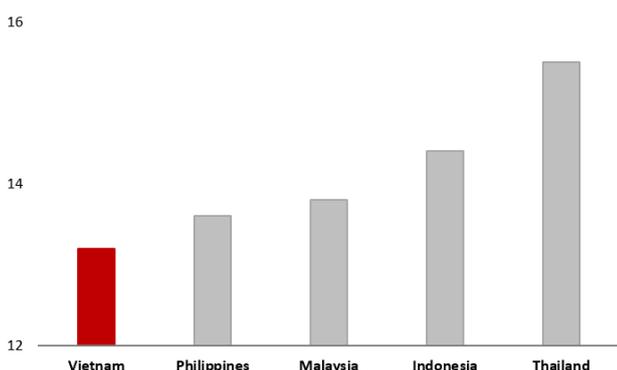
## Looking Ahead at 2022

In this year's "Looking Ahead" report, we focus on three themes that we believe will drive Vietnam's economy and stock market in 2022:

- **Continued Re-Opening Rebound** of Vietnam's Economy, which gathered pace in Q4 after the Government switched its approach from "Zero COVID" to "Living with COVID" and accelerated the vaccination of the country's residents. We expect 7-7.5% GDP growth in 2022, driven by a continued rebound of domestic consumption, which surged by nearly 30% quarter-on-quarter in Q4.
- **Continuation of Long-Term Growth Drivers**, which were *not* impacted by COVID, and which include: continued **FDI inflows** (which were stable over the last two years despite COVID), **urbanisation**, **ESG and digitalization**, among others.
- **Continued Macro-Economic Stability**, characterised by **stable/manageable inflation**, and a **modest appreciation of the Vietnam Dong**, despite the consensus expectation that the Fed will hike interest rates in 2022. Further to that last point, Vietnam (plus China) will be one of the few EM countries that is *not* expected to tighten monetary policy this year. In contrast, over 10 EM central banks hiked interest rates in 2021 to defend the value of their currencies, which Vietnam does not need to do.

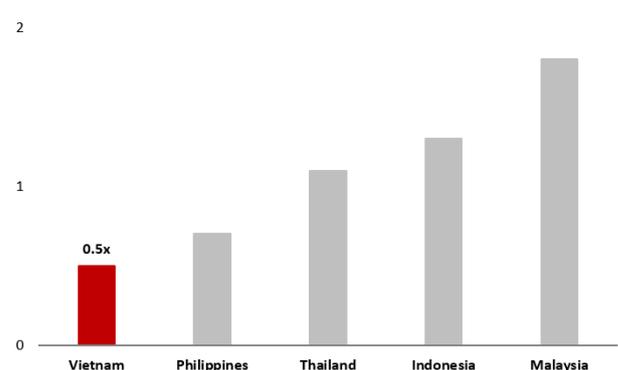
In addition to all of the above, for the last two months the Vietnamese media has been reporting that the Government is preparing a fiscal stimulus package to boost Vietnam's economy. Passage of the package is reportedly imminent, although it looks likely that the actual spending entailed in the plan will be considerably less than initially advertised.

**FY22 P/E Ratio**



Source: VinaCapital, Bloomberg

**PEG Ratio (P/E vs FY22 Earnings Growth)**



Source: VinaCapital, Bloomberg

Finally, we expect another very good year for Vietnam's stock market following the 37.3% increase in USD terms (or 35.7% in VND terms) of the VN-Index (VNI) last year, and we believe the market will continue to offer ample opportunities for active managers to outperform the index again significantly in 2022. Last year's surge in the VNI was largely driven by earnings growth of circa 30%, and the consensus currently estimates earnings growth of over 20% in 2022.

Furthermore, foreign investors sold EM stocks across-the-board in response to concerns about COVID and China, but investors are likely to return to EM and frontier markets given the likely resolution of these issues in 2022, as

well as the current, large valuation discount between EM and DM stock markets. If-and-when that happens, Vietnam's cheap valuations and strong earnings growth should lure some of those inflows.

**Continued Re-Opening Rebound**

We expect Vietnam's GDP growth to surge from 2.6% in 2021 to 7-7.5% in 2022 and believe that the country's economic growth could even exceed 7.5% this year, driven by vigorous rebounds in Vietnam's domestic consumption and construction activity, as well as by a resumption of tourist arrivals at some point in the months ahead.

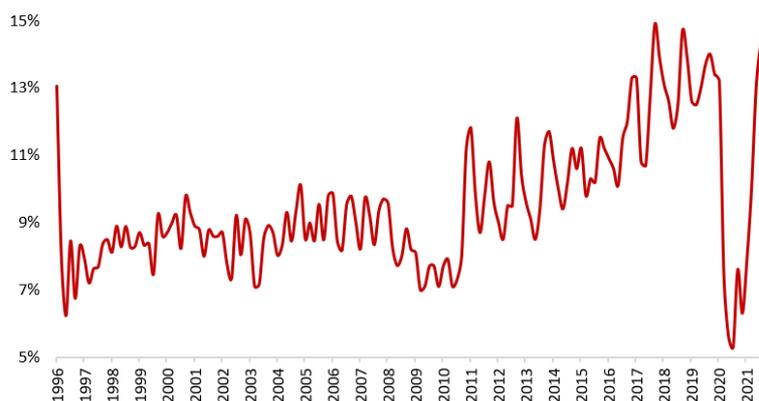
Specifically, we expect the growth of real retail sales in Vietnam (i.e., excluding inflation) to surge from a 6.2% drop in 2021 to 5% growth in 2022, versus consistent 8-9% annual growth pre-COVID. Furthermore, we estimate that consumption in Vietnam is still circa 10% below pre-COVID levels. We also expect the growth of Vietnam's construction activity to surge from 0.6% in 2021 to 8% in 2022 driven by "catch up" infrastructure spending (which is discussed below) and by an expected relaxation in regulations governing real estate development.

**Living With COVID Strategy Supports Consumption & Tourism**

In October, Vietnam's Government pivoted from a "Zero COVID" approach to a "Living with COVID" approach, which drove a reopening boom. The Government's aggressive vaccination campaign raised the proportion of the country's population who have received two COVID shots from 4% in September to over 90% of adults as of 5 January 2022, giving most Vietnamese people the confidence to return to work and paving the way for a resumption of foreign tourism – which directly accounted for about 8% of Vietnam's GDP, pre-COVID. We acknowledge, however, that that world is currently focused on the Omicron COVID variant, which has prompted Thailand and other countries to suspend their planned relaxations of quarantine restrictions for fully vaccinated tourists.

The timing of a resumption of Vietnam's tourist arrivals will be clearer after the Lunar New Year, which is at the beginning of February this year, but the prospects for Vietnam's tourism industry are already clear, and are evidenced by a surge in the desire of US consumers to travel abroad, according to the Conference Board's recent US consumer sentiment survey (a sentiment we believe is shared by consumers in other developed countries):

**US Consumers' Desire to Travel Abroad**



Source: Bloomberg, VinaCapital

**Not Much Help From Exports in 2022**

In our "Looking Ahead 2021" report, we discussed the demand for so-called "stay at home" products such as televisions, laptops, and furniture from consumers in the US which helped support Vietnam's manufacturing sector last year (note that manufacturing accounts for about 25% of Vietnam's GDP).

Vietnam's exports to the US - its largest export market - grew 25% CAGR over 2020-21, but: 1) there is very little chance that the US will impose severe COVID lockdowns again this year, and 2) US consumers bought an

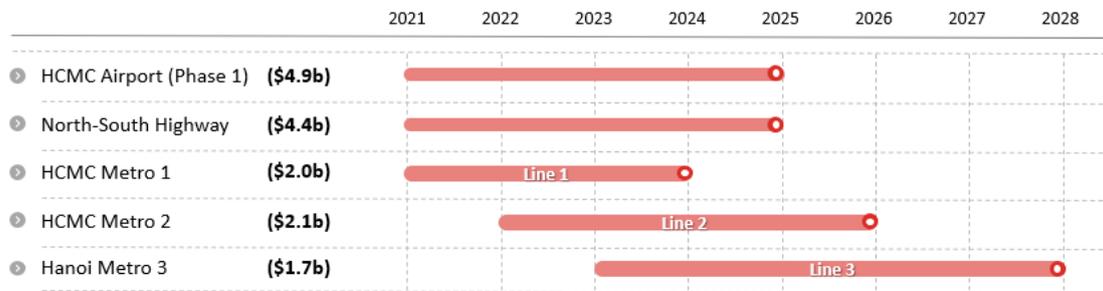
enormous amount of “stay at home goods” and other products in 2021, so unsurprisingly, their desire to purchase more “big ticket” items such as televisions, laptops, and other similar goods fell to a record-low, according to the University of Michigan's consumer sentiment survey.

**Infrastructure Spending**

In July 2021, the Government approved a plan to increase its infrastructure spending by about 40% over the next five years versus the previous five years (which we discussed in [this report](#)), but the Government’s infrastructure spending actually fell by about 10% in 2021 due to COVID. Consequently, we expect “catch up spending” on infrastructure development to help propel Vietnam’s construction activity, which contributes about 6% to the country’s GDP.

In 2021, ground was broken for the construction of Phase One of HCMC’s new USD16 billion airport<sup>1</sup>, and we expect the Government to significantly accelerate progress this year. Next, Vietnam’s new North-South highway has been under construction for years, but progress has been very slow for a variety of reasons, including the fact that the Government was previously trying to fund the construction of the highway via Public-Private Partnerships (PPP).

**Major Infrastructure Projects in Vietnam**



Source: VinaCapital

However, we understand that the Ministry of Transport recently decided to fully finance the development of this highway, which should dramatically accelerate the construction progress of this project in 2022. Finally, the recent completion of the initial segment of Hanoi’s first metro line, which went into operation in November, is a likely catalyst to propel the Government to follow through with the long-delayed completion of the first metro line in HCMC, as well as to extend that new Hanoi metro line, and to launch the construction of additional metro lines in both HCMC and Hanoi.

**Continuation of Long-Term Growth Drivers**

Vietnam’s long-term growth drivers remain intact despite COVID. The country’s most important growth driver is foreign direct investment (FDI), and FDI inflows remained remarkably resilient over the last two years, despite COVID. We expect continued strong inflows in 2022 – especially as travel restrictions are eased - which will make it easier for executives from Japan, Korea, and elsewhere to travel to Vietnam. Additionally, the recent announcement that LEGO corporation will invest USD1 billion in Vietnam to build its first **carbon neutral factory** will help attract other FDI investors that prioritize ESG when deciding where to invest.

In 2020, Vietnam’s FDI inflows fell by just 2% (to USD20 billion) despite a circa 40% drop in global FDI due to COVID (according to the UN). In 2021, Vietnam’s FDI inflows fell by just 1% despite the fact that Vietnam had some of the strictest COVID lockdown measures in Asia during the Delta Variant outbreak, which prompted articles from the international media about the difficulties FDI companies faced in Vietnam this year.

Despite that adverse publicity, firms producing high-tech products remain enthusiastic about investing in Vietnam. For example, LG Display announced USD2.2 billion of planned investments in 2021 that will nearly

<sup>1</sup> The construction of HCMC’s new airport will occur in three phases.

double the company's total investment in Vietnam. Samsung, which is Vietnam's biggest foreign investor (and private sector employer), announced that it will increase its production capacity of foldable devices in Vietnam by 50%, while Toshiba said it will relocate all of its electronics production in China to Vietnam and Japan.

Further to that last point, Vietnam remains the most attractive country for Japanese companies to invest in, according to a survey published by Deloitte in September (Korean investors were not surveyed).

### **Factors Supporting FDI Inflows**

Vietnam's main appeal as a destination for FDI stems from the fact that factory wages in Vietnam are about one-third those in China, and the quality of the workforce is comparable to that of China, according to surveys by JETRO and others. Vietnam's close geographic proximity to Asia's supply chains, especially in the high-tech industry, is another factor.

Further, an increasing number of multinational firms are seeking to diversify their manufacturing outside of China for a variety of reasons, including the fact that the US has maintained tariffs on China's exports to the US in the face of continued tensions between those two countries. In contrast, the US Treasury Department and the State Bank of Vietnam reached an agreement in July that removes the risk of tariffs being imposed on Vietnam's exports to the US.

Next, the impressive speed of Vietnam's COVID vaccination campaign once the Delta variant emerged (and despite a sluggish start) gives foreign companies confidence that the Government is committed to achieving a prudent balance between public health and economic health concerns as part of the "Living with COVID" strategy it has pursued since October.

Finally, the above-mentioned investment by Denmark's LEGO Corporation will reinforce Vietnam's environmental, social and governance (ESG) credentials to other prospective investors at a time when foreign investors are increasingly focusing such considerations. LEGO has an outstanding and highly publicized commitment to sustainability, as do many other major European companies.



### **Continued Macro-Economic Stability**

Investors in Emerging Market (EM) and Frontier Market (FM) stock markets are currently concerned that inflation could prompt central banks in those markets to increase interest rates, and that expectations of aggressive US interest rate hikes could depress the value of EM and FM currencies. Regarding the former, over 10 EM central banks have already started hiking rates. Regarding the latter, note that the value of the Philippines Peso fell by over 1% last month, following a depreciation of more than 2% in the last week of December as expectations of Fed QE rate hikes intensified.

### **Modest Inflation in Vietnam**

Vietnam's inflation rate was below 2% (year-on-year) at the end of 2021, but an imminent electricity price hike will add about 0.5%pts to the headline inflation rate. We also expect a bounce in Vietnamese pork prices (which fell by 30% in 2021) as a resurgence of African Swine Fever (ASF) pushed up Chinese pork prices 10% in December.

In short, we expect Vietnam's inflation rate to climb above 4% yoy in Q2 driven by higher electricity prices, pork prices, and by higher global oil prices. However, we do not expect global oil prices to climb significantly above USD85 per barrel this year, so we expect Vietnam's inflation rate to drop back to about 3% by the end of 2022.

In summary, inflation will be more visible in Vietnam this year, but it will not be a big enough issue that will cause the State Bank of Vietnam (SBV) to hike rates. It will also not have any significant impact on the value of the VN Dong, which we expect to appreciate by about 2% this year, driven by a rebound in Vietnam's trade surplus from about 1%/GDP in 2021 to 5% in 2022 (Vietnam's imports outpaced exports last year, because FDI companies built up large inventories of production materials which they will deplete in 2022).

**We are Not Worried About the Fed**

Most investors and analysts expect the US Federal Reserve to hike interest rates three times in 2022, which could hurt stock prices in EM and FM stock markets, including Vietnam's. We do not believe the Fed will follow through with its "dot plot" guidance to hike rates three times<sup>2</sup>, and more importantly, Vietnam is well positioned to shrug off aggressive Fed rate hikes this year.

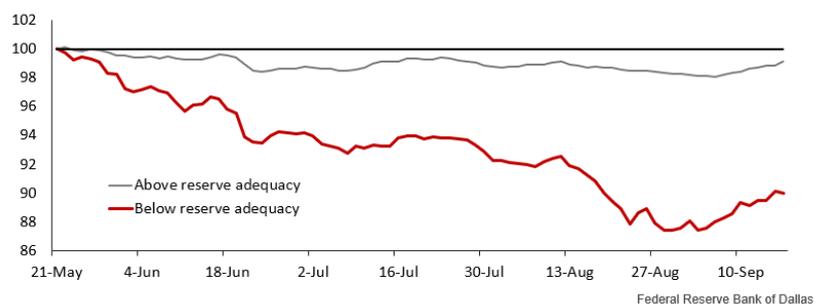
The Economist magazine recently published its assessment of which countries are the most vulnerable to Fed rate hikes in 2022, and Vietnam was near the very bottom of its list, as can be seen in the chart below, on the left.

**Fed Taper Vulnerability Ranking**

Country rank, 40=most vulnerable	Current-account balance*	Gross public debt*	Foreign-exchange reserves*	Consumer prices†	External debt‡	Vulnerability index score Average of five indicators
Argentina	12	37	39	40	36	33
Sri Lanka	33	39	21	24	38	31
Egypt	36	36	28	21	20	28
Pakistan	21	32	22	33	25	27
Brazil	20	34	26	31	10	24
Turkey	29	9	4	37	37	23
Chile	30	6	32	16	28	22
India	25	35	10	26	8	21
Nigeria	34	8	17	36	1	19
Malaysia	6	29	15	10	35	19
South Africa	7	27	8	19	32	19
Mexico	17	22	11	25	17	18
Poland	8	18	7	20	24	15
Indonesia	18	12	20	5	22	15
Philippines	16	21	12	17	5	14
South Korea	3	16	9	8	26	12
Thailand	19	20	2	3	14	12
Vietnam	9	14	1	6	19	10
Russia	2	1	5	28	4	8
Saudi Arabia	5	4	3	14	3	6

Source: The Economist

**Dallas Fed Research on 2013 Taper Tantrum**



In the chart above, economists at the Dallas Federal Reserve compared the FX rates of EM countries that did NOT have enough FX reserves (according to the IMF) to those that DID have enough reserves during the 2021 "Taper Tantrum".

Source: Federal Reserve Bank of Dallas, VinaCapital

Further to that last point, the Dallas Fed recently published research on the 2013 taper tantrum<sup>3</sup> which concluded that the Emerging and Frontier Market countries which were the most impacted by the Fed's last "QE tapering" were those that had too little USD reserves and/or had too much US Dollar-denominated debt.

The chart above right compares the taper tantrum's impact on the foreign exchange (FX) rates of EM countries that did not have sufficient FX reserves to those that did, according to the IMF. The exchange rates of countries with insufficient FX reserves depreciated by over 10% during the taper tantrum, which in turn prompted stock market corrections in those countries; countries with sufficient FX reserves emerged from the taper tantrum relatively unscathed, as can be seen above.

Vietnam currently has about USD100 billion of FX reserves, which is about 10% above the IMF's recommended level of reserves for the country, and Vietnam's foreign currency denominated debt is below 40%/GDP. Furthermore, about half of Vietnam's foreign currency denominated debt is essentially "soft" loans that are owed

<sup>2</sup> Note that: 1) the Fed's "dot plot" guidance on rate hikes/cuts has been accurate less than 40% of the time over the last 10 years, and 2) there are numerous indications that the US economy is on weaker footing than most analysts believe. It has become increasingly clear in recent weeks that there will not be another major US fiscal stimulus program – and the absence of fiscal stimulus will subtract around 3%pts off 2022 US GDP growth, according to the Brookings Institution and others.

<sup>3</sup> <https://www.dallasfed.org/research/economics/2021/0810>

to supra-national lenders (e.g., the World Bank) on concessionary terms. As such, this debt does not increase Vietnam's vulnerability to tighter global monetary conditions.

**We are Not Worried About China**

In recent weeks, economists cut their 2022 China GDP growth forecasts prompted by concerns that China's "Zero COVID" strategy will lead to more lockdowns (due to the spread of the highly transmissible Omicron variant) and because of ongoing issues in the property sector, including the recent default of Evergrande. But we believe there are two reasons why China's GDP growth is likely to remain surprisingly resilient in 2022:

- 1) Next year will be one of China's most politically important years in modern history, as Xi Jinping will seek an unprecedented third term as the country's leader at the Communist Party Congress in late-2022.
- 2) China did not stimulate its economy to offset COVID, so it has ample room for aggressive monetary and fiscal stimulus, and the Government has clearly signalled that it will use both to stabilize the economy.

Further to that last point, the unexpected Reserve Ratio Requirement (RRR) cut by China's central bank in December, coupled with reports that the government is encouraging Chinese commercial banks to accelerate mortgage approvals and to extend loans to financially sound real estate developers, reassures us that the Chinese government is orchestrating an orderly unwind of the country's real estate bubble. That said, the deflation of the Chinese property bubble is likely to be a protracted process that could depress the country's GDP growth for years to come.

In our opinion, the two most important points for investors in Vietnam as relates to China are that: 1) China is unlikely to experience a dramatic crash that would prompt foreign investors to pull money out of Asian stock markets, and 2) slower GDP growth in China will not have much impact on Vietnam, partly because of Vietnam's persistent trade deficits with China, which have averaged more than 10% of Vietnam's GDP over the last five years (and -15% in 2021!).

Finally, while we expect slower Chinese GDP growth going forward, policy makers have made it clear that they will defend the value of the Chinese Yuan as the country transitions from an export-driven economic model to a consumption-driven one. This is important because it means that Vietnam will retain (or even increase) its export competitiveness vis-à-vis China in the years ahead (i.e., slower Chinese GDP growth will *not* lead to a cheaper USD-CNY exchange rate).

**Another Good Year for Vietnam's Stock Market**

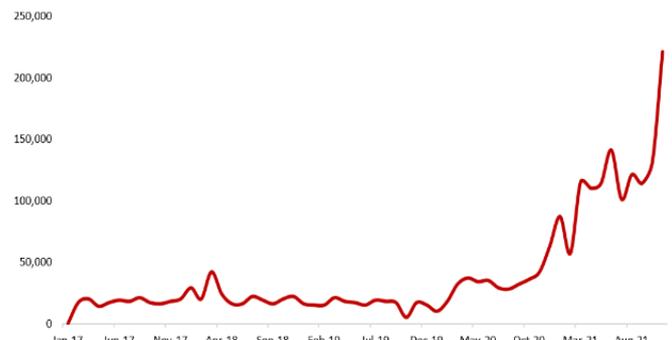
Vietnam's stock market surged 37.3% (in USD terms) in 2021, driven by expected earnings growth of over 30%, so the FY21 P/E ratio was essentially unchanged at circa 17x during the year. The consensus 2021 net profit growth forecast climbed all year as 2021 progressed - as can be seen in the chart below left – and this increase was the primary factor that drove the market higher in 2021, despite two major COVID outbreaks during the year.

**Consensus FY21 Earnings Growth Forecast**



Source: Bloomberg, VinaCapital

**New Vietnam Retail Accounts in 2021**



Source: VSD, VinaCapital

Clearly, the surge in the VN-Index was driven by corporate earnings growth last year, which is very important for investors to understand because:

- 1) Bull markets driven by earnings growth are healthier and more sustainable than those driven by P/E multiple expansion
- 2) We expect 24% earnings growth<sup>4</sup> in 2022, which should drive the market considerably higher this year
- 3) While a surge in retail stock brokerage accounts also helped support Vietnam's stock market in 2021 (see chart above, on the right), earnings growth was the primary factor that drove the market higher

Further to that last point, Vietnamese retail investors are surprisingly sophisticated when it comes to focusing on earnings growth, on the global macro environment (including the Fed's QE tapering, etc), and on sector-specific developments. Retail investors currently account for circa 90% of daily trading volume on Vietnam's stock exchanges, so active investors with a proper investment methodology that anticipates sector rotations and can accurately anticipate the earnings growth of individual companies are well positioned to outperform the VN-Index.<sup>5</sup>

Our current investment strategy remains focused on identifying stocks and sectors that benefit from the economic recovery that is already underway in Vietnam, including consumer discretionary, financials, real estate, and materials stocks. In addition, as mentioned earlier in this report, Vietnam's long-term growth drivers have remained intact despite COVID, so we also continue to focus on stocks and sectors that are beneficiaries of FDI inflows, infrastructure development, clean energy, and digitization.

The table below summarizes the sectors that we expect to benefit from these five investment themes in 2022. We are particularly focused on the banking sector (which has a circa 30% weighting in the VN-Index), property (which has a 25% weighting), and consumer discretionary stocks (which have a circa 3% weighting) – but should benefit from both cyclical and secular tailwinds this year.

DOMESTIC RECOVERY	INFRASTRUCTURE	FDI	CLEAN & GREEN	DIGITAL WORLD
<ul style="list-style-type: none"> <li>• <b>Banks</b> – less asset quality pressure on borrowers</li> <li>• <b>Property</b> – improved prospect for project launches.</li> <li>• <b>Consumer Discretionary</b> – increased foot traffic.</li> <li>• <b>Aviation related</b> – more flights, passengers, cargo.</li> </ul>	<ul style="list-style-type: none"> <li>• Airport</li> <li>• Construction Materials</li> <li>• Property</li> <li>• Utilities</li> <li>Indirect Beneficiaries:                             <ul style="list-style-type: none"> <li>• Industrial Parks</li> <li>• Stated Owned Commercial Banks</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Selected Industrial Parks (ie. with sufficient capacity, well located, etc)</li> <li>• Ports, Logistics, Transportation.</li> <li>• Consumer Companies &amp; Residential RE developers (benefit from higher personal incomes)</li> <li>• Indirect Beneficiaries: Construction Materials, Banks, Industrial Parks, Infrastructure Developers</li> </ul>	<ul style="list-style-type: none"> <li>• Utilities – Wind Power Projects, Renewable Energy</li> <li>• Electric Cars</li> <li>• Consumers – Recycled Materials</li> </ul>	<ul style="list-style-type: none"> <li>• Banks – digitalization of process or operations such as payment, digital banks, credit ratings &amp; approval process, data clouding, automated bancassurance advisory</li> <li>• Consumer Discretionary – ecommerce</li> <li>• Logistics – ecommerce</li> <li>• Stock Brokers – payment</li> <li>• Technology Firms</li> </ul>

Source: VinaCapital

Banks' earnings are likely to grow by about 30% this year, driven by 14% credit growth, and Vietnam's banks to be less impacted by COVID in 2022. Specifically, asset quality issues should have less of an impact on banks'

<sup>4</sup> VinaCapital's 2022 earnings growth forecast is in-line with the market consensus

<sup>5</sup> VinaCapital's VVF UCITS fund outperformed the VN-Index by over 10%pts in 2021

earnings and we do not expect banks (especially SOCBs) to sacrifice profitability to help support the economy (e.g., by offering concessionary lending rates) again in 2021.

Furthermore, two ongoing trends will support Vietnamese banks' profitability in 2022: 1) an improving loan mix (i.e., more retail and SME loans), and 2) lower funding costs, driven by a higher contribution from low-cost current account savings account sources. In addition, the Government's NPL forbearance measures will enable banks to spread their loan losses from COVID over three years, which will support banks' profitability this year<sup>6</sup>.

Finally, although we are quite optimistic about the overall prospects of the banking sector, we expect earnings growth of individual banks to vary from circa -13% to circa +25%, partly because the State Bank of Vietnam will allocate credit growth quotas based on asset quality, which varies widely among Vietnamese banks (we expect credit growth to range from 11-12% to over 20% this year). In addition, there are many idiosyncratic factors that could impact both earnings and share prices, including bancassurance deals with foreign insurance companies (which typically entail generous up-front payments) and turn-around/restructuring stories.

Next, we expect the earnings of real estate companies to grow by nearly 25% in 2022, driven by a near-doubling of sales/pre-sales of new housing units by property developers following a drop of more than 50% in 2021 because of the COVID lockdowns, as well as legal/regulatory issues that are now being resolved. In addition, the earnings of firms that have recurring revenues (e.g., real estate brokers and shopping mall owners/operators) are also set to surge this year.

Regarding the latter, continued enthusiasm for investing in real estate – thanks in-part to the low deposit rates that banks pay to savers – should ensure that property prices continue to rise in 2022 (we estimate that apartment prices in Hanoi and HCMC rose by about 10% in 2021). We believe that the continued increase in real estate prices and a pent-up demand to purchase homes to live in or for investment purposes will drive the above-mentioned, anticipated surge in the pre-sales of new housing units in 2022.

Finally, consumer spending should continue rebounding in 2022. We expect consumers to spend more on products that are perceived as having health benefits and we also believe that the pandemic has accelerated the trend of consumers shopping in the modern retail channel and via ecommerce. However, incomes were severely hit during the pandemic, so some consumers are likely to shift their purchases to cheaper products, and we believe that the sales of some non-essential or high-end goods will not recover to their pre-COVID levels this year.

## **Conclusions**

We expect Vietnam's GDP growth to surge by at least 7% this year, driven by the continuation of a vigorous consumption rebound that started in Q4 and by a resumption of foreign tourism at some point during the year. We estimate that domestic consumption in Vietnam is still 10% below pre-COVID levels and that as more of the world adjusts to "living with COVID," international tourism will gradually return as the year progresses.

We expect Vietnam's ongoing economic recovery to propel corporate earnings growth by over 20% in 2022, which should in-turn drive a considerable increase in the VN-Index this year. As we review what worked in 2021 in our portfolios and what we are focusing on in 2022, we continue to be optimistic and importantly, are focused on companies rather than the overall market.

Further to that last point, even though the market was up 37.3% in 2021, dispersion among sectors and stocks was quite high and we expect that there will continue to be winners and losers in 2022. The beta opportunity in Vietnam should continue to be very positive this year, but the opportunity for active managers to deliver even better performance remains.

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<sup>6</sup> Note that we are not overly concerned about asset quality issues, because we estimate that more than one-third of the loan losses that banks could eventually suffer from COVID have already been provisioned against, and because a high proportion of loans that Vietnam's banks extended are backed by real estate collateral – and property prices continued to climb over the last two years.

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