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The Divergence Between Vietnam's Strong Economy & Weak Stock Market

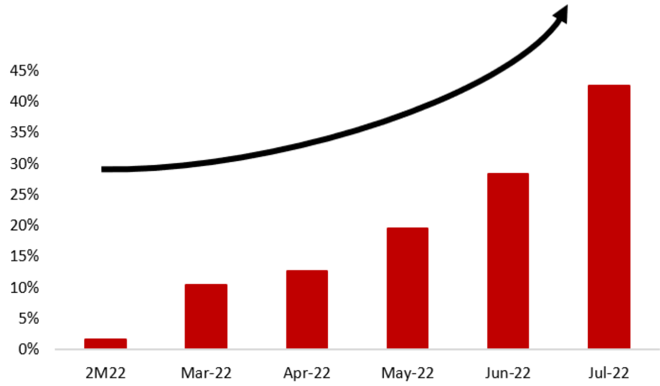
VinaCapital recently held a webinar which reviewed Vietnam's economy and stock market in the first half of 2022. Vietnam's Government has now released economic statistics for July, which showed that the country's economy continues to build on its strong 1H22 performance[1]. In this report, we summarize the current state of Vietnam's economy and stock market, outline what we expect for the last five months of the year and offer our explanation for the divergence between the weak performance of the VN-Index (VNI), which is currently down 17% year-to-date (as of August 2nd), and the country's very strong economic performance in 7M22.

Further to that last point, we discussed our expectation for 7.5% GDP growth in 2022 in the above-mentioned webinar. Last week's release of Vietnam's July economic statistics has not only reinforced that forecast but has also made it appear that the country's economy will grow by a stunning 10% yoy in the current quarter. Our expectation that Vietnam's economy will grow by at least 7.5% this year (and by at least 10% in Q3) leads us to believe that the consensus forecast for 16% earnings growth this year in Vietnam is too conservative. We expect earnings growth to exceed 20% this year, supported by Vietnam's solid economic performance – in stark contrast to the US stock market, where earnings growth expectations look unrealistically high, especially given that country's deteriorating economic outlook.

The Stock Market is Weak…

VN-Index in 2022

…But the Domestic Economy is Strong



Vietnam Retail Sales Growth (% yoy)

The year-on-year surge in Vietnam's retail sales has accelerated all year (see chart above right), which clearly illustrates that domestic consumption in Vietnam is currently the country's main economic growth driver. In our webinar, we discussed efforts that VinaCapital's research team made during Q2 to get a "bottoms up" read on the state of domestic consumption in the country, including in Vietnam's smaller cities as well as in the countryside. While our channel checks and other empirical research led us to believe that the domestic consumption numbers would be strong, we are surprised by how strongly it is actually rebounding.

Strong Domestic Consumption Offsets Weakening US Demand

In 6M22, Vietnam's real retail sales (i.e., excluding the impact of inflation) grew by 7.9% yoy; this figure surged to 11.9% in 7M22, which is far above the 7% yoy growth that we had previously been forecasting for 2022. This is important because we are often asked now whether the ongoing slowdown in the US economy - which is Vietnam's biggest export market - will weigh on Vietnam's economic growth. In other words, "if the US sneezes, will Vietnam catch a cold?". The short answer to that question is that while a slowing US economy is likely to temper Vietnam's export growth[2] and economic growth, the impact of that slowdown will be more-than-offset by Vietnam's strong domestic economy.

Finally, the revenues and earnings of companies listed on Vietnam's stock market are primarily driven by the domestic economy, which is why we would have expected the stock market to benefit from the unexpectedly strong domestic growth.

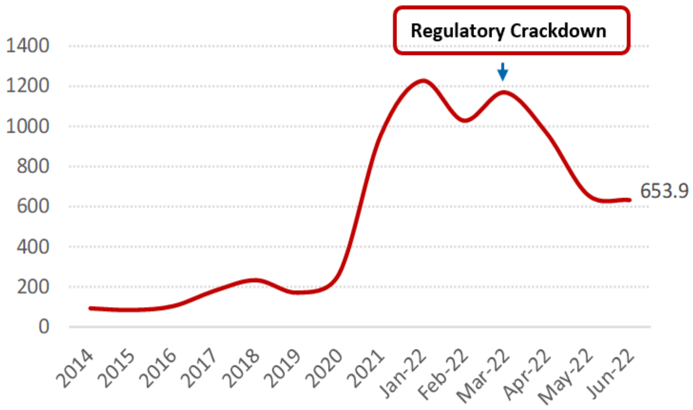
[1] This report discusses Vietnam's strong economy in 1H22
[2] Vietnam's export growth to the US slowed from 38% yoy in 7M21 to 24% in 7M22, although consumers are now shifting some of their consumption into lower priced goods as the global economy slows – which is mitigating the drop in Vietnam's export growth somewhat.

<u>The Divergence Between Vietnam's Stock Market & Economy</u>

Vietnam's stock market rose 37% in 2021, driven by a 36% surge in earnings. The consensus expects 16% earnings growth in 2022, and we expect earnings growth of over 20% this year supported by Vietnam's strong economic growth. All of this makes it somewhat surprising that the VN-Index is currently down 17% YTD. The Fed's aggressive rate hikes have dampened global stock market investors' sentiment (the S&P500 is currently down 14% YTD), but we would have expected Vietnam's strong domestic economy to more-than-offset weak stock market sentiment in the US and other markets.

That said, the main reason for the recent dour sentiment among Vietnamese retail investors is the Government's regulatory crackdown on illegal practices by certain companies that started at the end of March. That crackdown targeted companies that issued corporate bonds and used the proceeds of that bond issuance to speculate in the stock market. The Government's regulatory crackdown dampened local investors' enthusiasm to invest in the stock market, which is evidenced by the sharp fall in trading activity, as can be seen below, but we believe the Government's efforts to improve corporate governance and transparency in Vietnam will ultimately benefit Vietnam's stock market, and the country as a whole.

Vietnam Average Daily Turnover (USD mn)



Vietnam Has the Cheapest Valuation and 2nd Highest EPS Growth in ASEAN

P/E	VN	ID	MY	PH	SG	TH
2021	13.0	14.7	15.7	17.6	13.2	16.8
2022F	11.8	15.5	14.0	15.0	12.4	16.1
2023F	9.7	14.5	12.5	12.4	10.8	14.6

EPS Grw	VN	ID	MY	PH	SG	TH
2021	36.8	163.8	41.9	46.6	198.1	122.2
2022F	16.1	26.6	(5.8)	11.3	5.1	(4.5)
2023F	20.5	7.0	10.8	21.2	14.9	10.2

Finally, note that there are signs the Government is concerned about the unintended impact of the probe on the stock market, so this issue has had less impact in recent weeks, and that Vietnam already has the highest transparency and political stability ranking in Southeast Asia, according to <u>this report</u> from the "Political & Economic Risk Consultancy".

The Coming Bounce in the VN-Index

We expect another leg down in the US stock market, which could in turn drag Vietnam's stock market lower. However, at some point we expect the Fed to "pivot" away from its aggressive rate hike plans. Vietnam's stock market should be one of the biggest beneficiaries of a Fed pivot because Vietnam has the most attractive valuation in the region, and the second highest expected earnings growth next to Indonesia. Furthermore, we believe the quality/visibility of Vietnam's corporate earnings is currently much better than that of Indonesia and other regional peers.

Next, we mentioned our expectation that the earnings of the companies listed on Vietnam's stock exchange will grow by over 20% this year. We expect the earnings of the stocks held in our VVF and VAF funds to grow by over 40% this year because we continue to tilt our portfolios toward companies benefitting from the ongoing reopening of the economy. We also expect bank share prices to outperform in H2, as it becomes apparent that banks' post-COVID asset quality issues are much less severe than many investors had feared, especially in light of Vietnam's very high GDP growth in 2022.

The net conclusion of all of the above is that in addition to the divergence between the performance of Vietnam's economy and the country's stock market this year, there is also another likely divergence emerging between the price performance of companies with the very highest earnings growth versus the overall market. This gives active fund managers like VinaCapital the opportunity to outperform the benchmark VN-Index, which is reflected by the fact that our VVF and VAF funds have outperformed the VN-Index by 10%pts on average, YTD.

<u>Conclusions</u>

Vietnam's economy is even stronger than we had expected at the beginning of the year, but that strength is not reflected into higher stock prices due to the Fed's aggressive rate hikes and the recent regulatory crackdown in Vietnam. That said, we expect over 20% EPS growth in 2022, which should support a recovery in the VN-Index by the end of 2022 (note that a 36% surge in corporate earnings drove the VNI up 37% in 2021).

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