Vietnam Market Strategy

Stay defensive in 1H19

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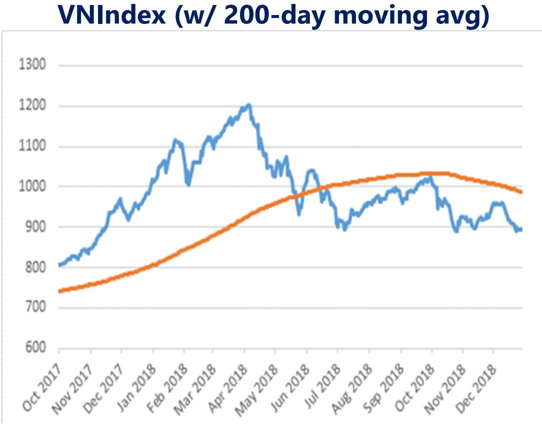
2019 is likely to be another volatile year for markets globally, and as we saw on Jan 3, Vietnam is no exception. However, we think the Vietnam market will muddle through with a range-bound trading pattern (i.e., +/- c.10% from here). We think the market could see more downside in 1H19 followed by greater stability in the second half of 2019. Thus, we suggest that investors position themselves as defensively as possible for now.

We peg our yearend 2019 VNINDEX target at 990 (13% above Thursday's close). Admittedly, such a valuation (c.15x PE) would be higher than pre-2017 levels, but ROEs are likely to remain structurally higher (c.18% in 2019 vs 13-15% pre-2018) given index composition changes and a recovery in bank earnings.

VNIndex (w/ 200-day moving avg)

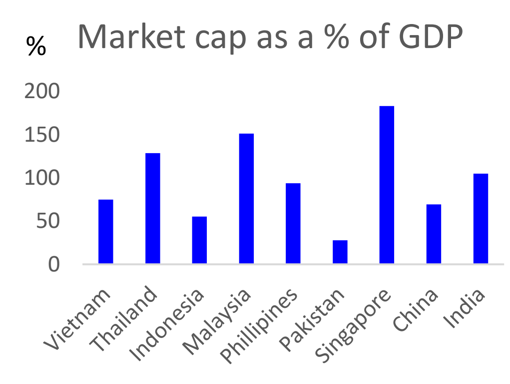


Themes and catalysts

- Domestic macro looks solid. FDI, VND, and employment should remain buoyant.
- But stock prices may lag as foreign inflows remain tepid.
- Global CBs could flash softening policies by 2H19. But for now, stick with defensive names with strong balance sheets.

Risks: Largely exogenous

- Global central bank policy tightening might soften, but it also might continue.
- China could drive downside (e.g., RMB depreciation) or upside (policy expansion).
- Faster-than-anticipated pace of capital markets reform could rekindle animal spirits.



Source: Bloomberg, Yuanta Research

Macro looks good… FDI likely to remain strong based on conversations with our colleagues in HK and Taiwan who cover China-based manufacturers. We expect VND buoyancy given FDI, a favorable current account, and sufficient FX reserves. Domestic policy rates may not move much higher, but effective credit costs are still likely to increase at least in 1H19. Net-net, these conditions should continue to provide a solid foundation for domestic demand growth.

…But it's hard to be sanguine on the short-term stock market outlook. SOE privatization may remain difficult even if legal/political issues are overcome given that market conditions remain tepid. MSCI emerging markets index inclusion remains a discussion topic, but does not appear likely this year. As such, foreign institutional activity is likely to remain subdued, which could have knock-on effects on already-weak sentiment among retail investors.

Risks to our cautious view are largely exogenous, and are *not* only negative. Actions by global CBs (remember, it's not just the Fed) could go either way. China is another wildcard. Domestically, major investment inflows from strategic stake buyers or a faster-than-expected pace of capital market liberalization could rekindle flames in the hearts of both retail and institutional investors.

Stay defensive for 1H19, but expect a recovery in 2H19 as global CBs soften

We suggest investors to position defensively for now. We think 1H19 will see greater volatility and downside risk but that conditions will ease in 2H19 as investors gain clarity on a softer direction for global monetary policy. For now, we think that investors would be wise to position themselves defensively by focusing on stock-specific balance sheets and cash flow / dividend yield stability as opposed to growth. This should both 1) protect against event risks, which are more likely to be negative than positive, and 2) in the case of yield plays, provide income support for portfolios.

The Bloomberg screen below represents a start (admittedly, a quick-and-dirty start) at identifying stocks that could be defensive based on some very simple quantitative metrics. We screened the market for companies that have relatively low (or negative) net debt levels, pay a dividend, and have market caps of at least US$300m.

Among these names, analyst Quang Vo has a BUY call on Masan (MSN VN) with target price of VND102,700, representing 32% upside from the Jan 3 close.

Stocks with defensive characteristics

Ticker	Name	Market Cap (USD m)	Net Debt / E (%)	Dividend yield (%)	Sector (GICS)
VNM VN	VIETNAM DAIRY PRODUCTS JSC	9,291.92	-28	0.8	Cons staples
ACV VN	AIRPORTS CORP OF VIETNAM JSC	8,272.32	-16	1.0	Other
GAS VN	PETROVIETNAM GAS JOINT STOCK	7,148.80	-50	2.4	Utilities
SAB VN	SAIGON BEER ALCOHOL BEVERAGE	6,865.65	-64	0.8	Cons staples
VJC VN	VIETJET AVIATION JSC	2,726.82	6	1.7	Industrials
PLX VN	VIETNAM NATIONAL PETROLEUM G	2,712.66	6	5.6	Energy
MCH VN	MASAN CONSUMER CORP	2,624.59	-8	3.9	Other
VEA VN	VIETNAM ENGINE & AGRICULTURA	2,172.83	-23	1.0	Other
MWG VN	MOBILE WORLD INVESTMENT CORP	1,583.50	36	1.4	Cons discretionary
FPT VN	FPT CORP	1,087.76	-14	5.6	IT
PNJ VN	PHU NHUAN JEWELRY JSC	661.14	35	2.7	Cons discretionary
KDH VN	KHANG DIEN HOUSE TRADING AND	554.96	-10	1.5	Real Estate
CTD VN	COTECCONS CONSTRUCTION JSC	538.38	-62	3.1	Industrials
QNS VN	QUANG NGAI SUGAR JSC	526.25	6	3.6	Other
FOX VN	FPT TELECOM JSC	495.29	-27	2.0	Other
VCG VN	VIETNAM CONSTRUCTION & IMPOR	437.17	16	1.8	Industrials
DHG VN	DHG PHARMACEUTICAL JSC	428.71	-32	1.4	Health Care
VCS VN	VICOSTONE JSC	410.91	23	1.5	Materials
REE VN	REFRIGERATION ELECTRICAL ENG	408.93	5	5.3	Industrials
DNH VN	DA NHIM-HAM THUAN-DA MI HYDR	399.88	19	8.0	Other
GEX VN	VIETNAM ELECTRICAL EQUIPMENT	382.26	42	4.1	Industrials
DPM VN	PETROVIETNAM FERT & CHEMICAL	370.47	-21	9.5	Materials
PVS VN	PETROVIETNAM TECHNICAL SERVICES	353.76	-63	2.8	Energy
VHC VN	VINH HOAN CORP	351.50	-5	2.3	Cons staples
GMD VN	GEMADEPT CORP	337.31	34	5.9	Industrials
VGC VN	VIGLACERA CORP	335.70	11	5.4	Industrials
NT2 VN	PETROVIETNAM NHON TRACH 2 PO	305.97	82	3.5	Utilities
SCS VN	SAIGON CARGO SERVICE CORP	301.13	-18	7.4	Industrials

Source: Bloomberg, Yuanta Vietnam

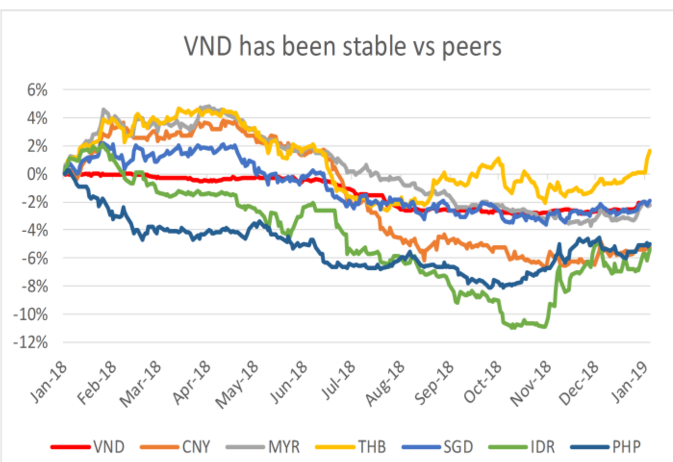
Vietnam's macro story to remain highly attractive…

Macro looks good… Strong FDI is very likely to continue. Our regional analysts in HK and Taiwan report that China-based manufacturers continue to show interest in moving operations to other countries, and Vietnam is typically near the top of the list given its proximity to China (where materials and components will still be sourced) and favorable trade relationships with a variety of end-markets. For some industries (e.g., textiles), the migration is largely done already, but higher value added capacity such as electronics manufacturing will likely continue to be shifted here.

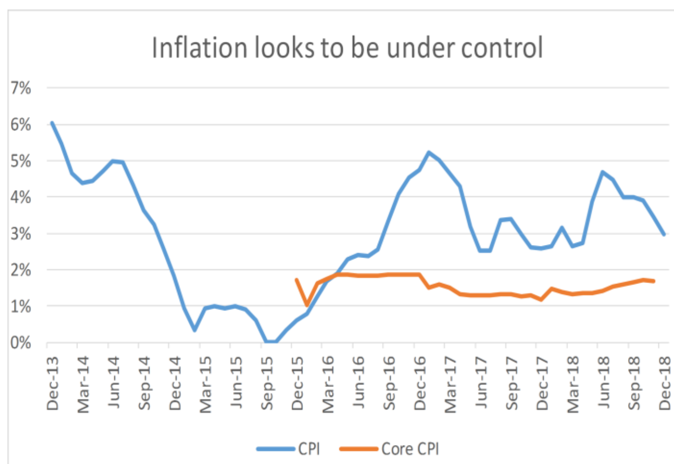
We think the VND looks strong given a favorable current account outlook and sufficient FX reserves. The VND has depreciated 2.2% since the start of 2018, in line with Singapore and Malaysia (yet without the latter's volatility) and outperforming the RMB, IDR, and PHP, all of which have fallen by more than 5% in the same period. Foreign exchange reserves are likely well north of US$60bn at yearend, representing 13-15 weeks of imports – this is more than sufficient given Vietnam's position in the global manufacturing value chain, in our view.

Domestic policy rates may not need to move substantially higher given relatively tame inflation (see chart below) The yearend CPI print of 3.0% was well below the State Bank of Vietnam's 4.0% target, and producer prices on the whole should remain under control given soft input prices.

However, financial reform and bank balance sheet constraints – in addition, obviously, to global liquidity conditions – are likely to push up effective credit rates anyway in 2019. Net-net, we think these conditions ought to continue to boost domestic demand, suggesting buoyant consumption growth and a stable property market led by real demand.



Source: Bloomberg



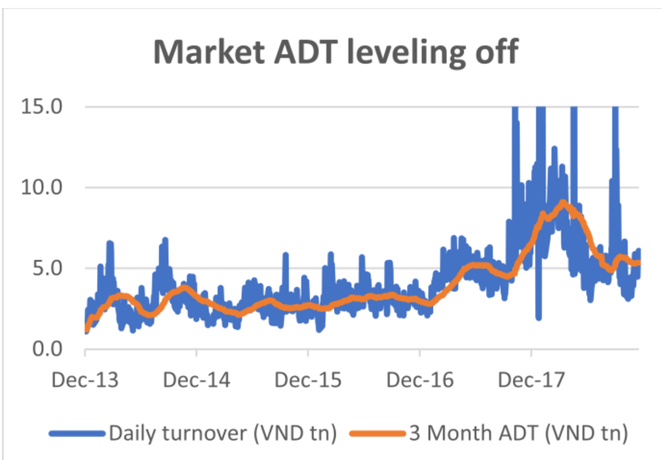
Source: Bloomberg

…but the stock market is not likely to start reflecting this

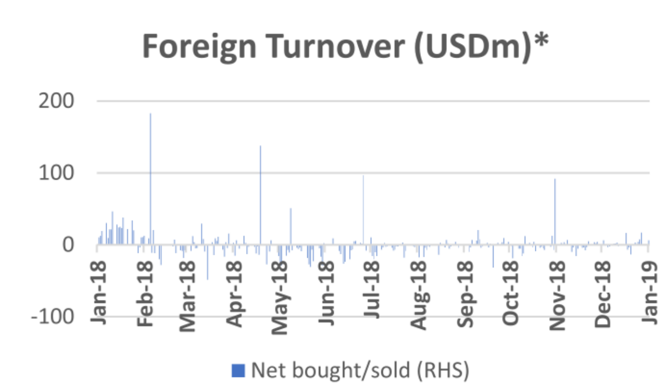
…Capital markets? Not so much. Looking at the most often-cited catalysts for the stock market, it's tough to be incredibly bullish on the short-term (6 month) outlook. Raising capital via SOE privatization may remain difficult even if the legal/political issues can be overcome, given that market conditions are likely to remain tepid at best.

Also, inclusion in the MSCI emerging markets index does not appear likely to happen this year given ongoing market access / FOL concerns. Assuming action to address these issues is taken, MSCI inclusion would still likely occur at some point in the next few years, but we don't expect it in 2019.

As such, foreign institutional activity is likely to remain subdued until such actions are taken. This lack of foreign participation could have knock-on effects on sentiment among retail investors (84% of the market in 2018), who may decide to sit on the fixed-income/time deposit sidelines. On the other hand, strong action to address these problems would likely have an immediate boost in sentiment among both investor groups. Thus, remaining focused with an eagle eye on market regulatory policy could pay off for the nimble.



Source: FiinPro, Yuanta Securities



**Excludes large put-through orders in MSN and VHM.*
Source: Bloomberg, Yuanta Securities

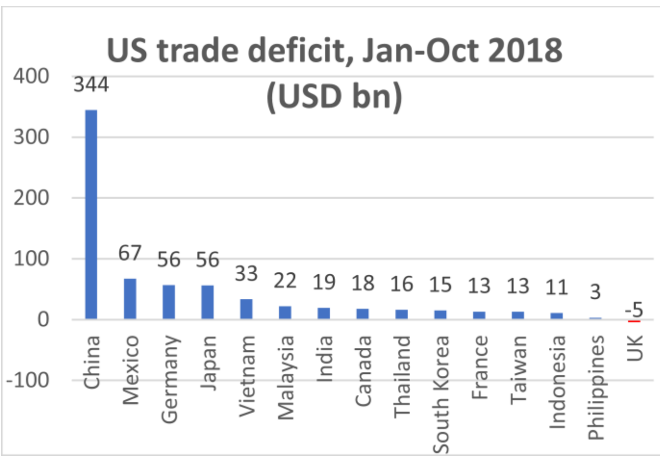
Potential downside risks? There is no shortage of these, but here are three risks that may be most cogent:

The downside risks are largely exogenous and related to global monetary, trade, and political policy

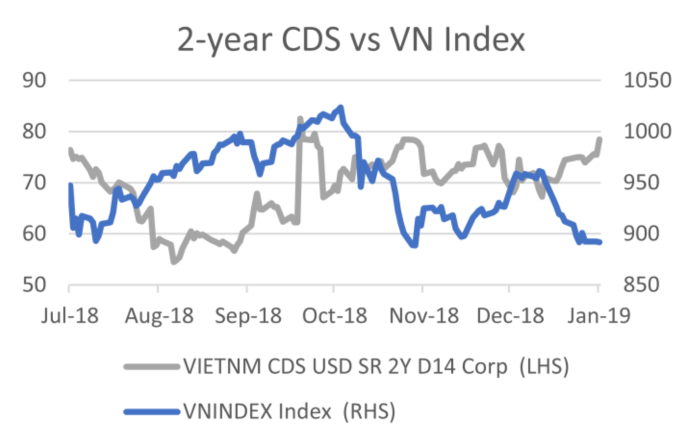
- **1) Tighter than expected global liquidity**. A rising cost of global capital is probably baked into current market expectations already as global CBs have shifted from QE to QT. We would be more concerned about this if the US macro outlook seemed to be as buoyant as advertised, but crumbling property markets and increased stock market volatility in the US lead us to believe that policymakers might tread more lightly than they did last year.
- **2) Significant VND devaluation**, as discussed above, appears unlikely to emerge from endogenous conditions in Vietnam. However, a sharp devaluation

of the RMB – which appears less supported by China's macroeconomic conditions and capital flows – might catalyse a similar move here too.

- **3) Expansion of "trade war" nations to include Vietnam?** FDI into Vietnam is a positive and ongoing theme, but bear in mind that this will likely result in a further increase in Vietnam's already-high trade surplus with the US. Vietnam's trade surplus with the US ranked fifth among major US trading partners in the first 10 months of 2018. While the deficit (from the US perspective) was less than 10% that of China, we think that there is a risk of Vietnam eventually being viewed as a "mini-China" by Washington. This would be especially likely if Vietnam is come to be seen as merely a transshipment center for goods that are largely (or entirely) produced in China. But in our view, the US-China rivalry transcends trade flows and enters the realm of the two superpowers' geopolitical power relationships. Thus, while the trade issue could become a negative for Vietnam eventually, we think that it won't be a problem in 2019.



Source: US Census Bureau



Source: Bloomberg

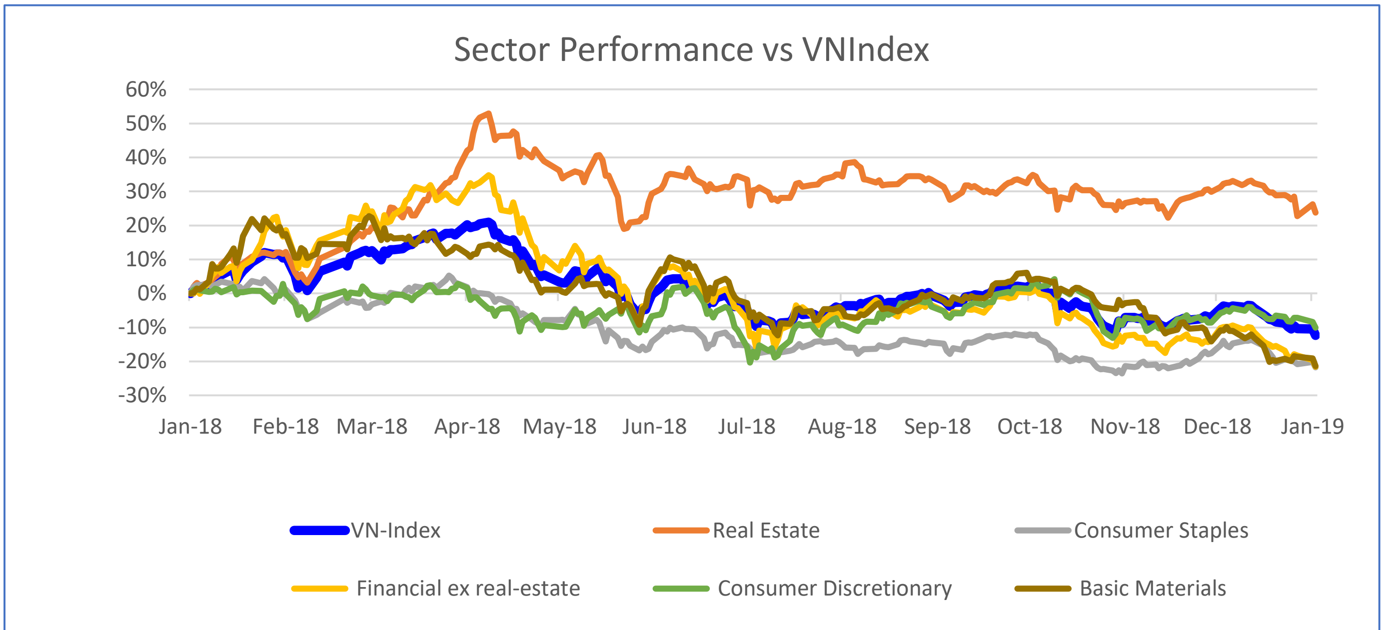
Potential upside risks? Black swans come in various shades and sizes – the unknown unknowns could surprise on the upside too. Belief in Santa Claus is probably not a great investment strategy, but nevertheless the list below comprises our belated Christmas wish-list for 2019.

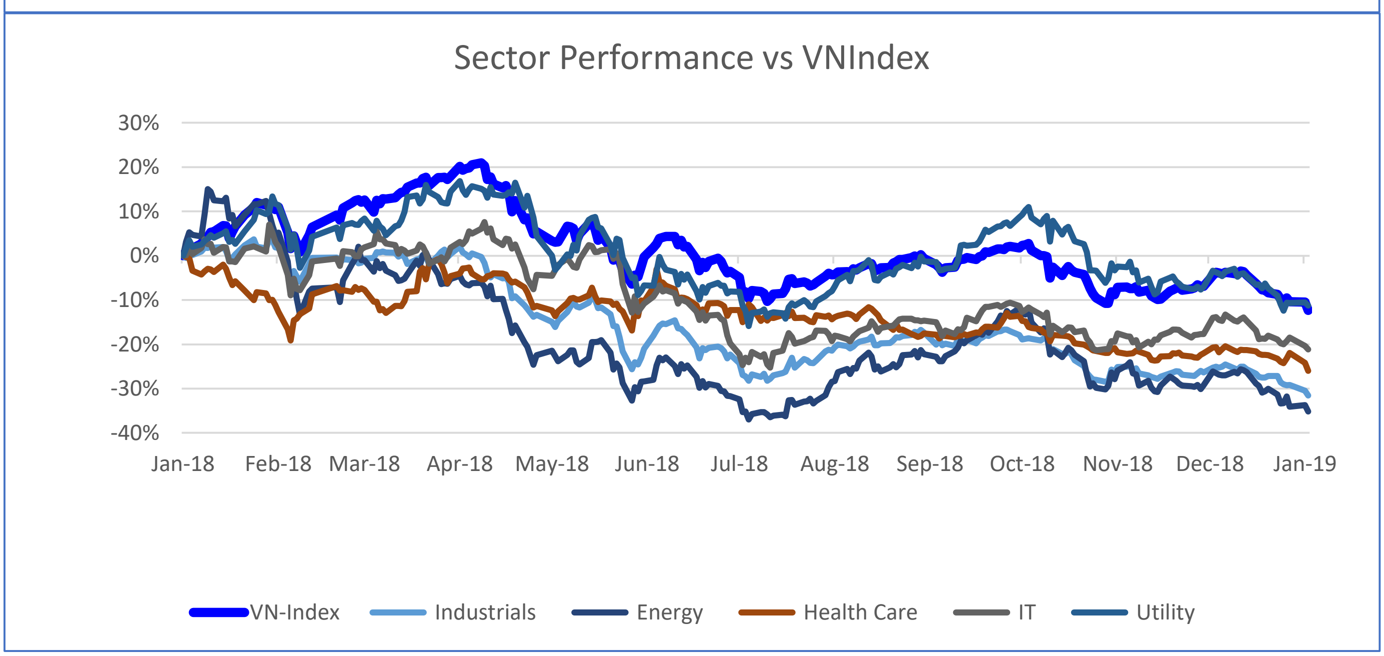
The market could surprise on the upside too.

1) Strategic capital inflows catalyze a return of the bull. Given the state of development of capital markets, a series of major portfolio investments such as occurred in 2H17-1H18 could once again force interest rates down and stock prices up. Market sentiment might not be great, but remember that strategic investors have a long term view and don't necessarily care about market sentiment (i.e., "when they're cryin', it's time to be buyin'").

2) Concerted action to address foreign investor market access. Clearly this will remain a focus of market attention and related newsflow will continue to be a short-term market driver. However, if substantial reforms are implemented, the market here would likely rerate structurally, regardless of weak sentiment for emerging markets as a whole in 2019.

3) A reversal (not just softening) of quantitative tightening. This would seem highly unlikely to start with the Powell Fed if it wants to have a shot at maintaining/rebuilding credibility. But both the BOJ and ECB were also QE participants and may have less of a reason (i.e., pretence of political independence) to stay the QT course especially as economic conditions in their respective jurisdictions appear to be weaker than those of the US.





Source: Bloomberg

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Ratings	Expected return within the next 12 months – excluding dividend
BUY	Above 20%
HOLD	Between -20% to +20%
SELL	Below 20%

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