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NOTE FROM THE CEO'S DESK

9 July 2018

This big correction may be a good foundation for a future new height!

Following my notes on the market turbulence on 24 May 2018, the Vietnamese stock market has continued to be unusually volatile. After recovering for eight consecutive sessions in early June after a rapid and severe decline in April and May, the leading index, the VNI turned back to the downward trajectory in the past four weeks. Particularly, the VNI plummeted 4.34% on 3 July and dived below 900 points on 5 July.

Reasons for this gyration are still those I mentioned in the previous notes. They include market factors, notably a correction of some large cap stocks after escalating in 2017 and 1Q 2018 and margin call pressure when the market fell, and macroeconomic ones including unexpectedly high quarterly inflation, pressures on rate hikes and domestic currency depreciation. In addition, capital outflows due to international asset re-allocation and trade tensions also add up to precautious sentiment among investors. All in all, these factors have been causing some negative impacts on the stock market in the short term.

Vietnam's inflation rate has reached 4.7% yoy and 2.2% ytd by the end of June 2018 and might exceed the Government target for the whole year. The U.S. Dollar has strengthened, partly due to the U.S. Federal Reserve Bank (Fed) already having raised interest rates twice in 2018 and planning more raises this year because the U.S. economy is already stronger than expected, but partly also as a safe-haven attracting funds from other countries. This has also impacted the Vietnam Dong (VND). After having appreciated by 0.2% against the U.S. Dollar in 2017, it depreciated particularly in May and June to lose 1.1% over the first half 2018. Investors will remember some lessons from 2007 - 2011 and are right to be careful in their equity investments if these macro-economic issues are not well controlled soon.

From our point of view, the economy is now very strong and the main economic growth indicators in 2Q 2018 are the highest since 2011, notably for GDP, manufacturing and services. Companies are accordingly showing strong profits and order books and the production managers' index is at a record high. The Government now ensures much more stable economic conditions than in 2007 and 2011 when credit growth surged and led to an overheated and unstable macro-economy. We think that the market may have been overly concerned about these risks in the short term since the Government is well informed about these and they have been communicating and implementing some policies in order to make sure the whole economy softly adjusts to its macro-economic targets. What we need to do is to wait and see how efficiently the Government deals with these issues.

What is probably causing the most uncertainty now are the recent actions taken by the U.S. administration in pursuit of 'fairer' trading conditions, i.e. smaller trade deficits, with its main trading partners. These include the EU, Canada and Mexico but China is the main target as it accounts for over 50% of its deficit. The U.S.A. imposed the first set of tariffs of 25% amounting to US$34 billion on a range of Chinese goods from 6 July 2018, and more might follow. As investors are concerned about adverse impacts on the Chinese economy, the Renminbi (RMB), China's currency, posted its biggest ever monthly fall against the U.S. dollar in June and lost more ground in early July to have fallen approximately 3.4% since then. The Shanghai Composite Index, the leading Index of China's Shanghai Stock Exchange, has also lost 11.3% since the beginning of June. And as China now is the second biggest economy in the world and the Vietnamese economy is close, both in terms of trade relations and in structure, these developments have also impacted investors' sentiment in Vietnam. We are worried about this risk and daily monitor this "trade war" as it is exogenous to us.

However, we still think that all the parties related with this "trade war" will, at the end, reach some new agreements and compromises since it cannot bring a stable and better market environment to any single country. We also note that in the course of the trade tensions, China could implement some improvements to its own economy, including the currency and increasing their competitiveness as a manufacturing hub.

But we also think that Vietnam's exposure to a "trade war" is limited. Although exports to China have increased by 28.0% to US$16.6bn, Vietnam does not supply many components but rather buys them from China, so it has a big trade deficit which grew by 4.2% to US$14.7bn in 1H 2018. On the other hand, Vietnam is also comparatively well positioned to weather the potential trade storm with its diverse exports. While some individual goods and produces may be impacted – LG and Samsung committed already in 2017 to build washing machine factories in the U.S.A after US imposed tariff on Vietnamese washing machines – Vietnam is a stable and low-cost production domicile which could benefit as production of other goods are re-located to Vietnam or other exports markets found.

So is this current fall a signal of a newly-formed crisis? We say "No". This fall is only a normal, big correction of this frontier stock market even though we still see some possible clouds in the far horizon. We hope these clouds will soon be cleared!

While we are not sure how long the present weakness of the market will continue, we are confident in the strength of the Vietnamese economy in the long term. We have been very careful during this period of market volatility. In the first quarter, we were very cautious of investing while the stock prices surged and held high cash balances while we waited for opportunities. When the market corrected, we were able to buy selected stocks at attractive valuations. The volatility of the markets at times as these mean we can, as we did in the past, build strong foundations and will create long-term wealth for you, our Funds' investors and our clients.

Yours sincerely,

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