

Market Briefing: Year of the Dragon

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Here's what you need to know

February 10th not only ushers in the Year of the Dragon but also starts the countdown to the 30th anniversary of Dragon Capital. In this auspicious year, we discuss our expectations for Vietnam's economy and equity markets, examining the critical elements influencing performance, and the potential risks and opportunities therein. We believe the key themes of the Year of the Dragon will be:

- **An anticipated economic recovery with clearer visibility on its impacts**, which should achieve ~6.5% GDP growth and 15-18% net profit growth (NPAT) for our top-80 universe. The Government's role in this recovery is pivotal by the likely continuation of robust monetary and fiscal policies, expected to drive public investment and instil confidence in private sectors. Credit demand will likely accelerate as low domestic interest rates penetrate the economy, leading to an expected consumption recovery by 2H24.
- **The market is expected to deliver a moderate return in line with earnings growth**. Our forecast of 15-18% NPAT growth reflects a broad-based industry recovery with 2024F PER of 9.9x. We expect the sectors to exhibit the most significant influence in 2024 will be banking (+18% YoY), consumer discretionary (+47% YoY), and materials (+41% YoY), contributing a potential 71% to the VN Index (VNI) earnings.
- **Our stock selection emphasises company resilience and consistent top-line growth**, capitalising on expected early recovery dynamics. We project the market to shift from the trough to recovery, with our strategy pivoting from scrutinising balance sheets to focusing on P&L, capitalising on the power of market share gain for future earnings. In this transition, companies with appealing PS and PE ratios are likely to outperform.

2023 Recap

The VNI, which historically prices in economic trends 4-6 months in advance, already reflects a recovery phase, ending 2023 on an upward trajectory with combined returns for November and December of +11.4%. Mid-cap stocks surpassed their large-cap counterparts by a significant 24.9% margin and companies with low PB ratios and high beta thrived. Conversely, names with low PE ratios lost their appeal to retail investors, who notably account for 88% of the market, due to earnings volatility from inventory management and input costs.

2024 Equity Market Drivers

- **Sound macroeconomic fundamentals should help the currency to remain within a +/-3% range**. This will potentially further encourage FDI inflows into the manufacturing and export sectors. Positive external balances, including a record trade surplus of \$28bn and FX reserves of circa \$90bn, should provide strong support for the dong. The interest rate differential, while a reality after the SBV pioneered rate cuts in 2023 as the Fed hiked, may have less of an impact for the simple fact the VND is not traded on the open market. Furthermore, the SBV has strategies in place to manage FX during times of global volatility, such as issuing SBV bills, selling forward contracts into the banking system to cool rates and buying forward contracts to support them.
- **A restocking in the US and EU will likely trigger a recovery in Vietnam exports**. We expect exports to recover approximately 10% YoY in 2024. We attribute this to the low levels of US wholesale inventories seen in Fig. 1 having already flowed into economic activity in Vietnam, thus inventory recovery is likely to prompt an uplift in exports. These markets collectively represented 42.4% of Vietnam's exports in 2023, with exports equalling approximately 80% of the nation's GDP. According to data from Vietnam Customs, monthly exports have already started to recover from \$27.9bn in April 2023 to \$31.5bn in December, with electronics accounting for approximately 43.2% of the total value in 2023.

Figure 1: US Inventory Levels



- **'Bamboo Diplomacy' is projected to drive robust FDI.** Following enhanced diplomatic ties with the US, Japan, and South Korea, total registered FDI reached \$36.6bn in 2023, a considerable 32.1% increase YoY, and disbursed capital was a record \$23.2bn. Highlighting Vietnam's diplomatic approach, it was the sole country visited by both Presidents Joe Biden and Xi Jinping in 2023. Notably, the largest FDI tech projects in 2023 were from the US and China; Amkor's \$1.6bn and Sunny Optical's \$2.5bn. This reinforces Vietnam's need to balance economic and political relations with both powers to preserve component supply from the former and access to the export market of the latter.
- **Lower rates should support credit growth and consumption.** A potential 50bps cut by the State Bank of Vietnam (SBV) in 2024 should ease the burden of mortgage and debt repayments, likely flowing through to consumer sentiment and encouraging discretionary spending in the recovering retail sector. The SBV set a 15% growth target for disbursed credit at the start of 2024 and one-year policy rates are now at pre-pandemic levels as shown in Fig. 2. Consequently, bank deposit rates have nearly halved to an average of 4.7%, and loan rates have dropped to 8-9% from 14-16%. The pace of deposit rate reduction exceeding lending rates is expected to drive strong earnings growth from NIM recovery, giving banks the leeway to further lower lending rates, thereby reinforcing the cycle of credit growth and consumer spending.

Figure 2: Policy Rates in a low Inflation Environment



Source: GSO, SBV

- **Equities will benefit from the domestic retail investor seeking alternative asset classes.** As previously stated, Vietnam's equity market is dominated by domestic retail investors, making up 88% of the market. Traditional investment channels like bank deposits and property are offering limited opportunities which could see the equity market as an alternative source of return. One-year bank deposit rates have now halved, offering unattractive returns, and the high rates offered in early 2023 are now maturing. While predicted to slowly recover via low rates and Government support, property comes with drawbacks such as larger capital requirements and lower liquidity. We predict property will be driven by owner-occupiers using cheap credit rather than speculation. Consequently, the equity market should benefit from positive inflows from these now less attractive asset classes.

Risks

- **The bond market is still a concern:** In 2023, approximately \$11.7bn of corporate bonds matured, with \$4.5bn extended. In 2024, an estimated \$11.4bn will mature, with real estate companies contributing 35.4% and banks 23.2%. While the risk of default persists, the banking system's significant available liquidity, reflected in interbank lending rates being at near zero and historically low deposit rates, positions the sector with enough dry powder to restructure problematic bonds. Concerns over insolvency still loom, however, with real estate bonds set to peak in March and September 2024. Vigilant monitoring of balance sheets is therefore imperative, with prudent asset and liability management at the bank level essential to facilitate refinancing.
- **Infrastructure bureaucracy may cause power shortages.** In 2023, Northern Vietnam faced energy shortages due to low rainfall affecting hydropower output and inefficiencies in the renewables sector, which delivered only about half of its actual 25% capacity due to delayed power purchase agreements. The Government is actively addressing these bureaucratic challenges, aiming to prevent a recurrence in 2024.
- **Geopolitics continue to be a factor.** Vietnam's deep integration into the global supply chain exposes it to external vulnerabilities. Trade protectionism, ongoing global conflict, a dramatic escalation of energy prices, supply chain interruptions, and shifts in major economies' policies could impact capital flows, domestic policy tightening, FX volatility, and trade balances.

Conclusion

The forecast GDP growth of 6-6.5% will likely be fuelled by our base case resurgence in global demand, stable FDI, rebounding exports, and fiscal spending. We expect that the anticipated rate cuts from the Fed in H2 2024 will lead to a potential pivot to US re-stocking, which would support recovery in Vietnam's manufacturing & exports and trickle down to domestic consumption. Supportive domestic monetary policy can continue if inflation is managed below 4% and the currency remains stable. On balance of the above, Vietnam's macro position is supportive of its equity market.

We forecast 15-18% earnings growth for our top-80 universe of stocks in the Year of the Dragon. We believe this will be led by earnings coming back into favour with the domestic retail investor, who may choose public equities over alternative asset classes that are currently offering underwhelming returns, reflected in 12-month bank deposit rates averaging 4.7%. We therefore shift our strategy from focusing on undervalued assets to rate-sensitive companies able to deliver cheap earnings growth. This growth will be driven by credit expansion and low interest rates, led by the banking, consumer discretionary, and materials sectors. With such a backdrop, our positioning leans towards financials, real estate, consumer discretionary, IT, industrials, and materials, marking a transition from a value-driven to a growth-oriented strategy.

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