GOOD MORNING VIETNAM

Luca Rossi takes a look at one of the frontier market standouts. But there's a caveat: move quickly, before it's too late

Take a communist country growing at 6.7% in 2015 – more than all its regional peers and among the fastest-growing emerging markets (EM) in the world. Add 8.1% annual growth in imports, foreign direct investments up 17.4% year-on-year and a steadily rising credit expansion. Guess what you have? Vietnam.

Until as recently as 1975, the Southeast Asian country, a member of the Association of Southeast Asian Nations (Asean), was divided in two and embroiled in a devastating civil war that followed the long-lasting conflict with the US. In the 1980s, millions of people fled the country in crudely built boats, creating an international humanitarian crisis. Since then, things have drastically changed: according to Bloomberg data, Vietnam will be the second-fastest emerging economy in 2016 following India and preceding Bangladesh and China. The free market reforms put into effect after 1986 have started to pay off, and the 'socialist-oriented market economy' has become a hunting ground for several international investors. What is more, experts believe Vietnam will be the biggest winner of the Trans-Pacific Partnership, the trade agreement that slashes an estimated 18,000 tariffs among the dozen participating countries, which could boost Vietnam's GDP by more than 10% by 2025. 'Vietnam is among the handful of Asean nations making the necessary moves to attract outsider interest through fundamental and structural changes,' EM veteran Mark Mobius says.

HUNTING GROUNDS

While several investors are trying to exploit the strong links between countries in the Mekong region (Thailand, Laos, Cambodia, Myanmar), *Modern Investor* chose to speak with a deep value Asia investor with a high conviction on Vietnam. The ASEAN Deep Value fund, managed by Asean Investment Advisors' principal David Roes, currently has more than 90% of its portfolio invested in Vietnam.

Ten years ago, the fund was invested in more traditional Asian markets such as Indonesia and Thailand. In mid-2010, two years after the global crisis, Roes started investing into Australia-listed real estate investment trusts, which were distressed following the financial mayhem, because he considered them a great investment opportunity given the solid nature of some of their underlying assets and the very cheap valuation. As he prepared to exit these positions and take profits at the end of 2011, he considered Vietnam as his next hunting ground. 'Vietnam was a screaming buy based on relative valuation, certainly not based on investors' sentiment. The whole picture wasn't that clear at the end of 2011,' he says.

One of the key measures that has attracted investors into the country is the series of policies to liberalise the economy and welcome foreign capital. 'The Vietnamese government has allowed foreigners to own land with basically the same rights as locals. Also, since September, they permitted foreign ownership of non-restricted companies up to 100%, whereas previously it was limited to 49%.'

Despite being unable to invest in everything (exemptions still apply for state-owned companies and sectors deemed strategically important), the robust investment landscape has been key in the country's recent success. 'History doesn't repeat itself but it certainly rhymes. In Vietnam, we see favourable trends kicking in as we saw in China 25 years ago. Demographics are very positive. There is a young population with relatively high education levels which is moving into consumer mode,' Roes says.

THE LIQUIDITY GRIP

One of the main concerns that institutional investors have when approaching emerging or frontier countries is the depth of their market, as well as its liquidity profile. But liquidity, according to Roes, needs to be measured in the whole context of a portfolio. 'Liquidity is always a risk in developing countries. If you didn't learn in 2008 that liquidity is a risk in developed markets too, you didn't understand anything about the crisis. This single-mindlessness that institutions have about liquidity is misplaced from my perspective.'

He says it is pure nonsense to demand daily liquidity from what it is effectively a private equity strategy such as his. 'We think like private equity investors: if you invest in our strategy, you need to take at least a three-year view. Since we operate in the small to medium-sized space, we think that the best buying time is when liquidity is at its worst.'

The other two main worries related to EMs are the effect of the US rate rise and the Chinese slowdown. In this regard, Roes says that developing countries are different and that some investors make a mistake considering Asia as a monolith. 'Look at Vietnam. It outperformed all the other Asean countries both on the currency devaluation as well as on the equity market appreciation side. It's true that you cannot insulate yourself entirely from the negative global sentiment. But the country is halfway through the recovery cycle, meaning that the cycle is not overdone, and the first half of it was principally domestically driven.'

His position on the relationship between Vietnam and China is even more clear-cut. 'Vietnam sends 11% of its exports to China, while it takes about 30% of its imports from China. To some degree, a Chinese slowdown will actually be beneficial for Vietnam because of the reduction in cost of import prices thus helping to reduce pressure on the trade deficit.'

At the time of writing, Vietnam's Communist Party delegates are meeting in Hanoi to begin the process of choosing a new set of leaders, including the next president, the prime minister and the party's general secretary. 'A number of the members of the party's committee are in their late 60s and early 70s and thus should be retiring. A more youthful government is likely to maintain the country's pro-business stance,' Roes says.

PROPERTY AND GOLD

Back in early 2012, Roes had a third of his fund's assets invested in global real estate. Some of these positions matured and were sold out. Being a late bloomer through the economic cycle, property companies are still the most discounted, he says. 'Where we sold off positions, we bought back into the same sector. Real estate firms are still trading at a big discount.'

'We are 60% focused on durable goods manufacturers, contractors, or developers with large land banks. It's the most attractive sector in terms of current relative valuation, while consumer goods stories in Vietnam are too pricey at present.'

Roes and his team have started to look into the resources sector too, without opening any positions in the portfolio yet. He thinks that they could work as a hedge against global shocks. 'Gold can been seen as an insurance policy and we don't object to having an insurance policy in the portfolio, especially if we can buy it very cheaply combined with depreciated currencies. Certain resources can work as a natural hedge against global contagion effects.'

TOP STOCK

'We bought API (Asian Pacific Investment Corp) when its market cap was at $3 million. Last year, they sold off one of their assets, which generated $5 million and raised an extra $5 million through a placement. It's an asset-heavy company with no leverage that survived the 2008 crisis. It has made money since then because it has focused on development outside of the large cities. We are a fan of the company's management and it became a high-conviction call.

'Back in May and June, the company's share price dropped by 44%, but not in relation to any specific negative development on the company level, and its market cap remains 3x higher than when we first entered – thus it remains a core holding of the portfolio. With at least four material projects in the pipeline, we still think the firm will be generating real estate-related revenues in increasing amounts in the near future.'

CONFIDENTIAL

THE BUYER

YAMAUCHI HIDEKI

FOUNDER AND CEO, GCI ASSET MANAGEMENT

GCI has been working and investing with the Asean Investment Management (Asean-IM) team for more than eight years. This relationship has been beneficial for us because Asean-IM is one of the few specialists in the small and mid-cap Asian equity market with experience reaching further back than the Asian financial crisis of 1997.

We have developed a close understanding of how the Asean-IM team identifies and executes its investment strategy. They are unique and have been successful in providing returns well above benchmark averages. As with any emerging market strategy, we have to accept that there will be times when the portfolio will experience higher volatility and lower liquidity. In Asia, these cycles tend to be exaggerated compared with developed market cycles. The counterpoint to higher risk is of course higher returns. We feel that the deep value focus of the portfolio is appropriate for the markets of Asia, and this focus helps to ensure the portfolio delivers positive returns in an appropriate timeframe.

At present, we agree that Vietnam has great potential, and many Japanese firms are actively engaging in direct investment into the country. As we look back, the bottoming of the Vietnam market in 2011 was an incredible opportunity that Asean-IM correctly identified. Although still a frontier market, the economy is progressing rapidly, bolstered by a reform-minded government and underpinned by its favourable demographics, low labour costs and strategic positioning.