THOUGHT FOR FOOD

2 in a (very) occasional series of Vietnam market insights

PXP Vietnam Asset Management

Vietnam and the possibilities of MSCI Emerging Market Index watch-list inclusion in 2019

During the January 2019 round of broker strategy presentations, we were somewhat taken aback to hear an outgoing head of research pontificate that Vietnam "only has to ask" MSCI to include the country on its Emerging Market Index watch-list and the decision will be a formality. That is not a view that we had heard before (or since) and the particular individual isn't known for making such bold pronouncements without over-simplification, but it's a thought, and possibly even a thesis that the authorities would be eager to put to the test if made aware of it. If only I knew how to bring it to their attention…..

Our hopefully less simplistic view of the possibilities derives from our interpretation of the progress made towards fulfilling the criteria missing for qualification, outlined below, in tandem with our strongly held belief that there are currently no other realistic candidates for re-designation. It might also be suggested that MSCI is in relatively urgent need of a "success" in the unfortunate aftermath of the last two EMI adjustments (three if you include Pakistan, which we think is a little harsh), namely Saudi Arabia and Argentina.

Vietnam is surely a strong candidate on its own merits, both macroeconomic & micro, and is perhaps not given sufficient credit for its attempts (albeit not yet fully successful) to further open the market to foreign investors. For example, Vietnam opened a derivatives market in September 2017 which was intended to allow all comers to participate. Indeed we, in preparation for the debut of said market, altered the investment policies of PXP Vietnam Emerging Equity Fund to permit the utilisation of VN30 futures contracts for hedging and efficient portfolio management. Through absolutely no fault of the Vietnamese authorities, but rather the disinterest of the foreign custodians in becoming Clearing Members of the exchange, it has not been possible from a risk management perspective for us (or any other foreign institution, to our knowledge) to become comfortable with settlement risks. Score one for Vietnam for trying, and we continue to search for solutions but it is probably going to need a re-think on the number of custodial licences in issue before anything happens to resolve the impasse.

THE MISSING CRITERIA

During our infrequent interactions with MSCI we have been guided to the conclusion that whilst Vietnam meets most *quantitative* criteria for inclusion (e.g a minimum of 3 companies with a market capitalisation of around US$1.6 billion with 50% of that in free float; at the last count Vietnam had 7 such companies and that may be at least a couple better now), it falls short mainly on *qualitative* measures, most relevantly the openness of the market to foreign investors and their equal treatment, facilitated by the simultaneous release of all corporate announcements in both Vietnamese and English.

THE IMPEDIMENTS:

1. "Restricted Sectors"

Onshore, the main obstacle to broader foreign access has been the existence of foreign ownership limits. That was supposed to be resolved by the passing of Decree 60 in 2015 but the introduction of so-called "restricted sectors" limited its application, and caused more than a degree of uncertainty as to whether the government was actually serious about opening the market or if such impediments reflect a residual resistance to fuller opening in some areas of the government along nationalistic lines, but we are hopeful that more pragmatic heads will ultimately prevail, with the forthcoming new Securities Law providing the solution.

The most profitable company in the country (at in excess of 20% of total exports) is surely Samsung (obviously not a Vietnamese company). Vinamilk, in spite of now being very nearly 60% owned by foreigners, hasn't upped sticks (or cows) and left Vietnam, so what difference does it ultimately make who owns the shares of a company? The better the management and governance the more profitable the company and the greater the benefits to the country, if that isn't a gross over-simplification, and that isn't to infer in any way that foreigners are better at running companies than the Vietnamese. Vinamilk's management is the same as it ever was, and we have voted for a continuation of that for the past fourteen years, and expect to continue to do so for the foreseeable future. Perhaps a greater understanding of the difference between "shareholders" and "management" is what is needed here.

2. Legal Conflicts

The conflict between a decree that allows foreigners to own in excess of 49% of the shares of a company not operating in a restricted sector and, for example, a revenue law which states that Vietnamese companies more than 51% owned by foreigners will be considered foreign companies and therefore subject to a higher rate of tax has made many companies reluctant to risk such "penalties" in spite of apparently being given assurances that this would not be enforced. A Decree has less seniority than an actual Law and so any policy change would be difficult to appeal, and a resultant retrospective higher tax bill extremely unwelcome.

3. Language Difficulties

The official language of Vietnam is, unsurprisingly, Vietnamese. This presents an issue in terms of *requiring* companies to simultaneously release announcements in a second language. Preferably English, so that I can read them. Vinamilk has been doing this voluntarily for years so it is not an immovable object, in our opinion.

POSSIBLE SOLUTIONS

We are encouraged by signs that the authorities recognise the confusion presented by the number of restricted sectors. The reduction of that number from the current 236 to no more than 20 has been suggested, and that would certainly remove another major obstacle to delivering a more open market.

The new Securities Law, which was released in draft form in October 2018 and which has been the subject of broad and inclusive debate with all interested parties, may assist in resolving the potential conflicts with other laws. A simple statement in the document that the Securities Law will prevail in case of conflicts with other laws might do the trick.

There is nothing to be gained from requiring *all* public companies to comply with simultaneous bilingual announcements, since many are too small to be of interest or have no foreign shareholders. However, if it were made a condition of inclusion in the VN30 index (or the VN50, or companies with a market capitalisation over $250 million wishing to be considered for inclusion in an index, or whatever is agreeable), it might be a way around the obstacle by making it, in effect, *voluntary.*

IN CONCLUSION

We are discussing watch-list inclusion here rather than immediate MSCI EMI re-designation. In our (admittedly somewhat biased) opinion, Vietnam's significant progress deserves recognition, and its path to full compliance would benefit from some encouragement in a perhaps less politicised way than did the abortive Saudi Aramco deal. The watch-list would, arguably, deliver that by giving Vietnam at least a year to complete its legislative process and would, at the same time enable MSCI to burnish its reputation for picking winners. A win-win.

This commentary is prepared by PXP Vietnam Asset Management Limited, and is solely communicated to, and directed only at persons who are investment professionals, high net worth companies or others who are entitled to be given the document under the law of the jurisdiction in which it is given. Persons receiving this factsheet should note that past performance is no guide to the future and, in particular, that the past returns of the Vietnamese stock market, or of companies listed on it, are no guarantee of the future returns of PXP Vietnam Emerging Equity Fund or PXP Vietnam Smaller Companies Fund. This commentary and the information contained herein must not be acted on or relied on for any purpose whatsoever. This commentary is strictly confidential and may not be copied or distributed or passed on by recipient. No understanding representation or warranty or other assurance, express or implied, is made or given by any person to the accuracy, fairness or completeness of the information or opinions contained in this factsheet and no responsibility or liability is accepted for any such information or opinions. It is the responsibility of every person reading this document to satisfy himself as to the full observance of the laws of any relevant country, including obtaining any government or other consent which may be required or observing any other formality which needs to be observed in that country.