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Vietnam emerges from a tough few years

By Fiona Rintoul

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Vietnam is still competitive in soft commodities such as rice

Having come through what Dominic Scriven, chief executive of Dragon Capital, describes as "a stinking four years", Vietnam is on the up.

The Vietnamese stock market was the third-best performing in the world in the first quarter of 2012 and has seen increased activity, with daily trading volumes rising three to fourfold. Much of this comes from local investors, but foreign investors are also showing interest.

The Templeton Frontier Markets fund has increased its Vietnamese allocation to 8.4 per cent, making Vietnam its fifth-largest geographic allocation, and many other frontier markets investors are following suit or thinking about doing so.

"There are a lot more people coming through. We're getting a lot more meetings offshore," says Kevin Snowball, chief executive of PXP Vietnam Asset Management, the second-oldest asset management company in Vietnam with a closed-end Vietnam fund listed on the London Stock Exchange.

So, what has changed in Vietnam and are the changes here to stay?

After the five-year slump in the Vietnamese stock market (with the exception of 2009) and after what Mr Scriven describes as "very real pain in the economy", which reached its worst when shipbuilder Vinashin defaulted on its debts in 2010, this year's good performance could be viewed as a natural rebound.

But local observers say there is more to it than that.

"There were some developments last year that are starting to feed through. Most important is a change in monetary policy," says Johan Kruimer, a managing director at Ho Chi Minh Securities Corporation.

The new central bank governor, in place since last year, has reined in credit growth.

Previously this stood at 28-29 per cent per annum; last year it was 12 per cent. At the same time, inflation fell to 14 per cent last year and will come down further this year.

"As a consequence for the first time in many years, the currency is stable," says Mr Kruimer.

"The last devaluation of the dong was in February 2011."

In fact, according to Mr Snowball, the dong was the steadiest currency in Asia last year.

In a country where people "have more physical gold than anywhere on the planet" because they do not trust their currency, this is a major breakthrough for foreign and domestic investors alike.

"We made money on the currency this year for the first time in six years, which was definitely a pleasant surprise," says Mr Scriven, who has been investing in Vietnam since before there was a stock market, having co-founded Dragon Capital in 1994.

And the monetary policy changes are just part of a wider reform drive, which includes consolidation in the banking sector and reform of state-owned enterprises, which account for 60 per cent of GDP.

Ultimately, this will lead to privatisations – the government has already announced the privatisation of Vietnam Airlines and published schedules for future privatisations – but first there will also be cost cuts of 10 per cent and divestiture of non-core assets.

These reforms all seem to be going in the right direction – although the government has to perform a difficult balancing act between restraint and growth, and recent rate cuts of 100 basis points are indicative of growth concerns – and local observers are persuaded that the political will is there to see them through to their conclusion.

"The government needs to stand behind the economic programme, and there is good evidence that it is determined to do so," says Mr Scriven.

There are also the positive factors that have never gone away: Vietnam's competitiveness in soft commodities, such as rice, rubber and pepper; its large, well-educated and young population; the industrialisation drive that has seen Intel locate its largest factory there.

"The stars do look aligned for a pretty good year," says Mr Scriven, particularly as valuations are still 70 per cent below the "very exuberant 2007 peak".

However, foreign investors looking to get a slice of the action face a number of problems.

A lot of what Mr Snowball describes as "lazy money" from foreign institutions has been invested in the two Vietnam ETFs.

But these have tended to exaggerate market movements, with the underlying FTSE Vietnam index for db-x trackers' ETF down 52 per cent last year as the VN stock market index (which includes companies foreigners cannot invest in) lost 30 per cent.

There are also companies that ETFs cannot access because of the foreign ownership limits, currently set at 49 per cent.

Thus, Vinamilk, which Mr Snowball says is Vietnam's best company and reached its limit some time ago, is not in the FTSE Vietnam index. However, it is in the PXP Vietnam fund, which launched in 2003.

Foreign ownership limits also affect new direct investors.

Other problems include research, which Mr Snowball says "in general is appalling", and the fact that it is virtually impossible to buy more than $100,000-worth of shares in a company in a day.

Meanwhile, short-termist local investors, who are "90 per cent pure gamblers", according to Mr Kruimer, do little to calm an already volatile market.

And yet this is a country that may be about to turn an important corner.

In addition to the other reforms, mutual funds and pension funds are to be introduced this year.

Interested investors may hesitate because of past frailties, but as Mr Kruimer observes: "The best entry point for this kind of ultra-volatile market is when you have to pinch yourself to be emotionally strong enough to invest."

In any case, he does not hope for a rush of foreign money and does not believe foreign ownership limits should be extended for now.

"If the country manages relatively modest economic growth over the next three to five years, there will be a tremendous recovery in prices," he says.

"But it will take a long time to get back to 2007 valuations. I personally hope we never get there because it was totally ridiculous."

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