

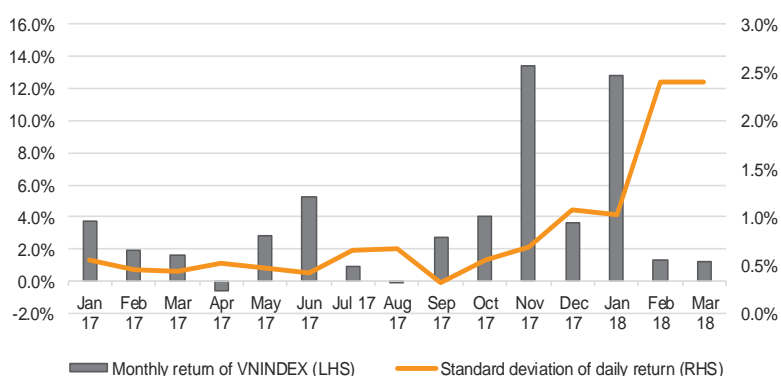
IS THE SURGE IN MARKET VOLATILITY THE CANARY IN THE COAL MINE?

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The sharp global market correction has ushered in a new era of volatility

Before the Lunar New Year, a big bout of jitters in the global equity markets triggered by the specter of accelerating inflation in the US ushered in a new period of volatility in Vietnam’s equity market. While the sharp correction in the VNINDEX proved to be rather knee jerk in nature with the index having clawed back all its pre-Tet losses and currently up 15.6% YTD, the new-found volatility looks like it is here to stay.

Figure 1: Monthly standard deviation of returns From Jan 2017 – Mar 2018

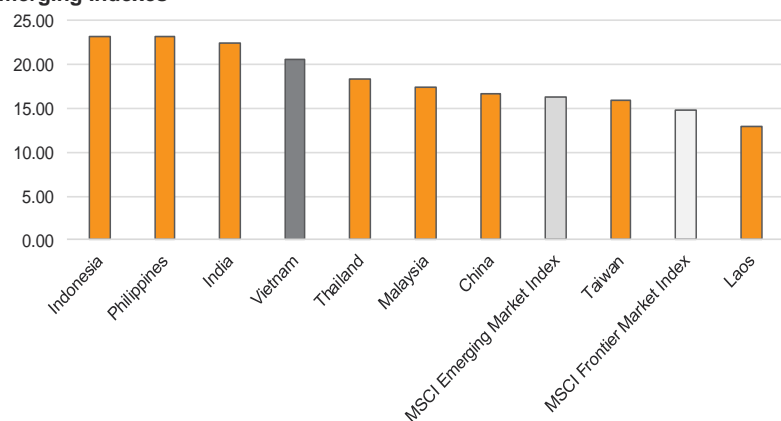


Source: VNDIRECT

Valuations are reaching heady levels despite strong 2017 earnings growth

Valuations have continued their skyward journey. The VNINDEX is now trading at a 9.6% premium to the regional average and a 38.2% premium to the MSCI Frontier Markets Index on a TTM P/E basis. More amazingly, the VNINDEX is also trading at a substantial premium to the MSCI Emerging Markets Index.

Figure 2: VNIndex TTM P/E versus the regional peers and MSCI Frontier and Emerging Indexes

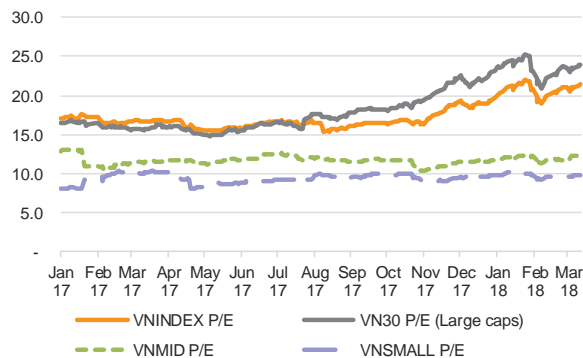


Source: VNDIRECT

Flows continue to chase large caps.

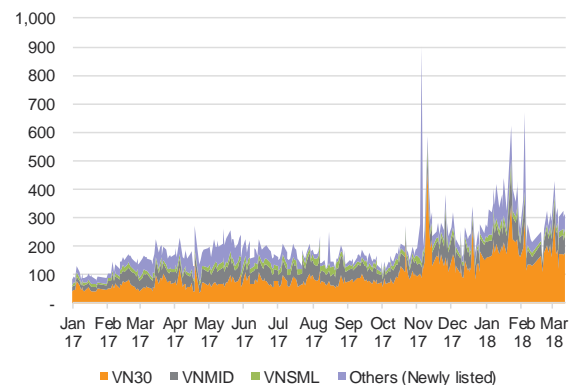
Market polarization or divergence continues with large caps having further widened their valuation premium over mid-caps and small caps.

Figure 3: TTM P/E of VNINDEX by tiers (Jan 2017 to Mar 2018)



Source: FiinPro

Figure 4: VNINDEX daily trading value by tier (Jan 2017 to Mar 2018)



Source: FiinPro

While the party might continue for months yet, heightened volatility could be a precursor to a tapering-off of the multi-year bull-run.

Global equity markets are long overdue for a correction and Vietnam cannot be a total exception to the rule. Downside risks are increasing including rising corporate leverage in the US combined with a potential surge in trade protectionism, triggered by Trump’s new tariffs on steel and aluminum imports into the US. Fears of a global trade war could spook investors enough to catalyze the return of the Bears. Vietnam’s growing exposure to global trade (total trade is 189% of GDP and total exports are 95% of GDP) leaves it with outsized exposure to a downturn in global trade. If a trade war really kicks-in, expect FDI flows to Vietnam to also slow, particularly in those categories of exports that are aimed at increasingly protectionist Western markets.

At the risk of sounding stale, we again advise investors to get selective.

We think select Banks, Energy, Real Estate, Retail and Agriculture stocks should be safe yet lucrative bets in this environment. Keep it simple with your stock picks underpinned by clear stories.

Banks will continue to ride the strong system-wide credit growth this year; LPB is our top banking pick as it looks cheap but VPB and HDB should continue to ride the consumer finance boom through this year.

Within power we like select names that will play the power infrastructure and capacity growth story; PC1 and newly listed POW (PV Power) both look good as an imminent rout in global equity markets is not going to suddenly ease Vietnam’s power bottlenecks; PC1 looks pricey on a trailing basis due to poor 2017 results which had more do to with revenue recognition timing and contract award delays than a real deterioration in fundamentals; the knee-jerk reaction to poor 2017 results has created an attractive entry point when you look at the valuation on a forward basis (2018 PE of 8.4x). POW looks reasonable for a giant in Vietnam’s power generation sector (TTM PE

of 15.0x), particularly in light of the 30-40% capacity expansion in the pipeline.

Even though the crude oil price rally seems to be sputtering out, we think PVS and PVT are good picks in the energy and energy-related space; PVS is cheap at just 0.96x P/B, and should benefit from renewals of long-term contracts as well as upcoming contract awards related to new offshore field development; unless oil prices really plummet, these projects are likely to go ahead for energy security and geopolitical reasons. PVT (TTM P/E of 13.3x) looks well poised to benefit from the lagged impact of the recent crude oil rally as well as from the increase in oil refining and coal-fired thermal power capacity starting this year, both of which are not fully-priced in.

Property continues to be on a stable footing but look at mid-end developers which are less vulnerable to the next down cycle; KDH looks interesting if not cheap (TTM 20.0x) as we think that access to the huge land bank gained through its merger with BCI gives it the ability to continue to capitalize on the massive latent demand in the landed properties segment.

We like retail as it is driven by domestic consumption which is relatively insulated from global trade dynamics. Sure local consumption will be hurt eventually if Vietnam's exports take a hit but there is a long lag effect. Within retail, we like PNJ for the staid, boring and predictable nature of its business; it has a formula that works and is "sticking to its knitting" with network expansion and store-level improvements driving growth. MWG is the sexier of the two but management seems to be toying with too many initiatives to combat the maturation of its handset distribution business; grocery retailing is a long and slippery slope and pharmacy retailing is a big unknown; too much uncertainty in an increasingly uncertain equity market environment.

We don't expect the world to stop eating if equity markets nosedive so time to look at select agricultural plays with vertical integration stories. The selection set is limited here but LTG continues to look undervalued despite its hard-to-access management (TTM PE of 6.4x) and PAN group is looking really interesting, albeit not cheap (PE of 19.3x) but it has a clear story with exposure to multiple promising agricultural and food market segments including seafood, confectionary and seeds.

We like HPG in the construction materials space for its market leadership and good management but a souring of sentiment on global steel stocks in light of import tariffs into the US could warrant multiple contraction even though business fundamentals remain strong; note, however, that HPG's exports to the US are less than 2% of its volume versus 5% for HSG and we believe that the commissioning of Phase 1 of the massive Dung Quat complex could trigger a re-rating next year.

JVC is a wildcard but one worth betting on as it is a clear turnaround story in a defensive sector. Our recent interactions with JVC make us cautiously optimistic on the company. Just like people will not stop eating if the world economy nose-dives, people will not stop getting sick (we will refrain from the temptation of calling the healthcare industry counter-cyclical but it goes without saying that volatile markets are not good for heart health). A transition in the revenue model from lumpy and volatile device sales to long-term service contracts with recurring revenue should improve quality of earnings and the new management looks committed and competent. Plenty could still go wrong as would be expected in any turnaround story but this is one stock that could generate alpha with fundamentals

being relatively un-impacted by global economic and trade headwinds. At a PE of 58.3x, JVC does not look cheap but earnings have not yet captured the turnaround. But yes, buy at your own risk.

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RECOMMENDATION FRAMEWORK

Stock Ratings

Definition:

- Add The stock's total return is expected to reach 15% or higher over the next 12 months.
- Hold The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
- Reduce The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the:(i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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