

“Mini Me”ⁱ – Vietnam Sailing in China’s Wake

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Thirty years ago, a bright photo of Nanjing Road in Shanghai at night, with its crowds and lights, illustrated the arrival of China on the world stage.

Report and photos by
Larry Speidell

Today, the action is on Hai Bà Trưng Street in Hồ Chí Minh Cityⁱⁱ. The street commemorates two sisters, Trưng Trắc (徵側) and Trưng Nhị (徵貳), who were military leaders riding war elephants to defeat the Chinese in 39 AD. They led their country for three years before China once again took control of Nam Viet and ruled it for another 900 years.ⁱⁱⁱ

Walking northwest on Hai Bà Trưng Street today, you see a vivid array of lights and sights. You pass an interesting courtyard on the right with the logo M & O interlaced in wrought iron on the main gate. Here, during the French conquest of Indochine, the refinery for “La Manufacture d’Opium” was opened in 1881 and continued production until 1954. After that, the place became part of Saigon’s red light district for two decades before going upscale. Now, the Park Hyatt is across the street, and “The Refinery”^{iv} in the courtyard is a French bistro. Here, we often met one of our brokers, who sat for hours drinking wine and chain smoking while sharing sordid tales of Saigon’s financial markets – like a real-life character out of Graham Greene’s novels.



Hai Bà Trưng, Hồ Chí Minh City

Further along Hai Ba Trưng, on the left is Nguyen Van Binh book street, lined with stalls, and there are also innumerable food alleys (for the brave of stomach). Further up is the Intercontinental Hotel, the Hard Rock Café and then, down an ominous, dimly lit alley on the left, is my new favorite: Pizza 4P, serving artisan pizza. All in all, a pleasant evening walk despite the occasional stench from sewers and the hazards of crossing streets amid the stream of motorbikes, which will generally flow around you when you simply march off the curb.

Vietnam's Competitiveness

Twenty years ago, Mini Me was the companion villain to Dr. Evil in Austin Powers' "The Spy Who Shagged Me," but today, some may view Vietnam as a companion villain to China in terms of trade.

Saigon fell to the communists in 1975. In 1978, Vietnam invaded Cambodia, and started a border war with China. Finally, Vietnam initiated its "doi moi" (Renovation Policy) in 1986 and made peace with China in 1991. By 1998, China had become Vietnam's biggest trading partner. In 2001, Vietnam signed a bilateral trade agreement with the US, and in 2007, Vietnam joined the World Trade Organization (WTO).

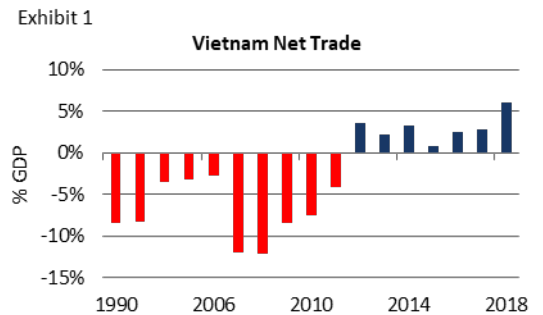
The result of WTO membership was initially pain, as the trade balance deteriorated on the back of massive imports of machinery and other capital equipment (Exhibit 1). In 2008, for example, Samsung invested \$670 million. Now after 10 years, its investment totals more than \$17 billion, it employs 100,000 people, and it has made Vietnam the second biggest exporter of smartphones, after China. Altogether, Vietnam has received more than \$110 billion of foreign direct investment (FDI), a third of it from South Korea.^v

FDI flows have been averaging above 5% of GDP for ten years, significantly higher than the levels of China and two of its neighbors, the Philippines and Thailand (Exhibit 2).

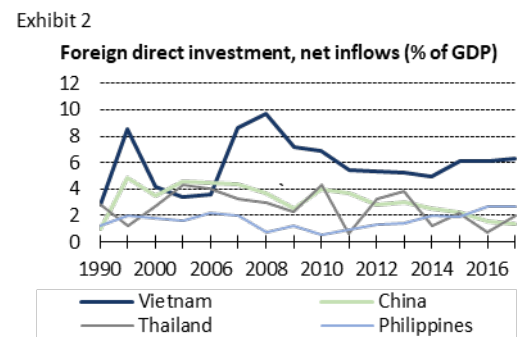
FDI is only part of the strong investment going on in the Vietnamese economy (Exhibit 3), with another growing part from domestic private investment. As a result, there has been a shift out of agriculture from 65% of employment in 2000 to 40% today, and an increase in urbanization, from 25% in 2000 to 35% today.

Where this progress becomes sensitive is that the US has experienced a rising trade deficit with Vietnam (Exhibit 4). The US is now 19% of Vietnam's exports followed by China and the EU at 17%. Meanwhile, the US is only 5% of Vietnam's imports versus 28% coming from China and 20% from South Korea.

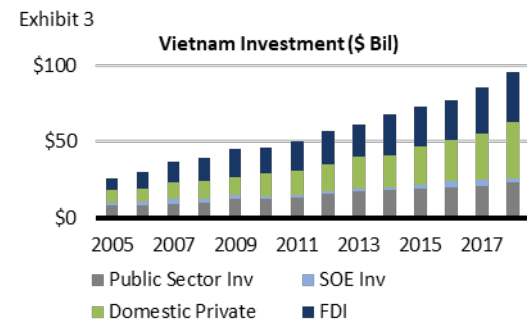
President Trump requested that Vietnam reduce its bilateral trade surplus by buying US military hardware, but then he learned that US law forbids it. Now, Vietnam is benefiting as a "second source" for production, given the US trade war with China, so Vietnamese exports should rise further. Hopefully Vietnam will not become the next trade target.



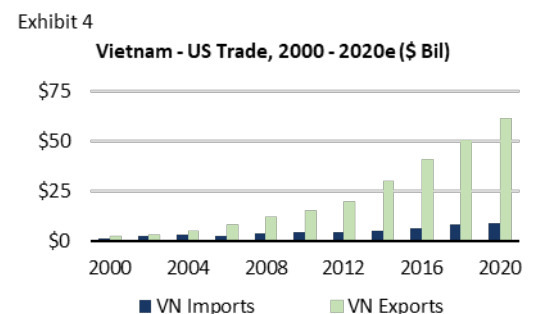
Source: World Bank WDI, 2019



Source: World Bank WDI, 2019



Source: Nguyễn Xuân Thành, Fullbright University, 2018

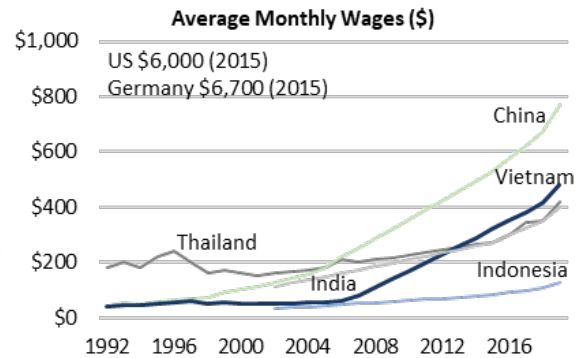


Source: Baker McKenzie, 2018

One reason for Vietnam’s trade competitiveness is its relatively low labor costs. China’s rising costs have provided a protective umbrella for Vietnam and other countries in the region (Exhibit 5).

But it isn’t just direct labor costs that count. FPT, based in Hanoi, is a major IT outsourcing company, with 56% of its outsourcing revenue coming from Japan. Its engineers are paid \$12,000 per year versus \$50-80,000 in Japan and \$100,000 in the US. More importantly, FPT can provide engineers at a total cost with overhead of \$25,000 per year, compared with \$35-40,000 from China and \$50,000 from India. And FPT’s outsourcing work is moving upscale from applications design and testing to AI, cloud and big data work.

Exhibit 5



Source: FGP, Statistics, EIU 2018

Exhibit 6 summarizes the latest data from the World Bank’s WDI database for Vietnam and three of its neighbors. In terms of population, Vietnam is on par with Thailand and the Philippines. Although it is the poorest in GDP per capita, it is second in rate of improvement. Meanwhile, its electricity consumption is double that of the Philippines but less than half the level of China.

Exhibit 6

	Vietnam	China	Thailand	Philippines
GDP Growth	6.8%	6.9%	3.9%	6.7%
GDP/Cap	\$6,776	\$16,807	\$17,871	\$8,343
GDP/Cap 5 yr. Growth	6.7%	8.2%	4.0%	6.5%
Population (mil)	96	1,386	69	105
% Literate	94%	95%	93%	96%
Infant Mortality <5 yrs/1,000	22	10	12	27
% Urban	35%	58%	53%	44%
GINI Ratio	35	42	38	40
Electricity/Cap kWh	1,411	3,927	2,540	699
% Banking Penetration	31%	80%	82%	34%
Market Cap (\$ bil)	\$12	\$8,711	\$549	\$290

Source: World Bank WDI, 2019

Walking Around

What is striking about Ho Chi Minh City (of which “Saigon” encompasses District 1) is the bipolar nature of the shops. The upscale malls host Versace, Armani and Gucci, but elsewhere there are mostly “mom and pop” shops with very few chain stores. Overall, Vietnam has 1.5 million small store-front shops, but now this is changing.



At Long Chau Pharmacy

For example, Mobile World gained its fame by claiming the lion’s share of the mobile phone retail market with more than 1,000 locations. Now it is converting some of its stores into consumer electronics retailers, driven by Robert Willett, a board member who was formerly the CEO of Best Buy.

At the same time, Mobile World has opened 400 small specialty food retail stores with upscale, quality produce and groceries. The shop that I visited felt like taking a step back to the time before grocery carts were invented. Much is packed into a small space with narrow aisles, but most of it looks good and fresh. Logistics are still

a challenge, however, as shelves are often empty before the day is half over. More disturbing was the discovery that the live-fish tanks had a couple of occupants floating belly-up. Regardless, these food stores are considered an improvement over the 9,000 open-air “wet markets” in Vietnam (so called because the floors are wet both from spraying the vegetables to keep them fresh and cleaning what spills).

Meanwhile, FPT Retail, a mobile phone retailer that was spun out of FPT last year, has acquired Long Chau, a small pharmacy chain with 22 stores that it plans to grow ten-fold in three years. Here again the stores feel like a step back in time, to days when pharmacies had ceiling-high mahogany cases of products, both prescription and non-prescription, and when sales clerks and pharmacists scurried to fetch what you might need.



A PNJ NEXT store

On the other hand, Phu Nhuan Jewelry (PNJ) is opening new stores that would be up to date in any city in the world. Five years ago, PNJ was struggling to transition from gold bullion sales and uninspiring jewelry designs to becoming a modern jewelry leader. Now it has a flourishing in-house design staff, and 70% of its products are made at its manufacturing center west of Ho Chi Minh City that employs 1,000 craftspeople. The new PNJ NEXT store, in a prime location, is bright and sophisticated with cases featuring jewelry set with emeralds, rubies, topaz and diamonds. And on the mezzanine

floor, they are now offering watches from name manufacturers as well as in-house brands.

As I was standing in PNJ's store, the melody of "Love is Blue"^{vi} played in the background, That song brought me back to 1968, when I was in the Navy and not sure where my assignment would take me. It was impossible then to imagine that I could be standing today in the midst of this capitalist, consumer-driven city of Saigon.

What should we do?

Vietnam is an attractive economy.

From a top-down perspective, the macro-economic picture is strong, with GDP growth of 6-7%, modest inflation and a strong trade outlook. With the US in a trade battle with China, many producers are looking to Vietnam as a second source, partly because it is rated well in a survey of Japanese producers in terms of employee quality versus wages (Exhibit 7).

And from a micro-economic standpoint, Vietnam has a rising middle class, which presents great opportunities to the consumer products companies that can serve them. The challenge for investors is finding the best way to participate.

Unfortunately, the government has imposed foreign ownership limits (FOL) on listed companies that range from 20% to 49%. In the case of many popular stocks, such as FPT, Mobile World, Military Bank, PNJ and Techcom Bank, these FOL limits are full. That means that foreign investors can only buy stock that other foreign investors already hold. These trades are typically done at a price 7% above the last closing price,

Exhibit 7



Source: Japan External Trade Org, JETRO, 2018

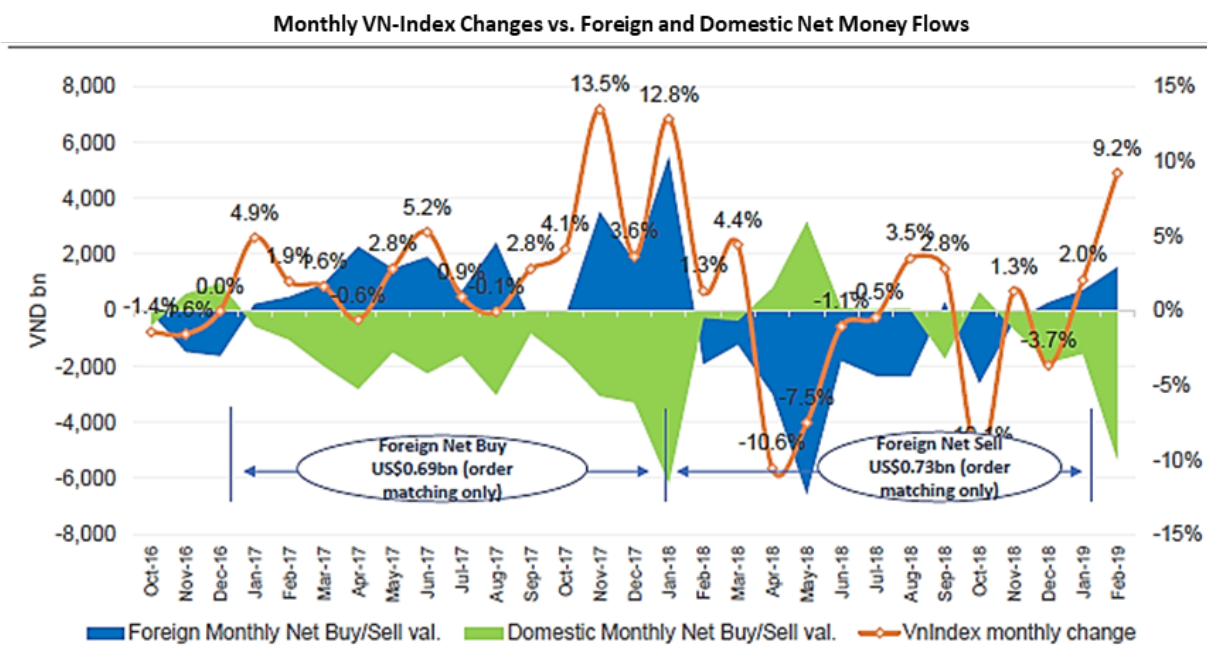
which means that transactions costs are the usual commissions and fees PLUS 7%. Investors hope that when they decide to sell later on, the FOL will still be in place, and they can recoup their 7%. Although companies have some discretion to abandon the FOL, the consequences would be onerous red tape. Mobile World, for example, would need pre-approval of new stores, because it would be “foreign owned.” As a result, change is unlikely for Mobile World. We have heard of investors willing to pay a premium of more than the permitted 7% over last close by going through the complex process of an off-market trade to pay a premium of as much as 45%. It is these restrictions that postpone Vietnam’s hope of being elevated from the frontier to the emerging market universe.

Another problem for foreign investors is that a large number of younger companies trade on the UPCOM, an over the counter market in Hanoi. Challenges here include liquidity and the quality and availability of information. Some of the opaqueness of the UPCOM market can be overcome by buying London listed funds, such as the Vietnam Opportunity Fund (VOF LN) or Vietnam Enterprise Investment and Development Fund (VEIL LN). They hold many larger Vietnamese stocks, but they also trade in UPCOM stocks where they have better access to information than foreigners.

Finally, the wild traffic on Saigon’s streets is mirrored by the volatility of the Vietnamese stock market. A confidant once wrote: “I look at technicals first, and if I like them, I look at fundamentals. VN is not a fundamental market...”

With an annualized standard deviation of 20%, Vietnam’s volatility is the same as China although lower than Colombia (27%) and Turkey (28%). However, Vietnam has a higher autocorrelation (the degree of trending is measured by lagging sixty-month price change windows over periods from one to five months). This autocorrelation statistic of 1.15 is lower than those of Denmark (1.27) and Italy (1.21), but when combined with Vietnam’s higher volatility, it makes the market trend more important. In light of this, Exhibit 8, from FiinGroup, 2019, is interesting.

Exhibit 8



Source: FiinPro Platform. NOTE: HOSE only; Data is order-matching value only

Their data show that foreign buying and selling tend to move the market, while local investors happily sell to foreigners or buy from them. Thus, despite 75% of trading being from local retail investors, foreign investors must take some of the blame for Vietnam's market cycles.

However, as with plunging into a chaotic stream on motorbikes to cross the Saigon streets, our advice is to plunge into Vietnamese stocks with an eye on the distant horizon of opportunity while ignoring the near-term waves.



Mass Transportation in Saigon

"In a famous comedy skit, Mel Brooks plays a 2000-year-old man. The interviewer asks, 'What was the means of transportation [2000 years ago]?'

His answer: 'Mostly fear ... Fear would be the main propulsion.'

"The societies that have been able to implement the required policies [for promoting growth] are all ones that have experienced excruciating trauma and intense fear: Japan after losing World War II; South Korea after the Korean War; Taiwan after the Chinese Civil War; Singapore after its traumatic separation from Malaya (which meant facing two much larger powers, Indonesia and Malaysia); Vietnam after wars with France, the United States and China; and China after a century of foreign humiliation and tens of millions of deaths from domestic strife." – Bill Overholt^{vii}

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Frontier Global Partners, LLC
7817 Ivanhoe Avenue, Suite 200
La Jolla, California 92037
Telephone: (858) 456-1440
Fax: (858) 456-2040
<http://www.frontierglobalpartners.com>

ⁱ Mini Me – Verne Troyer in "Austin Powers: The Spy who Shagged Me", 1999

ⁱⁱ Walking on Hai Bà Trưng https://www.youtube.com/watch?v=SwbbqX3uc_g

ⁱⁱⁱ Trưng sisters, https://en.wikipedia.org/wiki/Tr%C6%B0ng_Sisters

^{iv} <http://therefinerysaigon.com/>

^v Investment in Vietnam, Phone Home, The Economist, April 14, 2018

^{vi} https://en.wikipedia.org/wiki/L%27amour_est_bleu Paul Mauriat conducted/recorded an orchestral "easy listening" version that was a number-one hit in the USA for five weeks in February and March 1968

^{vii} China's Crisis of Success, William H. Overholt, *Harvard University, Massachusetts, 2017*