BULLISH PROSPECTS FOR VIETNAM'S CAPITAL MARKETS

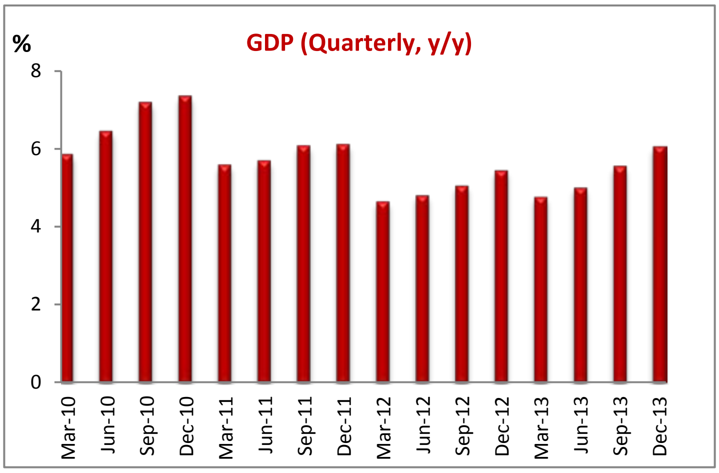
Vietnam capital markets are on an uptrend that is likely to be sustainable going forward. We wish to analyse the factors behind this current market cycle and offer an outlook for the year ahead.

I. REVIEW OF 2013

The Vietnam markets performed well in 2013, with the VNI (Viet Nam Index) increasing by 22% and emerging as the best-performing market among ASEAN countries[1]. The macro framework proved to be favourable.

GDP growth was moderate and attained 5.4%, an improvement over the 5.0% recorded in the previous year. Though not as high as some neighbouring Asian countries (e.g. China), the growth rate is respectable and lies in a moderate range so as not to cause upwards pressures on the price levels.

Vietnam's GDP has increased steadily but at a moderate pace

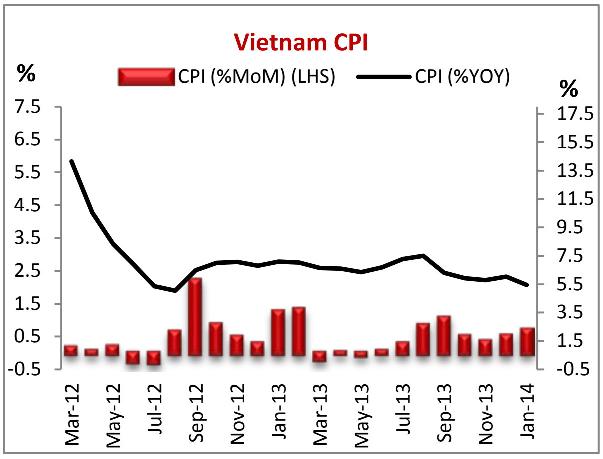


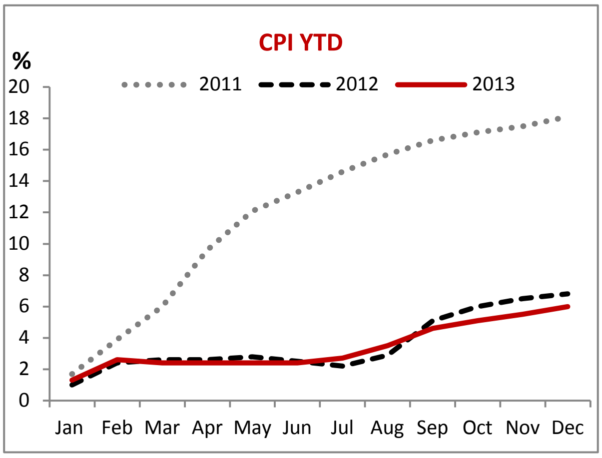
Inflation was very much under control at 6.0%, the lowest CPI increase in a decade. This was remarkable considering that inflation was at 20% as recently as 2011. With lower inflation, COF (cost of funding) can decline, thereby boosting enterprises' cash flows, and allowing more business expansions. In the short run, reductions in interest expense improve P&L positions of listed companies, leading to better earnings growth.

Interest rates have come down steadily with yields on the 5-year benchmark VGB declining by almost 3% by the end of year. Lending rates have subsided from levels of 18-22% in 2011-12 to an average of 8-12% in 2013. Asset valuations got a boost from such lowered interest configuration. The bond market grew considerably and recorded the fastest expansion of any fixed-income market in Asia.

[1] Refer to Appendix for chart comparing Asian equities index performance

Inflation has declined considerably from 20% in 2011 to 6% in 2013





As for the VND it showed remarkable resiliency, as the SBV carried out only one devaluation of 1% at mid-year. By the end of 2013, the dong depreciated 1.3% versus the dollar, far below the goal of 2-3% as set by the government. This is a comfortable position for Vietnam's currency given that the loss in value was 9% as recently as 2011. Currency strength (or at least its stability) has a critical role in maintaining foreign investors' confidence that their investments value is not eroded over time.

At end 2013, the general conclusion is that Vietnam has been successful in restoring macroeconomic stability. This is the result of a long effort that started in 2011 with a comprehensive reform program (labelled Resolution 11) issued from the highest political authority. Therefore the political will to stay the course came from the top, and the program was a success. Consequently, inflows of FDI and FII were given a boost, resulting in healthy trade surpluses and stronger FX reserves. The VND benefitted by becoming more stable and resilient under competing pressures.

II. Outlook for 2014

Looking forward to 2014 we think that the record of 2013 will be sustained. In fact, we think this year will be almost a replica of last year but in the form of an improved version, leading to better market results.

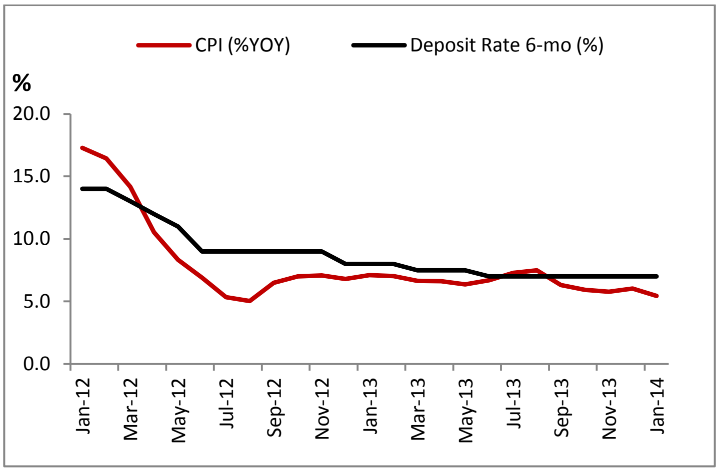
GDP growth will be further propelled by good export performance and FDI inflows. Inflation continues on its moderate track in the 6.5-7% range.

The PMI has been above 50 for 5 consecutive months, indicating an expanding manufacturing sector

The VND stability will be maintained, and even further consolidated, as the SBV has set a goal of keeping any depreciation in the currency value to 1-2%, instead of a wider range of 2-3% in the previous year.

Interest rates will be managed downwards to further promote economic growth. The central bank has announced a policy objective of lowering lending rates across the board by a further 1-2% as compared to 2013. Domestic business enterprises will benefit because their access to capital in recent years has proven quite limited in spite of good liquidity in the banking system.

Depositors have enjoyed real returns on their investments



Looking forward, we can also mention some other favourable factors that will render the Vietnam markets attractive to investors, both foreign and domestic.

1. **FDI inflows are on track** for another year of substantial increase. Recent data for January 2014 showed a 53% rise in new commitments compared to the corresponding period of last year. Direct investments are by definition long-term fund flows which will contribute to enduring economic development. A prime example is Samsung's

commitment to set up multibillion dollar factories in Vietnam, essentially transforming the country into its production hub of electronic equipment for all ASEAN markets. The FDI sector has been going strong and contributes substantially to a strong export performance: latest data indicated a USD1.41 bn trade surplus for January 2014 – the highest such surplus ever.

2. **The bad debt problem** is finally being seriously addressed. The VAMC (an agency set up to handle this problem) has bought up USD1.5 bn of NPL (non performing loans) from commercial banks and will continue to do so going forward. In 2014 it will begin to sell such debts to interested investors. A framework for foreign investors' participation is being set up.

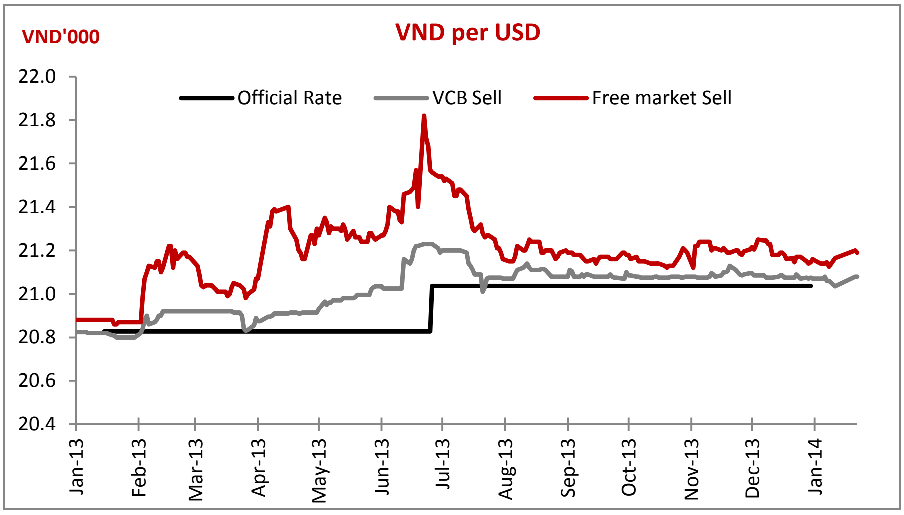
3. **SOE reforms are being sped up** to reduce a drag on the country from this inefficient economic sector. A rising stock market is actually helping to accelerate the process. SOEs are no longer afraid of going public at less than their perceived book values, and this would give a stimulus to the equitization program. In 2014 the IPOs of several large scale SOEs are on track especially Vietnam Airlines, a profitable enterprise. These new listings attract foreign investors due to their large market capitalizations which can fit better into their portfolios. A similar sign of interest has been the booming **sales of Vietnam focused ETF shares on international markets**. They are traded at a slight premium indicating fund managers' effort to include Vietnam into their portfolios.

4. **A campaign to combat economic malfeasance** and bureaucratic abuse has been launched with support from the highest political authority. A few recent trials of misbehaviour by high-ranking officials have received widespread media coverage and have resulted in several death sentences.

5. Looking to the near future, **there are no political events (party conventions, government reshuffling) that can interfere** with good economic policy making. Such political stability has been a plus element with foreign investors in the past and is set to continue in the future.

6. Vietnam's economic and financial system has proven **quite resilient in the face of US policy changes, especially concerning the tapering of the QE3** liquidity program. In fact Vietnam's capital inflows have been mostly long-term in nature, and it has not attracted much "hot money" flows that can come and go quickly, and lead to financial instability as in the case of India or Indonesia. Another distinction is that Vietnam's external position is fairly robust due to its strong FX reserves, and the country has not issued any material amount of fixed-income obligations in recent years.

The USD free market rate has stayed within 1% of the official rate, implying a stable VND



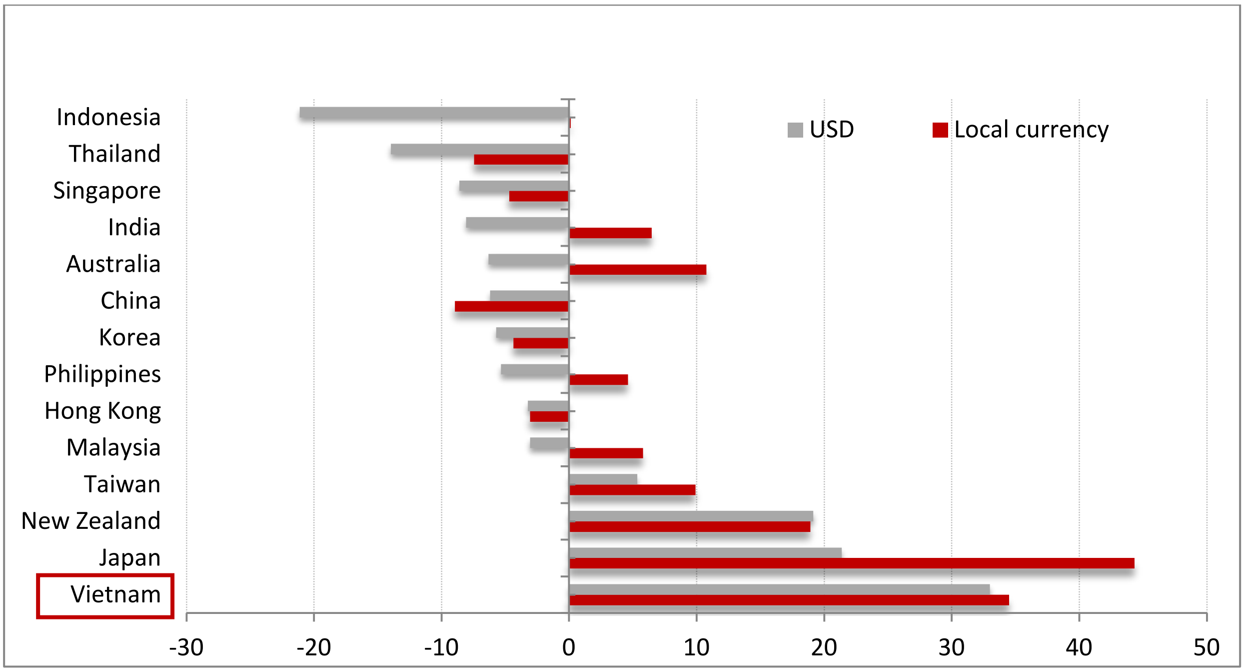
III. Concluding observations

- **The current macro-economic configurations in Vietnam (namely, moderate growth, low inflation, and a stable currency) are conducive to good market performance.** The VNI gained 22% in 2013 and is popularly projected to gain 15-20% this year. Foreign investors have been in a net-buy position during 2013, and this trend has been continuing strongly in 2014 as well.
- In our opinion, **foreign investors are favourably impressed** by the enduring macro stability achieved by the Vietnam government. Current policies are in place to maintain that condition going forward. The reform program introduced in 2011 is now considered to be irreversible, providing comfort to investors that another stop-go cycle can be avoided.
- The **features of Vietnam's market** that attract investors (low valuations, political stability, a young labor force) **have been in place for some time**. But now that the macro configurations mentioned above are firmly consolidated, investors have begun to feel much more comfortable in making their disbursements.

Such a situation will likely have staying power and provide a long-lasting beneficial impact on the current bullish market cycle.

Appendix

Asian equities performance
Country index price performance from 1 Jan 2013 to 31 Jan 2014



Source: Thomson Reuters, Bloomberg as of 31 Jan 2014

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