VNDIRECT
WISDOM TO SUCCESS
Retail Salesnote

MAKE HAY WHILE THE SUN SHINES – 2nd Nov 2018

Following my last note "**Winter is coming: Autumn tantrums should trigger a portfolio rebalancing",** several distressed readers of this email series wrote in to say that the free fall in share prices made it rather difficult to actually rebalance their portfolios; after all, an unrealized loss is still – well, unrealized. They were locked-in.

With the last trading session providing some reprieve from the relentless downdraft experienced in October, it would appear that a little window of opportunity has opened to sneak in some reallocations before we head back into correction territory. Also, bear [no pun intended] in mind that November has historically been a "rebound" month for US equities and Vietnam's stock market movements are increasingly synced with that of the US markets.

Q3 earnings show that the Vietnamese economy remains in rude health

We ran some numbers yesterday on Q3 earnings across the market and here are the summary statistics:

- 788 companies announced results
- + Average revenue growth: 17.2%
- + Average NPAT growth: 24.4%

Of the 72 companies with consensus forecast data in Bloomberg:

- + 29/63 (46%) of companies outpaced full year consensus forecasts of revenue growth in 9M YTD (banking names excluded for obvious reasons)
- + 37/72 (51%) of companies outpaced full year consensus forecasts of earnings growth in 9M YTD

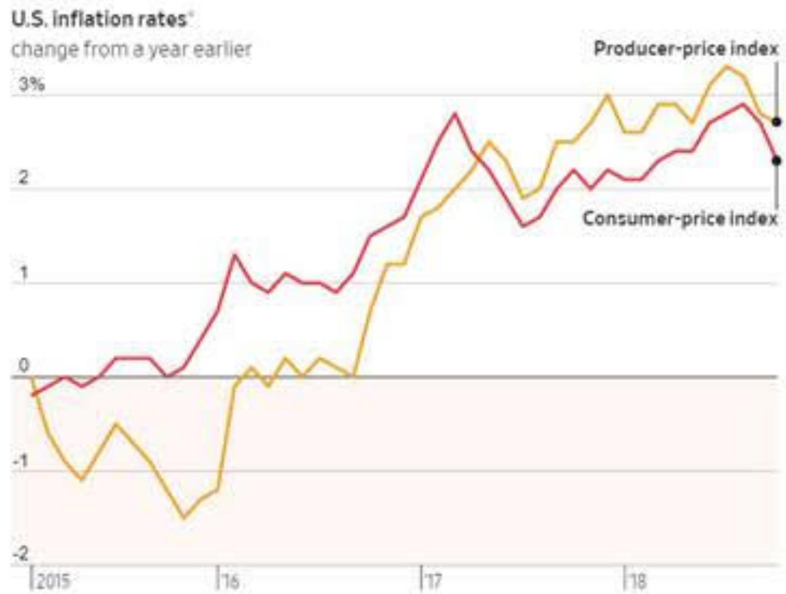
Solid top line growth and market-wide margin expansion indicate that demand remains robust, lending companies significant pricing power to boost margins even as certain commodities like oil and steel have seen strong runs in the past year.
With more than half of the companies covered by the street on track to beat their full year consensus earnings growth forecasts, it looks like the market is in oversold territory. Perhaps, but with several clouds building on the horizon for the global economy and equity valuations, I would think that investors should capitalize on any opportunity created by a market rebound to rejig their portfolios.

And here is why.

US inflation is clearly ticking-up: The Fed will keep a lid on animal spirits.

While we are watching Vietnam inflation readings like a hawk, what is probably much more material to VN equity valuations at this point is US inflation. The Fed reigns supreme.
The signs are ominous – look at the inflation readings below in the US:

Source: Wall Street Journal



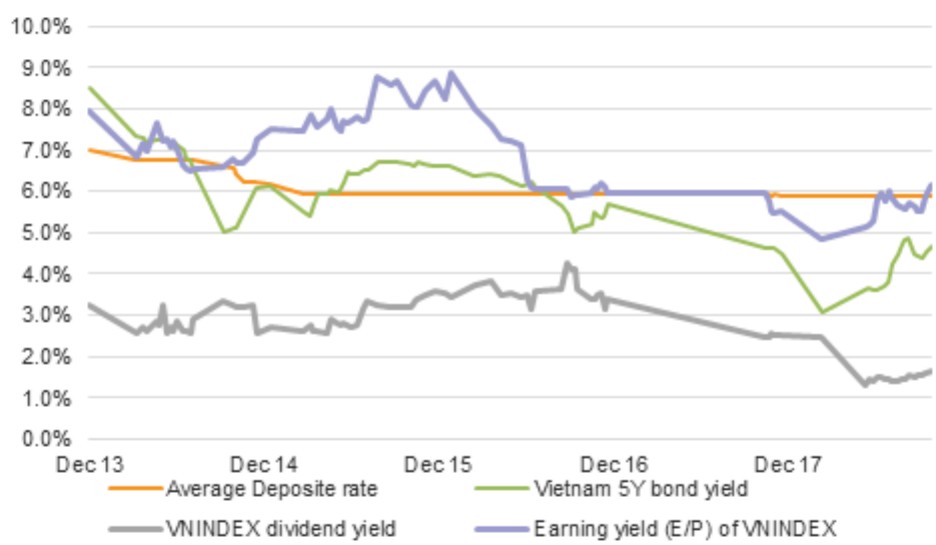
Source: Wall Street Journal

The week Amazon hiked its minimum wages, I put out a note saying that this was both a lead indicator of a tightening labor market as well as a catalyst for a "ripple" of competitive wage increases across the economy. It appears that the wage increases are really coming through now as shown in the chart below:

Source: Wall Street Journal

So I stick to my base case view that a material flattening of the predicted Fed rate hike trajectory is rather unlikely. This means the Vietnam equity market correction is far from done. The October correction is just one episode in what will be a spasmodic series of market corrections over the next several months and into 2019. Once again, nothing cataclysmic but enough to be wary of.

Also, comparing Vietnamese equity returns versus fixed income returns in Vietnam shows that the "equity risk premium" (as measured by the spread between the earnings yield and the bond yield rate or the bank deposit rate) has narrowed to somewhere between a fraction of a percentage point to around 1.5 percentage points, depending on how you measure it. Also, aggregate dividend yields are not juicy enough to compensate for this. And this dwindling of the "Equity risk premium" and falling dividend yields have played out over a period in which market volatility has gone through the roof. Not really compelling.



Source: VNDirect, Bloomberg, GSO

Defensive stocks are aplenty: seek and ye shall find

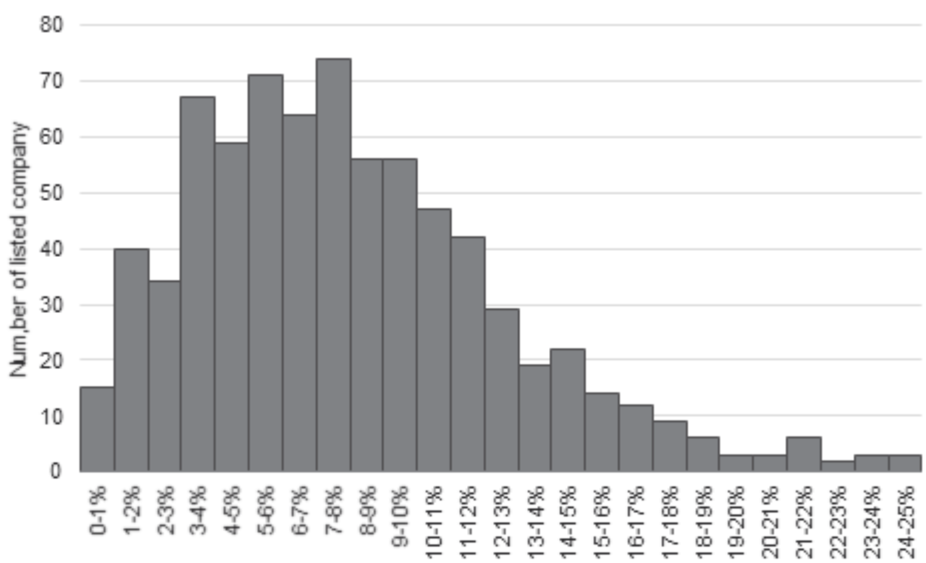
Rotating into defensive sectors is an obvious response into a skittish market. But the Vietnamese market is a strange animal in which the boundaries between supposed "cyclical" and "defensive" sectors are blurred. A classic example is the divergence so far this year between real estate and construction / construction materials which are generally expected to move in tandem. Property has been among the best performing sectors this year while construction stocks have languished at the bottom of the sector performance league table.

So, we think a "bottoms-up" approach to defensive stock selection is more sensible in a Vietnamese context. We developed our own "defensive" scoring tool which rates stocks on a whole range of attributes such as dividend yield, historical earnings CAGR (to ensure that valuation discounts were not due to poor earnings growth), discount/premium to sector average P/E and P/B as well as discount/premium to the stock's own historical P/E and P/B. We also layer on ADTV to measure illiquidity risk, stock Beta to capture risk as measured by volatility and, finally, leverage to account for solvency risk. We aggregated all these individual attribute scores into an overall score of "defensiveness" *(note we did not factor in governance risk as this is virtually impossible to quantify).*

What was also striking during this scoring exercise was that, despite a low and falling market-wide dividend yield, there are a boatload of stocks that pay very handsome dividend yields. Here are the results of our analysis:

While 45.6% of stocks across the listed universe do not pay a dime in dividend, ***489 stocks carry more than a 7% dividend yield and 303 stocks carry more than a 10% dividend yield.***

Dividend yield distribution across the Vietnam Stock Market



Note: excluding the companies that do not pay dividends

VNDirect List of Top 25 Most Defensive Stocks

Stock	Exchange	Market Cap (US$m)	Dividend Yield (%)	Beta	TTM P/E	P/B	ADTV (US$)	Total defensive score
TDH	HOSE	34.6	10.1%	0.72	6.8	0.3	276,510	12
SHI	HOSE	23.3	7.8%	0.38	3.8	0.6	129,586	11
LHG	HOSE	39.8	8.1%	0.69	3.8	0.8	301,636	11
SKG	HOSE	40.9	9.0%	0.57	6.4	1.1	188,119	11
PPC	HOSE	234.1	14.7%	0.53	5.6	0.9	365,445	11
NTC	UPCOM	48.5	8.5%	0.50	6.0	2.7	259,216	10
PHR	HOSE	160.2	8.3%	0.86	5.6	1.4	398,979	10
CEO	HNX	82.0	8.1%	0.99	9.3	0.8	298,231	9
DPM	HOSE	305.0	11.0%	0.65	10.9	1.0	406,256	9
DCM	HOSE	219.5	9.3%	0.76	10.5	0.8	156,809	9
KDC	HOSE	224.6	6.3%	0.35	-	0.8	116,978	8
AAA	HOSE	104.8	14.0%	0.72	8.8	0.9	1,213,950	8
VSC	HOSE	81.6	5.3%	0.81	6.5	1.0	394,155	8
NT2	HOSE	297.1	12.4%	0.41	8.2	1.9	206,961	8
CTI	HOSE	66.6	6.1%	0.43	11.4	-	1,411,028	7
FMC	HOSE	46.6	16.6%	0.87	7.7	1.7	183,707	7
IDI	HOSE	95.3	6.5%	0.90	3.8	0.9	872,297	7
KSB	HOSE	61.7	5.4%	0.63	4.5	1.6	410,281	7
BMP	HOSE	196.0	7.2%	0.85	9.9	2.1	259,009	7
CVT	HOSE	34.7	6.8%	0.92	4.4	1.3	378,899	7
REE	HOSE	408.3	5.2%	0.98	6.1	1.0	659,539	6
VGC	HNX	291.9	6.3%	0.70	10.9	1.0	789,693	6
GMD	HOSE	342.7	5.6%	0.86	4.2	1.3	1,502,541	6
VCS	HNX	486.5	5.6%	0.87	7.9	4.1	1,146,362	6
VCG	HNX	344.3	6.6%	0.93	6.3	1.1	842,386	6

Source: VNDirect analysis, Bloomberg

Needless to say, the "defensive score" above is not all-encompassing as it does not factor in governance risk and nor does it look at forward earnings or expected discontinuities. But it could still serve as a useful starting point from which to layer on qualitative considerations (eg. the expiration of the subsidized input gas price policy for DCM or the perpetual governance cloud that hangs over IDI) and cherry pick defensive names for your upcoming portfolio rebalancing.

Drop us a line if you would like more details on our "defensiveness" scoring methodology.

Have a great weekend,

ANIRBAN LAHIRI

Head of Research

NGUYEN THE TRUNG, **ERIC**
Associate Director
Trung.nt@vndirect.com.vn
+84 937478432

VNDIRECT
WISDOM TO SUCCESS