Bi-Weekly Report
August 28, 2020

Goooood Morning Vietnam!

Vietnam Benefits from U.S.-China Decoupling & Supply Chain Shifts

Bottom Line

Vietnam's economic growth is a story about globalization. Over the past few decades, the country transformed itself from an agriculture focused economy to a manufacturing and export oriented economy. Vietnam entered multiple trade agreements, implemented economic reforms, and made its business environment more friendly to foreign firms. The result was a surge in foreign direct investment (FDI) and increasing exports. Vietnam's GDP more than doubled between 2006 and 2019.

In our view, Vietnam's economic transformation is not out of steam yet. Deteriorating U.S.-China relations are causing more companies to diversify their supply chains and leave China. Vietnam is one of the primary beneficiaries of the trend to shift supply chains due to its lower labor costs. As a result, we expect FDI to remain strong, which should support continued economic growth.

Main Points

► **Strong FDI Growth the Last Decade Allowed Vietnam to Grow its Exports**

- Total registered capital grew at a 7.8% annual rate from 2010-2019.
- Over the last decade, Vietnam's +18.4% avg. y/y U.S. export growth was nearly 3x more than the export growth in Malaysia, Taiwan, and Thailand.

► **Vietnam's 2020 Economic Growth Remains Positive Despite COVID-19**

- Growth estimates entered contraction territory for most of the world during the pandemic, but Vietnam's projected 2020 economic growth remained positive.

► **Vietnam Trades at a Slight Discount with An Attractive Setup**

- Vietnam trades in line with the world after reaching +3std in 2018 / 2019 during the U.S.-China trade war. Following recent underperformance, Vietnam's LTM rolling return gap vs the world is approaching -1std.

► **Weak Global Trade & Productivity Constraints are Risks to Economic Growth**

- Domestic consumption alone is not going to power Vietnam to pre-pandemic levels. In the near-term, the country's outlook is tied to a successful global economic restart and the return of consumption.
- Vietnam's labor shortage and stressed infrastructure network both represent risks to the country's ability to reach its economic potential.

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Trade Details

Trade Type
Intl Equities / Asia / Vietnam

Trade ID
IEQ.2020-13

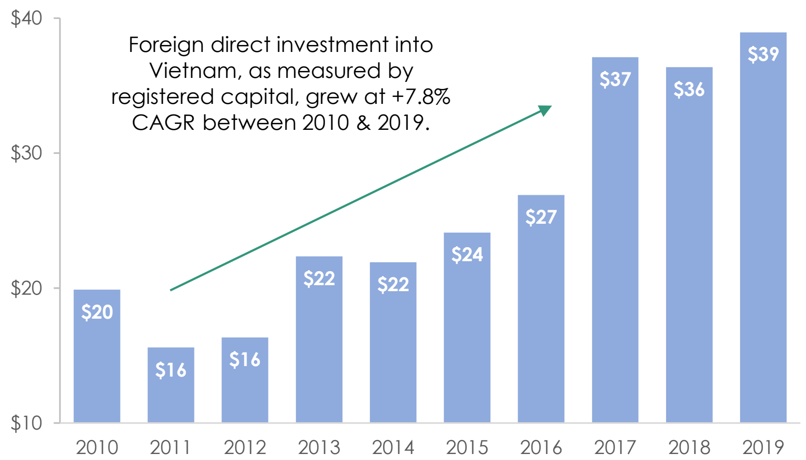
Ticker(s)
VanEck Vectors Vietnam ETF (VNM)

Benchmark
FTSE All-World ex U.S. Index (VEU)

Research Portal →

Strong FDI & U.S. Export Growth as Business Climate Improves

Figure 1: Vietnamese Foreign Direct Investment Per Year in Billions



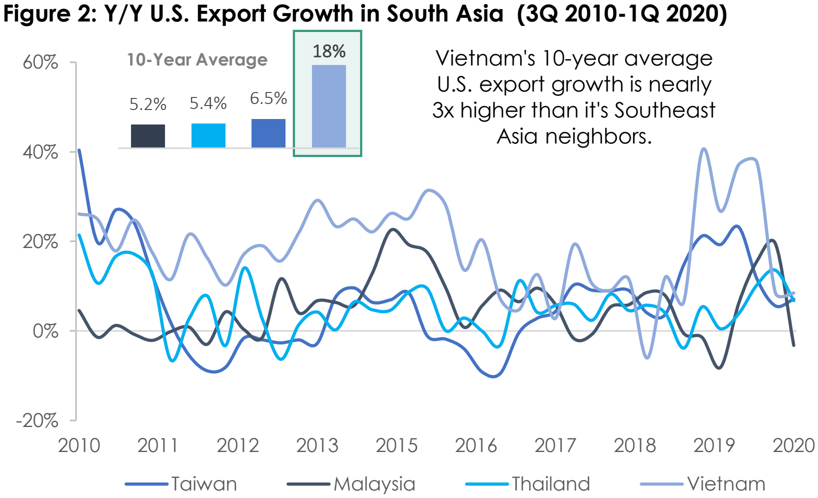
Source: MarketDesk Research, General Statistic Office of Vietnam

Foreign Direct Investment in Vietnam Doubled between 2010 & 2019 …

● Figure 1 charts the total registered capital for licensed projects each year from 2010 through 2019. Vietnamese and foreign companies are required to obtain a registration certificate to initiate an economic project.

● Total registered capital for licensed projects in 2019 doubled over 2010's level. FDI remains a significant driver of Vietnam's economic growth. We expect FDI growth to remain strong due to deteriorating U.S.-China relations and corporate discussions related to global supply chain diversification. Increased FDI should support higher Vietnamese economic growth.

Figure 2: Y/Y U.S. Export Growth in South Asia (3Q 2010-1Q 2020)



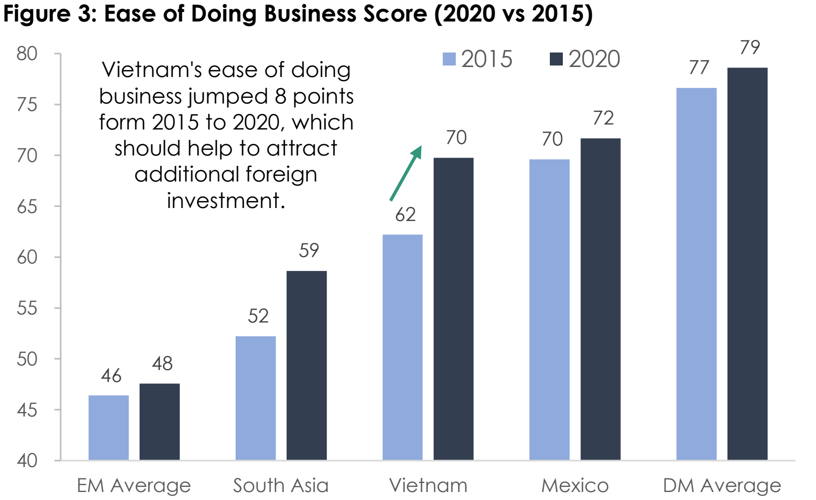
Source: MarketDesk Research, U.S. Census Bureau

Vietnam's U.S. Export Growth Surpasses South Asian Peers …

● Figure 2 charts the y/y U.S. export growth for four South Asia countries: Malaysia, Taiwan, Thailand, and Vietnam. Each of the four countries is considered a suitable replacement for Chinese supply chains.

● Vietnam's U.S. export growth consistently outperformed the other three South Asia countries. Over the last decade, Vietnam's +18.4% average y/y export growth was nearly 3x more than Malaysia (+5.2%), Taiwan (+6.5%), and Thailand (+5.4%). We attribute this to strong FDI growth the past ten years (see Figure 1). Continued strong FDI could sustain Vietnam's strong U.S. export growth.

Figure 3: Ease of Doing Business Score (2020 vs 2015)



Source: MarketDesk Research, Doing Business (The World Bank)

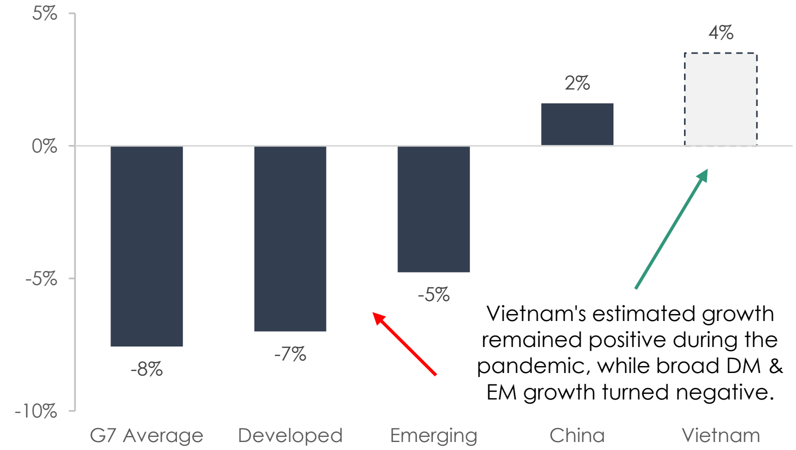
Vietnam's 'Ease of Doing Business' Score Highlights Economic Reforms …

● Figure 3 compares the ease of doing business score, which measures the gap for each economy against the best regulatory performance observed across all economies, in 2020 versus 2015. A score of 70 means the economy was 30 points below the best regulatory performance across all economies.

● Vietnam's ease of doing business score jumped 8 points between 2015 and 2020 to close the gap with Mexico, which is another supply chain substitute. Two notable Vietnamese reforms occurred: (1) the corporate tax rate was lowered from 22% to 20% in 2016 and (2) Vietnam joined the amended Trans-Pacific Partnership in 2018.

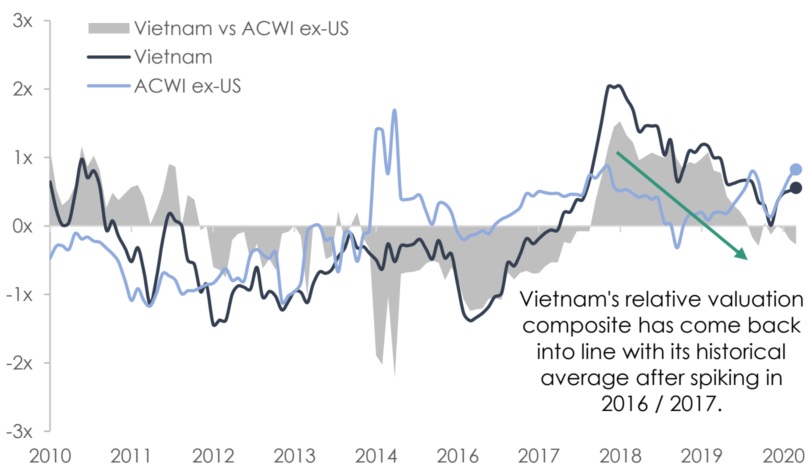
Positive 2020 GDP Growth at a Valuation Discount

Figure 4: Forecasted 2020 Real GDP Growth (as of 8/25/2020)



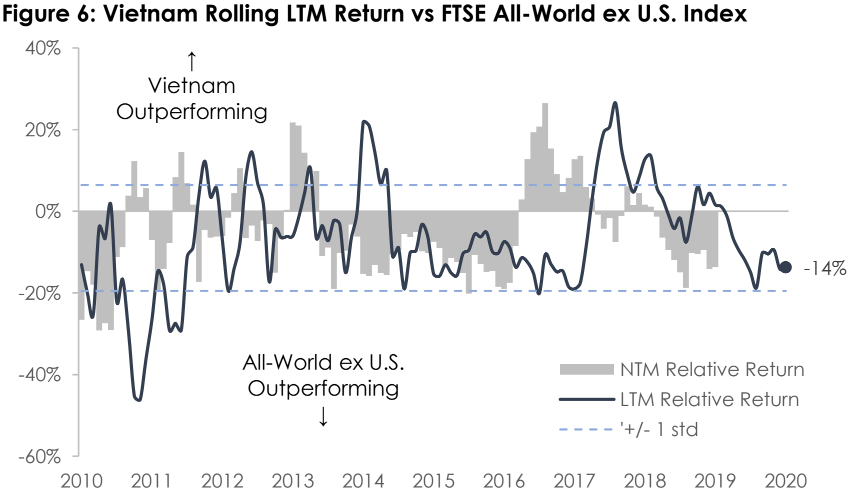
Source: MarketDesk Research

Figure 5: Vietnam Valuation Composite vs FTSE All-World ex U.S. Index



Source: MarketDesk Research

Figure 6: Vietnam Rolling LTM Return vs FTSE All-World ex U.S. Index



Source: MarketDesk Research

Vietnam's Forecasted 2020 GDP Growth Remains Positive Despite COVID-19 …

- Figure 4 graphs forecasted 2020 real GDP growth for the G7, developed markets, emerging markets, China, and Vietnam. Growth estimates entered contraction territory for most of the world during the pandemic, but Vietnam's projected 2020 economic growth remained positive.

- Economic growth projections highlight Vietnam's continuing economic transition. While the 3.5% 2020 growth estimate is below the 7% growth experienced in both 2018 and 2019, we believe Vietnam can continue to outperform from an economic perspective. Deteriorating U.S.-China relations, shifting global supply chains, and economic reforms should benefit Vietnam.

Vietnam's Valuation Premium is Now a Valuation Discount …

- Figure 5 charts the valuation composite gap between Vietnam and the FTSE All-World ex U.S. Index. After trading at a premium during most of 2018 and 2019, Vietnam now trades more in line with global valuations.

- Vietnam is consistently cited as a beneficiary of the U.S.-China trade war. The late 2016 / early 2017 valuation spike suggests trade uncertainty and the U.S.-China decoupling support higher Vietnamese asset values. We believe increasing U.S.-China trade war and geopolitical tensions will push more firms to diversify global supply chains, which will support higher Vietnamese economic growth and valuations.

Vietnam's Underperformance vs World Points to Attractive Setup …

- Figure 6 charts the rolling LTM return gap between Vietnam and the FTSE All-World ex U.S. Index. The gap currently sits near the -1std line.

- Following its strong performance run between 2016 and 2017, Vietnam steadily underperformed the FTSE All-World ex U.S. index the past three years. We attribute Vietnam's recent underperformance to mean reversion. The country was overvalued after investors bid up the country during the U.S.-China trade war. Now that valuation metrics are more in-line with the world (see Figure 5), we believe Vietnam is once again attractive as the U.S. and China battle for supremacy.

Reliance on Global Trade & Productivity Constraints

Key Risks — Capacity Constraints & Reliance on Global Trade …

There are two primary risks to a tactical Vietnam position. Vietnam's globalization success story over the past few decades means it is now more dependent on global trade to support economic growth. In addition, the country faces constraints related to infrastructure, labor, and alleged favoritism toward state owned enterprise.

#1 Reliance on Global Trade: Vietnam benefitted tremendously from the globalization wave over the past three decades. The country embraced trade liberalization. Vietnam joined the ASEAN free trade area in 1995, signed a free trade agreement with the U.S. in 2000, joined the World Trade Organization in 2007, and joined the amended Trans-Pacific Partnership (without the U.S.) in 2018. Together, the trade agreements lowered trade barriers, such as tariffs, and allowed Vietnam's exports to grow.

While global trade powered Vietnam's economic growth, the country now faces a new reality. Its economy is more correlated to global trade. The current health pandemic highlights Vietnam's growing vulnerability. Exports overall fell -6% y/y during 2Q20 as global trade slowed. The country's status as an outsourced manufacturing hub leaves it uniquely vulnerable. Exports of bags, wallets, suitcases, hats, and umbrellas dropped -26.5% y/y in 2Q20. Tourism is another concerning issue for Vietnam, with tourist arrivals dropping more than 98% y/y in each month from April 2020 through July 2020.

The risk is export oriented countries face a prolonged period of weak global trade. Domestic consumption alone is not going to power Vietnam to pre-pandemic levels. In the near-term, the country's outlook is tied to a successful global economic restart and the return of consumption. A rebound in labor-intensive manufacturing and international tourism are crucial to get the economy back on track. Over the long-term, we believe the country will continue to gain export market share as companies shift their global supply chains and the U.S. and China march toward an inevitable decoupling.

#2 Labor & Infrastructure Constraints: Vietnam faces two significant constraints related to future economic growth. The immediate issue is the country's tight labor market. Vietnam's population is only 7% of China's population. As more companies look to shift portions of their supply chains to Vietnam, demand for skilled workers is creating a labor shortage. The labor shortage is restricting expansion plans and could limit Vietnam's ability to grow exports.

The longer-term issue is Vietnam's infrastructure network, which materially lags behind China. Economic growth is stressing the country's infrastructure as freight volumes increase and electricity demand grows. The country's roads, ports, and freight network remain a work in progress.

Vietnam's ability to sustain its strong economic growth is highly dependent on the country's ability to solve the labor shortage and infrastructure issues. Solving the issues will require a combination of regulatory reforms, deepening capital markets, and improving the educational system.

Trade Implementation — Vietnam Focused ETF

This tactical Vietnam position is built on two catalysts: (1) Vietnam's strong FDI inflows over the past decade and (2) the potential for companies to shift supply chains due to worsening U.S.-China relations. The timeframe for this tactical position is +12 months in our view. The structural reforms required to address the labor shortage and infrastructure issues will take time. It will also take multiple years to shift supply chains. In the near-term, we believe worsening U.S.-China relations are a positive catalyst for Vietnam's performance and valuation.

The goal of this tactical position is to gain exposure to the broad Vietnam economy and market rather than actively picking single name securities. In our view, a Vietnam ETF offers the most diversification and ease of trading. Our preferred Vietnam ETF is the VanEck Vectors Vietnam ETF (ticker VNM). Refer to page 5 for additional information.

From an entry perspective, VNM has entered a rising channel with the ETF making slightly higher lows and higher highs since the start of June 2020. As of 8/26/2020, VNM closed at $14.80 and is nearing the upper range of the channel. Our preference would be to let it settle lower to the $14-14.20 range before initiating a position.

Impacted ETF

Figure 7: Selected Vietnam ETF

Ticker	Company	YTD Return	Notes / Rationale
Vietnam ETFs			
VNM	VanEck Vectors Vietnam ETF	-9.0%	Broad market exposure to Vietnam; 27% real estate, 25% tech, 12% consumer staples, 10% financials, 7% industrials, and 6% consumer discretionary

Source: MarketDesk Research. ***Note:*** *The benchmark for this tactical opportunity is the FTSE All-World ex U.S. Index (VEU).*

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