When will Vietnam achieve Emerging Market status?

The Vietnamese capital markets have undergone an unprecedented transformation due to the rapid growth in the number of private investors. Within one year, 2.5 million new trading accounts were opened, pushing the total market value above 300 billion dollars due to new inflow. With a daily liquidity of nearly 1 billion dollars and 80% activity from domestic investors, Vietnam seems ready to transition to the larger Emerging Markets Index (EM index).

If Vietnam were to be included in the EM index, the country could attract significantly more foreign capital and potentially see a revaluation of various listed companies. To qualify for inclusion in the MSCI EM index, 18 criteria must be met, related to a country's economic development, market capitalization and tradability of shares, and market access. This requires a sufficiently developed infrastructure for trade and settlement of transactions.

The two biggest obstacles Vietnam still has to tackle are the Foreign Ownership Limits (FOL) and the mandatory pre-financing for transactions. Pre-financing means that you first need to deposit the local currency (Vietnamese Dong) in your account to carry out a purchase transaction. The FOLs are restrictions on the percentage of the total number of outstanding shares of a company that can be owned by foreign investors. For Vietnamese shares, the FOL varies depending on the sector and the company, but is usually between 30% and 49%.

At the moment, the most popular stocks are "closed" to foreigners because the FOL limit has been reached. Approximately 15% of the TCM Vietnam fund is invested in these FOL shares. Foreign investors regularly offer premiums above the current price to take over these shares. If the FOL for Vietnamese shares were to disappear, this would likely be beneficial for the share prices, as the lifting of the restrictions on foreign ownership could lead to greater demand for Vietnamese shares from foreign investors.

MSCI reviews the classification of countries each year and usually publishes its findings in June. Vietnam could potentially be first included in the 'possible upgrade' list as of June 2023, if sufficient progress has been made. A year later, an announcement could be made that the country is being included. If everything goes according to plan, Vietnam would actually be included in the EM index another year later. It was initially hoped that the first phase of the process would be completed by June 2023, with inclusion in June 2025. However, we believe that recent events will delay this process for Vietnam by at least a year.

Last year, the Vietnamese stock market underwent the largest correction in over 10 years (-30% in euro) after the government intervened heavily in the issuance of corporate bonds following malpractices. The CEO of Van Thinh Phat Holding (not a position in the fund) was arrested and the rules were tightened at a time when many companies wanted to roll over their loans. This reduced liquidity and caused interest rates to soar, causing stocks to plummet and even a bank run on Saigon Commercial Bank (not a position in the fund). Many investors experienced margin calls for the first time due to these sharp declines, resulting in stocks being sold off at knockdown prices and often limit down.

Therefore, the government's focus was on addressing misconduct within the system by combating both private and public corruption and refining some rules regarding bond issuance. The chairpersons of both the stock exchange and the regulator had to resign, which has led to delays in the implementation of an improved market infrastructure. The good news is that the Vietnam Securities Depository and Clearing Corporation (VSDC) was established in December 2022 and is expected to make the new trading platform called 'KRX' operational by mid-this year. This removes one of the significant obstacles to promotion to the EM index.

The above developments provide an interesting entry opportunity for investors seeking exposure to Vietnam. Due to the market correction, it is now attractively valued, with shares trading at around 10 times earnings based on expected earnings for the next 12 months. This is a significant discount compared to the average price-earnings ratio of 16.4 for the Ho Chi Minh Stock Exchange over the past ten years. Whether you consider Vietnam the largest Frontier Market or one of the smallest Emerging Markets, it is a country that could add meaningful diversification to your portfolio in the coming years.

TCM Investment Funds
May 2023

Sources:

Holding, V. (2023). A new frontier in Vietnam. *UK Investor Magazine*. https://ukinvestormagazine.co.uk/a-new-frontier-in-vietnam/

Massmann, O. (2023, 7 April). *VIETNAM FROM A FRONTIER MARKET TO AN EMERGING MARKET – WHAT YOU MUST KNOW*. Duane Morris Vietnam. https://blogs.duanemorris.com/vietnam/2023/04/06/vietnam-from-a-frontier-market-to-an-emerging-market-what-you-must-know

Outlook Frontier Markets 2023 - TCM Investment Funds. (2023, 12 January). TCM. https://www.tcminvestmentfunds.nl/blog/outlook-frontier-markets-2023/8