Yardeni Research, Inc.

MORNING BRIEFING
December 19, 2017

Good Morning, Vietnam

See the pdf and the collection of the individual charts linked below.

(1) Southeast Asia family vacation. (2) First stop: Hanoi. (3) Mopeds are like dragonflies in this city. (4) Government determined to rev up economy. (5) Enticing foreign investors with beer. (6) Next stop: Thailand, where a gift sometimes isn't. (7) The investment equivalent of a white elephant.

Vietnam I: Dodging Mopeds in Hanoi. Greetings from Hanoi! I'm just starting a yearend family vacation touring Vietnam, Cambodia, and Thailand. Hanoi is a bustling city with 7.5 million people. Public transportation is minimal. So most of the commuters travel to and from work by mopeds. There are a million of these minimalist vehicles in Hanoi and 44 million in Vietnam.

No one obeys the traffic laws as mopeds drive through red lights and go the wrong way down one-way streets. Our guide told us to look both ways when we cross the street even if it is a one-way road. He also told us to maintain a constant pace when we cross, so the moped drivers can judge whether to proceed behind us or in front of us. No wonder the locals compare the moped traffic to a swarm of dragonflies. While I am dodging mopeds in Hanoi, I asked Sandy Ward to bring us up to speed on Vietnam and Thailand. Here is her report:

Vietnam II: Frontier Dragon. Dragons figure prominently in Vietnamese folklore: Its people are said to be descended from the union of a dragon and a fairy. Dragons symbolize power, prosperity, and nobility. Vietnam is often referred to as the "land of the ascendant dragon" because the slender S-shape of the Southeast Asian country resembles that of the mythological creature rising. "Rising dragon" aptly describes its current economic status as well.

Vietnam is one of the fastest-growing economies in the world, with GDP expanding at an average annual rate of 6.4% since 2000, according to an overview by the World Bank. GDP growth this year is projected to reach 6.7% compared with an expected gain of 2.9% in GDP globally and 5.1% for developing East Asia Pacific countries, excluding China. The Ho Chi Minh Stock Index is up more than 40% ytd in dollar terms compared with a rise of 36.3% in the MSCI Emerging Market Asia share price index through December 15 (*Fig. 1*).

Despite the strong showing, Vietnam continues to be ranked as a "frontier" market by indexer Morgan Stanley Capital International (MCSI), failing to make the list of countries under consideration for reclassification to emerging market status when it was released this past summer. Hurdles to Vietnam achieving reclassification include ownership limits on foreign investment as well as difficulties converting foreign-exchange accounts and failure to meet English-language disclosure rules; these will need to be cleared before the country's status is elevated by MSCI, a 7/4 report on 4-traders.com noted.

Still, it's worthwhile to take a tour of Vietnam and examine the forces behind the current boom, especially as we mark the 50th anniversary of the Vietnam War:

(1) *Roaring GDP growth.* The economy surged in Q3, expanding at a rate of 7.5% y/y, the fastest growth since Q1-2008, on strong showings in the services and industrial sectors. Growth in the previous quarter was revised upward to 6.3% y/y. Services, which rose 7.3% y/y in the nine months through September compared to the same period a year ago, is benefiting from increased international tourism and domestic consumption, mainly from China.

Manufacturing rose 12.8% y/y in the first nine months of 2017 as foreign outfits opened more factories in Vietnam. Agriculture rebounded from the worst drought experienced in a century in 2016 and advanced 2.9% y/y in the nine months ended September. Both sectors have contributed to producing the world-leading GDP growth that is much faster than rates seen in Vietnam's Southeast Asia counterparts (*Fig. 2*)**.**

Vietnam's growth is right in line with the central bank's 2017 target of 6.7% and reduces the need for further stimulus, a 9/28 Bloomberg piece noted, pointing out that Vietnam unexpectedly lowered interest rates in July for the first time in three years. The article noted too that Prime Minister Nguyen Xuan Phuc asked the central bank to bring down bank lending rates to give a lift to businesses. After failing to meet growth targets in 2016, his first year in office, Prime Minister Phuc pulled out all the stops and also pushed for a 21% increase in credit growth, despite concerns about rising debt levels and bad loans.

(2) *Samsung exports from here.* Double-digit growth in manufacturing translated into a 22.3% y/y jump in exports in Q3. Much of that growth can be explained by the success of South Korea's Samsung and the popularity of its smartphones, Deloitte Touche Tohmatsu Analyst Lester Gunnion explained in the firm's 9/28 *Asia Pacific Economic Outlook*. Samsung represents 20% of Vietnam's total exports, and 40% of all Samsung's smartphones are made in Vietnam.

(3) *Manufacturing PMI north of 50.* The Nikkei Vietnam Manufacturing Purchasing Managers' Index dipped slightly in November to 51.4 from 51.6 the previous month, as new order growth slowed and production output stayed level. Raw material shortages drove input prices higher and led to higher selling prices for the third straight month. Yet manufacturers continued to add staff, and purchasing activity showed a solid increase, suggesting the latest conditions represent a temporary soft-patch, IHS Market Associate Director Andrew Harker wrote in a 12/1 report.

(4) *Thirsty dragon.* Bottled and canned beer represents more than 20% of Vietnam's consumer goods market. The market is growing at a double-digit rate as the economy continues to grow and wages rise, according to an 11/12 *FT* article. Already, its 92 million people drink more than 4 billion liters a year, making the country the fifth-largest consumer in Asia in per-capita terms.

The government announced plans in late November to sell a majority stake in the country's largest beer company, the state-owned Saigon Beer Alcohol Beverage Corp., or Sabeco, whose shares were listed publicly a year ago and since have more than doubled in value. Despite strong foreign interest, only one investor, Thai billionaire Charoen Sirivadhanabhakdi, has submitted a bid so far, according to a 12/12 *WSJ* article. His Vietnam Beverage Co., a unit of Thai Beverage PCL, made a $2.25 billion bid for a 25% stake. The sale is seen as a test of how serious the government is about opening the economy to foreign investment.

Thailand: Land of the White Elephants. In Thailand, white elephants are considered highly auspicious because of their association with Buddha's birth and are a symbol of divine royal power. The expression "white elephant" derives from when Thai kings would show displeasure with certain subjects by bestowing upon them a white elephant whose expensive upkeep would lead to financial ruin.

Thailand has been one of the best-performing markets this year, and the MSCI Thailand share price index is up 16.7% ytd in baht through December 15 and 28.6% ytd in dollars (*Fig. 3*). The index hit a record high on December 12 for the first time since July 10, 1995. Thailand's Q3 GDP expanded at the fastest pace in more than four years—4.3% y/y, on faster growth in agriculture and services, and higher exports—yet continued to lag the growth rates of its Southeast Asia peers.

For the full-year 2017, the government statistics agency projects growth of 3.9%, and for 2018, 3.6%-4.6%. Consumer spending should strengthen following the end of a year-long period of mourning in October for King Bhumibol Adulyadej, and a government plan to spend $46 billion on infrastructure should also provide a boost, according to an 11/19 Bloomberg report.

Still, wages are falling, household debts are high, and the ruling military junta has called for elections next year, creating uncertainty. Trading at a forward P/E of 14.9, near the top of its historical range, while forward earnings growth for 2018 is estimated at 8.0% and revenue estimates are falling, Thailand appears to be the investment equivalent of a white elephant (*Fig. 4*, *Fig. 5*, and *Fig. 6*).

CALENDARS

US. **Tues:** Housing Starts & Building Permits 1.240mu/1.27mu, Current Account -$116.7b, Kashkari. **Wed:** Existing Home Sales 5.520mu, MBA Mortgage Applications, EIA Petroleum Status Report. (*Wall Street Journal* estimates)

Global. **Tues:** Germany Ifo Business Climate & Business Expectations Indexes 117.6/110.8. **Wed:** Carney. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose to yet another record high last week for all three indexes. LargeCap's forward earnings was higher for a 21st straight week; MidCap's was higher for a 17th week; and SmallCap's has risen in 15 of the past 21 weeks. Momentum remains strong as the yearly change in forward earnings is up from six-year lows in early 2016, and should remain strong as the new tax rates take effect in 2018. In the latest week, the rate of change in LargeCap's forward earnings edged down to 10.2% y/y from a 70-month high of 10.3%, which compares to a six-year low of -1.8% in October 2015; MidCap's dropped to 16.2% from a 72-month high of 16.4%, which compares to a six-year low of -1.3% in December 2015; and SmallCap's dropped to 10.2% from 10.5%, which compares to a 39-month high of 13.0% in mid-July and a six-year low of 0.3% in December 2015. LargeCap's consensus growth rates expected for 2017 and 2018 have remained strong throughout this year instead of falling. Furthermore, the growth rates for 2018 should improve for all three indexes if the corporate tax rate change becomes effective in 2018. Here are the latest consensus earnings growth rates for 2017 and 2018: LargeCap 11.4% and 11.2%, MidCap 11.1% and 14.3%, and SmallCap 4.3% and 20.6%.

S&P 500/400/600 Forward Valuation (*link*): Forward P/E ratios were mixed for the three indexes last week. LargeCap's weekly forward P/E rose to a 14-year high of 18.4 from 18.2. It's up from a 15-month low of 14.9 in January 2016 and the post-Lehman-meltdown P/E of 9.3 in October 2008, but remains well below the tech bubble's record high of 25.7 in July 1999. SMidCap's P/Es had stalled for most of 2017 following the post-election meltup, but has been rising again recently. MidCap's forward P/E edged down to 18.3 from 18.4, and is below LargeCap's P/E again for only the third time since 2009. MidCap's P/E remains below its 15-year high of 19.2 in late February when Energy earnings were depressed and the record high of 20.6 in January 2002, but is up from a three-year low of 15.0 in January 2016. SmallCap's rose to 20.1 from 20.0, which compares to a 51-week high of 20.2 at the beginning of December and a 15-year high of 20.5 in December 2016 when Energy's earnings were depressed. That's up from a three-year low of 15.5 in February 2016, and just 0.8ppt below SmallCap's record-high P/E of 20.9 in April 2002. Prices remain near record highs for all three indexes, but their "E"s still remain low as the bottom-up consensus awaits final passage of the legislative and timing changes to the tax rate. Looking at their daily forward price/sales (P/S) ratios, valuations last week were mostly higher for the three indexes: LargeCap's P/S of 2.07 on Friday is at a record high, MidCap's 1.33 is down from a record high of 1.39 in early March, and SmallCap's 1.03 is down from 1.08 in early March and its record high of 1.17 in November 2013.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): With the Q3 earnings season completed, Q4 earnings revisions activity has slowed considerably. The S&P 500's Q4-2017 EPS forecast rose one cent w/w to $34.77, and is down only 0.6% from $34.98 at the end of Q3. If Q4's estimate holds until the end of the quarter, that would mark the smallest decrease in a quarterly forecast since Q1-2011. The $34.77 estimate represents a forecasted pro forma earnings gain for Q4-2017 of 11.7%, up from 11.6% a week earlier, and compares to Q3-2017's blended estimate/actual of 8.4%, Q2's 12.3%, and Q1's 15.3% (which was the strongest growth since Q3-2011 owing mostly to easier comps for Energy). Since the end of Q3, Q4 estimates are higher for three sectors, lower for seven, and steady for one. Energy's Q4 forecast has jumped 21.4%, followed by these sectors: Utilities (up 2.7%), Tech (2.4), and Telecom (0.0). Materials' Q4-2017 forecast has fallen 9.6% for the worst decline, and is followed by: Industrials (-8.9), Consumer Discretionary (-5.5), Real Estate (-5.1), Financials (-2.4), Health Care (-2.2), and Consumer Staples (-1.0). The S&P 500's Q4-2017 forecasted earnings gain of 11.7% y/y would be its sixth straight gain after four declines. Nine of the 11 sectors are expected to record positive y/y earnings growth in Q4-2017, and four are expected to beat the S&P 500's forecasted y/y earnings gain of 11.6%. That's because analysts expect Energy to report another large profit jump in Q4 relative to very low earnings a year ago. That's better than Q3-2017, when eight sectors rose y/y, but down from Q2-2017, when all 11 sectors rose y/y for the first time since Q3-2011. The latest forecasted Q4-2017 earnings growth rates vs their blended Q3-2017 growth rates: Energy (129.7% in Q4 vs 161.0% in Q3), Materials (25.5, 7.0), Tech (14.9, 24.0), Financials (13.6, -7.3), S&P 500 (11.7, 8.4), Utilities (9.2, -4.6), Consumer Staples (8.7, 4.8), Consumer Discretionary (5.3, 3.8), Health Care (4.7, 8.3), Industrials (4.0, 3.1), Real Estate (-1.1, 3.8), and Telecom (-1.8, -2.8). On an ex-Energy basis, S&P 500 earnings are expected to rise 9.4% y/y in Q4, up from 6.1% in Q3 (which was the slowest growth since ex-Energy earnings rose just 2.2% in Q2-2016) but down from gains of 9.6% in Q2 and 11.0% in Q1.

S&P 500 Q4 Earnings Trend vs. Past Quarters (*link*): With the December-quarter books nearly closed, the current Q4-2017 EPS forecast of $32.76 has dropped just 0.6% over the 11 weeks since the quarter's start. That's the slowest pace of decline since Q1-2011 and much better than 2.6% decline recorded for Q3 over the same time period. It marks the 27th straight quarter that forecasts have fallen, but the decline is smaller than the average 4.0% decrease over the same time period and below the average 6.4% decline in Q4 estimates since 1994. Analysts expect EPS for Q4-2017 to be up 11.2% y/y on a frozen actual basis, ahead of the 5.0% gain for Q3-2017, but that would mark the sixth straight quarter of higher EPS on a y/y basis. Since 1994, the Q4 earnings surprise has been positive in 15/23 years (all but 1995, 1997-1998, 2000-2002, and 2007-2008). We think Q4 will mark the S&P 500's 36th straight quarter of positive surprises—a streak dating back to Q1-2009 and longer than the prior 10-quarter positive surprise streak (Q1-2003 to Q2-2005).

GLOBAL ECONOMIC INDICATORS

Eurozone CPI (*link*): November's CPI rate rose to 1.5% y/y, matching its flash estimate, after easing from 1.5% to 1.4% in October. The rate remains below the ECB's goal of just under 2.0%. The main component with the highest annual rate once again was energy (4.7%, up from 3.0% y/y in October), accelerating for the first time in three months. Meanwhile, the yearly rates for the remaining components show food, alcohol & tobacco (2.2 from 2.3) slowed from October's eight-month high, while rates for both services (1.2) and non-energy industrial goods (0.4) matched October's rate. The core rate—which excludes energy, food, alcohol, and tobacco—held at 0.9% y/y, after falling below 1.0% in October for the first time since May. Of the top four Eurozone economies, inflation rates in Germany (1.8% y/y) and Spain (1.8) were above the Eurozone's 1.5%, while France's (1.2) and Italy's (1.1) were below. Ireland (0.5) and Cyprus (0.2) had the lowest rates.

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