EASE OF INFLATION SIGNAL SAVES MAY'S EQUITY MARKET?

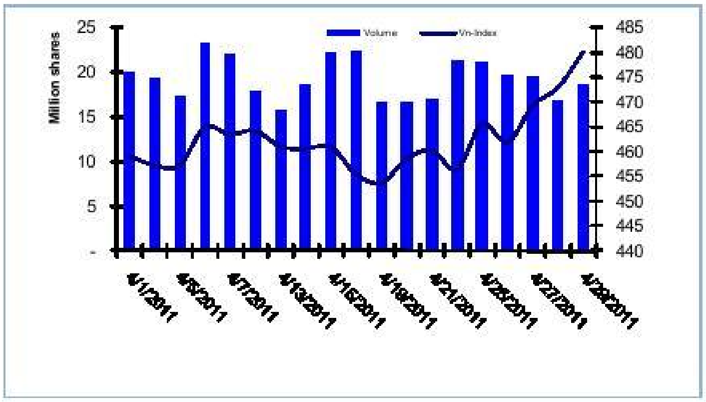
MARKET APRIL 2011 SUMMARY

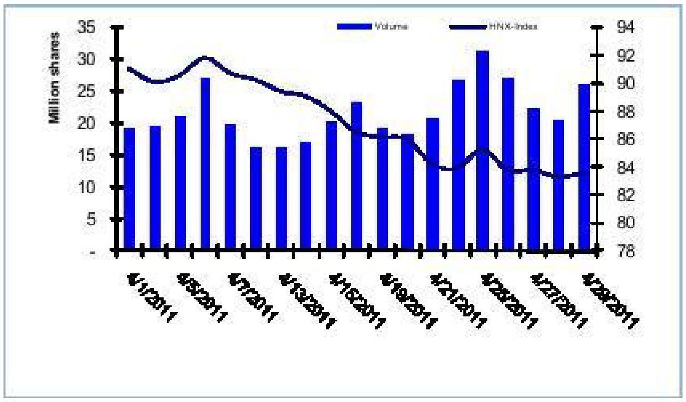
April is a contradictory month for VN-Index and HNX-Index performance (rise for VNI and decline for HNX). Trading volume went down significantly with the average of 19 million shares/session and 21.5 million shares/session for the HOSE and HNX respectively.

In April, foreigners were still net buyers with short-term trading strategy focus to decrease the average price for securities shares such as SSI, KLS, BVS, etc. They also actively bought in VCG, BVH, MSN, FPT, PVD to create upward trend for those tickers. On the other hand, although VCB and CTG were purchased heavily, the price stayed par. STB was the biggest net selling victim. EFT VNM registered to buy VCG and KLS at huge volume while the remaining cash is low, which cause confusion for local investors.

Also during April, the market has undergone though 3 upward periods, enough for T+4 on 6 April, 15 April and 25 April. VCG, SHN and BVS were the main drivers for the HNX while on the HOSE, PVD, BVH, MSN, VNM were the main players. Overall, penny stocks continued to climb down in contrast with large caps. Real estate tickers were at huge selling pressure due to the concern over the outlook of the market in 2011. Price decline of other sectors such as financial services, steel, rubber, VCx, SDx, … have been slow down.

In April, the market reacted fairly strangely when VN-Index normally picked up when bad news came and dropped when there is good news or lack of information.





Market performance in April- Source: SMES

MARKET MAY 2011 OUTLOOK

The equity market in May is receiving both positive and negative news though none of them is predicted to be significant. The biggest hope for the month is probably the downtrend of inflation compared to April. However, the forecast of 1.8% - 2.0% (Source: The Ministry of Trade & Commerce) means that the CPI is staying high compared to the same periods of previous years. With the forecasted inflation, we do not believe in any potential short-term changes in the monetary policies; hence, the cash flows are still facing numerous difficulties. Unless the interest rates are reduced, any indices rise is more temporary. In May's monthly investment strategies report, we are also commenting in depth the impacts of the excessive 'margin' lending (leveraged financing) in 2010 on the 2011 recovery probability under the pressure of the high financing costs and shortage of funds. This is one of the key reasons explaining the slower recoveries of the equity market this year even when there is good news. In general, the stock market is trading around the bottom zone in the medium term, and such should only end when per month inflation goes below 0.6% and lending rate below 14.0%. It is forecasted would take a few months ahead for those expectations to come true, so the market is yet appropriate for short term disbursement. Long-term investors might want to refer to the Quarter I earnings performance and the 2011 business plan to pick the strong fundamental firms in the shortlist, ready for BUY decisions once the outlook gets brighter.

Our comments on May stock market are based on 3 different approaches: Fundamental, Behavioral, and Technical.

Fundamental Point of View:

We are not pessimistic over the short and medium outlook of the local equity market, but skeptical on the overoptimistic comments on any surprising performance in Quarter II due to the pressure of the 3 key factors: Inflation, interest rate, and credit tightening. The overabuse of the leveraged lending in 2010 when the price was about 30% - 100% higher than the current implies the stress of the supplies of shares when the market shows signs of weak recoveries to take back the funds. Although there are good cash flows from the dividend payments in Quarter II, those might be just enough to compensate for the opportunity and/or actual borrowing costs rather than reinvestments. How those factors are going to impact May's market performance?

Inflation gets eased, yet remains high

As analyzed above, the forecasted number from the Government is 1.8% - 2.0%, in our view, is not purely positive news. Compared to the CPI of 0.27% of the same period last year, the forecast is around 6 times higher. The accumulated 12 consecutive months push the inflation rate approximately 20%. The only positive perspective is that the CPI is lower than April, which implies a downward trend for the remaining periods of the year (under the assumption that there are no further significant price adjustments of the electricity and petrol).

Even if the May's CPI turns out to be much lower than the forecast, there are stills risks that the price simply transfers to the following months. In recent years, inflation is considered stable only when it stays low at the range of 0.5% - 0.6% in the continuous 2-3 months.

A number of analysts believe that the peak of inflation is the bottom of the equity market. The relationship is not always true in this case since it depends on how the 'peak' is calculated. If we consider each month separately (this current month compared to the previous), April's CPI might be the peak unless there are new big shocks. However, if we compare to the same period of the previous years or look at the 12 consecutive month's number, the answer might be different. Some calculations and forecasts indicate that the peak is going to happen in Quarter III. That means the bottom of the equity market is going to be in Quarter III, not May. On the other hand, during the first 4 months, although the stock market experienced a series of bad news, the 450 points of VN-Index has not been broken. It means the likelihood of further drops is low. Therefore, we might consider the current market traded around the bottom zone while the lowest point is very hard to predict. With the opportunity cost of ~ 20% per annum, holding the shares for too long means that investors do make losses. A more suitable investment strategy for short traders is probably to wait until the macroeconomic outlook is brighter, opening the chances for the adjustments in the interest rates and credit growth, etc.

Ease of Inflation is not enough; Interest rates need to go down for a sustainable bouce-back

Assuming inflation will go down gradually from May as estimated, can the market fully recover? Ignoring the impacts of psychological factors, the equity market needs aggressive changes of the second 'key', which is the interest rate level. In fact, interest rate has direct impacts on the opportunity costs for investors, the cash flows into the market, the performance of enterprises, etc. Deposit rate up to 17% p.a. (including bonus), borrowing cost for manufacturing firms in the range of 16% - 20%, especially the financial services rate quoted from securities firms climbing up to 23% - 25% are creating strong barriers for market recoveries.

- **High interest rates are pushing up the opportunity costs**: Assuming VN-Index starts at 460 points. To reach the return of 17% p.a., VN-Index needs to rise to 540 points, which is too ambitious under the current circumstance. This explains why cash still stands out of the equity market and is more favourable over bank deposits. The more the interest rate drops, the lower the opportunity costs would be. If the deposit rate goes down to 12% p.a., the target of 515 points (VN-Index) in one year seems more feasible.

- **High interest rate means low financial gearing for short traders**: This includes both active and passive impacts. It means that not only investors are cautious about the services but securities firms restrict the provision of financial leverage for clients as well. Once the demand drops, raising funds at the cost over 20% without full utilization equates the erosion of profits. If the interest rate level in the market decreases, those active and passive effects will be loosened, enhancing market liquidity. In 2010, short trading cash flows were the main cause for the market upward cycles. Currently, such cash flows are being tightened, therefore, unless the interest rates go down reasonably, we are not optimistic about the prospect of a sustainable market in the short and medium term.

Potential share supplies from margin trading in 2010 are huge – Another pressure for market recovery

Since December 2010, the market seems to forget the story of margin trading and its impacts when the market pulls back. The main assumption comes from fact that securities firms announce they have withdrawn most of the funds or no longer participated in such activities. However, in our view, this is not totally true. The risks from those margin trading is going to have further impacts in 2011 any time when the indices show sign of weak recoveries. There are some noticeable reasons:

- In 2010, thousands of billions of VND were provided by securities firms for margin trading. Many of which have not fully shown on the balance sheet since the service is not legal. During the strong peak-up weeks end of November, beginning of December 2010, liquidity was maintained at the range of 3,000 – 5,000 billion VND per trading session continuously. Immediately after that, the market dropped very quickly on both performance and liquidity. Penny stocks, which used margin trading the most, lost around 30% - 50% value with minimal liquidity. In reality, those penny stocks have fallen into the 'warning' range of securities firms and legally they can take most of those assets for the prop-trading portfolio. For securities firms that used their own funding, it is much safer since they can wait for the market recoveries to sell down. However, most of securities firms raised the fund from outside, and the longer the funds are trapped, the riskier it would become:

  - Financial cost stress: Securities firms still have to pay the borrowing cost at around 20% p.a. for those funding without any revenue compensation. Clients who made lost and had to transfer the asset to securities firms have been running out of financial capability.

  - Loan call stress: In line with the limit of the credit in the non-manufacturing sectors, those margin funding is facing up with loan call risks. If the average period for those loans is between 3 – 6 months, the peak for loan call (if not extended) will fall into Quarter II. The only way to solve the problem is to sell down the portfolio from clients if there are chances. Hence, the market is still under huge pressure for 'cheap' share supplies if demand picks up. The main obstacle is where to get thousands of billions of VND to absorb those supplies if the interest remains high and credit is tightened?

- For investors with financial capabilities to maintain the margin trading accounts, the financing costs are very big while most of the small and mid-cap stocks tend to fell. The lower the price, the more cash has to be bumped into their existing portfolio to avoid bankruptcy. The market is waiting for new investors and new sources of cash, which is a long-term story, and it would only happen if the indices grow sustainably.

Then for short trading investors in 2010 and securities firms providing those gearing services, high interest rates are causing numerous difficulties as time passes. If the market remains weak for long enough, there will appear supplies of stocks at the 'floor' price at any time when the call of funds cannot be further delayed. This is a fundamental difference between the market in 2011 versus 2009, and the equity needs much more supporting factors to repeat the recovery story of 2009!

May: Liquidity is still a key concern

Since the monetary policies are preventing the cash flows into the equity market, we believe liquidity is a more important performance indicator than VN-Index or HNX-Index. At the moment, a big crash together with significant jump in liquidity (over 2,000 billion VND/session) is more ideal than the increase in VN-Index and HNX-Index with very low liquidity. If liquidity cannot exceed 1,500 billion VND/session (2 exchanges), there is no hope for a sustainable recovery: It implies that:

- It means that investors' psychology is cautious, so they are reluctant to transfer cash into stock investment channel.

- Foreign investors do not disburse funds aggressively due to the fear of macroeconomic risks.

- New sources of funds are still outside the equity market.

Overall, it is too early to expect over the short-term recovery of the market as a whole though there are weak signals on and off. The fact is that long-term economic problems cannot be solved in one or two months. It is going to take longer, and investors need to get used to the concept of 'patience' for any desired returns.

Technical Point of View:

Unlike previous years, this April experienced decrease in trading volume on the Vietnam stock exchanges. VN-Index rose around 3% in April but HNX-Index plunged more than 8%. The hike of large cap stocks helped VN-Index to escape the medium term downward trend from the beginning of February. Even so, the decreasing trading volume and lack of short-trade stocks put a large doubt on the current upward trend in the medium term. On the other hand, pennies were excessively sold causing HNX-Index to fall constantly closing to the bottom end like in Feb/2009. The lowest floor of these stocks is still a myth although some stock went down 50% recently. It can be seen that since the beginning of the year, the possession of large cap stocks is safer than penny.

- Technical analysis of VN-Index

VN-Index came back to the medium term upward trend during the last sessions of this month as it broke the medium resistance barrier. However, the current trend is unconvinced because trading volume is still low and the rebound was supported by the large cap stocks'. As such, we need more time to observe the following sessions after the holiday to determine the market's trend in the medium term. If the market bounces backs when liquidity is weak, perhaps the defensive strategy of investing on blue chips will be more suitable than focusing on pennies even though the continuous decrease of these stocks is pretty tempting. Certainly, the allocation should stay more with other large cap stocks that have not risen and have technical signals at strong support area. 450 is the first support level and 470 is the second one. The psychology barrier no.1 is at 480 and the second one is at 500.

Vn-Index technical chart:

- Technical analysis of HNX-Index

HNX-Index has been falling sharply and is currently in support level of 82.3 which equivalent to Fibonacci 161.8% on 9/3 and 21/3. From the weekly graph, HNX-Index is facing the psychology level of a strong downward trend. The falling speed of the current bubble is at an area when the index often reversed in the past and a bit worse than the 2008 downside period. The candlestick pattern has an Inverted Hammer shape. A Bullish Garley pattern also appears in the graph and RSI (14) is in the oversold area. These signals warn a reversal. Noticeably, trading volume in the weekly graph also goes up for the second consecutive week. This week's rise of trading volume and overcome of the average MA (15) with an Inverted Hammer candle pattern is very similar to a weekly graph in Feb/2009. Therefore, investors should pay close attention to HNX's movement at the present, especially after the holiday. If the market still cannot overcome the resistance barrier in the medium term after the holiday and continues to lose points, the floor seeking cycle should be taken from the similar signals in 2008. With the current signals, HNX-Index can only meet the floor after 4 weeks of trading during the floor seeking process. The support level no.1 is at 82.3 and the second one is at 79.1. The current psychology barrier in the medium run is at 86.8.

HNX-Index Technical chart:

Behavioural Point of View:

Since January, investors' psychology has almost unchanged. Low liquidity end of April despite the strong rise in VN-Index shows that investors remain cautious about the market's sustainable performance. Some factors that are impacting investors' behaviours include:

- Vietnam equity market is generally influenced vigorously by psychological factors beside fundamental indicators. Psychology is shaped on the basis of expectations. The current issue is that most of investors do not expect the market can recover before end of Quarter III, hence, behavioural factors do not well support the recoveries. Even cash is abundant in saving accounts, it is not easy for them to get transferred into the equity.

- Investors' psychology is impacted by 3 main expectations include: (i) ease of inflation to the average in coming months, (ii) loosening of credit, supporting market liquidity, (iii) interest rates for margin trading going down to the previous year's level. Those 3 factors interacted and only one of them becomes true, the others will follow up very quickly in a few weeks. In May and June, liquidity is going to reflect the expectation of investors over those factors.

- Ignoring fundamental factors, the market under the stress of psychology of investors is not suitable for short trading. Highly liquid stocks should be the main focus of investors during this period of time.

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