



Why Not Bangladesh and Vietnam?

January 2016

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"You see things; and you say, 'Why?' But I dream things that never were; and I say, 'Why not?'" --George Bernard Shaw, "Back to Methuselah" (1921)

Frontier Asia as an engine of growth in a sluggish world? Why not?

Bangladesh and Vietnam as the biggest winners in the Goldman Sachs "Next 11" universe¹ (Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam)? Why not?

Could they also lead the members of the Standard Chartered "7% Club"² (countries expected to grow at least 7% per year during the next decade: Vietnam, India and Bangladesh, Nigeria, Ethiopia, Tanzania, Uganda and Mozambique). Again, why not?

The cases for Vietnam and Bangladesh as the new leaders of global growth are not improbable or without precedent.

We have seen the Asian Tigers of Taiwan, South Korea, Hong Kong and Singapore approach developed world status from similar origins. We have seen the rise of China. We have seen India reinvigorated under new leadership. These successes are contagious among the neighboring poorer countries in the region. Today, Bangladesh and Vietnam are each growing at roughly 6%, which will double their economies in a dozen years. They are low cost producers that combine attractive labor costs with rising productivity. McKinsey³ includes both countries in its list of the "Next 15," countries that will both drive global growth over the next 10 years and become luxury goods markets themselves.



Korail slum, Dhaka, Bangladesh

¹ <http://www.goldmansachs.com/our-thinking/archive/archive-pdfs/brics-book/brics-chap-13.pdf>

² http://articles.economictimes.indiatimes.com/2011-04-14/news/29417553_1_economies-gerard-lyons-monetary-policy

³ <http://www.mckinseyonmarketingandsales.com/sites/default/files/pdf/LuxuryScope.pdf>

But today, these countries are struggling with priorities. A manager in Bangladesh recently told me “the poor in Bangladesh accept their lot.” However, it was clear, from looking around his fine office, that he hadn’t tried being poor. Meanwhile, in Vietnam, chrome and glass condo towers for the elite stand beside crumbling buildings built under the French rule of Indochina a century ago.

Both countries are in the bottom third of the ranks of economic freedom measured by the Heritage Foundation. Vietnam at 51.7 trails Russia and China, while Bangladesh at 53.9 is still lower than Nigeria and India. But the cup may be half full. Vietnam has registered one of the strongest gains among countries, improving by 24% since 1995, while Bangladesh started even lower and ended higher, gaining 39% (while the average country gained 7% over the period). Within the scores, sadly both countries are weak on measures of corruption, with Bangladesh at 27 versus Vietnam’s 31 (out of 100).

Other macro measures illustrate how these regional neighbors can follow different paths to similar high growth rates (we include Pakistan because it was once joined with Bangladesh as a single Muslim nation):

- 1) Literacy is 95% in Vietnam versus 62% in Bangladesh, and partly because of this, industry contributes 38% of GDP in Vietnam versus 27% in Bangladesh. Vietnam is moving upscale into electronics versus the concentration in Bangladesh on RMW (ready-made garments).
- 2) Women’s literacy is 93% in Vietnam, but only 59% in Bangladesh, although nearly equal to that of men, whereas in Pakistan, women’s literacy is 15 percentage points lower than men’s.

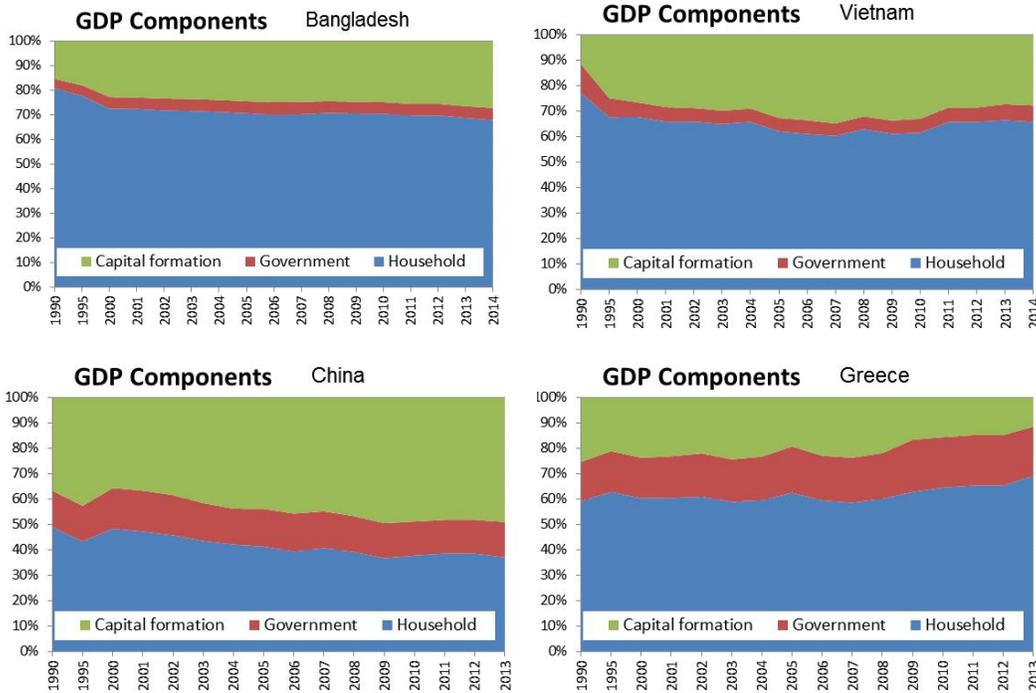
	Vietnam	Bangladesh	Pakistan
GDP Growth (2015 est)	6.0%	6.0%	4.0%
Inflation	2.0%	6.0%	6.0%
Population (mil)	94.3	169.0	196.2
People / km sq	285	1138	246
% Literate	95%	62%	55%
% Literate Female	93%	59%	40%
% under age 15	24%	32%	33%
Life expectancy	72.7	70.9	67.1
% Urban	34%	34%	36%
GDP / cap (PPP)	\$5,600	\$3,400	\$3,100
Electricity/cap kWh	1,124.6	212.8	357.3
% Unemployed	2%	5%	7%
Land (km sq)	331,210	148,460	796,095
Market Cap (\$ bil)	\$38.2	\$41.7	\$43.7
Market Cap/GDP	28%	19%	18%
GDP (Official Exch Rate)	\$186.0	\$185.4	\$236.5
GDP % Agriculture	18%	15%	25%
GDP % Industry	38%	27%	22%
GDP % Services	44%	58%	53%
Military exp % GDP	2.4%	1.2%	3.0%
Economic Freedom	51.7	53.9	55.6

Source: *The World Factbook, CIA, 2015*

<https://www.cia.gov/library/publications/the-world-factbook/>

GDP per capita for Vietnam is 50% higher than for Bangladesh, despite similar-sized economies, because Bangladesh has nearly double the population - and nearly four times the population density of both Vietnam and Pakistan.

Two things stand out about the composition of GDP in these countries: high investment and small government. As shown in the charts below, capital formation for the two countries doesn't begin to approach that of China, which has had an investment bubble. Nor do their government sectors compare in scale to those of China, or that shown in the chart of troubled Greece...



Bangladesh

"They have done so much with so little for so long, they can do anything with nothing" – Old saying

Korail is a few blocks and a short ferry ride from the Westin in the upscale Gulshan district of Dhaka. While frontier investment managers typically talk to the top 1%, the frontier opportunity is based on our hope that the "bottom of the pyramid"⁴ is breaking out of the poverty trap and catching up, following the path that many emerging countries have already taken.



Source: http://www.daily-sun.com/assets/news_images/map_of_vietnam.png

⁴ "The Forgotten Man", Franklin D. Roosevelt, April 7, 1932, radio address: "...the forgotten man at the bottom of the economic pyramid."

Slums exist everywhere in the world, and it is too easy to overlook them. Korail is a mere quarter of a square kilometer of filled land along the polluted brown water of Banani Lake. This is home to more than 50,000 people, giving it one of the highest population densities of any place on earth (equivalent to 200 people living on a quarter acre lot).

The economics of Korail are dismal. One survey (www.globalvoices.org) found that 30% of the workers in Korail are day-laborers, 20% rickshaw and van-pullers, 18% garment workers and 12% traders. Average income is \$30-50/month, and rent for an 80 square foot home is \$12/month.



Korail Dhaka Bangladesh

Kids under 15 are a third of the population, and they seem to spring out of the ground when you produce a camera, especially one that prints images. The rough alleys lined with crumbling corrugated metal shacks, make one wonder how survival is possible in this squalor, let alone progress. Yet the kids' bright faces belie their surroundings.

Something else is at work here. After visiting three one-room schools, lacking even window glass, I believe that what is at work is education. Many of these schools are run by BRAC, the world's largest NGO (the parent of BRAC Bank which we own in our portfolios). Altogether, there are 52 schools in Korail, and BRAC runs 18 of them. The World Bank measure of literacy shows a 4% gain for Bangladesh in the past two years. This is thanks to schools like these that did not exist here twenty years ago.

Ning Ma, FMAM Portfolio Manager and Director of Research, was in Bangladesh in February, 2015, in the middle of hartals (strikes) staged by the opposition Bangladesh National Party. Traffic was at a standstill, and the outlook was for escalating violence. Since then, the ruling Awami League has crushed the opposition, turning the country into a de facto single-party state. This is somewhat similar to Sri Lanka, when President Rajapaska crushed the Tamil Tigers, ending civil war and establishing an autocratic regime that brought stability. Initially Sri Lanka was treated as a pariah, but then gradually foreign agencies and investors returned. So too in Bangladesh, law and order is leading to growth and to a return of foreign investors.



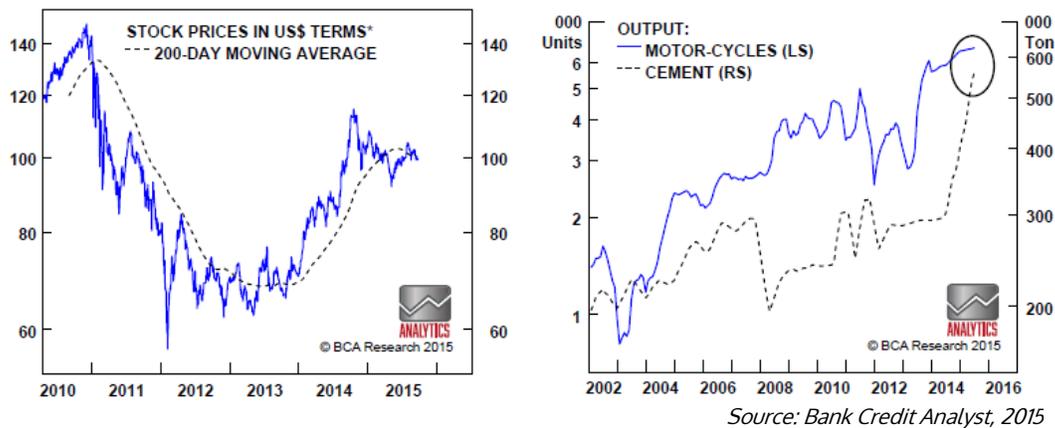
A BRAC School in Korail

One prominent foreign investor is India which strongly favors the current government. India practically surrounds Bangladesh with its border stretching 4,142 kilometers, while the border with Myanmar is merely 271 km and the coastline is 580 km. Now Bangladesh may get a boost from India's resurgent growth.

Another boost is that Bangladesh is a net energy importer, so it benefits from lower oil prices. The government has not yet lowered product prices, and while some of the gains are going to government salaries, much is going into infrastructure projects. For example, after the World Bank backed away, the government is now funding the \$4 billion Padma Bridge project, 40 km south of Dhaka, which will significantly reduce transportation costs to the Mongla Port.

Meanwhile, another sign that the government is getting its act together is that “load shedding” (power outages) are down from four hours a day to one.

Now both production and stock prices are up in Bangladesh. The stock market PE ratios are generally in double digits, but the fundamentals suggest that opportunities can still be found.



Retail investors account for 80% of stock market trading, so the market tends to be volatile. But this leads to inefficiency that is a plus for active managers. Careful research can yield rewards - so long as you don't listen to the brokers too much.

One stock that has done well is Brac Bank, 47% owned by BRAC (the NGO) and 5% owned by the International Finance Corporation. Given the mission of its parent, Brac Bank specializes in small and medium size enterprise loans (SME) with typical loans of \$1,000-\$8,000, whereas most other banks focus on SME loans of \$30,000 or more. Brac has recently introduced bCash for electronic banking to reach the un-banked 70% of the population via mobile phones, and in early 2016 they will launch bCash loans of \$150 at 18% interest.



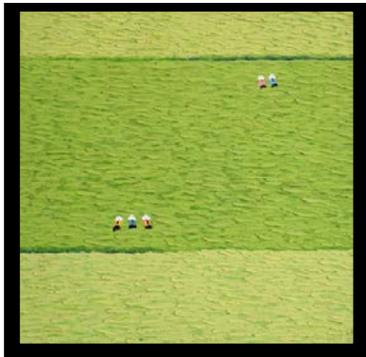
Korajl, Dhaka, Bangladesh



Vietnam

"I have to say that after 25 years in the business, I look at technicals first, and if I like them, then I look at fundamentals. VN is not a fundamental market. People don't care about PE/PB/EBITDA etc. you have to play momentum here. Eternal discussion I have with clients, but you don't want to be stock in a market that implodes from completely overvalued/overbought to the exact opposite. Vietnamese equities are only fun to invest in if your timing is right. Can't see it differently."

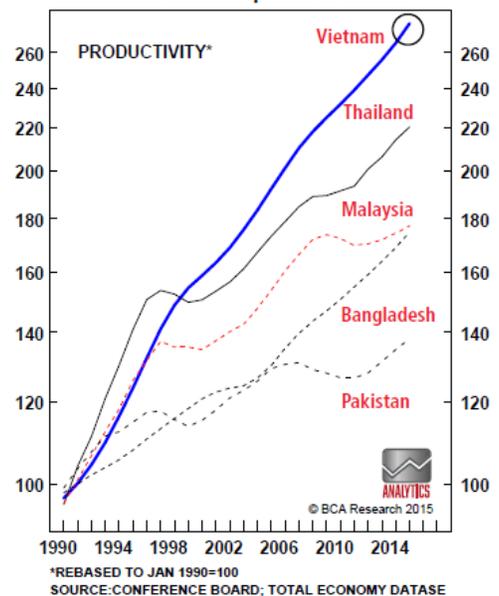
- Johan Kruijmer, Hi Chi Minh Securities, 2010



Vingroup art collection, Hanoi

The story of Vietnam is a story of productivity. The energy level of the people is high, beginning with the pace of motorbike traffic in the streets and extending into the factories, where worker output is leveraged by capital investments. Accession to the World Trade Organization in 2007, led to a negative balance of trade for five years, but the benefits are now being reaped. Electronics exports have increased from 3.5% in 2004 to 9% of exports, thanks in part to investments by Samsung and Intel. Vietnam's single party state shows no signs of changing, and government reforms in the first quarter of 2015 will be stalled by the party congress. On the trade front, however, the country received a windfall in October 2015 with approval of the TPP (Trans-Pacific Partnership) that gives significant tariff breaks to participating nations – the United States, Australia, Brunei, Chile, Vietnam, New Zealand, Peru, Singapore, and Malaysia. Vietnam is opening more to imports, as it has been the most protected country in the TPP with an average tariff of 9.5% (followed by Malaysia at 6.1%). On the other hand, Vietnam's exports of textile, agriculture, pharmaceuticals and electronics will all benefit when implementation of TPP takes place over the next couple of years.

Vietnamese Productivity Growth Has Been Superior To Others



Source: Bank Credit Analyst, 2015

Corruption remains a problem. The country has a long history of supporting bloated inefficient state owned enterprises (SOEs), and much of the private sector is characterized by "crony capitalism" as well. The Business Anti-Corruption Portal, an organization sponsored by Western governments, notes that companies doing business in Vietnam "are likely to experience bribery, political interference and facilitation payments" with "the land administration, construction sector and public administration are especially prone to corruption."

In their upscale housing development outside Hanoi, Vingroup displays paintings from the impressive art collection of its founder, Pham Nhat Vuong. He studied in Moscow and then moved to Ukraine where he started Technocom, which dominated the instant noodle business. In 2001, he moved back to Vietnam and has grown his real estate enterprise to amass a billion dollar fortune. Perhaps it is coincidence, but the government decided to build a convenient four lane bridge connecting two of his new development projects.

Complexity has also been shown to create investment challenges in Vietnam. Most companies are not content to concentrate in a single business they understand. Instead, following the Peter Principle⁵, they diversify until they get in trouble. An example is Phu Nhuan Jewlery (PNJ), <http://pnj.com.vn/en/>. The company recently divested its fuel distribution business and has been writing off its entire investment in Dong A Bank, run by the husband of the Chairwoman of PNJ. Fortunately, PNJ's basic business of designing and retailing gold jewelry is prospering, thanks to increased emphasis on its design department. At a 2016 PE ratio around 10x, the stock is interesting.

Another example of complexity is evident in the recent ownership changes at Military Bank, headquartered in a modern new office tower in Hanoi. In late 2015, the bank issued 38% dilution in the form of new shares, with a 10% stake going to the State Capital Investment Corp (SCIC) and some other major shareholders increasing their stakes, including Vietnam Helicopter (8%, up from 4.7%) and Maritime Bank (9.5% vs 7.4%). The government also allowed Vietcom Bank (7%) to retain its stake, thus eliminating their anticipated overhang in the stock. Despite these opaque transactions, however, the company continues to be a good bank and a cautious lender. Its PE is 7x and the PB is 0.9x.



PNJ Design Group, Ho Chi Minh City

⁵ The Peter Principle, Raymond Hull, Laurence J Peter, 1969

Why Not?

"Some people see things as they are and say why? I dream things that never were and say, why not?"

Robert F. Kennedy, University of Kansas, March 18, 1968



Hoan Kiem Lake, Hanoi - "I lost my leg in the war" she said, as she sold a greeting card with the cut out silhouette of two lovers.

Investing in both Vietnam and Bangladesh is like betting on both the hare and the tortoise. Vietnam is the more exciting tourist destination, and it is more exciting for investors as well (although that may not be entirely positive). In contrast, Bangladesh is the more plodding of the pair, but with its larger and younger population, it is a market full of potential. If the frontier is following the path that emerging markets travelled twenty years ago, why not view Vietnam and Bangladesh as mirroring the opportunities that China and India presented in the 1990s? Why not indeed.

About Frontier Market Asset Management

Founded in 2006, Frontier Market Asset Management holds more than 35 years' worth of investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.

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