PYN ELITE

Investor letter 1/2020

17.3.2020

PYN ELITE'S NET ASSET VALUE HAS DECLINED

PYN Elite's net asset value (NAV) per unit has decreased by 16% since the beginning of the year. The Vietnamese equity market has taken a blow from the coronavirus epidemic and has decreased by 21%, but the blow remains a moderate one because the market was cheap from the outset. The portfolio positioning created earlier on has worked well for us. We have had no stake in Vietnam's listed oil & gas companies or in the steel industry. The weight in companies with cyclical industries and construction was substantially decreased over the last two years or so. Similarly, the airlines and air traffic companies in Vietnam's equity market were absent in our portfolio. We additionally carried out a lucky stock trade late in the year, cashing in a large portion of our position in the MWG retail group, thanks to which the fund received EUR 40 million in cash after the turn of the year.

The sell-off wave in the Vietnamese equity market has dealt a much harsher blow to the most vulnerable industries compared with the index, creating an opportunity to pick some stock blocks that have become available at very attractive prices. With a few block deals, we have gradually increased the share of the damaged stocks in our portfolio. Our EUR/USD forex hedging has, as intended, leveled out the fluctuations in the NAV per unit. The VN Index currently stands at 761 points, –37% compared with April 2018, when the index peaked at 1200 points. Our target level for the VN Index remains at 1800 points. The modernization of the Vietnamese financial markets may, if successful, even create pressure to raise the target level in the next few years.

PYN Elite vs. Vietnam Index

	From the beginning of the COVID-19-epidemic	Year-to-date	6 month	1 year	VN-Index peak
VN-Index	-22 %	-21 %	-23 %	-24 %	-37 %
PYN Elite	**-18 %**	**-16 %**	**-17 %**	**-18 %**	**-27 %**

Source: Bloomberg, PYN Fund Management

ANALYSIS

An investor will in great likelihood always achieve good returns by purchasing cheap stocks from the target markets for which he/she has been able to determine a long-term growth potential regardless of global crises.

In sensitive stock market situations, daily upward and downward movements are intensive, and in a market such as Vietnam, extremely attractive block offers will become available only on bad days. Aiming at a specific absolute floor price often does not yield maximal profit.

What matters is the selection of the target market. If the market is highly priced, due to an extended outperformance, this may eat into the potential future performance for several years. Companies' profit margins have often reached their maximum limits over the previous years and substantial profit increases may be difficult to achieve in the future. If continuous economic growth has been created by increasing public debt, the potential for overall future growth may have been eaten up already.

The stock markets of the countries where growth is structurally sound are not spared from stock market crashes but, as a rule, they always rebound similarly to a fairly sharp V curve, in other words the recovery after a crash is relatively rapid.

NO NEED TO WORRY ABOUT VIETNAM

When Vietnam goes through a global recession, it means only 5% GDP growth. This happened in 2009, when the harm to the real economy left a dent in Vietnamese exports. The global financial market went into a crisis in 2008 and foreign trade decreased –23% year-on-year over 2009. Vietnamese exports went down 8% during that same year, while the country’s share of the global foreign trade grew from 0.39% to 0.46% over the same period.

Vietnamese exports in 2008-2009

Vietnam exports	2008	2009	Change
World foreign trade	16 108 billion USD	12 385 billion USD	-23,0 %
Vietnamese exports	**62,79 billion USD**	**57,52 billion USD**	**-8,0 %**
Vietnam's market share	0,4 %	0,5 %	

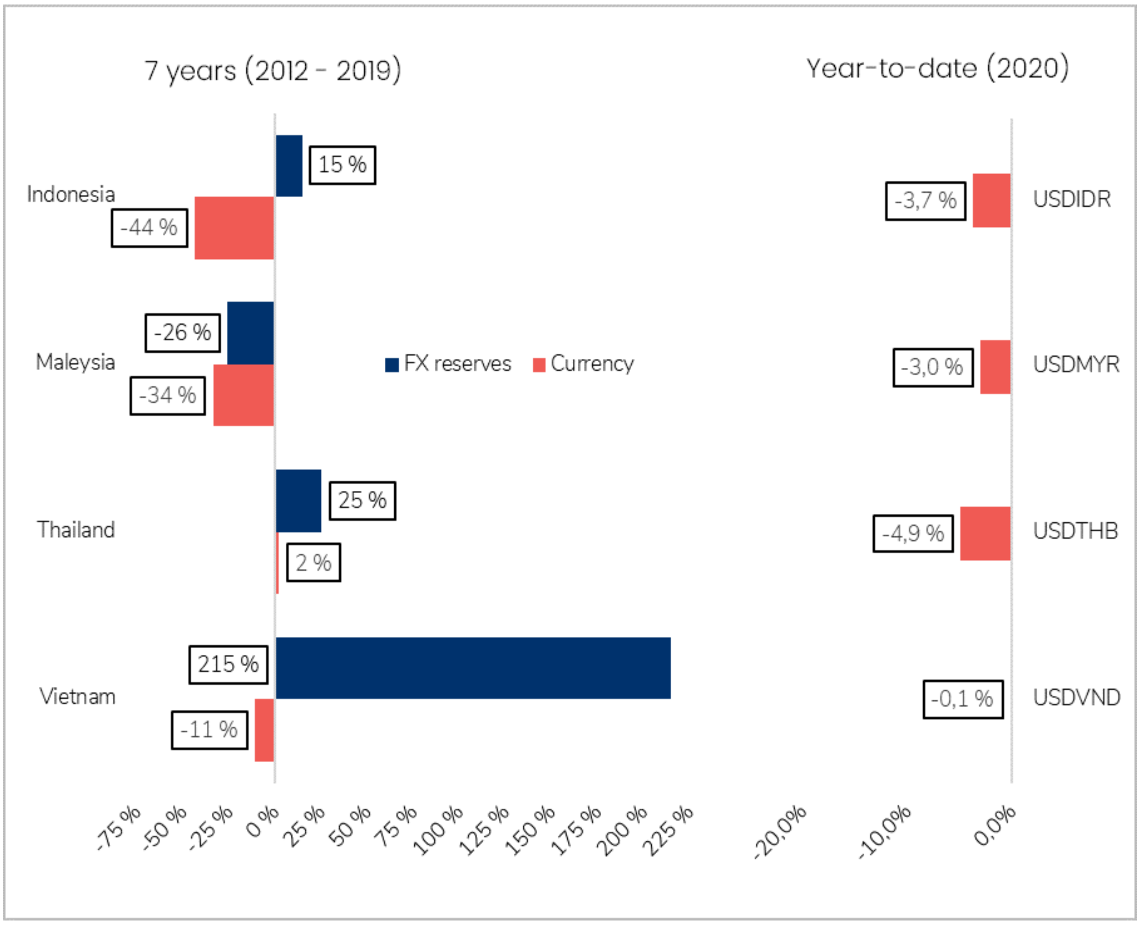
Source: IMF

Vietnamese exports are highly competitive, and the industrial capital expenditure has been very strong in recent years, and as a result, many industries have modern production plants. The country’s exports also benefit from diversity, ranging from cell phones and coders to rice and fruit and everything in between. When China closed its borders, it froze the fruit and vegetable exports. Now, with China recovering and the borders open again, this category of export trade is likely to be among the first ones to recover, while Western exports to the US and Europe are threatened by substantially diminishing demand over the next few months.

DONG HAS SUCCESSFULLY RETAINED ITS VALUE

In previous years, Vietnam’s central bank allowed the country’s currency to devaluate 1% to 3% per annum in order to bolster exports and the growth of the forex reserves. These goals have been achieved. During the last couple of years, the Vietnamese dong has remained relatively stable while the other Southeast Asian currencies have zigzagged up and down. At the dong’s current level, Vietnamese exports have remained quite competitive and the dong is not subject to devaluation pressures for the time being. The situation may even see a reversal in the coming years. Vietnam may allow its currency to gain strength, but the time is not ripe yet, as the country is being industrialized at a vigorous pace. The Vietnamese financial system is open only in part, and the central bank could continue to take rather stark measures to steer financial activities also in the future. Vietnam’s foreign debt is very low, less than 40% of the country’s GDP. Long-term debt constitutes 80% of Vietnam’s foreign debt, which amounts to USD 110 billion in total, and most of the foreign debt, 61%, consists of public sector loans, mainly long-term project financing from international, inter-governmental institutional debt. Should the global financial system end up in a state of shock during this year or in the next few years, the repercussions to Vietnam would mainly be felt in the form of decreased exports demand and investments, coupled with ruined performance in the stock market due to the negative sentiment, but even then, the impact on the real economy could still be limited.

VIETNAM DONG VS ASEAN CURRENCIES

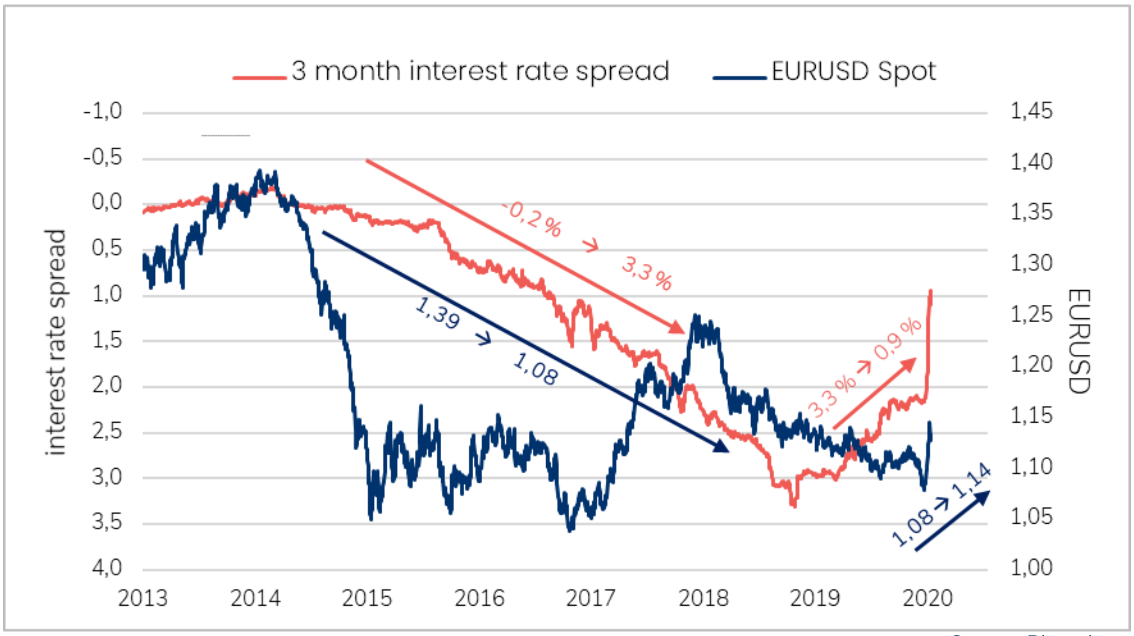


Source: Asian Development Bank (ADB), Bloomberg

PYN ELITE'S FOREX HEDGE

We started to hedge our EUR/USD exposure with forward contracts in the spring of 2019, with the intention of keeping the exchange rate of this currency pair fixed over the next few years. The core idea of this measure was to lock up the benefit we gained from the weakening of the euro from 1.55 to the 1.10 level over the previous years. We maintained the hedge roughly for a year, during which time the currency pair moved moderately up and down, and our hedge eliminated this fluctuation from our portfolio. Consequently, the changes in the NAV per unit were almost exclusively aligned with the changes in the share prices of our portfolio stocks. It is impossible to predict short-term or even medium-term fluctuations in foreign exchange rates. As regards long-term historical correlations, however, there are data and indications available for determining if the currencies may perhaps undergo similar changes in the future, too. As for the EUR/USD pair, the indicators monitored by us include the changes in the interest rate spread. When we started out with our hedge, the interest rate spread was more than 3%. In our view, the interest rate spread may remain more narrow in the coming years and this could result in higher valuations of the EUR/USD pair.

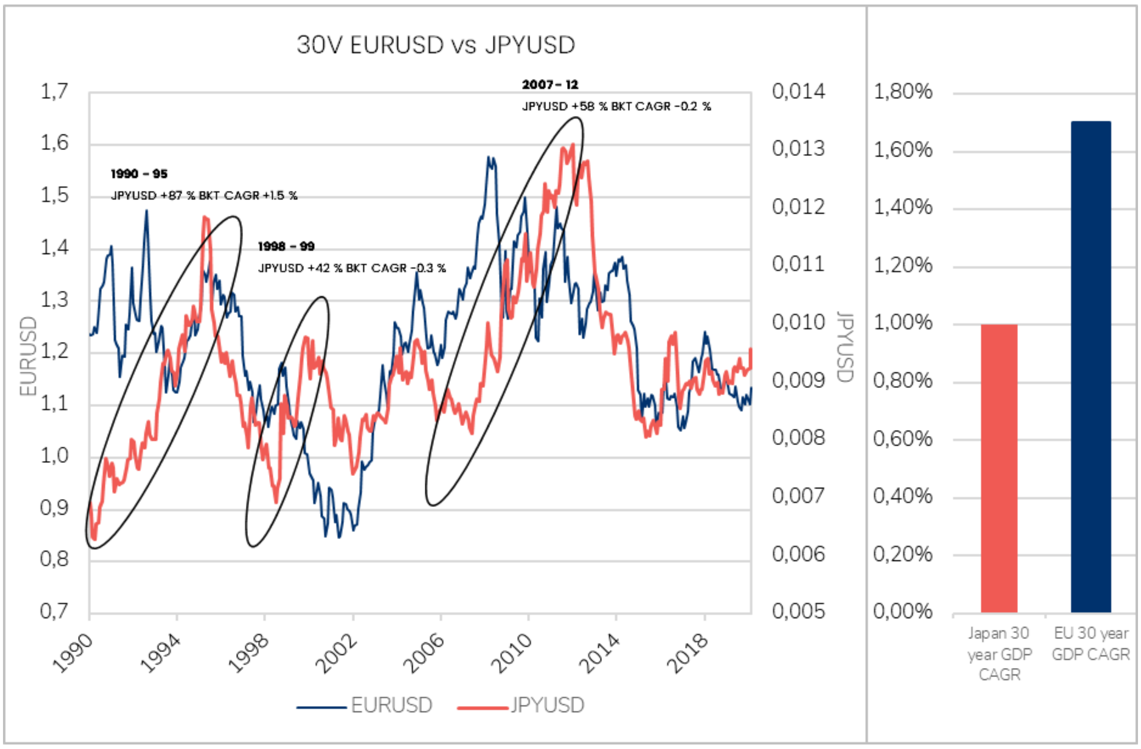
USD EURO INTEREST DIFFERENTIAL



Source: Bloomberg

Due to the unpredictability of currency movements, it is sensible to look into the events over a long term and the circumstances in which such movements have taken place. The forecasts envision a period of slowed down economic development in Europe, similarly to Japan, and there may be valid reasons for this. The graph below shows the circumstance in which the Japanese currency moved stronger during the last 30 years. Interestingly, the Japanese yen has experienced three surprisingly clear periods of appreciation relative to the US dollar even though Japan's economic growth has been fairly negligible for 30 years and the years in which the yen strengthened didn't even coincide with stronger periods of growth in the economy. Granted, this analysis only represents one simplistic way to gain some insight into this difficult topic linked with several contributing factors.

JAPANESE YEN BIG MOVEMENTS WITHOUT ECONOMIC GROWTH

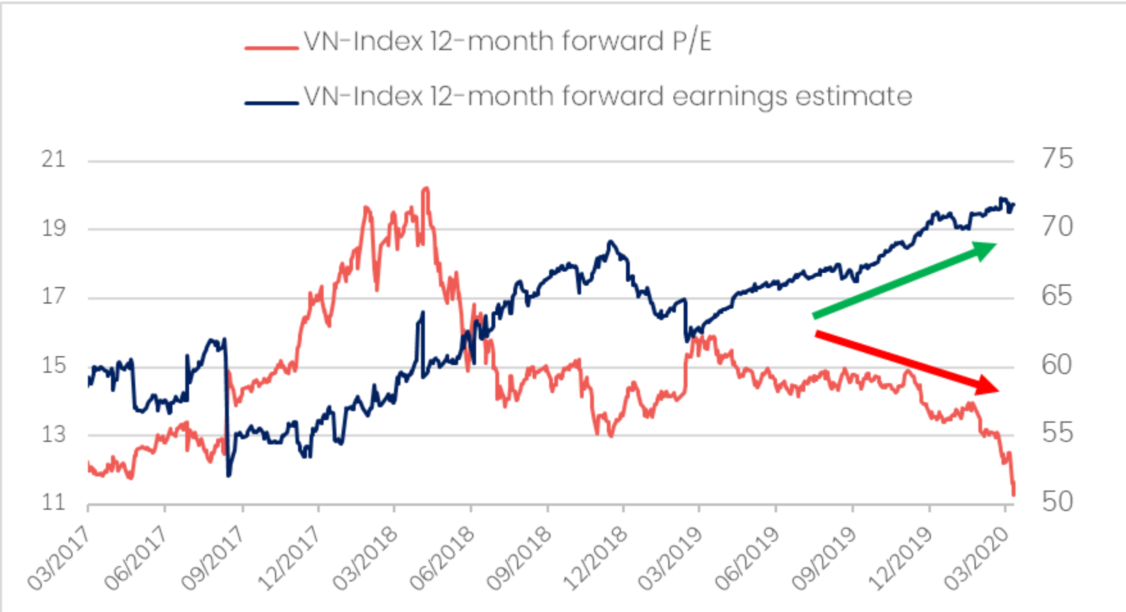


Source: Bloomberg, World Bank

VIETNAMESE LISTED STOCKS ARE CHEAP

The VN Index reached a high level in terms of the PE valuation in April 2018 and the stocks started to cool down after that. However, the trend of the listed companies' forecasted earnings has continued to move upwards while the market's PE valuation has slipped down. This has resulted in pressure for a renewed surge in stocks, to avoid the entire market PE dropping too low, considering the excellent earnings forecasted for Vietnam in the next few years. In view of Vietnam's long-term growth forecasts, the country' stock market would easily tolerate a PE level of 15. Now the VN Index PE for 2020 has dropped to 10.6 and Vietnam All Shares trades at a PE of 8.6. With such average figures, the Vietnamese market of course offers a huge number of ridiculously cheap stocks, with PE valuations around 6. Vietnamese manufacturers are running their plants at high capacity and production hasn't halted at any point. However, Bloomberg's consensus earnings estimate for Vietnamese listed companies will also without a doubt be cut back substantially in the near future, depending somewhat on the industry.

VN-INDEX IS VERY LOW PRICED



	12 month P/E	2020 P/E
VNX All Shares	9,3	8,6
VN-Index	**11,4**	**10,6**

Source: Bloomberg

PYN ELITE 2020 YTD

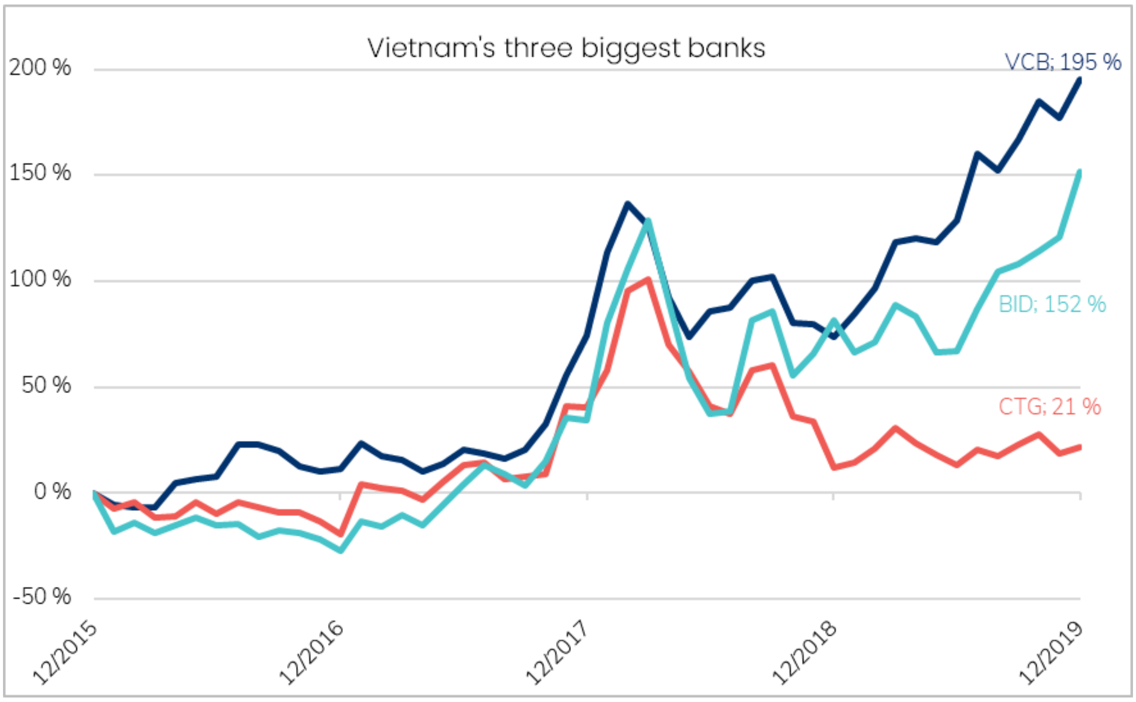
Since the start of the year, we have purchased Vietnamese stocks for a total of EUR 56 million and sold them off for EUR 11 million. The fund received the cash from the MWG trade concluded in late November no sooner than in January, after which the fund has had access to generous cash resources. Much of it was used to purchase a block of shares in the CTG bank already in the second week of January, before the COVID-19 chaos, but even that has so far turned out to be a successful trade. Since then, we have bought stocks from industries devastated by the virus outbreak at block prices we have felt good about. We sold off a small illiquid position in the Vietnamese car dealership chain SVC during the upheaval. An ownership tussle in the company opened a window of opportunity for our sell-out. We booked a slight loss from the deal, but even so we got a higher price from the block sell than would have been possible at the start of the year. We got EUR 3.6 million in cash from the deal. In addition to the CTG bank purchase, we have added to our portfolio entirely new stocks: Vietnam's airport operator ACV, Saigon's air cargo company SCS as well as a few other target companies we have been accumulating.

We have also had some additions to our current positions. The February subscription round brought in more than EUR 7 million in new net subscriptions, which is also one factor contributing to our current positive operational status.

KEY ALLOCATION CHANGES CTG

Vietinbank (CTG) is one of Vietnam's three biggest state-owned banks. VCB has enjoyed the best management out of these three banks, while BID and CTG have shared second place. The number-two banks have had old balance sheet provisions allocated over several years, an inheritance from Vietnam's homegrown 2010–2012 recession. The Japanese MUFG bank has a substantial holding in the CTG bank and is understood to be willing to significantly increase its role, but the Vietnamese Ministry of Finance has not allowed this so far. The CTG bank's owners have also included the World Bank's investment arm IFC. Some of the owners have grown frustrated with the positive but very slow development over the last few years. CTG's provisions substantially decreased precisely at the end of 2019, however, and the coming years seem promising, both regarding the easing up of the provisioning pressures and eventual ownership reorganization. One of the bank's owners kept a substantial block of shares available at a high price for more than a year. Word passed around and, due to this offer, the stock market did not react to the positive earnings development during 2019 and the stock remained sluggish. We participated in clearing up this block and the stock has since gained in vigor. We have high expectations of this allocation in the next few years, even though the virus epidemic will temporarily weaken also the Vietnamese banks' earnings growth.

VIETNAMS BIGGEST BANKS



Ticker	Earnings 2016	2019	Earnings growth %	Stock return %
VCB	5 632	16 662	196 %	195 %
CTG	**5 333**	**7 096**	**33 %**	**21 %**
BID	4 603	6 449	40 %	152 %

Source: Bloomberg, Company financial statements

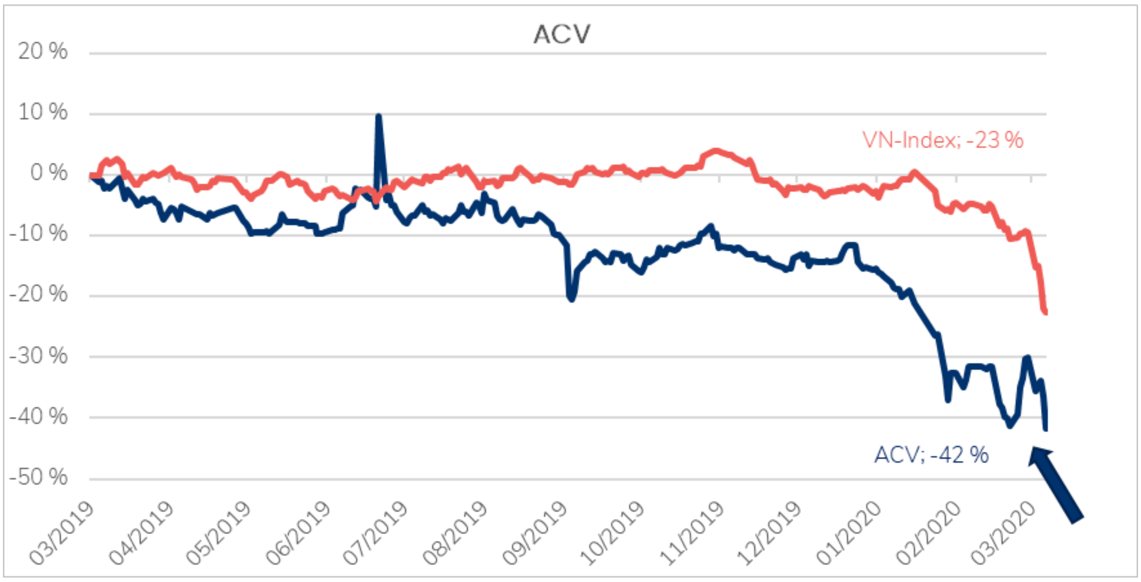
ACV

ACV owns and operates a total of 22 of Vietnam's biggest airports.

	2017	2018	2019
Revenue	13 830	16 089	18 292

The company's EBIT margin has remained at the 50% level. Only 20% of ACV's revenue consists of income other than air traffic fees, while the corresponding figure at many other Asian airport companies is nearly half of the revenue. It can indeed be expected that an increasing share of ACV's revenue growth will, over the next few years, come from airport premise leases and passenger-focused business, in addition to an increase in air traffic. For the last couple of years, during Vietnam's weak stock market cycle, the stock has traded around 80,000 to 90,000 dongs per share. The coronavirus has stopped international air traffic and the drop in revenue and smashed earnings will be significant for the next few months. However, this has not changed the company's growth outlook for the coming years. The share price dropped close to 50,000 dongs. We managed to negotiate a block deal for a purchase price of 48,500, below the stock market price. The price level may vary a lot over the next few months, but we believe that we made a good deal in compliance with our Vietnam strategy. The stock now amounts to 3.3% of the portfolio.

ACV PRICE CHART

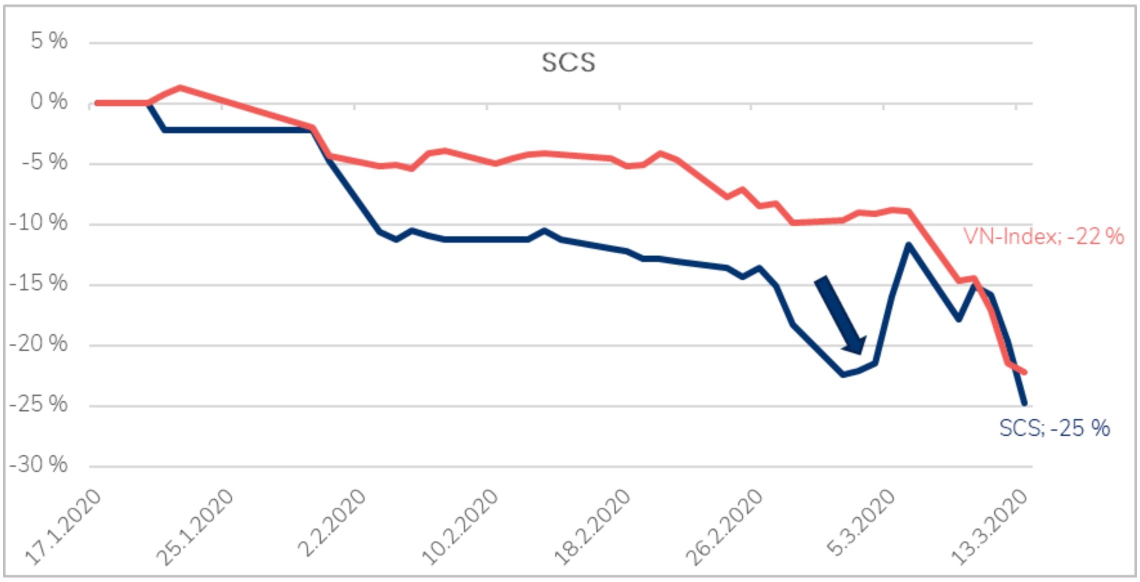


Source: Bloomberg

SCS

The air cargo company SCS has so far survived the current situation with very little operative damage, but the stock has already come down from last fall's 160,000-dong level, as one foreign fund started to sell off its shares. SCS is already well known to us because the company's shareowners include the port and logistics company Gemadept, one of our previous holdings. The SCS shares were already then a crown jewelry in Gemadept's balance sheet. The share price has come down further 25% during the Covid19 sell-off wave and we grabbed a block when the share price had declined by 22%. SCS now amounts to 2.7% of our portfolio and the latest share price is 100,000 dongs.

SCS PRICE CHART

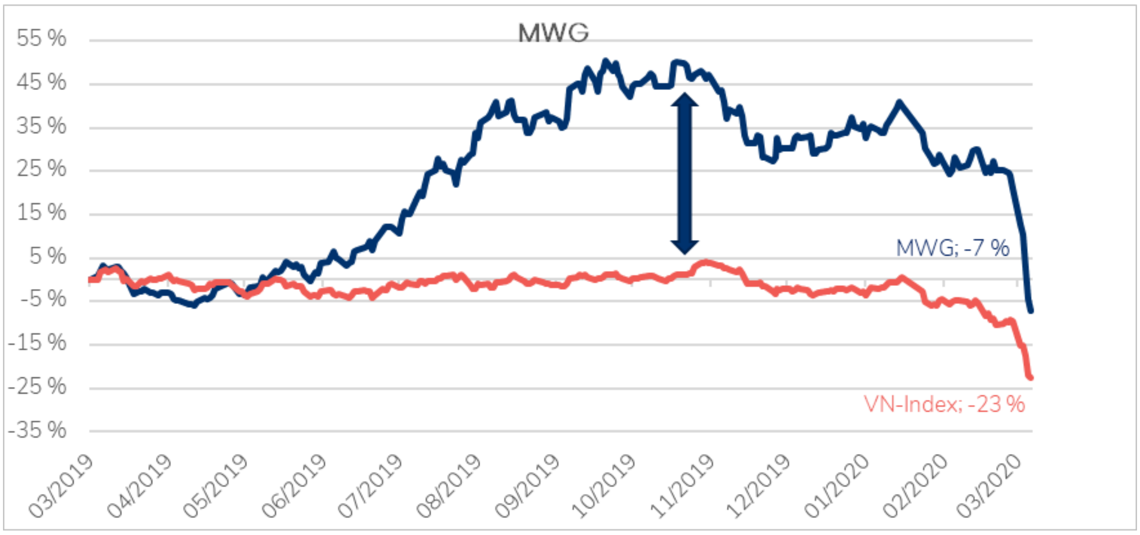


Source: Bloomberg

MWG

For a long time, we have appreciated the retail group MWG's way of growing and still maintaining the group's overall earnings growth, even during new business launches. MWG is an exemplary company in Vietnam, perhaps the best managed in the entire stock market. However, we decided late in the fall to halve our position and cash in the accumulated very sizable return because other interesting opportunities appearing simultaneously in the market. Because the stock has the biggest weight in our portfolio, the sale freed up room for the other stocks to increase to the 20% maximum weight specified by our portfolio rules. According to the rules, at most two stocks may reach this limit at a time. We timed the sale to coincide with the moment when the MWG stock had outperformed the VN Index since summer 2019 and we additionally acquired a substantial premium price compared with the local stock exchange price. Our continued expectation is that MWG will be successful, even though we recently concluded another deal with its shares, at a price we felt was very good. It will not be until April, however, before the cash from this deal will be in the portfolio. We believe that the MWG share's current position is in balance with the rest of our portfolio. The coronavirus has substantially brought down the MWG share price because one of the group's outlets had to be closed due to a salesperson becoming infected by a customer. The resulting sell-off wave is entirely out of proportion and the share will have a lot of room for an upward rebound from these levels.

MWG PRICE CHART

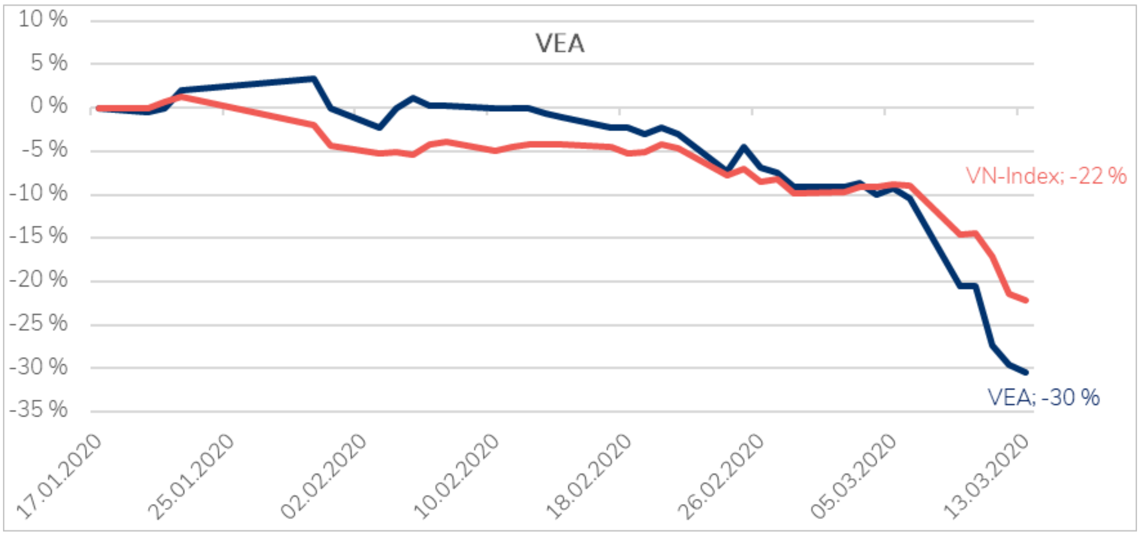


Source: Bloomberg

VEA

Even while we sold off the car dealership SVC, we simultaneously increased our allocations in the car and moped plant owner VEA. The single most important product made by the company's three plants is a Honda moped, whose market share in Vietnam exceeds 70%. All three plants target their products for Vietnam's domestic markets, and we believe that at some stage in the next few years, the plants' car sales will overtake mopeds in terms of the company's earnings. The February sales figures were good for Honda mopeds, but we expect the company's car sales to suffer from the current situation, and even the moped market will probably take a blow. The plants have improved their capabilities to start producing electric mopeds and cars, and each car plant is managed by international executives selected by the brand owner (Honda, Toyota and Ford). The VEA holding company is old-fashioned and still under pressure from the previous governance practices, but things are going in the right direction and the subsidiaries operate independently, unharmed by this legacy. China published rather chilling figures of crashing car sales in February, and this has undoubtedly contributed to the VEA's falling share price.

VEA PRICE CHART



Source: Bloomberg

COMMENTS

We have adjusted the earning figures of our key positions downwards in real time as the virus outbreak progresses. The graphs and market key figures used in this letter are from Friday March 13, 2020. On that day, PYN Elite's main positions, which represent 82% of the entire portfolio, stood at average PE rates of 7.0 for 2020, 5.7 for 2021 and 4.8 for 2022. The figure for 2020 now seems slightly too optimistic, considering how unpredictable the situation is, but in view of the next few years' earnings growth, I have great confidence in our portfolio selections and the earnings outlooks of these companies.

We have heard encouraging news from China and South Korea on overcoming the epidemic. Vietnam has managed to keep the infections well under control, but many companies in the retail and service industries are in trouble because of the ongoing global epidemic, both due to the impact on tourism and also due to local people being less inclined to go out in public. The European and US economies will suffer a substantial decline in their GDPs over the next few months. The situation will hit US growth especially hard, as the retail and services to the private sector make up such a prominent portion of the GDP. Vietnam's GDP growth will not reach the targeted 7% level in 2020, but there is no reason to question the Vietnamese economy's capability to continue growing even this year.

I would like to finish by leaving our clients with some numerical data which, while perhaps being somewhat tragicomic, may offer some comfort. PYN Elite's NAV per share declined 8% early in 2003 due to the SARS virus, but at end of the SARS year, the fund had scored the biggest annual increase in its history, 199%. Perhaps it is also appropriate to add one more sentence here: previous returns are no guarantee of future returns.

I would like to humbly thank our loyal clients for riding out the situation. Let's head into the future together.

PYN ELITE

Petri Deryng

Portfolio Manager