Naomi Waistell
Portfolio Manager
Naomi joined Polar Capital in August 2020 as a Portfolio Manager on the Polar Capital Emerging Market Stars Strategy. She has 15 years of industry experience.

Indonesia and Vietnam: Rising stars in emerging markets

We look for growth opportunities. It is at the core of all we do. When looking top-down across our Asian markets, a couple stand out as benefiting from compelling, structural changes that are reshaping emerging markets over the medium term: Indonesia and Vietnam. We have long invested in these countries, but global shifts have compounded their advantages and growth potential. There are a number of observable similarities between the two, including strong GDP growth, being key beneficiaries of global supply-chain redistribution, big corporates moving in, young populations of ample size and high targets for GDP-per-capita improvements. However, there are differences too in terms of the types of investment opportunity, the political situations, the challenges faced and the maturity of the capital markets. I visited both countries earlier this year to take a closer look.

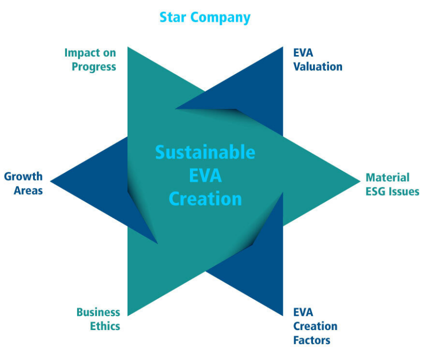
Indonesia

There is no stronger message that can be sent at a private investment conference than the country's President opening it. That is exactly what happened earlier this year when I was in a large hotel auditorium in Indonesia, one of just a handful of foreign investors at a 600+ strong forum at which most were clothed in traditional batik tunics, creating a sea of colour as we stood for the Indonesian national anthem and in walked President Jokowi (Joko Widodo). It was a palpable moment in which the gear changed in the room and the air was imbued with tangible respect. It was hard not to sit a little closer to the edge of my seat and turn up the volume on my translation headset. Just as well as when he addressed the room he was softly spoken and amiable, funny even: "Dealing with Covid, I lost a lot of sleep", he said, "but not a lot of weight".

Source: Polar Capital

Jokowi the joker is deceptively laid back. He has been in power in Indonesia since 2014 and has earnt high esteem for steering the country from being an infamous member of the 'fragile five' (a group of emerging markets with twin deficits), to now, one of the fastest five emerging markets according to IMF forecast GDP growth rates for 2023.

Quality and distribution of growth is important for the future of Indonesia. Some of the President's themes were about ensuring that no-one is left behind as they target increasing GDP per capita to \$21,000-\$29,300 by 2045 (from below \$5,000 currently). Social concerns of this kind are not seen as a luxury, but an essential building block for a resilient economy and stable political system. Another clear priority of Jokowi's time in office has been an ambitious infrastructure rollout, with 21 airports, 18 ports and close to 2,000km of new toll roads constructed. Redistributing more growth across ex-Java regions to benefit more of Indonesia's >17,000 islands is seen as vital. Jokowi is evidently and rightfully proud of the considerable progress that has been achieved so far, but has a new vision for what Indonesia can be and is capable of. Manufacturing in Indonesia has been declining and the services economy is not in high value-added areas. The ambition of the country's new industrial policy targets a greater share of value-added areas by gaining more from their natural advantages in resource richness, rather than just exporting the raw materials: down-streaming. This is to encourage investment and greater return, is seen as Indonesia's just desserts and is the flagship policy and economic opportunity. For too long, the government believes, low income countries like theirs have got too comfortable simply digging up and shipping out basic ores, as that is the fastest route to cash – but not anymore. Jokowi's message was clear – Indonesia "cannot be satisfied" with this approach if they want to catapult their value creation and potential to become a developed nation. The government projects down-streaming can increase GDP by \$699bn and create 8.8 million jobs over the next decade – a huge impact.



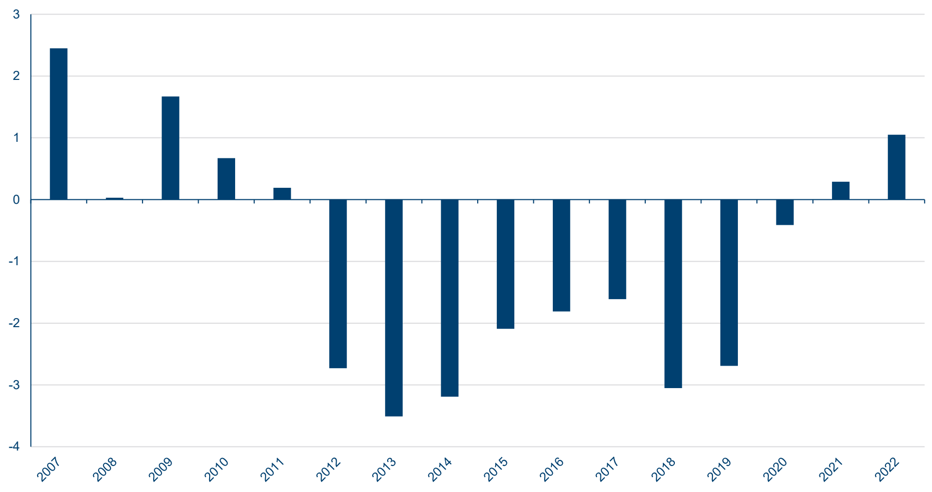
All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

"Indonesia is likely to be the first market in Asia to begin its monetary easing cycle later this year. Inflation has started to roll over and the central bank kept interest rates on hold at their last meeting in April"

The ultimate goal is to become a hub for electric vehicle (EV) batteries, as Indonesia is home to almost all the necessary metals for that supply chain and is partnering with Africa for access to lithium. Given the nature of the archipelago, with various resources located on different islands, logistics to integrate all this will be a challenge, but one Indonesia seems intent on surmounting for the potential size of the reward if they can become one of the largest EV and parts producing nations.

Additionally, the recent turnaround in Indonesia's fiscal health appears sustainable. Economic policy has been tightly managed, leading to a better-than-expected recovery from the pandemic after being hit hard. The fiscal deficit widened from -1.8% GDP pre-pandemic to a low of -6.3% in mid-2020, far beyond the 3% GDP band typically set, but 2021 outperformed budget targets and the fiscal deficit was further halved in 2022, from -4.9% to -2.4% with the addition of support from strength in the commodity sector. The strong recovery is attributed to swift, targeted action supporting the bottom end of the economy and SMEs in particular. The current account also hit record surplus levels in 2022, having returned to surplus for the first time in a decade in 2021 due to the export growth demand and price rises in commodities. Given the ongoing diverging trends in goods exports and imports so far in 2023, Indonesia could record a third year with its trade account in the black.

Indonesia: current account balance (% of GDP)

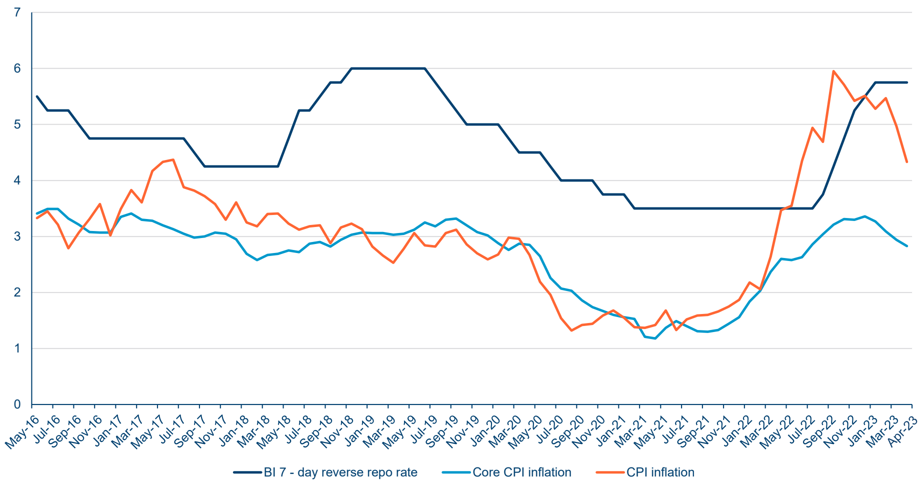


Source: Bloomberg, as at 31 December 2022.

Indonesia is also likely to be the first market in Asia to begin its monetary easing cycle later this year. Inflation, which never reached the heights of some more developed markets, has started to roll over and the central bank kept interest rates on hold at 5.75% at their last meeting in April, with Bank Indonesia intimating they see the potential for it to come back within their target range by August. This fundamentally stable macro outlook bodes well for its investment backdrop.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Bank Indonesia policy rate and Indonesia's CPI inflation (%)



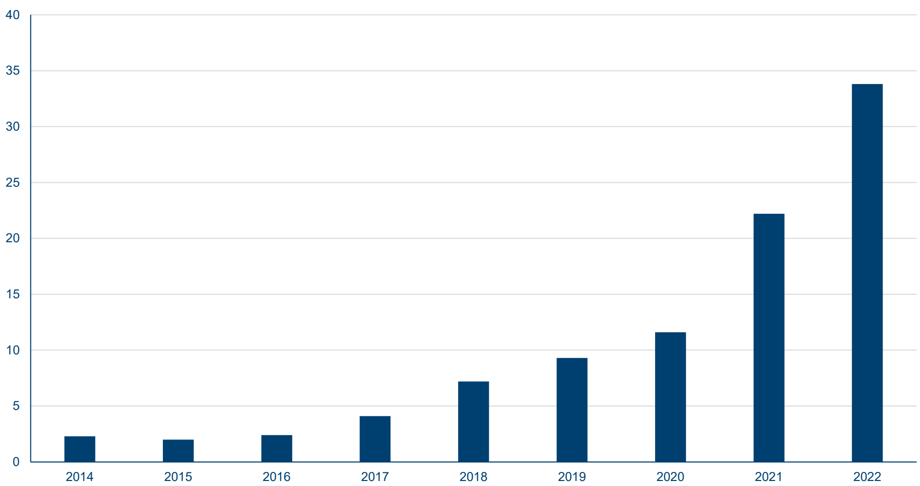
Source: Bloomberg as at 28 April 2023.

Indonesia's flagship down-streaming strategy and EV ambitions

Commodities dominate Indonesia's exports, accounting for 53% of all exports in 2022. The country is resource-rich but processing-poor, something it wants to change under the new economic vision. It boasts material global market share in numerous key materials including tin, steel, copper and, importantly, nickel. A number of these metals are set to see sustained high demand due to the global energy transition and the EV revolution, and Indonesia will be one of the largest producers of 'green metals' globally. The government wants to incentivise global companies to invest and build plants in Indonesia, not just buy their materials. Bringing production industry closer to the mine to gain efficiencies might make sense, especially if the metals can be consolidated.

"Indonesia boasts material global market share in numerous key materials including, importantly, nickel…[which are] set to see sustained high demand due to the global energy transition and the EV revolution, and Indonesia will be one of the largest producers of 'green metals' globally"

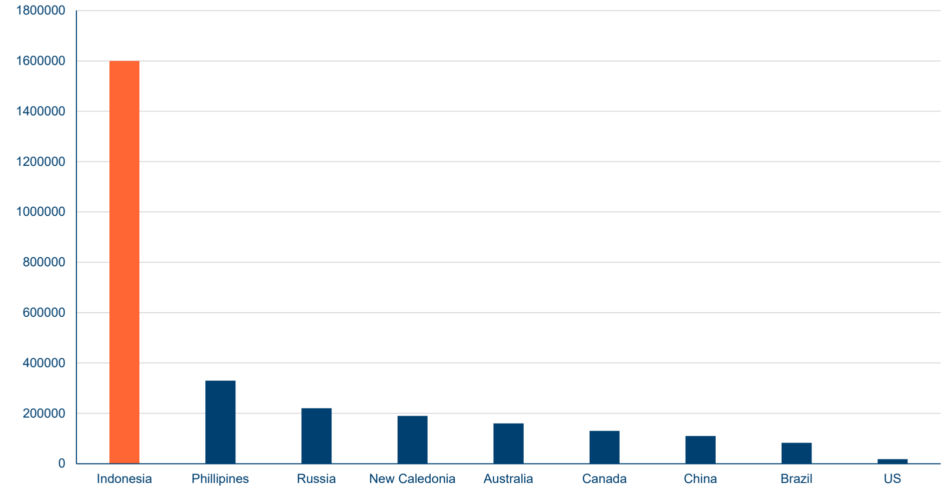
Nickel and its downstream export product, Indonesia (US$ billion)



Source: Bank Indonesia, 2023.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Top nickel producing countries (2021, metric tons)



Source: Investing News Nickel INN, 23 February 2023.

"Indonesia does not want to be the Saudi Arabia of clean fuels but would rather capture more of the higher-margin parts of the value chain"

For now, nickel is the biggest opportunity, with Indonesia the world's largest producer and home to vast resources. This has been the focal point of the government's down-streaming goals. The nickel strategy is a long-term policy which recognises that though today nickel's dominant use remains stainless steel, the sheer volume needed to meet the rise in demand for nickel-rich electric batteries as the world decarbonises could see that end market account for 30% of overall nickel demand. Indonesia is aware how well-positioned it is for this era, however does not want to be the Saudi Arabia of clean fuels but would rather capture more of the higher-margin parts of the value chain. Therefore, the government has been set on garnering greater investment into ore processing, battery making and even the delivery of finished EVs.

The first step in this was an initial ban on exports of nickel as early as 2014, forcing domestic metal processing, and while this was slightly relaxed for any low-grade product to help with the budget deficit during 2017-19, a full ban on any export of nickel ore has been in place since January 2020. In 2022 a further extension to the ban was implemented, covering processed product with less than 70% nickel content – a sign of pushing ever more firmly towards the export of value-added goods. The result of this is that nickel exports have skyrocketed from $2.4bn in 2016 to $34bn in 2022.

The types of nickel required for the traditional stainless steel market and the new, high-growth EV battery market are quite different and Indonesia's natural laterite (or limonite) deposits are predominately what is called Class II nickel (or nickel pig iron) and not as easily lent to battery-making as Class I, a sulphate material which contains a minimum of 99.8% nickel. The world's largest source of Class I nickel, however, was Russia with 20% of supply, meaning supply of this sought-after mineral is tighter than ever. Evolving technologies mean Class II laterite ores can be processed in HPAL (high pressure acid leach) smelters to produce an intermediate product called MHP (mixed hydroxide precipitate), which is then able to be refined further into Class I or, excitingly, MHP can also be directly used in the production of battery cathodes and anodes.

Nickel battery value chain from laterite ore

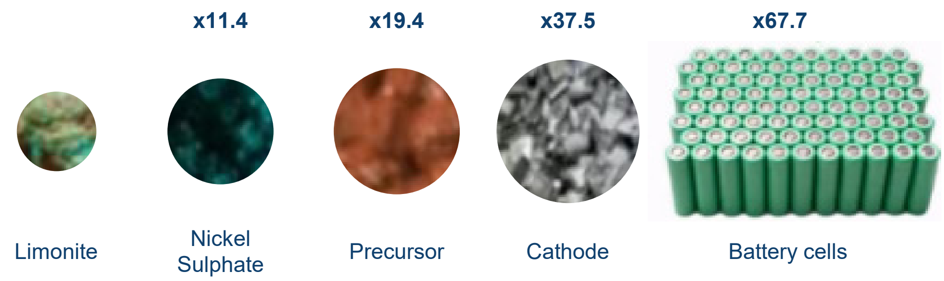
Source: Polar Capital Emerging Markets & Asia Team, May 2023.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Indonesia commissioned its first HPAL project in 2021 as a JV (joint venture) between its own Harita and China's Ningbo Lygend, from which production began in the second half of that year. The country's second HPAL opened in November 2021 and is a JV between China Molybdenum and Tsingshan, both Chinese firms. These projects are clear examples that the government's down-streaming policy is bearing fruit in attracting investment. Total nickel smelters in Indonesia (including other types) are said to reach 30 by 2024, an increase from two before the first nickel export ban in 2014. Not only is Indonesia the largest producer of nickel, but it is on course to become the largest processor of refined nickel within the next few years, overtaking China. The country's HPAL pipeline includes projects from China's GEM co, a JV between BASF and Eramet, a partnership between Indonesia's Vale and China's Huayou as well as a similar Sino-Indo tie up between ANTAM and CATL. The future looks bright.

Indonesia's desire to retain more of this chain themselves becomes self-evident, presented with the multiplier effect on value accretion through it, and how powerful even small adjustments in market share could be to the structure of the economy and future GDP.

Added value of nickel products



Source: Ministry of Investment of the Republic of Indonesia, May 2023.

The vision is for a fully integrated supply chain, so the economic transformation does not stop at smelting but goes right through to battery-making and final vehicle production which is targeted by 2027-28. In August 2022, Hyundai, together with LG Energy Solution, announced they would be building the country's first EV battery plant, east of Jakarta. It is set to be a 10GWHh plant to be completed later this year. Indonesia is targeting 140GWh in battery production by 2030, with around one-third of this for export.

"To support the inward investment they are seeking to stimulate, the country is offering attractive incentives including reduced mining royalties, income tax breaks and zero export taxes"

To support the inward investment they are seeking to stimulate, the country is offering attractive incentives including reduced mining royalties, income tax breaks and zero export taxes, though the ambition is to produce a more comprehensive, US Inflation Reduction Act (IRA)-style credit system. Improvements have also been made to logistical bottlenecks such as long lead times on permitting and allocating low-emission energy sources for high value-add industries as well as programs to upskill the labour force. There is still much to be done and ministers reported that the President's direct instructions are to push forward with large-scale investment into down-streaming, so the significant pipeline of battery chain investments they have can be realised. The blue chip names already invested, or who have signed agreements to do so, show that Indonesia has already become a serious player in the global EV industry. That is only likely to attract more attention and potentially spur further investment in a way that could see the country on a sounder structural footing as the returns generated from a fully integrated, higher value EV supply chain allow it to break free from the cyclical commodity reliance that has hampered its fiscal accounts and standing in the eyes of investors for so long.

Merdeka Copper Gold

We currently have one investment in Indonesia in the Polar Capital Emerging Market Stars Strategy, which we view as the most advantageously exposed to these structural changes: **Merdeka Copper Gold** (Merdeka). Merdeka is a diversified miner with a long history in strong operational execution and backed by a group of very high-class Indonesian and international strategic shareholders, including a 5% stake from CATL.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

The core copper and gold mining side of the group has two copper mines and two gold mines; one of each is mature and producing and the other is in development, giving the company significant resources for future growth, particularly in copper. During my time in Indonesia, I travelled to Banyuwangi, at the very Eastern tip on Java Island to visit the co-located Tujuh Bukit copper project, which is the largest growth driver, and existing gold mine, which has a few years' life remaining. Inferred resources of the copper project are 1.8 billion tons, containing 8.2 million tons of copper and 28.6 million ounces of gold and places this as one of the top copper projects globally, with first-quartile cash costs. Interestingly, while I was there I was able to witness the top of the range machine-learning equipment the company uses to validate their human, geological interpretation of rock compositions to enhance their accuracy. Production which should start from 2025-26 will be phased to target a higher-grade zone initially to spread the cost and bring forward cashflows. Profit from this project can be transformative compared to the company's previous year's profit levels. Notably, Indonesia is also considering banning exports of copper ores.



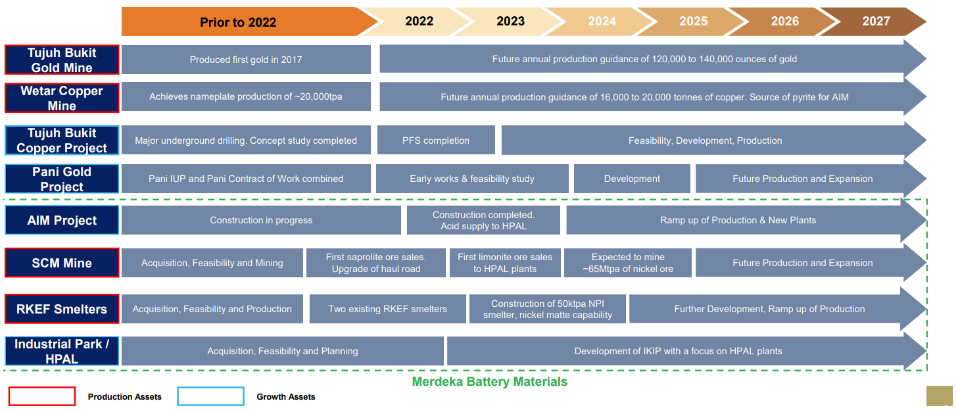
Source: Polar Capital

In a move that has transformed the long-term opportunities and exposure of Merdeka's business, in March 2022 they acquired assets to form their 55% subsidiary Merdeka Battery Materials (MBM), giving the company unique ownership of an integrated segment of the nickel supply chain. This ties the company in exactly with the government's down-streaming policy. MBM's assets consist of a nickel mine, SCM, with a large, multi-decade resource of 1.1 billion dry metric tons at 1.2% Ni, containing 13.8 metric tons of nickel. The company also includes two RKEF smelters (for smelting saprolite, with a third being built), with other HPAL smelters planned, an acid-iron leaching facility which supplies necessary acid and steam materials into the HPAL process and is integrated into the core mining business as it can use pyrite feedstock from the Wetar copper mine. All of this is situated or being built within a very large, jointly owned industrial park, intended to create a future nickel ecosystem.

"I was able to witness the top of the range machine-learning equipment the company uses to validate their human, geological interpretations to enhance their accuracy"

Partners on the smelters are largely Chinese, including CATL, Tsingshan and Huayou Cobalt which grants MBM greater access to technological expertise while balancing project risk.

Merdeka projects overview



Source: Merdeka Copper Gold, as at 10 March 2023.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

We have followed Merdeka Copper Gold for a number of years and part of my visit to operations on the ground was to form a further assessment of their ESG practices. The company is committed to a net zero 2050 target and, prior to that, reducing greenhouse gas emissions by 29% by 2030. They are already using a great deal of renewable energy from geothermal sources and have some solar capacity. The Tujuh Bukit mine will use 100% renewable energy from this year. The company's carbon offsetting program, which includes significant mined land rehabilitation and mangrove restoration which also enhances biodiversity, was also encouraging to see. Impressively, their water data is linked to the government's environmental office in real time, so they have very close ties there where there is ongoing work on permit-granting for environmental issues. There is more to come from Merdeka on these kinds of improvement but the progress and action so far is an encouraging mark of management attention – indeed, ESG factors are part of the executive compensation structure. There are undeniably high-risk ESG issues but they are being well managed and mitigated. While there is more to be done, we believe in investing in 'improver' companies that want to move up the ladder and in so doing see the potential for significant real-world impact going hand-in-hand with the best opportunities for financial returns.

The Indonesian market

As has been reported recently in the press, in the first quarter of 2023, the amount raised from Indonesian IPOs outstripped the US market in what was a record period for the Jakarta Stock Exchange. This continued in April, with large listings of Harita Nickel, following by the IPO of Merdeka Battery Materials (discussed above) and more offerings slated for this year. There appears to be appetite for Indonesian equities and a clear trend for green energy listings in the country.

Trading on a 13.7x P/E puts the market on a 10% P/E premium to broader emerging markets this year, though a discount to its own historic multiples. After a strong relative 2022, Indonesian market performance has been flattish year-to date, offering an opportunity to find select, quality growth investments for the Strategy.

A friend to all

As will have been evident from the names mentioned thus far, the dominant FDI (foreign direct investment) into Indonesia for the last few years have been China, Hong Kong, South Korea and Singapore with the US joining more recently and the EU only just starting. Ongoing comfort levels for some of the Western nations requires continued progress on regulation and economic reform, which is being worked on.

"The typical Indonesia way is to sit in a warung (neighbourhood restaurant) and talk openly. This open-hearted approach, they argue, is also what they try to foster in their international relations"

Indonesia was also very proud to host the G20 Summit in 2022, giving the country an opportunity to showcase on a global stage its physical assets, practical proficiency, openness to the world for business and investment, and also the soft power the government is capable of from the resulting projects and agreements. Ongoing oscillations since notwithstanding, that Indonesia was the platform and able to at least be perceived as having a role in playing peacemaker, setting up a Joe Biden/Xi Jinping meeting on their soil, was significant. Ukraine was also invited to the summit, despite not being a member of the G20. Indonesia took the view that vital discussions, which would of course relate to Ukraine, would not be possible without everyone in the room. It is an example of Indonesia being big enough to think for itself, chart its own course and not just follow a predefined blueprint.

The typical Indonesia way is to sit in a warung (neighbourhood restaurant) and talk openly. This open-hearted approach, they argue, is also what they try to foster in their international relations. The country has a long history of non-alignment and wants to be seen as a 'nice guy' country, trying to broker solutions rather than taking sides in any global problems. They remain neutral and have not been part of any military pact as a matter of foreign policy since the constitution of 1945. Notably, Jokowi was one of very few people to have met all of Xi Jinping, Joe Biden, Volodymyr Zelensky and Vladimir Putin during 2022.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Ultimately, Indonesia puts itself first. How long it can keep everything cosy as a friend to all as it hopes to increasingly attract larger and larger sums of capital from countries which are at loggerheads and not keen to share the same supply chain, without being pushed to lean more one way or another, is unclear.

There are discussions ongoing in the US to determine to what extent Indonesian-sourced EV battery materials and components will be eligible for US IRA tax credits, due to the pervasive nature of Chinese JVs in their supply chain and the requirement to separate Chinese from non-Chinese nickel sources to ensure no involvement by a country of concern. Indonesia is said to be working closely with the US and all international companies on this as well as wishing (of course) to continue to supply the US, China and Europe. Indonesia does not currently have a free trade agreement (FTA) with the US (their IRA tax credit scheme is given where a threshold percentage of the product is generated in FTA countries), but there is the hope that countries which are part of the Indo-Pacific Economic Framework will be given the same treatment as those that have.

The risk for the US is choosing to exclude Indonesia, the world's third-largest democracy with the fourth largest population of 278 million people, which could dramatically increase in clout over the next decade to become a global top-10 economy, rather than just the sixth largest emerging market, with a sizeable middle class emerging as living standards rise. The difference in consumer spending power is visible even since my previous visit five years ago and that should accelerate given the ongoing explosion in access to digital services.

There are very few economies that have been able to compound GDP as fast as Indonesia. It is a country to be taken seriously; it has the means and the will for investors to employ capital, make a return, and leave – an important cycle. The re-established health of the economy, helped by commodities has been a successful model in the Middle East for a long time, but one this country wants to evolve, to take greater ownership of and stabilise so that it can be prosperous with or without that.

Vietnam

China Plus One

We view Vietnam, not yet officially an emerging market, as one of the very best investment locations in our universe for the long term. It is one of if not the fastest growing Asian economy, taking the baton from China a few years ago. It has a thriving, young, working-age demographic, with more than 70% of its population under 35 and who come at much lower cost than their equivalents in China or the US. Many years of consistently high GDP growth have been due to a highly attractive combination of political stability with sound pro-market execution from the socialist government which has managed to slash poverty from 17% to less than 5% in a decade and now productivity gains are coming through too, with urbanisation, wage increases and skills enhancement creating a middle class. A new investment into core infrastructure is a further leg to growth which has stalled due to an anti-corruption drive, but targets $120bn in investment across roads, airports and other key projects over the next 6-7 years.

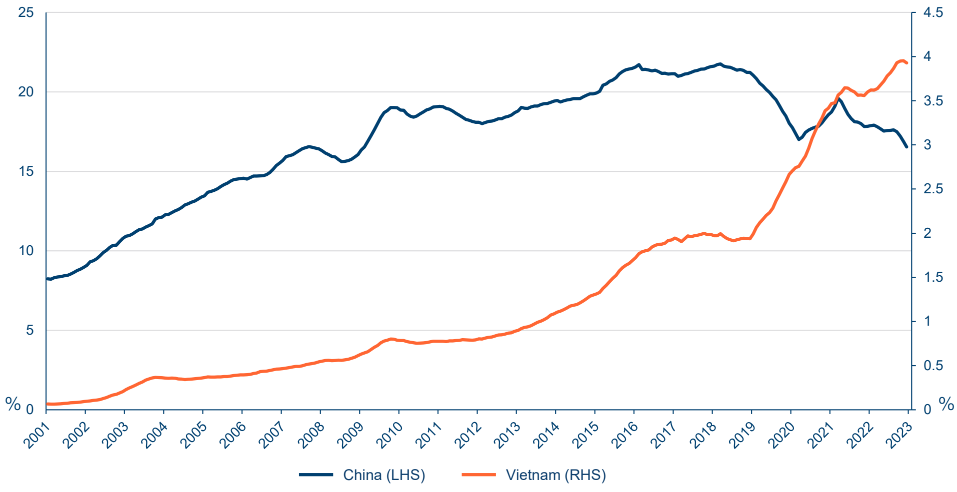
"We view Vietnam, not yet officially an emerging market, as one of the very best investment locations in our universe for the long term"

Perhaps the best-known growth driver for Vietnam is its step-change in FDI from exports due to geopolitics or what is widely known as China Plus One – its beneficial status from companies diversifying their supply chains away from the neighbouring giant to Vietnam which is lower cost and lower left-tail risk. The country's share of exports, to the US in particular and globally, had been increasing incrementally until 2015 when the trajectory started to make greater gains, but it was the backdrop of US/China trade tensions from 2018 when there was a more pronounced rise as China lost share as tariffs were imposed. The pandemic, with differing restrictions globally, of course meant further shifts in supply chains and companies considering how best to structure their facilities.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

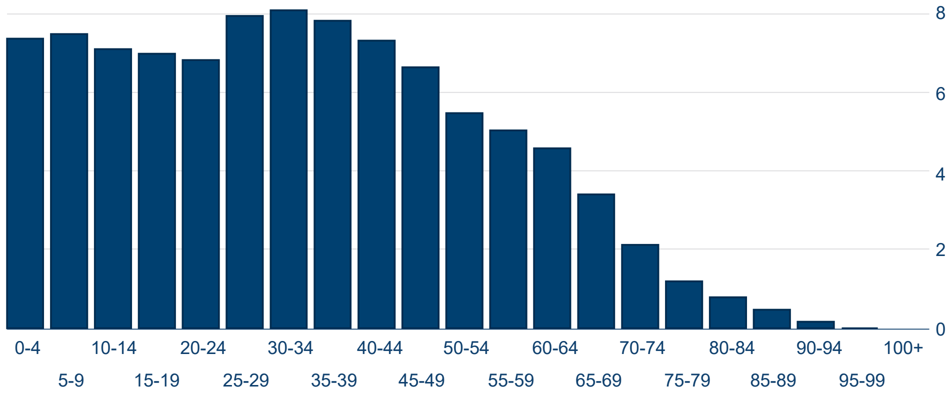
“Vietnam continued to sign key trade agreements during the lockdown period…making it easy for companies to do business there, positioning itself ever more as a manufacturing expert with ease of access to broad, international markets”

Vietnam versus China market share of US imports (12 months moving average)



Soure: IMF International Trade Statistics, UBS Calculations, 31 December 2022.

Vietnam population by age group, 2021 (mn)



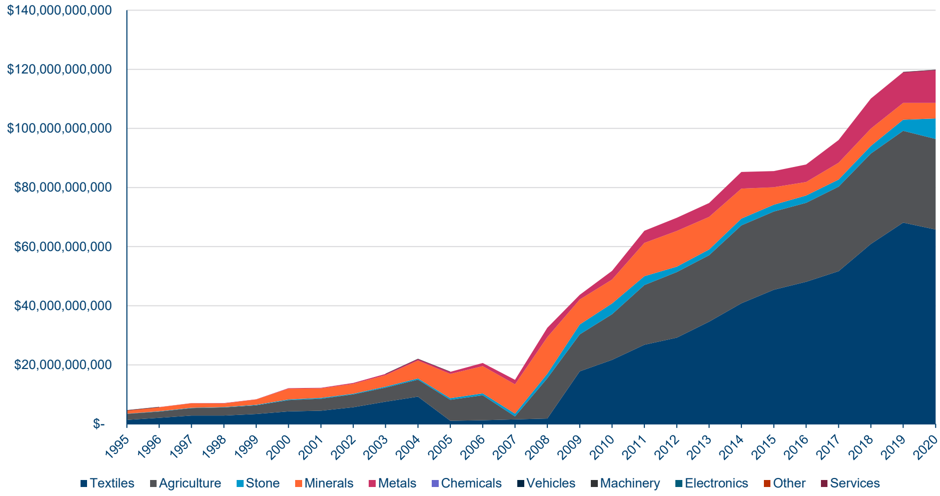
Source: FT & UN.

Vietnam continued to sign key trade agreements during the lockdown period, for a total of more than a dozen, including the RCEP (regional comprehensive economic partnership). These partnerships will make it easy for companies to do business in Vietnam, positioning itself ever more as a manufacturing expert with ease of access to broad, international markets and benefitting from 3,000 kilometres of coastline, not least the close connections to China.

The government is targeting GDP per capita of $18,000 by 2045, up from less than $4,000 today which is less than a third of China’s current level. The runway for growth is undeniably large and the targets ambitious but Vietnam is now moving more towards manufacturing higher value products: more in electronics rather than textiles. Electronics have increased to more than 40% of goods exported from less than 15% in 2010. As testament to this, last August Apple announced they would start producing MacBooks and Apple Watches via their suppliers in Vietnam, in addition to some iPad production they moved there during the Covid disruption. This will involve the buildout of large plants and greater commitment to investment in the country. They are far from alone. Other US companies with facilities in Vietnam include Microsoft and Google and more and more companies are moving portions of their production to a second source such as this to ensure security following deglobalisation trends or even blacklists being imposed. One of Vietnam’s most critical FDI sources is **Samsung Electronics**. The South Korean technology giant employs tens of thousands of people in Vietnam across a number of sites and is the largest investor in the country, with 50% of its handset produced there.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Vietnam exports



Source: Atlas of economic complexity, 2020.

During my visit to Vietnam, I drove out a couple hours from Hanoi to visit companies and plants based close to the Haiphong industrial area. I was struck first by the work already done on upgrading the highways, which were brand new and high quality, and then by the demand for units in the industrial area I drove through which was fully occupied and a new area is being developed close by for additional demand. The plant I visited – for a car company – was equipped with 1,200 leading-edge robots. No investment is being spared. This is not a frontier market plant, but an example that what can be done elsewhere, can be done just as well, if not better, in Vietnam and at far lower cost. Vietnam is not yet widely recognised as a global manufacturing hub, but there is certainly a structural trend of more companies looking at their options and thinking strategically. We do not see this reversing and Vietnam will continue to do very well for a long time to come.

"Vietnam is not yet widely recognised as a global manufacturing hub, but there is certainly a structural trend of more companies looking at their options and thinking strategically"

Last year's trouble in the property market and bond market

While this long-term structural view on the market remains very much in place for us, there have been some shorter-term headwinds influencing the market. These caused a steep pullback in 2022, with the market down more than 35%, and residual caution is still influencing this year's dynamics and some property developers and banks tumbling further.

The turmoil began when, in March 2022, the chairman of property developer FLC was arrested for market manipulation. This did not cause too many ripples until, in September the State Bank of Vietnam (SBV), seeking to cool what they feared could be an over-buoyant real estate market which had been growing very strongly – it expanded 16% in the first nine months of 2022, far ahead of total credit growth of 11% and accounting for more than 20% of overall credit – stepped in to restrict credit to the property market (Vietnam runs on a credit quotas systems). The unforeseen consequence of this was a liquidity crunch at banks which caused them to reduce or halt all lending to balance the sudden disruption. The banks hiked rates to attract the additional liquidity they were missing and, in a reversal of the typical order of things, SBV followed the banks in also implementing a 100bp rate hike.

Regulators carried out a first wave of reforms in September 2022, known as Decree 65, in an attempt to professionalise the bond and real estate markets and interactions between them to promote transparency. These included the requirement to be a professional investor, compulsory credit ratings for bonds above a certain value and the need for fundraising to be linked to specific projects.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

However, while these reforms had the most creditable intentions, they proved too onerous for Vietnam's burgeoning market and exacerbated the liquidity issues, causing issuance to crater and creating cashflow problems for real estate companies. Many bond issuers or holders repurchased bonds or requested repayment due to concerns in upholding the new requirements.

To add insult to injury, in October there was a second arrest and a second rate rise. This time the chairwoman of a real estate company, Van Thinh Phat, was arrested, accused of high value bond fraud. This time there were spill-overs due to the close relationship between the developer and Saigon Commercial Bank which then saw a run on deposits. The government was quick to step in with a full guarantee to stem this and any further contagion, but public confidence was shaken. Interest rates were raised a further 100bps following this episode.

The bond market in Vietnam is nascent and has been allowed to develop ahead of sufficient guardrails and regulations being put in place around it. What has been made clear from the experience of the past 12+ months is that there have been a number of bad actors with the opportunism to exploit these loopholes, such as raising bond capital for unclear purposes. However, what is also evident is the government's swiftness of response and desire to restructure the system. Decree 65 was perhaps ill-judged, and badly timed given the coincidence with a rate-hike cycle, redoubling the pressure on the system. The regulator has now amended these reforms via Decree 8, issued in March 2023, which now allows time for bond issuers to negotiate repayment timings as many real estate companies face pressure on bonds coming due over 2023-24 and there have already been a number of defaults as property companies have suffered from weak demand and tighter credit conditions. Other aspects of Decree 65 have been postponed until next year. Due to the relatively small scale of Vietnam's bond market ($30bn), this period of stress is manageable by the banks who have large and growing credit books from other sources able to handle any default, though these should be able to be restructured or the collateral repossessed.

"The market for residential housing in Vietnam is not made up of investors, second-home buyers or speculators, but real buyers motivated by urbanisation and standard of living trends"

Therefore, we do not see this as something that threatens the health of either the property or the banking sector for the medium term and are not overly concerned. This is more a case of growing pains. All banks in Vietnam, including our portfolio company **Vietnam Technological and Commercial Bank** (TCB), have a degree of exposure to the property sector which for some time has been a strong tailwind. 2022 was a very difficult environment but management are highly disciplined and annual pre-tax profit ended up 10%. It is a bank with one of the higher ROEs in Asia (20% in 2022), trading at a rock-bottom multiple of <4x forward P/E and 0.7x P/B despite expectations of c20% earnings growth and a sound capital position.

Vietnam's compelling, top-down story of fast growth, a growing middle class and rising income levels support our belief that there will continue to be an increasing number of people who want to buy quality housing so structural demand should remain very strong. The market for residential housing in Vietnam is not made up of investors, second-home buyers or speculators, but real buyers motivated by urbanisation and standard of living trends which we believe makes the market very well supported. With the SBV now on a rate-cutting cycle, having lifted the system credit growth quota from 14% to 16%, plus a great deal of supply having been taken out as many developers failed during this period, overall conditions have eased and confidence is returning.

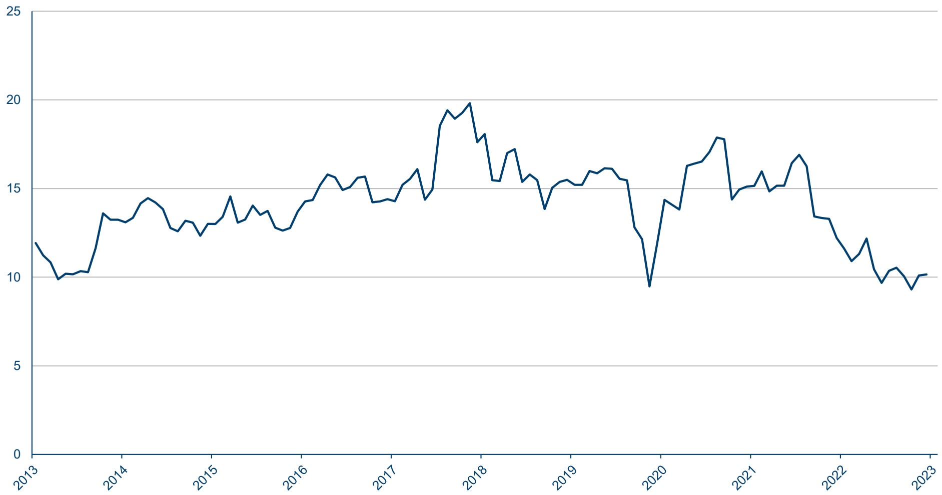
Our holding in the real estate sector in Vietnam, **Vinhomes**, is the largest and most blue chip property developer in the country. It is very well capitalised and has access to a vast landbank which puts it at a huge advantage to its peers. Company management have historically shown themselves to be shrewd capital allocators in replenishing their landbank in down markets at lower cost. While the market has remained subdued, the company has been more strategic in timing launches for consumers, to control supply, meaning inventories are now low. They expect to see volumes pick up in the second half of 2023 as the easing of credit conditions filters through to consumers.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Gaping undervaluation = compelling opportunity

The Vietnamese market is now trading back at close to historic lows, despite all its long-term attractions. Some of the world's cheapest and yet fastest growing companies can be found in this exciting market. The Polar Capital Emerging Market Stars Strategy allocates just over 4% of its capital to this future emerging market leader, spread across IT services and consumer investments as well as the aforementioned real estate and banking exposure.

Vietnam market P/E (VNI index)



Source: Bloomberg as at 28 April 2023.

A criticism sometimes levelled at this enthusiasm for Vietnam is that it has been a market of the future for a while and some technical features of market access, liquidity, settlement and FX policy have held back broader investor appetite. However, with many other emerging markets now moving up the risk curve and Vietnam currently at these valuations and with improving macros, the balance of risk looks highly favourable, especially for the long-term buy-and-hold investor who can accept a market premium which may be required to gain access to select companies with such potential.

"If anything, there is now an even larger opportunity for Vietnam's manufacturing sector [and] there are real blue chip companies in the country that can deliver significant upside'

There is frequent hope that Vietnam may be upgraded from its current, off-benchmark or frontier market status to emerging market status by MSCI. The Vietnam stock market overall now meets the size and liquidity requirements to be included, with a four-fold surge in retail participation during the past 2-3 years, driven by digital account technology. However, the limiting factor is the strict foreign ownership limits (FOLs) that constrict the market depth. Companies could change these on an individual basis, but they do not want to open up too much and create the possibility that a Chinese or other large entity could launch a takeover, however low the possibility. The government aspires to emerging market status and could solve the problem via a similar method to that used in Thailand. That requires setting up a state-owned enterprise as yet there has been no movement on that.

While passive flows from an upgrade would be a bonus, we do not regard this as necessary for our core, positive investment thesis. Regardless of the market status, after the precipitous drawdown, but with no change in the fundamentals – if anything there is now an even larger opportunity for Vietnam's manufacturing sector – there are real blue chip companies in the country that can deliver significant upside.

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Final word

The reversal of deglobalisation is one of the biggest themes of our times. Trade wars, tariffs, the global pandemic and even a war among two democracies in Europe means that a focus on the control and resilience of supply chains is front and centre for all companies. We are living through a recalibration of the way the world organises the plumbing of its business and things are changing in ways that even a few years ago would not have been possible to predict. These changes, as ever, spark winners if they are astute enough to seize the initiative and execute on them. We believe Indonesia and Vietnam are two such winners and are focused on finding Star companies in these star economies for our Emerging Market 'Stars' Strategy.

Naomi Waistell
Portfolio Manager, Polar Capital Emerging Market Stars Strategy
12 May 2023

Signatory of:

PRI Principles for Responsible Investment

A proud participant of:

Climate Action 100+ Global Investors Driving Business Transition

All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital, and may not be achieved. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of securities in this document. A list of all recommendations made within the immediately preceding 12 months is available upon request.

Risks

- **Capital is at risk and there is no guarantee the Strategy will achieve its objective. Investors should make sure their attitude towards risk is aligned with the risk profile of the Strategy.**
- **Past performance is not a reliable guide to future performance. The value of investments may go down as well as up and you might get back less than you originally invested.**
- The value of a strategy's assets may be affected by uncertainties such as international political developments, market sentiment, economic conditions, changes in government policies, restrictions on foreign investment and currency repatriation, currency fluctuations and other developments in the laws and regulations of countries in which investment may be made. Please see the Strategy's Prospectus for details of all risks.
- The Strategy may enter into a derivative contract. The Strategy's use of derivatives carries the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as failure amongst market participants.
- If the currency of the share class is different from the local currency in the country in which you reside, the figures shown on this webpage may increase or decrease if converted into your local currency.

Important Information: This website is provided for the sole use of the intended recipient and is not a financial promotion. The Polar Capital Emerging Market Stars Strategy (the "Strategy") is a Strategy of Polar Capital Funds plc which is authorised by the Central Bank of Ireland as an Undertaking for Collective Investment in Transferable Securities under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. 352/2011), as amended. This website does not seek to make any recommendation to buy or sell any particular security (including shares in the Strategy) or to adopt any specific investment strategy. This website does not contain information material to an investor's decision to invest in the Strategy. Shares in the Strategy are offered only on the basis of information contained in the prospectus, key investor information document ("KIID"), and the latest annual audited accounts. Copies are available free of charge from Polar Capital at the below address or on www.polarcapitalfunds.com. The KIID is available in Danish, Dutch, English, French, German, Italian, Norwegian, Spanish and Swedish. The prospectus is available in English.

Third-party Data: Some information contained herein has been obtained from third party sources and has not been independently verified by Polar Capital. Neither Polar Capital nor any other party involved in or related to compiling, computing or creating the data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any data contained herein.

Holdings: Portfolio data is "as at" the date indicated and should not be relied upon as a complete or current listing of the holdings (or top holdings) of the Strategy. The holdings may represent only a small percentage of the aggregate portfolio holdings, are subject to change without notice, and may not represent current or future portfolio composition. Information on particular holdings may be withheld if it is in the Strategy's best interest to do so. A historic complete list of the portfolio holdings may be made available upon request. It should not be assumed that recommendations made in the future will be profitable or will equal performance of the securities. A list of all recommendations made within the immediately preceding 12 months is available upon request. This webpage is designed to provide updated information to institutional investors to enable them to monitor the Strategy. No other persons should rely upon it. The information provided on this webpage should not be considered a recommendation to purchase or sell any particular security.

Information Subject to Change: The information contained herein is subject to change, without notice, at the discretion of Polar Capital and Polar Capital does not undertake to revise or update this information in any way.

Forecasts: References to future returns are not promises or estimates of actual returns Polar Capital may achieve, and should not be relied upon. The forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation. Forecasts are based upon subjective estimates and assumptions about circumstances and events that may not yet have taken place and may never do so.

Statements/Opinions/Views: All opinions and estimates constitute the best judgment of Polar Capital as of the date hereof, but are subject to change without notice, and do not necessarily represent the views of Polar Capital. This material does not constitute legal or accounting advice; readers should contact their legal and accounting professionals for such information. All sources are Polar Capital unless otherwise stated.

Benchmark: The Strategy is actively managed and uses the MSCI Emerging Markets Net Total Return Index as a performance target and to calculate the performance fee. The benchmark has been chosen as it is generally considered to be representative of the investment universe in which the Strategy invests. The performance of the Strategy is likely to differ from the performance of the benchmark as the holdings, weightings and asset allocation will be different. Investors should carefully consider these differences when making comparisons. Further information about the benchmark can be found at http://www.msci.com/. The benchmark is provided by an administrator on the European Securities and Markets Authority (ESMA) register of benchmarks which includes details of all authorised, registered, recognised and endorsed EU and third country benchmark administrators together with their national competent authorities.

Risk: Factors affecting Strategy performance may include changes in market conditions (including currency risk) and interest rates, as well as other economic, political, or financial developments. The Strategy's investment policy allows for it to enter into derivatives contracts. Leverage may be generated through the use of such financial instruments and investors must be aware that the use of derivatives may expose the Strategy to greater risks, including, but not limited to, unanticipated market developments and risks of illiquidity, and is not suitable for all investors. Past performance is not a guide to or indicative of future results. Future returns are not guaranteed and a loss of principal may occur. Polar Capital may also receive a performance fee based on the appreciation in the NAV per share and accordingly the performance fee will increase with regard to unrealised appreciation, as well as realised gains. The performance fee may create an incentive for Polar Capital to make investments for Polar Capital Funds plc which are riskier than would be the case in the absence of a fee based on the performance of Polar Capital Funds plc.

Country Specific Disclaimers: Please be aware that not every share class of every strategy is available in all jurisdictions. When considering an investment into the Strategy, you should make yourself aware of the relevant financial, legal and tax implications. Neither Polar Capital LLP nor Polar Capital Funds plc shall be liable for, and accept no liability for, the use or misuse of this document.

Country Specific disclaimers: In the United States the Strategy shall only be available to or for the account of U.S. persons (as defined in Regulation S under the United States Securities Act of 1933, as amended (the "Securities Act")) who are "qualified purchasers" (as defined in the United States Investment Company Act of 1940, as amended (the "Company Act")) and "accredited investors" (as defined in Rule 501(a) under the Securities Act). The Strategy is not, and will not be, registered under the Securities Act or the securities laws of any of the states of the United States and interests therein may not be offered, sold or delivered directly or indirectly into the United States, or to or for the account or benefit of any US person, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of such securities laws. The securities will be subject to restrictions on transferability and resale. The Strategy will not be registered under the Company Act.

Singapore: This document has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this document and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of Shares may not be circulated or distributed, nor may Shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor Pursuant to Section 304 of the Securities and Futures Act, Chapter 289 of Singapore (the "SFA") or (ii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. The Prospectus and Information Memorandum are available to download at www.polarcapital.co.uk alternatively; you can obtain the latest copy from the Polar Capital Investor Relations team.

Hong Kong: The Strategy is a collective investment scheme but is not authorised under Section 104 of the Securities and Futures Ordinance of Hong Kong by the Securities and Futures Commission of Hong Kong. Accordingly, the distribution of this document, and the placement of interests in Hong Kong, is restricted. This document may only be distributed, circulated or issued to persons who are professional investors under the Securities and Futures Ordinance and any rules made under that Ordinance or as otherwise permitted by the Securities and Futures Ordinance.

Australia: The Strategy is not registered and has not authorised nor taken any action to prepare or lodge with the Australian Securities & Investments Commission an Australian law compliant prospectus or product disclosure statement. This document may not be issued or distributed in Australia and the shares/interests in the Strategy may not be offered, issued, sold or distributed in Australia by the investment manager, or any other person, under this document other than by way of or pursuant to an offer or invitation that does not need disclosure to investors under Part 6D.2 or Part 7.9 of the Corporations Act, whether by reason of the investor being a 'wholesale client' (as defined in section 761G of the Corporations Act) or otherwise. The investment manager holds Australian financial services licence no. 528982 covering certain services to wholesale client.