

AFC VIETNAM FUND UPDATE

Fund Category	Vietnam Public Equities
Country Focus	Vietnam
Subscriptions	Monthly at NAV (five business days before month end)
Redemptions	Monthly at NAV 30 days notice
Benchmark	VN Index
Fund Manager	Vicente Nguyen
Investment Manager	Asia Frontier Capital (Vietnam) Limited, Cayman Islands
Investment Advisor	Asia Frontier Investments Limited, Hong Kong
Fund Base Currency	USD
Minimum Investment	USD 10,000
Subsequent Investments	USD 1,000
Management Fee	1.8% p.a. of NAV
Performance Fee	12.5% p.a. of NAV appreciation with high watermark
Fund Domicile	Cayman Islands
Launch Date	23 December 2013
Custodian Bank	Viet Capital Securities, Ho Chi Minh City
Auditor	Ernst & Young, Hong Kong
Administrator	Trident Fund Services, Hong Kong
Legal Advisor	Ogier, Hong Kong
ISIN	KYG0133A1673

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The VN-index jumped to a new record high thanks to commodity related stocks like Petrovietnam Gas (GAS), which jumped 30% over the month. With nearly 100% of eligible adults now having received a first vaccine shot in Hanoi and HCMC, and more than 85% fully vaccinated, optimism returned over an imminent recovery of the economy. The market advance was broad based with all market sectors experiencing strong gains. The VN index gained an impressive +7.6%, while our NAV reached USD 3,529, another strong gain of +4.4% for the month, according to internal estimates.

Market Developments

Computer chip shortage, car production delays, port congestions, a lack of truck drivers – whatever you can think of – inflationary pressures. After (too) many months of denial, officials finally acknowledged that inflation is real and not temporary, as they wanted us to believe for quite a long time. Their argument, that current inflation is just the result of the temporary supply chain nightmare we are currently experiencing is not wrong, but wasn't every inflationary period in the past (40's war period or 70's oil shock for example) always a result of too little supply (reduced level of certain production) chased by too much demand (loose money policy, wage growth)?

Tapering is certainly on the mind of Western central banks, but we can also see first interest rate trend reversals in some countries around the world, such as for example New Zealand, Norway, Poland or South Korea.

FED Funds rate 1954-2021

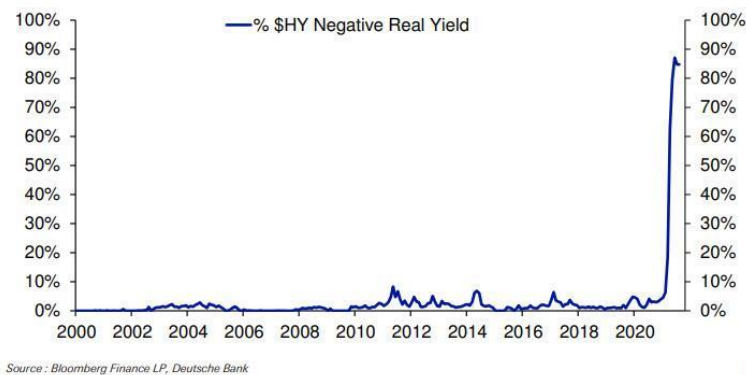


(Source: Macrotrends LLC)

The recent recession might be the only one where rates were not lowered throughout the recessionary period, but the chart makes it obvious why. Unlike Japan or Europe, the US did not enter negative interest rate territory. With all current discussions from financial commentators about slight differences in interest rates between countries, it looks like a lot of hot air when we compare current rate levels both to historical standards, as well as with real interest rates. Meanwhile, even US high-yield bonds are not making any money for their investors on an inflation-adjusted basis.

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Figure 1: 85% of the US HY market currently yields below US CPI.



With very high risk needed to achieve any positive real return in the bond market, it is not surprising at all, that bond funds see outflows and investors are looking instead for stocks and alternative investments. An end to free money policies and a return to more normal interest rate levels, to let's say around 3% in the US and Europe, would certainly be a disaster for bond investors, but not necessarily for stock investors. We likely would see a setback for the high flying, highly valued and highly weighted tech sector, but sectors like banks for example, would finally see an end to their long-lasting lending margin misery. If commodities continue their inflation-induced bull market run, other, not highly weighted sectors would also flourish. Because of sector weightings, this would mean on the other hand a correction for the main indices, and the widely favored index-ETF's could take a hit, while actively managed funds can take advantage of the sector rotation.

Similarly in Vietnam, the bottom in interest rates seems to have been reached, although with an inflation rate of less than 3%, Vietnam is one a few countries still offering positive real interest rates.

Benchmark interest rate 2012-2021



Sector rotation is also ongoing in Vietnam and the financial sector, especially the insurance sector, should benefit from this new interest rate cycle. Meanwhile, investors are closely watching the current announcements around third quarter results. With lockdown related production reductions receding, investors are not concerned about the already expected and priced in weak results of the last quarter and are instead trying to figure out how strong the recovery will be over coming quarters. For that reason, it might be a surprise that many companies in the export sector, e.g., textiles, have rallied 30-50% from their latest correction, but the answer lies simply in the still intact positive long-term outlook for the sector. The same can be said for one of our investments, a producer of wooden kitchenware, children's toys, and home furniture with strong exports, a very healthy balance sheet and a strong management team. Despite production halts in the third quarter and a 70% (!) loss in revenues, the company still managed to stay profitable with only a slightly reduced net profit margin of an impressive 17%. Here, once again, it has paid off that we focus on companies with strong balance sheets and good business models.

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GDT from Nov. 2012 – Oct. 2021



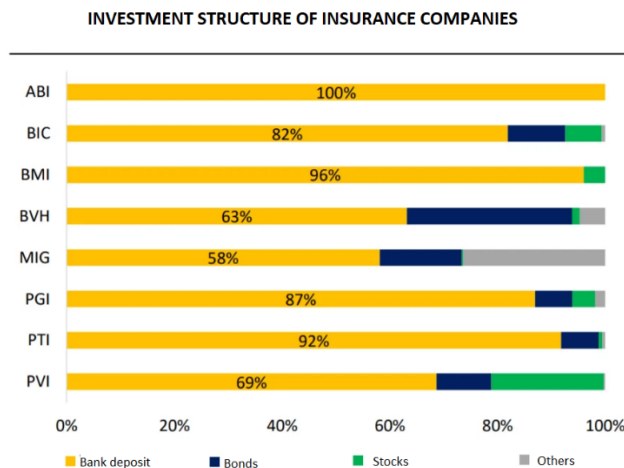
(Source: Viet Capital Securities)

Please note the lowest price in the chart was minus VND -24,000 in 2012! This price is not a mistake by itself, but many of our holdings pay high dividends, and therefore, the stock price and the chart are adjusted on the event of dividend payments – you will not find this phenomenon easily in US stocks... and still, the stock is trading at only 10x earnings based on 2022 estimates, and offers a dividend yield of 7%.

The best deal is buying at the bottom!

In January 2020, when the first COVID-19 outbreak happened in Vietnam, the government launched a large economic stimulus package, with low interest rates being one of the key policies. At that time, we forecasted that low interest rates would strongly support and benefit the banking sector, and hence we increased our investment in this sector and made handsome profits to date. Many bank stocks surged 200-300% within 12 months, such as for example LPB or VPB, the largest bank holdings in our portfolio at the end of 2020. The low interest rate policy benefited the banking sector, but on the opposite end of the spectrum, it damaged the profitability of the insurance sector. Most insurance companies generate their profits from bank deposits and bond investments.

Bank deposits contribute 80% of total insurance companies' investment



(Source: BSC, insurance companies, AFC research)

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With tumbling interest rates, profits of insurance companies were negatively affected, and this is also the reason why Saigon Securities Corporation (SSI), the largest broker in Vietnam, wrote a report last year about the insurance sector, advising its clients to avoid insurance stocks because of the negative impact of the low interest rate environment. Insurance stocks indeed showed poor performance in the last 12 months, particularly in the first half of 2021 where for example Bao Viet Holding (BVH), the largest insurance company in Vietnam, declined by around 12%, compared the VN-Index which performed +27.6% over the same time period.

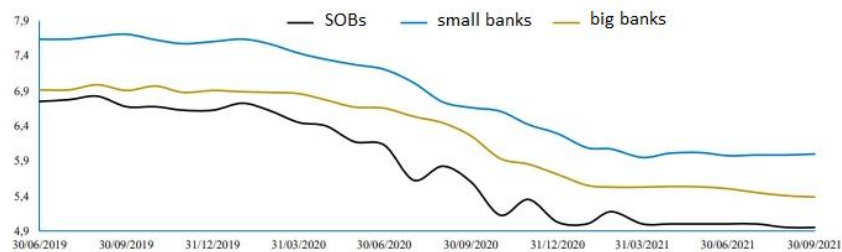
Bao Viet Holding from Jan. 2021 – Oct. 2021



(Source: Viet Capital Securities)

During the last two years, 12-month deposit interest rates at commercial banks plunged massively from around 7-8% to 4-5% p.a.

12-month deposit interest rate at banks



(Source: BVSC, FiiPro)

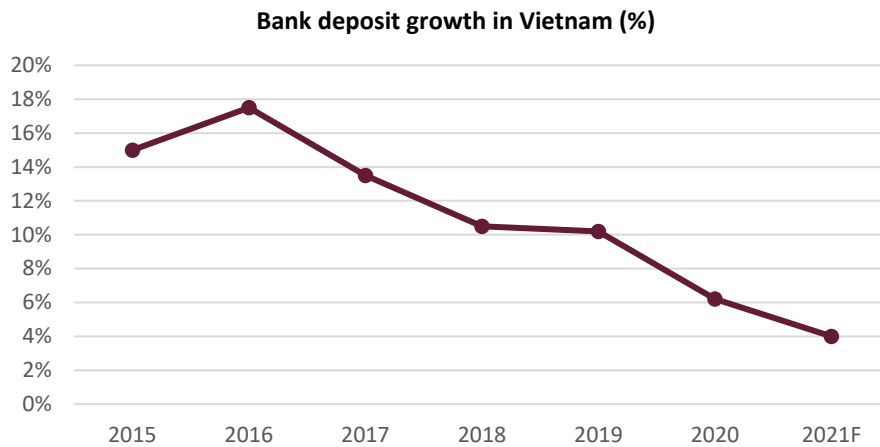
Deposit rates started to drop dramatically from the beginning of 2020 to the end of March 2021 before stabilizing over the last six months. In our view, current interest rates in Vietnam have already reached their bottom and have little room further to fall.

The lowest bank deposit growth in history

The Vietnamese government wants to lower deposit interest rates to drag down the lending rate consequently which is expected to boost credit growth to stimulate the economy. However, banks find it very difficult to attract new deposits in a low interest environment. Hence the bank deposit growth reached a new record low in 2021 of only 4%. Low interest rates encourage banking clients to withdraw their money and to buy real estate or stocks instead. In August 2021, the total bank

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deposit balance in Vietnam dropped by around VND1,000 bln (USD 44 mln), which is not a big amount, but it is seen as a serious warning signal for banks, not to lower their deposit rates any further.

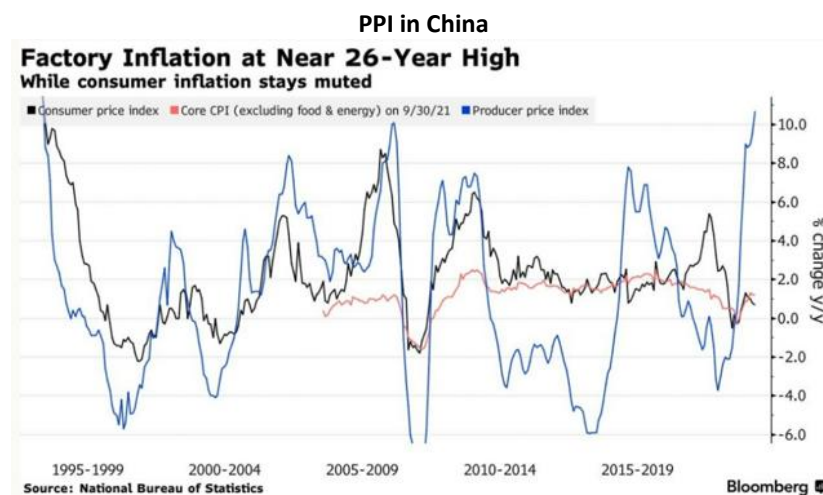


(Source: SBV, AFC Research)

In October 2021, vice Governor of the State Bank, Mr. Dao Minh Tu, also said that there is not much room for lowering interest rates any longer when deposit growth is decelerating. When deposit growth continues to fall, it will hurt credit growth and the economic recovery. In fact, in the last 2 months, many small banks had increased their deposit rates slightly. For example, Sacombank (STB), one of the largest private banks in Vietnam, announced mid of October an increase of its 2-month deposit rate from 2.8% to new 3.4%.

Inflationary pressures

Another reason which hinders banks to decrease their rates further is inflationary pressure. In October 2021, CPI increased to 1.8% which is still at a level which is not concerning, but “the inflation pressure is escalating” according to a recent statement of the Prime Minister, Mr. Pham Minh Chinh. In September, the producer price index (PPI) in China surged over 10%, the highest level in 26 years. In Vietnam, the lockdown in Q3 tempered inflation, but that might change in the current quarter.



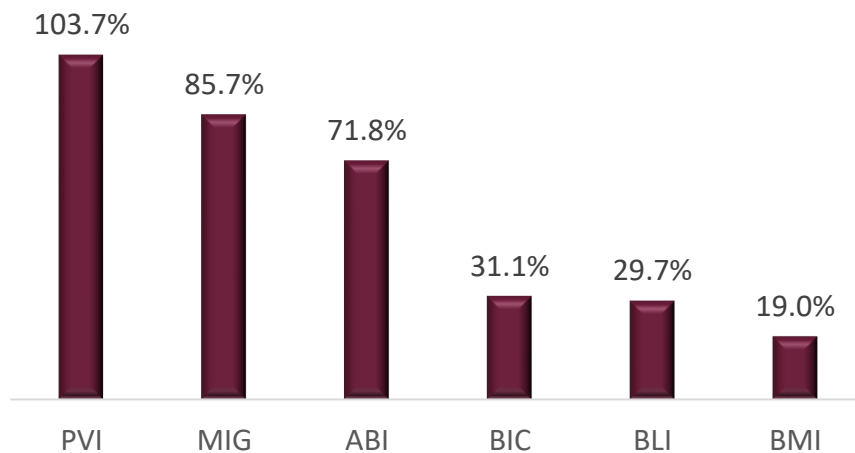
(Source: Bloomberg, National Bureau of Statistics)

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China is the largest trading partner of Vietnam with a total volume worth over USD130 bln per year. Every year, Vietnam imports around USD85-90 bln of goods and materials from China. Therefore, when the producer price index in China jumps, it will also affect Vietnam indirectly. According to Mr. Pham Duc Thanh, Director of Vietnam Strategy and Economic Research Center, the producer price index (PPI) in Vietnam had increased substantially to 23% in the first nine months of 2021. He expects that price increases will be transferred to consumers sooner or later. Therefore, if inflation goes up further, the State Bank of Vietnam has to intervene and try to ease inflation. Tightening monetary policy may be applied, hiking interest rates is one of the first options which may be considered.

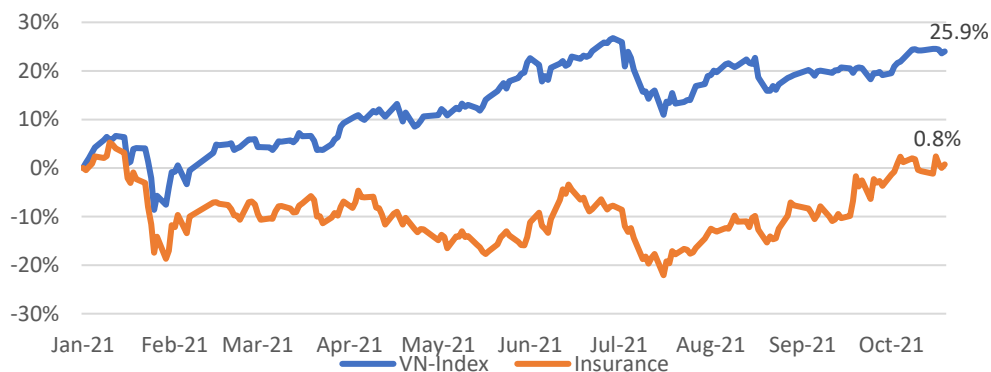
For the above reasons, there is not much room for deposit interest rates to go down further and when deposit rates eventually start to rise again it will have a very positive effect on profits of insurance companies. We therefore believe that the timing to overweight the insurance sector in our portfolio is optimal. Furthermore, the overall revenues in the insurance sector grew by around 13% in the third quarter, regardless of the impact of COVID-19. Many insurance companies also announced very positive results, such as for example Agricultural Bank Insurance, which reported a record high profit before tax in 3Q-2021 of VND151 bln, an increase of 70.8%! PVI Corporation, the largest non-life insurance company, also reported a huge net profit growth of 103.7% for the third quarter. Although the short-term growth and long-term outlook of the insurance sector is very optimistic, insurance stocks still underperformed so far against the index this year, but we believe they will start outperforming soon.

Net profit growth of insurance companies in Q3/2021



(Source, insurance companies, AFC Research)

Insurance sector underperformed vs VN-Index in 2021

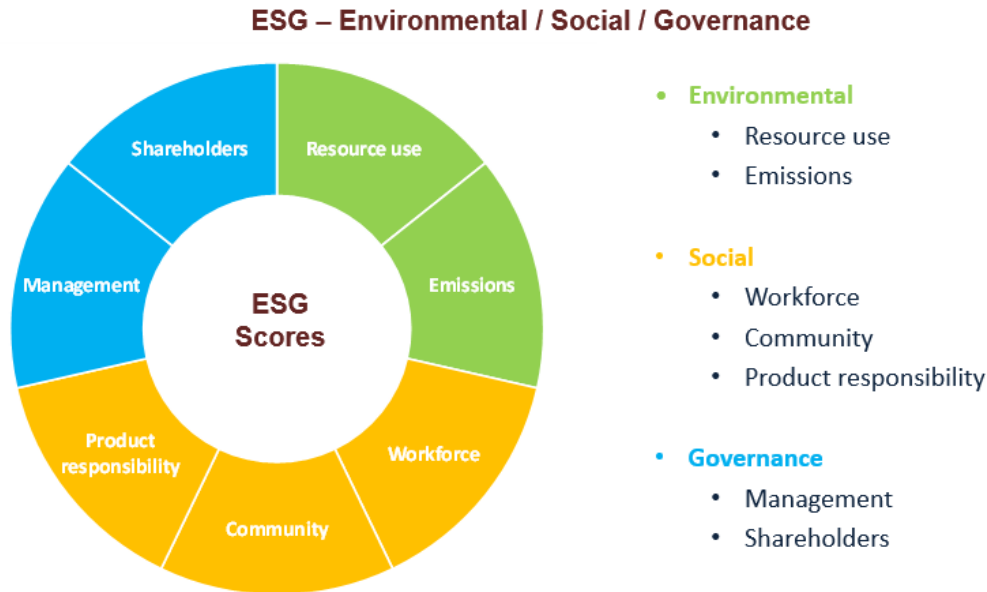


(Source: HSX, AFC Research)

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New rules increasing pressure to implement ESG in the investment process

Environmental, Social and Governance (“ESG”) factors have become increasingly prominent throughout the business world. Indeed, the AFC Vietnam Fund has taken steps on our own accord to recognize ESG as important in recent years. The coherent framework surrounding ESG provides clear guidelines for us to act ethically, morally, and responsibly in a way that investors expect.



(Source: AFC Research)

The focus on climate – regulatory convergence

Understandably, regulatory bodies worldwide are emphasizing the ‘E’ in ESG. Regulations issued in August of this year by the Securities and Futures Commission “SFC” in Hong Kong, where our fund is registered, has mandated all funds must take climate-related risks into consideration in their investment and risk management processes, and make appropriate disclosures thereof by August 2022. However, the lack of reliable emissions data on the part of many investee companies poses a challenge, at least for now.

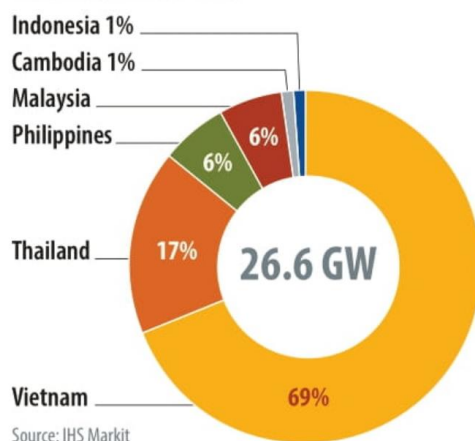
There has been a gradual recognition that Vietnam cannot continue to sacrifice the environment for economic benefit. Central Vietnam suffered from devastating floods in 2020, while air pollution around Hanoi has been particularly acute for years. These events lay bare Vietnam’s vulnerability to storms and floods, but they have combined with higher quality-of-life expectations from the middle class to make it imperative for the government to act on climate change. Fortunately, they have done so with the new Law on Environmental Protection, which was introduced in line with international standards and is set to take effect on the first day of 2022. Naturally, our task assessing the ‘E’ in ESG will become easier with the convergence of regulations in both investor and investees’ jurisdictions, as investee disclosures on their environmental impact will become more commonplace.

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Seeing Green in Vietnam

Notwithstanding current problems, the green energy transition in Vietnam is well under way. Coal contributed more than 50% to the national power-generation capacity in 2020, but this proportion is set against the backdrop of the enormous growth potential of the renewables sector. Vietnam is already the leader in Southeast Asia for renewables, wielding the highest installed capacity of solar power.

Largest markets based on cumulative installation in 2020



Assuming Vietnam follows through on its ambitious Power Development Plan VIII (“PDP 8”) to reduce reliance on fossil fuels and cut carbon emissions in the long term, the AFC Vietnam Fund will continue to be on the lookout for opportunities in this field.

Economy

Macroeconomic Indicators				
	2018	2019	2020	Oct-21
GDP	7.08%	7.02%	7.30%	1.42%
Industrial production (YoY)	10.2%	8.9%	3.4%	3.3%
FDI disbursement (USD bln)	19.1	20.4	20.0	15.2
Exports (USD bln)	244.7	264.2	281.5	267.9
Imports (USD bln)	237.5	253.1	262.4	269.4
Trade balance (USD bln)	7.2	11.1	19.1	-1.4
Retail sales (YoY)	11.70%	11.80%	2.60%	-8.60%
CPI (YoY)	3.54%	2.79%	3.23%	1.81%
VND	23,175	23,230	23,108	22,751
Credit growth (YoY)	13.9%	12.1%	10.5%	7.4%
Foreign reserves (USD bln)	60	73	92	94.8

(Source: GSO, VCB, State Bank, AFC Research)

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Subscription

The next subscription deadline will be 24th November 2021. If you would like any assistance with the subscription process please be in touch with Andreas Vogelsanger.

Best regards,

AFC Vietnam Fund

Estimated NAV as of 31st October 2021

NAV	3,529*
Since Inception	+252.9%*
Inception Date	23/12/2013

Monthly Performances AFC Vietnam Fund

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2013	USD												+2.37%	+2.37%
2014	USD	+8.75%	+4.50%	+2.18%	-4.65%	-0.32%	+1.45%	+1.86%	+5.49%	+3.87%	+2.83%	+2.50%	+0.60%	+32.50%
2015	USD	+0.44%	+1.76%	-0.96%	+1.93%	-0.48%	+0.06%	+0.22%	-4.57%	+1.18%	+6.90%	-1.82%	+0.25%	+4.62%
2016	USD	-0.10%	+3.30%	+1.28%	+3.17%	+1.40%	+4.97%	+3.0%	+0.13%	+0.11%	-1.83%	+0.88%	-1.76%	+15.29%
2017	USD	+1.90%	+1.10%	+1.94%	+1.03%	+2.96%	+4.52%	+1.94%	-4.38%	+1.09%	-0.75%	+1.47%	+0.01%	+13.33%
2018	USD	+0.41%	+0.42%	+0.58%	-0.93%	-3.24%	-0.12%	-1.28%	+0.79%	+3.02	-2.14%	+0.45%	-2.05%	-4.17%
2019	USD	-1.63%	+2.90%	+1.58%	+0.82%	-3.35%	+1.98%	+1.18%	+1.63%	-1.89%	-2.34%	-1.59%	+2.31%	+0.70%
2020	USD	-1.41%	-3.93%	-18.44%	+12.72%	+4.28%	-0.28%	+0.78%	+8.65%	+6.02%	+0.72%	+6.91%	+12.77%	+27.66%
2021	USD	-1.89%	+9.49%	+5.84%	+1.58%	+6.37%	+8.37%	-1.30%	+8.47%	+3.80%	+4.4%*			+54.5%*

*According to internal estimates

**The Fund has appointed ACOLIN Fund Services AG, succursale Genève, 6 Cours de Rive, 1204 Geneva, Switzerland, as its Swiss Representative. NPB Neue Privat Bank AG, Limmatquai 1, 8024 Zürich, Switzerland is the Swiss Paying Agent. In Switzerland shares shall be distributed exclusively to qualified investors. The fund offering documents, articles of association and audited financial statements can be obtained free of charge from the Representative. The place of performance with respect to [shares distributed in or from Switzerland is the registered office of the Representative.*

The fund is authorized for distribution to professional investors in Hong Kong, Japan, Singapore and the UK.

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