

Driehaus Emerging Markets Small Cap Equity Strategy Summary

NOVEMBER 2023

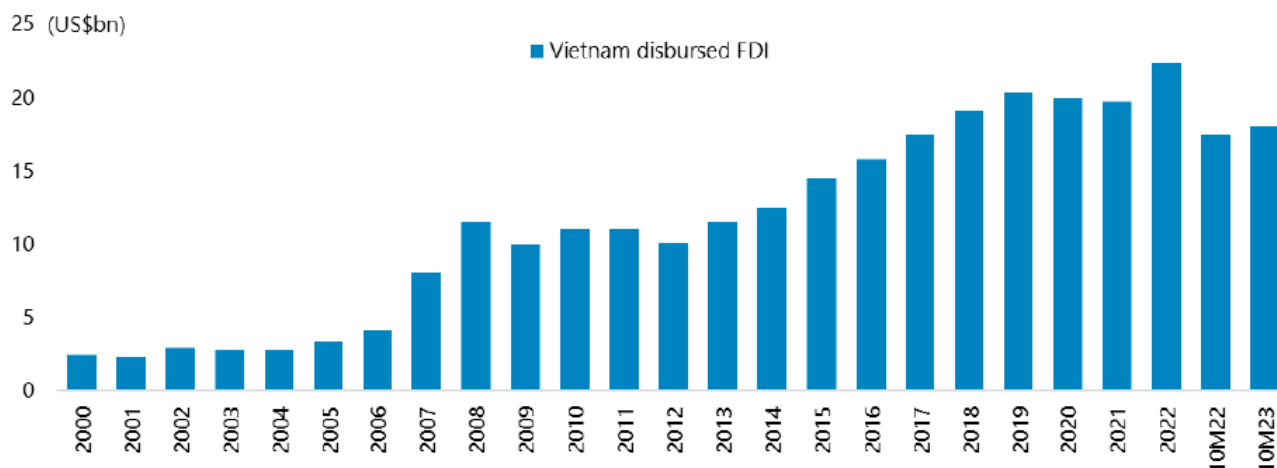
Vietnam has been one of the fastest growing emerging economies over the last decade, supported by rising foreign direct investment (FDI), as the country has been a natural beneficiary of shifting supply chains.

Despite growing optimism on the state of the economy, Vietnam's equity market remains challenging for foreign investors to access, as the country is not included in major emerging market (EM) indices, and liquidity and accessibility have been hampered by foreign ownership restrictions.

The strategy has long held an off-index exposure in Vietnam, recognizing the strong growth prospects in areas like banking, IT services, and consumer. Presently, the strategy's top position is a Vietnamese company, which we believe holds significant growth potential in the IT services industry. This month's commentary provides an update on recent developments and the investment case for Vietnam.

The structural investment case for Vietnam centers around the rapid growth in the domestic economy, supported by a young, well-educated population of 99 million. Amid an environment of global uncertainty around supply chains, along with rising labor costs and a peak in the working age population in China, Vietnam has been the clear beneficiary of "China + 1" efforts to diversify manufacturing capacity over the past decade. Since the Global Financial Crisis, annual FDI disbursements in Vietnam have doubled (Exhibit 1). While growth slowed in Vietnam during the pandemic, the country showed its resilience, maintaining positive GDP growth in 2020 and 2021, while re-accelerating in 2022 (Exhibit 2).

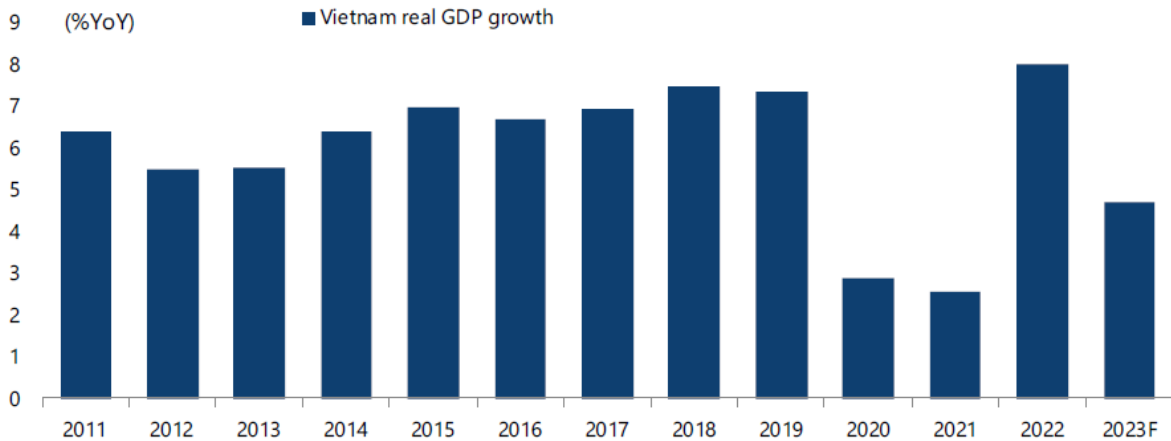
Exhibit 1. FDI Disbursements



Note: Data up to October 2023.

Source: Ministry of Planning and Investment, General Statistics Office, CEIC Data

Exhibit 2. Vietnam Real GDP Growth



Note: Consensus forecast for 2023. Source: General Statistics Office, Bloomberg

Unfortunately, strong GDP growth does not always translate into strong equity market performance, and Vietnam's market has underperformed the broad MSCI EM Index by 1500 basis points over the last two years, after hitting new all-time highs in early 2022.

The proximate cause of this underperformance is related to tightening financial conditions in the wake of the arrest of a prominent real estate tycoon facing fraud charges last year. While Vietnam has seen considerable growth in its real economy over the last decade, the financial system remains relatively nascent, with a small corporate bond market and institutional investor base in proportion to the country's GDP.

The silver lining is that while the issues in the banking and property sector have weighed on the broad equity market, they are unlikely to prove systemic in nature, and the central bank has responded by easing liquidity and cutting interest rates by 150 basis points over the course of 2023. Moreover, Vietnam boasts sizable current account surpluses and FDI, further supporting domestic liquidity conditions.

For the past several years, the strategy has held a large position in Vietnam's leading IT services company. Increasingly, this company has derived a growing portion of its revenue from digital transformation, a rapidly growing vertical within the industry, and is well positioned for growth in areas such as cloud, AI, and IoT.

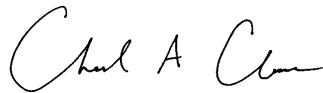
While the company is relatively small in headcount compared to global peers with 30,000 employees, a key part of the business model is the operation of an education segment, which maintains a full-time student population of 100,000, with potential to double in the next few years. This creates a virtuous circle, creating a captive source of domain knowledge, while driving a significant headcount increase in the years ahead, all of which should enable the company to scale up its business and take on larger projects.

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Vietnam has been well recognized as an attractive manufacturing destination, and we believe the competitive advantages of lower labor costs and growing technology capabilities will prove attractive for global companies that are looking to outsource IT services.

Frequently, we are asked by investors why they should consider an active approach in EM, and Vietnam is a prime example of the value of active management in the asset class. Over a long-term horizon, the IT service company has appreciated nearly five-fold since 2007, while the broad Vietnam equity index is flat over the same period. Understandably, investors have been frustrated by EM's inability to translate strong GDP growth into strong equity market performance, and this is an example of how an active approach in the asset class can capture these benefits.

Until next month,



Chad Cleaver, Lead Portfolio Manager
Driehaus Emerging Markets Small Cap Equity Strategy

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