

# FINDING GROWTH IN ASIA: CHINA AND VIETNAM



WRITTEN BY:  
ROBERT T. LUTTS  
PRESIDENT, CHIEF INVESTMENT OFFICER

To succeed in today's challenging financial markets requires thinking outside the box. This is nothing new for our firm as we have been looking for growth on a global basis since 2002. My first trip to China in 2002 opened my eyes to a vibrant and healthy economy that was growing at 4 times the rate of growth of the United States economy. Investing in this kind of environment puts the "wind at your back" and has the potential to produce better-than-average returns. Having just returned from an 11-day research trip to Singapore and Vietnam, I believe the case for the emerging markets is quite strong. A growing middle class is the primary driver of new growth in the region. Banking services, education, health care, transportation, food products, and infrastructure all should experience above-average growth. We believe most

investors are underexposed to this area of the equity markets. Our favorite emerging markets include China, Brazil, India and Singapore. In the frontier class we favor up-and-coming Vietnam. It has a young and educated population that is eager to join the ranks of more affluent populations. A more favorable regulatory system and a pro-free-markets initiative will help Vietnam become one of the faster-growing economies in Asia. We believe it is an ideal time to boost exposure to this region. Here are some of my personal observations while in Asia in May of 2009.

1.) Asia has slowed down like the rest of the world; however, **the Asian banking sector and property sector are in much stronger condition than the developed economies like the United States and**

**the United Kingdom.** I met with the new CEO of the second-largest publicly traded bank in India and heard some very good news regarding lending and banking services in India. I believe the leading Chinese and Indian banks continue to remain quite profitable and growth rates in the coming decade could easily top 20% per year.

2.) **Debt levels in Asia are very attractive from an investor's point of view.** Today the United States has a mortgage to GDP ratio of about 80% (this means we are 80% leveraged). As a result of significant cultural differences, Asians seem to avoid debt and prefer to save before spending. This means these economies will be much more vibrant in a downturn. China has a mortgage to GDP ratio of only 11%, while India's is a miniscule 5% and



Rob Lutts (center) meeting with executives of TV Plus in Hanoi, Vietnam. On the left is Truong Nguyen of IDG Ventures. This women-led company is a star performer in the media sector in Vietnam.

Vietnam's is only 2%. There is plenty of room for these debt levels to rise in these economies. This means higher levels of growth can be achieved with the use of some financial leverage.

3.) **The spirit of entrepreneurship is alive and well.** After many trips to Asia, I have come to learn that it seems that a disproportionate share of Asian companies have the luxury of higher profit margins. This is true for some easy-to-understand reasons. First, the government taxation is much less in these economies. There is no large social services sector that requires high corporate taxation and corporations are viewed as a critical component of the countries' economic growth engines. Secondly, we know companies in Asia have much lower labor costs and lower infrastructure costs, which allows for much higher net margins. We find banks in India with double the margins of banks in USA and retail stores in China with 30% net margins (very rare in the developed economies).

4.) **Vietnam operates in the shadow of China but is following in the footsteps of China; and, we believe Vietnam will experience great growth in the coming years.** In Vietnam, the economic system

is quite robust and we anticipate longer-term GDP growth in the 6-8 percent range. I met with a private media company in the television production business that was experiencing dramatic growth in the 35% area. The women-led company was positioning to continue that level of growth for many years. The middle class in Vietnam is growing fast and therefore media growth is in a favorable position.

The world continues to become smaller and smaller as the emerging economies continue their journey to higher levels of income and consumption. We favor the areas in the emerging economies that are benefiting from the extraordinarily large middle class in the emerging markets. It is estimated that there are more than 1.4 billion people with incomes of \$5,000 to \$20,000 in the emerging economies (China, Brazil and India being the largest). We believe that we are entering a period of time when a large surge of consumption from within these economies drives growth at a very high level... think the United States in the 1950s. We have positioned our clients to benefit from banking services, education, health care, transportation, retail, and infrastructure improvements. We believe most investors

are not properly exposed to the growth opportunities we have uncovered. Our on-the-ground meetings, twice a year, with local executives of these Asian companies allows us the confidence to properly position our clients for this growth.

*Robert T. Lutts is President and Chief Investment Officer of Cabot Money Management, Inc. in Salem and Boston. Cabot is a fee-only independent wealth manager and has been building wealth for clients since 1983.*

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Cabot Money Management, Inc.  
216 Essex Street, Salem, MA 01970  
978.745.9233 • [www.eCabot.com](http://www.eCabot.com)

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