An Analysis of Realities in Vietnam Based on Behavioral Finance

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1. Overreaction on the Vietnamese stock market

Many people feel pessimistic when the stock market has experienced continuous falls, with some slight recovery at times, in recent months. Some others think that the market will keep falling and the VnIndex will pass 800 and even 700 mark. Under current condition, however, this possibility can hardly happen. The basic reason may be that the Vietnamese stock market is in the first stage of a process called "overreaction," when it, after some strong increases, starts to fall drastically, which many financial studies have called "short- term momentum and long- term reversal."

In more developed economies, their stock markets reflect basic changes in the economy. It plays the same role in Vietnam, a remarkably emerging country in recent years. Along with encouraging signs of the international integration are their side effects that constitute signs of the overreaction. This process is ignited by pieces of good news (Vietnam became a WTO member and got PNTR status, etc.), which makes many people place confidence in a bright future of the market. Where does the overreaction make its appearance?

First of all, it comes from companies. Many directors, because they felt either self-confident or eager to take chance after Vietnam got accession to the WTO or they were unaware of challenges posed by international competition have shown overreaction by mobilizing idle money in large quantities, which leads to danger of over-investment. When the economy starts to take off, everybody feel optimistic regardless of their advantages or disadvantages and try their best to secure large sum of money to expand their investment, restructure their business and improve their market shares. Many even take advantage of the chances to make easy money by manipulating prices of stocks instead of focusing on long-term business strategies.

The second kind of overreaction is the confidence that many people feel when they decide to start their businesses. Quite a few young people want to be owners of businesses right after graduation when they didn't know exactly what business management or role of businesspersons really are and many of them have borrowed money to buy stocks. Some experienced businesspersons have also established their own companies and believed that good chances would help them develop well. Those who start business so hastily without knowledge and anticipation of the coming stages of economic cycle will meet with a lot of risks. Widespread entrepreneurship is an encouraging sign but starting business in haste and fear of missing chances is somehow a kind of overreaction to the initial economic growth.

Consumers also have their own overreaction. Studying annual export and import, we see that Vietnam has imported not only capital goods and raw materials needed for production but also consumer's goods in very large quantities. This means that consumers also feel more optimistic and get readier to consume imported non-essential goods. When this trend that is reasonable during economic booms gets excessive, it becomes an alarming sign to the economic growth.

The last overreaction is from investors. They tend to be happy to see companies issuing more shares and pay dividends in shares and their reaction makes the price higher. Both foreign and local mutual funds with full knowledge and experience also put their money in various projects because they believe in a bright future, which can easily lead to the first stage of the overreaction, or short-term momentum. Foreign institutions tend to estimate the Vietnamese market as too hot based on the P/E ratio, but in fact they pay no attention, may be intentionally, to the fact that the market is in a period when expectations are very high, thus causing a big short-term momentum. No warning or analysis can reverse this trend within a short time.

Many people may be of the opinion that such reactions are reasonable, not excessive ones, because the economy is developing well and it's reasonable to earn profit by doing business or making sound investments. But not all businesses or investment are sound. In the stock market for example, prices of many stocks are very high although the prospectus shows no remarkable profit or promising dividend. Reasons for these high prices may be "foreign investors are considering acquiring them," "this business is profitable after the accession to the WTO," or "the company is carrying out promising projects." Many stocks at present have high and very high P/E ratios. This situation only reflects high expectations from investors, not a hot market as what warnings say. The market only becomes hot, or very hot, when expectations prove to be unrealistic, that is, when all investment projects carried out by the company certainly end in failure.

It is possible? The possibility of this situation is higher than what investors are expecting when risks involved in the WTO membership are not full felt in the market and its advantages are not as high as expected. When investors feel disappointed, the long-term reversal begins.

The increasing crowd of investors has pushed the price up for several years, the invisible hand of the market is starting to adjust it with the result that the price will fall at a speed higher than the one that has pushed it up. Experience form foreign market shows that strong increases in the price in the past can make it to keep increasing in some more years. After this period, the price will fall faster than the speed it gained when rising, and more importantly, the second period may last for a long time instead of existing as short-term adjustment as seen in the short-term momentum. Such model is explained as overreaction that comes into being when the market during a period full of good news is slow to adjust itself when bad news comes with the result that the rise in price continues for a time. When the price comes back to its reasonable level, it leads to a long falling period and stay unstable for a very long time.

Many people are believing that the falling period will take a long time to come, but studying past happenings in such economic as in Thailand, Indonesia and South America, we see that both spectacular rising periods and more spectacular falling periods are not too long. But their prolonged and serious consequences of these changes make it difficult for these emerging economies to come back to their "golden ages" because they affect profoundly the mentality of investors, social unrest and economic structure. What have happened in Argentina and Thailand in the past are worth consulting.

Many people may argue that Chinese stock market, in a country that got accession to the WTO before Vietnam, has experienced no fluctuations so far and still keeps on rising. This argument is right because at present, both Vietnamese and Chinese stock markets are still in their "short-term momentum." But comparing the momentum in the Chinese market with the one in Vietnam is as unreasonable as comparing the 80-million people market in Vietnam with the one-billion people market in China. Such a huge market as the Chinese one may survive a bigger inflow of capital and a bigger overreaction but it doesn't mean that Vietnamese market could do the same. In other words, there must be measures to dampen the overreaction in the market, and the whole economy as well, that originated from the optimistic attitude after the accession to the WTO. Such an attitude is necessary but any good thing that gets excessive will become a bad one.

After a boom there will be a recession, and this situation happens everywhere. The problem is how authorities to reduce these cyclic impacts. The fact that American and European authorities are trying their best to implement their monetary policies and control the inflation in order to maintain stock exchanges and economic growth rates show that no country is spared from such rises and falls. The only difference is that fact that more experienced authorities can reduce the overreaction of investors and the whole economy by adjusting their monetary and fiscal policies, thereby smoothing their economic growth and avoid shocks to the economy.

When the overreaction happens, if authorities give only warnings or take administrative measures to deal with them instead of making adjustments to the policies, the market usually ignores their efforts, or even reacts negatively. The market during it short-term momentum is like a car running downhill but the bottom hasn't yet come into view. It's vain to tell it to stop. So it's better to act as its driver who tries to brake it in order to avoid a serious crash.

2. Vietnamese stock market: a "rising star" effect

We now see the market from another aspect, not at effects on the price by reaction of investors but at their expectations. Let's examine the following example. In a football team, there are two strikers: one is trained in a foreign football school and famous for his ability to score and he has scored many goals in recent matches; and the other is an ordinary player who shows no remarkable talent and has missed many chances recently. The question is: in the coming matches, or in the years to come, will the football star keep proving more excellent than the ordinary player?

Some people think that he can do it while others disagree. In reality, the majority will believe the football star will play well for many matches. That is why rich football clubs have spent a lot of money buying football stars from all over the world. Track record of a football star may affect expectations of the coach, the club management and those who concern. Many people hope that he will play better and better and contribute mote to the whole club. Such expectation may be easily found in the Vietnamese stock market.

Articles about the Vietnamese stock market on both foreign and local newspapers last year are numerous. It is really an emerging star, like such footballers as Cristiano Ronaldo and the like.

Regardless of warnings about a hot market, many investment institutions, including ones that have given such warnings, are investing in the Vietnamese stock market. From experts to amateur investors all give the same answer when asked about prospect of the Vietnamese market. They say that in spite of being hot recently the market looks optimistic in the coming years; and all adjustments and unfavorable changes are only temporary and small, and the market will keep rising for years to come. This is exactly the attitude towards a rising star, a field of study that attracts a lot of researchers of behavioral finance.

Many studies on the American basketball show that apparent effects of basketball stars have no "remarkable relations with past data," and a study even concludes that trust put in stars is not only a mistake but also a serious one. Studies on the behavioral finance theory, with examples of sports stars, may help policy makers and investors understand more correctly the Vietnamese stock market.

Firstly, the more famous the player, the more strategies worked out by opposing teams. They pay more attention to the star and do everything to make him useless. A lot of articles on foreign newspapers have carried information with implications about the Vietnamese stock market. All surveys of policies on the market meet with strong reaction from both local and foreign investors. The fact that stock market authorities continuously deny the possibility of imposing taxes on ordinary shares, or stricter control over foreign investment or mutual funds reflect the effort to nullify the sports star.

Secondly, the expectations of the sport star, especially by ones who lack full information, may be wrong. Many people may be misled by good information about the star. A statement saying that the government "hasn't yet considered controlling the foreign capital now" ("now" never means "never") could be accepted as a gift for investors after the Lunar New Year Festival, which made the price skyrocket regardless of various warnings. The other side of the overreaction is the fact that what follow "positive overreactions" are not trivial adjustments but major ones that aim at restoring the equilibrium before such information, which may lead to "collapse" of the market with the result that many blue-chip stocks are devalued when the market price falls. This explains why many speculators got rich quickly by buying devalued stocks during the falling period of the market.

Thirdly, if a warning is given when everybody places their expectation in the Vietnamese securities stars, they still maintain their decision although they feel somehow uncertain. Concealing bad information about the star and amplifying good news on the stock market are worrying fact that requires more attention.

Fourthly, the more people believe in the bright future of the stock markets, the richer speculators get by trading in securities. This situation has something to do with a phenomenon of behavioral finance: success stories in the stock market are we-only-see-the-winner situation, because no loser is ready to say how much he/she has lost. The mass media tend to imply that the majority are winners, including many laborers or hawkers, and only a few players with full knowledge is among losers.

Studies on the financial behavior theory show that the Vietnamese stock market may become a long-lasting star if authorities know how to manage causes of disastrous consequences. And these authorities include the securities commission, listed companies and professional investing institutions.

The Securities Commission and Ministry of Finance should ensure transparency of information, reliability of technical facilities, and quantity and quality of commodities with a view to encouraging appearance of new stars, thereby avoiding excessive attention to certain blue-chip stocks.

Listed companies had better innovate themselves and improve their business performance in order to maintain trust by investors instead of establishing subsidiaries specializing in financial investment. Quite a few companies even mobilize capital to invest in securities. Chinese securities authorities have become aware of this trend and have banned companies from issuing more shares to secure money needed for financial investment.

The most serious mistake is to use regulations and rules to intervene in the behavior or mentality of the public. The best approach is to help investors get more investing knowledge and skills so they can realize possible risks when making financial investments instead of following common trends. Regrettably, many investors are rushing into the market without knowing how it is working while the task of disseminating necessary information about the stock market seems too difficult for securities authorities.■