

# Will the Olympic Spirit lead to a Korea Surprise?

February 2018

**Deep down, in places hidden from plain view and sentiment concealed under layers of pride and prevailing political current, Koreans want to be united.** They are truly one people, and often even one family torn apart by one of the biggest travesties of history, by indeed a grave miscarriage of ideology.

So as trivial as the opening days of the 23rd Winter Olympiad in PyongChang may seem... they are, in our view far from trivial. The coming together sets the foundation for momentous progress towards peace and re-unification of a singular people, and indeed what should always have been a singular nation, a singular culture.

The unprecedented (the first time since 1950-53 Korean War) presence of key members of the Kim dynasty, from north of the border visiting South Korea, the tears wept by the North's head of state, Kim Jung Nam during the Olympic opening ceremony, to the serene show stealing smiles of Kim Jong Un's own trusted sister and confidant, Kim Yo Jong, suggests there is most definitely more to come.

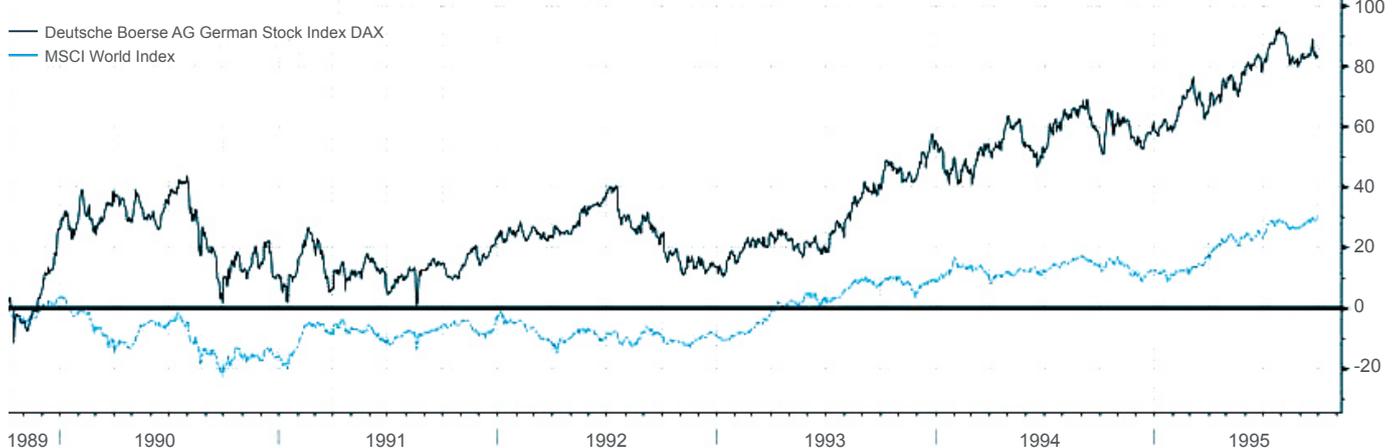
And, in addition to the overwhelmingly powerful spirit of the most revered of sporting events, the state visits to Seoul's Blue House for official meetings with South Korean President Moon Jae In, and even the symbolism of the lunch menu where no expense was spared in the painstaking attention to detail feels like a precursor of significant developments ahead. Of note, the Korean word for 'family member' is 'people eating food together,' and menu items consisting of food that transcends well beyond the 34th parallel into the North were chosen, in

addition to delicacies directly from the North co-mingled, seemingly seamlessly... as it once was, and perhaps as it was always meant to be.

**It was a historic coming together of athletes and celebrities, alongside key political figures from both sides of the parallel, all competing and performing under one flag, perhaps as one nation, signifying the inherent long-term desire to re-unify.**

But all pomp and circumstance aside there will be some very real and formidable challenges ahead particularly given the strong political personalities, egos, and international geo-political vested interests at play. Even if low probability military conflict remains a possibility. These considerations create considerable uncertainty in terms of trying to put a timeline on how to invest for what we do believe to be an eventual certainty, one day. We do, however, have a precedent for the possible outcome. Like in Germany, the most recent example of such a monumental effort, there will be growing pains as the process takes shape, along with the obvious long-term opportunities afforded by such an event. The Berlin Wall officially came down on November 9th, 1989, driving significant opportunities and challenges for a newly re-unified Germany. The DAX significantly outperformed global indices, as shown here—some c40% above MSCI World Index over the subsequent five years<sup>1</sup>. Key South Korean indices too, in our view would be in a position to significantly benefit from a much bigger, stronger and unified Korean market, all growing pains aside.

**FIGURE 1:**  
DAX vs MSCI World



Source: RWC, Bloomberg, DAX versus MSCI World, 1989-1995

1. Source: Bloomberg

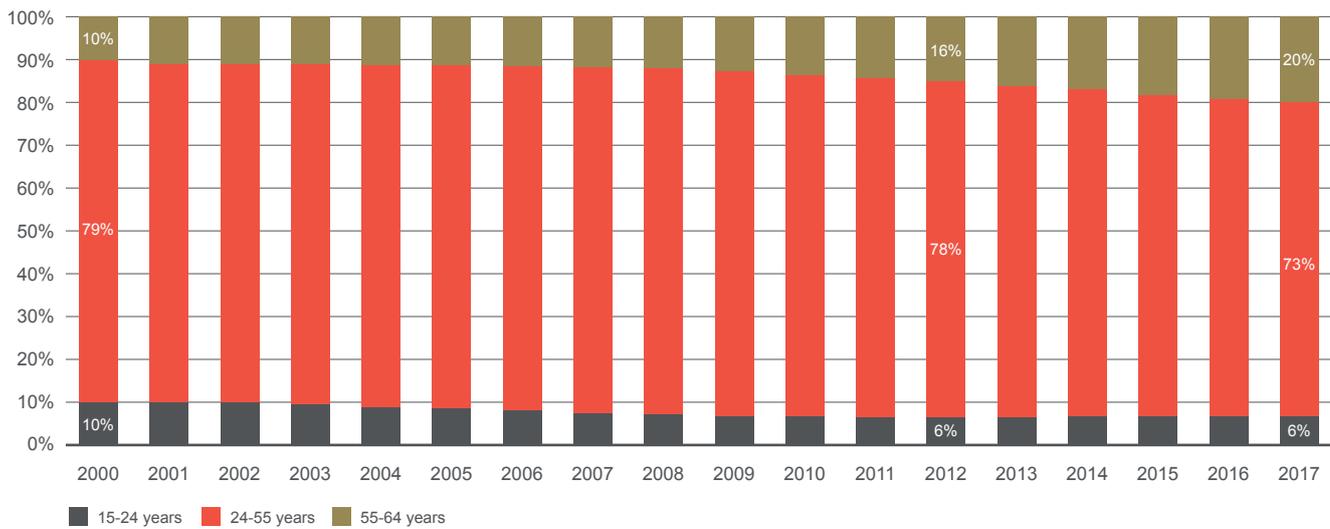
**Reflecting specifically on South Korea, and independent of any reunification, RWC’s macro view remains very constructive**, indeed one of the most constructive within the context of the Emerging Markets we invest in. South Korea’s economic recovery strengthened over the past two years despite geopolitical tensions and political uncertainty preceding last year’s presidential election. We believe the South Korean manufacturing and exporting juggernaut in particular, should continue to help drive the economy as global growth continues to strengthen perhaps even providing a boost to domestic consumption growth which had hitherto been softer.

Despite this positive near-term back drop in the South, students of economic development will be quick to point out that demographics wins in the long term. And that is where the ageing/greying population and one of the slowest birth rates in the world will hurt. Practically speaking it is also the most significant economic incentive

to reunify. South Korea is already the 5th largest economy in Asia, and the top 15 globally. Integrating with the North would only make them economically stronger, over time, as was the case with Germany.

Ceteris paribus, South Korea’s workforce is expected to decline by 10 million from today’s 36 million workers in 20 years while the labor force in the North stands at close to 20 million today only to decline marginally in the same period, not to mention the North’s lower median age providing a badly needed boost to working age demographics<sup>2</sup>. In addition to this c50% boost in workforce, population density dynamics improve as well. Given its mountainous terrain, the South has some of the most densely populated cities in Asia, with its capital Seoul at roughly twice the population density of New York City. Of course, the complete homogeneous fit in culture and language represents the obvious cherry in the proverbial economic pie, in terms of seamlessly being able to integrate the workforce, over time.

**FIGURE 2:**  
Korea Employment by Age of Workforce



Source: RWC, Bloomberg, 2000-2017

2. Source: United Nations, Haver Analytics

**Bottom up, at RWC, we continue to seek and find compelling investment opportunities, some of which lend well to a reunification scenario.** We have invested in infrastructure, retail, as well as technology themes which would certainly benefit from a longer-term reunification effort between North and South Korea. Clearly, we need to balance between near term growth catalysts absent any reunification, as well as the potential optionality of any favorable reunification developments, which limits the level of 'dream' we can practically infuse into our Korean portfolio.

That said, an example of a current portfolio investment is **Samsung Engineering & Construction (028050)**, the oldest construction arm of the largest, most established chaebol, or family-owned business conglomerate, in South Korea. Samsung E&C is not only heavily involved hydrocarbon and refining plants globally, it is also heavily involved in the construction of factories, technology plants and power stations within Korea. As construction will clearly be a big drive of any reunification effort, we feel Samsung E&C not only will benefit from rising oil prices and global increased capex in refining capacity, it provides strong optionality on any reunification developments. Historically we have also invested in **Hyundai Development (012630)** the largest domestic builder of homes and office buildings, a name we would certainly revisit if catalysts for a reunification became more evident.

On the retail front, we are invested in **E-Mart (286000)** which operates one of the largest chain of discount stores selling food, clothing and household goods. As in Germany post its reunification in the early 1990s, the retail expansion opportunities afforded by an enlarged

addressable market obviously presents massive upside optionality. And absent this catalyst, E-mart continues to execute well in South Korea with increased online sales profitability, and larger ticket size transactions, garnering increasing share of South Korea's F&B retail industry.

We also own **ING Korea Life (079440)**, arguably one of the best run life insurance firms in South Korea, taking share and expanding markets in an otherwise slow growing industry. The name would see a significant boost in addressable market on any reunification scenario with the North particularly as disposable incomes increase and financial inclusion drivers take hold.

Outside of these domestic plays, we are invested in the massive Korean manufacturing and export machine dominated by electronics and semiconductor components. While not necessarily a direct beneficiary of a stronger, re-unified Korea, **Samsung Electronics (005930)** and **SK Hynix (000660)** will continue to benefit from the increasingly memory hungry smartphones, data-centers, and other artificially intelligent devices (including cars and appliances), which we feel will continue to grow globally, and to which an open and more accessible North Korean market will incrementally contribute to, over time.

At RWC, we remain very excited about the opportunities offered by a Korean reunification, but cannot ignore the formidable and obvious hurdles: we are dealing with some very difficult personalities (Kim/Trump) and, despite a low probability, even military conflict could be possible. While these factors along with other US, Chinese interests will take time to resolve, we do believe a reunification of the Korean peninsula carries a high probability in the next 50 years.

**CONTACT US**

Please contact us if you have any questions or would like to discuss any of our strategies.

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