



## Why the South Korean Stock Market is Attractive, Despite North Korea

The South Korean stock market is a great place to find value, and particularly right now when the U.S. stock market is so overvalued. In our view, the investment returns over the next 7-10 years are probably going to be more attractive in South Korea than the United States.

### The Korean Stock Market (KOSPI) - A Top-Down Valuation Approach

If you look at the Korean stock market, also known as the KOSPI, the Price/Book ratio is barely above book value, and the P/E ratio is less than 10x. Furthermore, the Korean market is even cheaper than these surface-level valuation measures suggest because many Korean businesses own the shares of other Korean companies which have real value but are not captured by the traditional valuation metrics that are picked up on a Bloomberg screen.

StarCapital provides a [free tool](#) to help you understand which countries are cheap and which countries are expensive. Across several valuation measures, including Price/Book, Price/Sales, Price/Earnings, and the Shiller P/E ratio, South Korea comes up as the #1 cheapest country in the world. The table below shows the ranking of the most undervalued 12 countries:

Fundamental Valuation Ratios in International Equity Markets as of 06/30/2017.										
Country	Weight	CAPE	PE	PC	PB	PS	DY	RS 26W	RS 52W	Score
Korea (South)	1.9%	15.3	12.9	5.9	1.1	0.7	1.5%	1.05	1.11	1
Austria	0.2%	17.2	16.6	5.9	1.3	0.8	2.6%	1.07	1.19	2
Czech	0.0%	8.8	12.9	5.9	1.3	1.1	6.3%	1.02	1.08	3
Hungary	0.0%	13.6	10.4	7.7	1.4	0.8	2.6%	1.04	1.12	4
Italy	1.1%	14.6	38.8	5.9	1.3	0.6	3.1%	1.03	1.12	5
Poland	0.2%	12.1	16.6	9.0	1.4	0.9	2.2%	1.04	1.16	6
Portugal	0.1%	12.3	23.9	6.1	1.4	0.7	4.2%	1.04	1.09	7
Turkey	0.3%	11.1	11.1	8.5	1.5	1.0	2.6%	1.07	1.09	8
Spain	1.4%	13.5	18.4	7.1	1.6	1.3	3.6%	1.03	1.12	10
Russia	0.8%	4.9	7.1	4.4	0.8	0.7	5.1%	0.87	0.93	11
China	1.1%	15.4	7.4	4.1	0.9	0.7	4.0%	0.96	1.01	12



## The South Korean Stock Market (KOSPI) – an Attractive Value

As an aside, you might be wondering what the most expensive countries in the world are (see table below).

Mexico	0.7%	22.8	18.6	11.5	2.4	1.4	2.2%	1.04	1.06	28
Malaysia	0.6%	16.5	18.5	11.8	1.7	2.2	2.9%	1.00	1.01	29
Netherlands	1.2%	22.0	20.1	13.0	2.0	1.2	2.5%	1.02	1.08	30
Australia	2.1%	17.2	19.3	11.4	2.0	1.8	4.4%	0.97	1.01	31
Ireland	0.2%	34.5	19.1	15.7	1.9	1.9	1.1%	1.03	1.10	32
Denmark	0.7%	36.1	24.8	14.6	3.1	2.3	2.1%	1.06	1.10	33
Canada	3.1%	20.4	20.9	9.6	1.8	1.5	2.8%	0.96	0.99	34
Switzerland	2.8%	23.7	25.1	17.3	2.6	2.1	3.0%	1.02	1.07	35
Indonesia	0.6%	19.7	21.1	15.3	3.3	2.9	2.2%	1.01	1.03	36
India	2.8%	20.6	22.8	16.9	2.7	1.9	1.5%	1.01	1.07	37
Philippines	0.4%	22.0	20.6	11.3	2.3	1.7	1.6%	0.98	0.97	38
Belgium	0.7%	22.9	27.6	12.6	2.0	2.1	3.3%	0.98	1.00	39
United States	42.0%	28.0	22.4	13.2	3.1	2.0	1.9%	0.98	1.03	40

## The U.S. Stock Market (S&P 500 Index) - an Unattractive Value

It's important to remember that valuation measures are only useful for making long-term investment decisions. The more undervalued a particular stock market is, the more likely you will be in generating more attractive returns over a seven to ten-year period by investing in that market. Valuation measures are usually not helpful in predicting near-term stock market returns. In 1998, U.S. tech stocks, already grossly overvalued, continued to rally for two years before finally correcting severely. If you are a long-term investor, you are better off paying attention to valuation and trying not to worry about short-term price fluctuations, in our view.

### Why is the Korean Stock Market Cheap?

It's a difficult question to answer. To be honest, we are not exactly sure why Korean stocks are cheap. We are also not sure that it matters.

However, we can confidently say that Korean stocks are not cheap because of current headlines related to a potential armed conflict between the United States and North Korea. We say this because South Korean stocks have been cheap for years, and Korean stocks have rallied in 2017. That rally has occurred despite the fact that the risk of armed conflict with North Korea has increased substantially.

Our speculation is that Korean stocks are cheap for two reasons.

First, it's difficult to invest in individual Korean stocks as a U.S. investor. There are few ADRs that you can buy in the United States and you can't directly own individual Korean stocks without opening up a brokerage account in South Korea.



Second, South Korean companies do not typically return cash to shareholders as aggressively as U.S. companies do. That's a knock against South Korea and a lot of other countries. On the other hand, Korean companies also don't abuse stock options and other forms of equity-linked compensation as aggressively as U.S. companies do.

These are certainly drawbacks, but, in our view, Korean stocks pay you well for living with these drawbacks.

### **What Happens if There's a War between North Korea and the United States?**

We believe a war is highly unlikely. Such a war would involve at least two countries with nuclear weapons. Including Russia and China, four countries with nuclear weapons could become involved. All four countries understand the game theory behind mutually assured destruction (MAD). For that reason, we expect all parties involved to pursue their national interests through diplomacy.



While we believe this is the most likely outcome, we could be wrong in our optimistic assessment.

If we are wrong, that means a major war that will break out in Asia, potentially involving nuclear weapons. Along with North Korea, South Korea will be hardest hit. The South Korean stock market will go down in value. To put it incredibly mildly, that wouldn't be a good development at all.

However, South Korean semiconductors power the world, from computers to smart phones to cars to data centers. A war would disrupt the global semiconductor supply chain. Such a disruption will affect world markets, not just the South Korean stock market. The risk to financial markets is not at all limited to South Korea.

In summary, if a war happens, it will likely be world markets that go down in value, not just South Korea. If a war doesn't happen, South Korea has more long-term upside than a lot of other countries, in our view. The risk-reward profile looks attractive, despite the threat of an outbreak

Sincerely,

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