

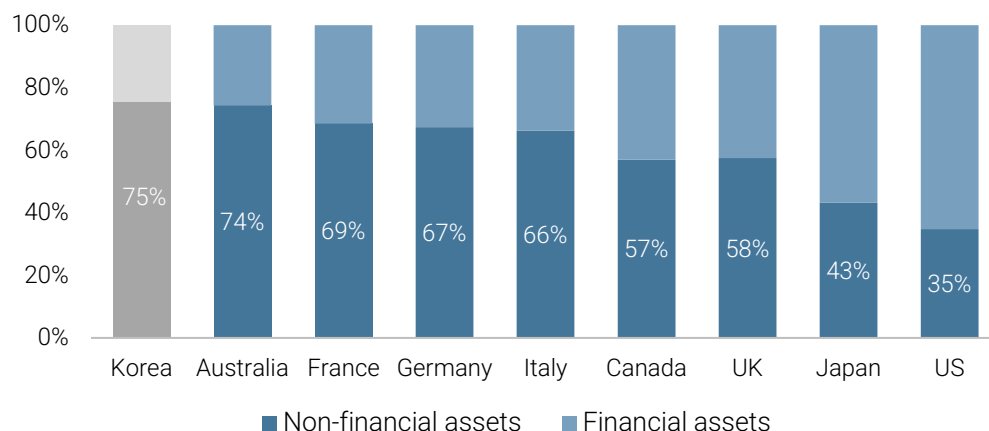
President Yoon Focuses on the “Korea Discount”

South Korea's stock market has persistently traded at a discount to its global peers on a simple valuation basis. Despite the high quality of many of its companies, this “Korea Discount”, which is primarily due to historical concerns around corporate governance and capital allocation, presents the beginnings of a compelling and timely investment opportunity as discussed below.

The Korea Discount now seems to have become a target of President Yoon. His first public activity for 2024 was to attend the Opening Ceremony of the first trading day of the Korea Stock Exchange. President Yoon is the first incumbent South Korean President to make such an appearance, showing his keen interest in reforming the Korean equity market. While Dalton would love to believe President Yoon is boosting the Korean market in an effort to help our firm and its clients, his motivation is more likely driven by the urgent need to offer Korean savers alternative ways to grow wealth amidst a housing bubble. Nonetheless, this renewed attention could ultimately unlock significant value for investors.

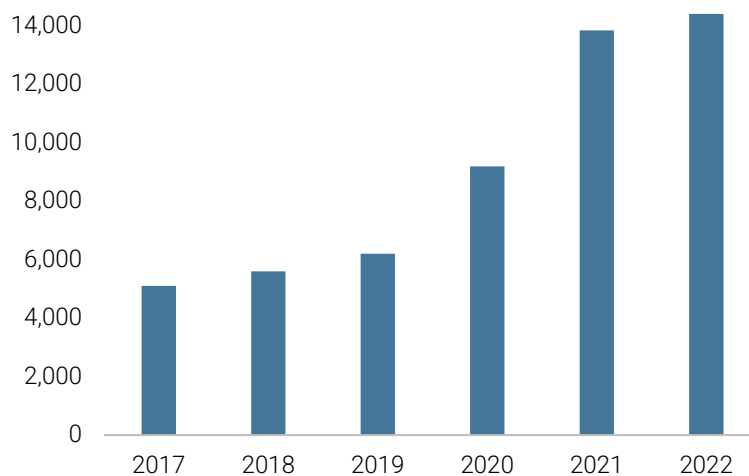
As background, let us first consider South Korea's historic heavy concentration in real estate. With up to 75% of household net asset wealth tied to the sector (Chart 1), soaring real estate prices have resulted in significant price inflation and debt accumulation among Korean households. This "real estate frenzy," fueled by a long-held belief in the market's infallibility, now faces increasing headwinds from rising interest rates, posing potential financial stability risks. Additionally, high property prices are often cited as a key contributor to the nation's low birth rate.

Chart 1 - Household Investments in Non-Financial vs Financial Assets (Estimated, 2013 - 2016)



Unlike the booming real estate market, the Korean stock market performance has been lackluster for more than a decade, understandably leading to limited interest from domestic savers. Recognizing this, President Yoon appears to understand that to switch the mindset of Korean investors and cause a structural shift into the equity market, he needs to address the persistent poor stock market performance and eliminate or reduce the Korea Discount. In his speech, he was keen to highlight early signs of success in this initiative, pointing out that the number of individual Korean security account holders has nearly tripled from five million to fourteen million just over the last few years (Chart 2).

Chart 2 – Number of Koreans investing in Korean Equities (thousands)



Steps to address the Korea Discount

During the Korea Stock Exchange's Opening Ceremony for 2024, President Yoon announced his intention to reform tax systems and eliminate the Korea Discount:

- **Tax simplification:** Scrapping capital gains tax on financial investments and further reducing stamp duty rates will directly improve after-tax returns for Korean investors.
- **Enhanced shareholder protections:** Addressing weak minority shareholder rights, a known contributor to the Korea Discount, protects them against unfair treatment.
- **Reduced inheritance tax burden:** Lowering the punitive inheritance tax rate reduces the incentive for controlling families to keep prices low to minimize the tax burden. Incentivizing controlling families to maximize company value aligns their interests with minority shareholders.

Interestingly, the idea of a Korean “value re-rating” program, which includes “naming and shaming” poor performing companies, has also been discussed in recent weeks. This initiative, modeled after similar efforts by the Tokyo Stock Exchange targeting gross undervaluation, proposes public identification and censure of underperforming companies. We believe such a program with its combined top-down government pressure and existing bottom-up activism from local and international activist investors, could significantly enhance the Korean market's appeal and unlock latent value for investors.

Implications for the Korean market and for Dalton's portfolios

President Yoon's speech confirmed that he plans to use “Eliminate the Korea Discount” as one of his main political messages for the upcoming General Election. While this has exciting potential return implications for the Korean market, it remains to be seen whether his execution will be effective. However, the fact that the opposition party is also focused on the stock market (as opposed to the real estate market) shows that the Korean political establishment views the stock market as a major and necessary area of improvement in the Korean economy. Moreover, Korea will always closely monitor its neighbor, Japan, and the more Japan succeeds in its reforms, the more Korea will be influenced to follow suit.

As an engagement-focused active manager, we view Korea as a prime hunting ground where shareholder activism can drive major improvements in target companies. We also work closely with the leading opinion groups such as the Korea Corporate Governance Forum to make sure our voices and those of our clients are heard. If pressure for change continues to build in Korea, with increasing support from the Korean government, we believe there will be exciting times ahead for the Korean market!

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