

## It is official again... it is emergence as usual for the Hermit Kingdom!

*...according to the oracle that is MSCI Barra!*

*June 2009, Adrian Cowell, Director and Fund Manager*

### To emerge or not to emerge, that is the perennial question to mangle the MSCI Bard

The institutional investment world may have been eagerly awaiting the results of the protracted MSCI Barra conclave (also known as the Market Classification Consultation – a twelve month process, with preliminary conclusions presented after six months in December 2008) on whether the stock market of the Republic of Korea (RoK) should be reclassified as a “developed market”, thereby joining the MSCI World Index, or whether it should remain in division two, another year of losing out in the play-offs and more “emergence as usual”! Then again, the investment world may not have been waiting – there is after all, a lot of other stuff going on!

The consequences of promotion, were it to happen, would be a peninsula shift of tectonic proportions from a 12.4% weighting in the MSCI global emerging markets index to a drastically downsized but doubtless perfectly formed 1.64% weighting in the world index (*Source: Factset, June 19*). Had it won through in the play-offs, the RoK, that “shrimp between two whales” (the listed bottom half of the dangling peninsula between China and Japan), would have become an even smaller fish in the developed pond, the victim of passive (*surely massive – ed*) adjustments in quotas! Portfolios would probably concentrate to match their managers, and rafts of mid caps and small caps would be cast adrift in the West and East Seas - lost to the investment world. Rampant Exchange Traded Funds (ETFs)!

In any event, come 15<sup>th</sup> June 2009, the puff of white smoke from said conclave was either not to be, or possibly the smoke was lost in the exhaust clouds blasting off from the launch pads of Musudan-ri and Dongchan-ri in the Democratic People's Republic of Korea (DPRK) as the Dear Leader, Kim Jong-II, apparently randomly, loosed off rockets of various sizes in various directions to accompany his 25<sup>th</sup> May detonation of a 20 kiloton thunderbox at Punggye-ri. This detonation was initially detected as a seismic tremor 10km underground measuring 4.7 on the Richter scale. It is now probably confirmed as his second underground test of a nuclear device, the equivalent of the bomb dropped on Nagasaki. Perhaps it was a big night the night before, Dear Leader and Brilliant Comrade... yes we now have a new Brilliant Comrade in the mix!

But we digress.

The RoK, the publicly quoted half of the Korean peninsula formerly known, perhaps appropriately, as the “Hermit Kingdom”, will remain in hermitage with a review of its status and progress on reforming key issues to be assessed again in June 2010, despite meeting developed market qualifications in terms of economic development and liquidity in the markets.

Three accessibility issues have been cited as reasons for emergence as usual;

- 👑 Convertibility of the currency – the on-shore Korean won market is too constrained, and there is no off-shore market in the currency.
- 👑 Foreigner ID system – this system is too rigid, complicating inter alia block trades and in specie transfers.
- 👑 Anti-competitive practices relating to provision of real time stock market data.

These three areas present significant challenges for the Korean authorities. Currency convertibility impacts management of the exchange rate, capital flows and foreign reserves, cramping a possibly genetic predilection for hands-on management residing within the Ministry of Strategy and Finance and the Bank of Korea. The foreigner ID system is in part linked to this issue. Real time stock market information is a more commercial issue between the Korea Stock Exchange with its indices/information, and the use thereof by others to develop investment products.

The MSCI Barra press release dated 15<sup>th</sup> June 2009 drew encouragement from “the goodwill expressed by the Korean authorities through their efforts to understand the issues and explore options to address them”. Doublespeak?

Comment from within the RoK was of a different tone.

On 16<sup>th</sup> June, the *Maekyung*, the leading economic daily stated; “as Korea accounts for 13% of the MSCI Emerging Markets Index, MSCI would find it difficult to market the index if a large part of it left! Sectorally Korea contributes 27.9% of IT, 29.7% of consumer discretionary, and 32% of industrials.” So there. Bric that in your pipe and smoke it.

The Korea Times, an English language daily, on the same day wailed in umbrage; “chills the country’s hopes once and for all for more investors....” Aha! So develop, and they will come! As simple as that.

In the same article the Korea Times quoted a spokesman for the Korea Stock Exchange who was not surprised. “after months of reviews, MSCI recommended... to revise some practices and regulations... but we could not follow the advice. It is not certain whether MSCI will upgrade Korea during next year’s review as the country has no immediate plan to phase in the MSCI recommendations”. Therein lies the rub.

And there we are. Intransigence either side of a line of yellow tape crossing the table in the market access equivalent of the hut in the truce village of Panmunjom in the Demilitarised Zone (DMZ), where DPRK and RoK negotiators have met on and off for more than fifty years, purportedly to try to bring the Korean War to an end.

However, the world of indices is a competitive one. Footsie 1, MSCI 0! The Footsie will promote Korea to developed market status in September 2009. On the one hand we have a trans-Atlantic battle of the benchmarks, and on the other the efforts of an aspiring economic climber and its regulatory environment!

### Something is rotten in the state of the peninsula...

As pan-peninsula tension continued to rack up remorselessly month-on-month, the southern half of the peninsula was rocked by the shock suicide fifteen months after leaving office of populist former President Roh Moo-Hyun, aged 62. On Saturday 23<sup>rd</sup> May, on an early morning hike near his home, he stepped off a cliff. On leaving the Presidency, Roh had taken many computer files and retired to his home town of Bongha near Kimhae to work a small farm.

The Prosecutor’s Office had been conducting a rather public investigation into alleged bribes totalling W6bn received in part by the former president’s wife from a Pusan shoe maker, Park Yeon-Cha. She then tried to buy a house for their son in the United States where he had been studying and was working.

The Prosecutor’s investigation advanced over the months and Roh suffered the indignity of being driven in a motorcade from his home in the south east of the country all the way to the Seoul Prosecutor’s Office in the north west for interrogation. The ex-Presidential progress was broadcast live on TV. His answers wobbled and his family members were subjected to similar interrogations. Would charges have been filed followed by conviction and prison? There is plenty of precedent.

By the time of his departure from office, the hapless Roh had become exceedingly unpopular. That notwithstanding his suicide has become a rallying standard and perhaps more worryingly a symbol of polarisation for some and hopelessness for many. It was the cue for tidal waves of national mourning as the populace (as many as 5 million paid their respects at altars set up across the country) took to the streets bedecked in yellow. There was a predictably heavy-handed response from the riot police who were out in force blocking off areas of central Seoul (Seoul Plaza was actually blockaded for 12 days) to prevent the mustering of mourners potentially with other intent. The run up to the state funeral was not a particularly dignified spectacle.



Sources (left to right): <http://www.welt.de/english-news/article3825826/Seoul-a-sea-of-yellow-for-former-President-Roh.html>, <http://news.ninensn.com.au/article.aspx?id=819496>, [http://www.thespec.com/Wire/News\\_Wire/World/article/574198](http://www.thespec.com/Wire/News_Wire/World/article/574198).

The incumbent President, Lee Myung-Bak, has work to do to improve his image, his government and his communication. He is proposing a “fundamental remedy” that will be announced in due course after having made careful deliberations for a long time. Can he change his style which, despite getting him elected in a landslide, seems entrenched, a throwback to previous authoritarian regimes, and explains his now very low popularity rating? Time will tell but something simmers and suspicions are rife.

The Prosecutor General, Lim Chae-Jin, has resigned; his statement reported in the Korea Times on 4<sup>th</sup> June said “amid various political scandals, we did our best to win public trust through a fair investigation, but have failed to meet expectations”. Apart from its pursuit of Roh, the Prosecutor had tried to arrest Chun Shin-Il, a tour company CEO, a key suspect in the same corruption scandal. Chun may have involved aides of Lee Myung-Bak. Chun is a friend of 40 years from university days. The Seoul Central District Court rejected the application.

Bribes of W6bn are peanuts in the Presidential pantheon of corruption. Of the surviving former Presidents, one, Chun Doo-Hwan, was sentenced to death, subsequently commuted, another Roh Tae-Woo (no relation) was imprisoned, and myriad sons of the other two, Kim Yong-Sam and Kim Dae-Jung, did time at presidential pleasure. Roh Moo-Hyun’s brother was convicted. There is something of a tradition for a new president to go after his predecessor. Expect this tradition to continue.

So why suicide? The substance of Roh’s legacy, if such there was, was in tatters. The sunshine policy towards the DPRK, inherited from his Nobel Peace Prize winning predecessor, Kim Dae-Jung, has unravelled completely. A waste of time and money, and a study in circular motion back close to where it started if you believe the war mongers. Roh came in on claims of a corruption free Presidency, and that, for however little in absolute terms, has also gone west. Was suicide a proportionate or a weak response? It seems a paradoxical choice in someone with the drive to become president. Or was his Presidency as much the result of other forces as his own desire?

The peninsula is a land of melodrama, high emotion and exaggerated reaction as any watchers of the ever-popular TV “*durama*” (soaps) will know. The RoK suicide rate in 2005 at 26.1 in 100,000 (11.8 in 1995) was the highest amongst OECD nations (Japan ranked second with 23.7, followed by Belgium with 21.1, Finland with 20.1 and Croatia with 19.7) and suicide was the fourth most common cause of death. Celebrity suicides are not rare with several actresses, businessmen and politicians making the choice. In his suicide note as published in the Korea Times on 24<sup>th</sup> May Roh wrote “What is left for the rest of my life will be nothing but a burden for others... I can’t do anything due to bad health... Life and death are both just a part of nature, aren’t they? Don’t feel sorry. Don’t blame anyone. It’s all fate”.

Whatever the explanation, it is a sorry state of affairs.

One message of condolence from the DPRK arrived two days after his death measuring 4.7 on the Richter scale.

**It was Kim Il-Sung the “Great Leader”, it is Kim Jong-II, the “Dear Leader” and it may be Kim Jung-Eun, the “Brilliant Comrade”... if the plots and sub-plots don’t get him!**

So it could be a three part from the Kims of the DPRK as they prepare to extend the envelope “to boldly go where no man has gone before” and enshrine three generations of one family as consecutive leaders of a communist country. Dynasty or Die-nasty. They have already accomplished one generational transfer with Kim Jong-II succeeding his father Kim Il-Sung, and now the gradual process of preparing for another seems to be officially underway with the conferment of the title of “Brilliant Comrade” (*Yongmyong-han dongji*) on favoured third son Kim Jung-Eun, born 8<sup>th</sup> January 1983. He is 26 years old. His now-less-than-robust/less-than-rotund father is 67 years old and may be recovering from a possible stroke he reportedly suffered last year. Then again, extrapolating reports that the DPRK may be looking to import expensive and sophisticated medical equipment suggests that he may not... be getting better. Yes, the DPRK’s got talent!

Very little is known about the littlest Kim. He spent some time in Switzerland at an International School (1998-2000) and a public school, though not as long as his middle brother Jong-Chul, and his elder brother Jong-Nam. He attended under the assumed name of Park Un. He is apparently competitive and likes basketball. He liked/likes to wear military fatigues and pack a pistol. From 2002-2007, he studied Military Science at Kim Il Sung University with enthusiasm. After his mother’s death in 2004 he is reported as having ballooned to 90kg at only 175cm tall. There are also rumours of diabetes, high blood pressure and a motorcycle accident. Sounds like several chips off his father’s block.

If recent reports emanating from Japan are to be believed, he still doesn’t like his eldest brother Jong-Nam very much, having plotted to murder him in Macau with less than Brilliant results. The Chinese authorities apparently foiled the attempt, which was allegedly undertaken without the knowledge of the father.

Perhaps this display of fraternal “kimship” should not be a surprise as there have been earlier reports of assassination attempts both ways. There are different mothers involved, never a promising start, and there is a significant age gap. Jong-Nam is from number two and Jong-Chul and Jong-Eun are from number three. And let’s not forget that there is now a wild card number four in the mix, as yet without progeny, but... Kim Jong-II does seem to like testing his missiles. The Brothers Kim behaviour is worthy of the worst excesses under several Chosun Dynasty (1392-1910) rulers of Korea. Grim if no fairytale.

Jong-Nam was the favoured son. His fall from grace is attributed to a combination of events; vowing publicly to reform the DPRK on his becoming the heir apparent, and subsequently the defection of his aunt. It was already complete by the time of his arrest in 2001 when he attempted to visit Tokyo Disneyland on a forged Dominican Republic passport. He has since been residing in Macau.



The "Brilliant Comrade" Kim Jung-Eun at school in Switzerland

Sources: [http://english.chosun.com/site/data/html\\_dir/2009/06/18/2009061800411.html](http://english.chosun.com/site/data/html_dir/2009/06/18/2009061800411.html),  
<http://alphaedge.wordpress.com/2009/06/02/the-new-successor-of-north-korea>

The littlest Kim seems to have been nominated Acting Chairman of the National Defence Commission, an unofficial position, but one that nonetheless assists the Chairman... who is of course his ailing father Kim Jong-II. Baby Kim appears unlikely, temperamentally, to be ready for the mantles of high office as de facto Deputy Minister of Defence and number two in the 1.1 million standing Army, and is perhaps more suited to shooting paint balls. Graduation and earning the respect of the military could take years and all sorts of projects and wild adventures. *Aiiiigooooo* as they say in Korea. This introduces an added dimension of risk on the health, faculties and longevity of Kim Jong-II. His recent lobbying and detonation could be largely for internal consumption as an imposition of will, but that sophisticated medical equipment would probably do nothing for world peace and tranquillity.

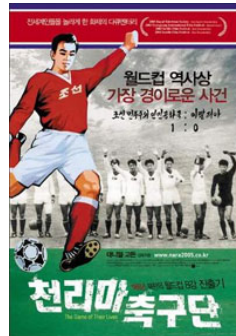
Externally, the actions of China in this great game of succession could be critical. The economic reality of China relations with the RoK long ago left the political baggage of the DPRK behind. It seems that China is not best pleased with the current fissile and ballistic behaviour of the DPRK and, along with Russia, has signed up to UN sanctions. And after years of residence in Macau (and presumably some relationship building) China may prefer Jong-Nam over Jong-Eun as the Brilliant Alternative should it ever come to a straight choice for China to make. Jong-Nam now appears to owe them one! The DPRK Korean-call-centre in waiting could just become a casino in the interim... but it could be claimed that dealing with it already is, as the House... of Kim... wins every time. *Faites vos jeux!*

### And the DPRK has now qualified for the finals of the 2010 Soccer World Cup in South Africa...

....evoking comparisons with their only previous performance at a World Cup Final in 1966 when they reached the quarter-finals defeating Italy along the way before losing to Portugal 5-3 after leading 3-0. That performance was exceeded by the RoK in 2002 reaching the semi-finals and losing to Germany 0-2, also despatching Italy along the way. Symetry plus. Meanwhile the RoK has also qualified for 2010 making it seven consecutive World Cup Finals.



a 10 Chon stamp ...



a poster: DPRK 1 Italy 0



Park Do-ik, the goal scorer vs Italy



Park Do-ik's goal against Italy



Post match celebration; DPRK 1 Italy 0



Eusebio ends the dream; Portugal 5 DPRK 3



Team reunion in 2002

Sources (left to right, by row): <http://www.stampsbythemes.com/allimages/47942.jpg>, [http://www.visitseoul.net/visit2007en/\\_upload/article/2009/02/article\\_09114356510.jpg](http://www.visitseoul.net/visit2007en/_upload/article/2009/02/article_09114356510.jpg), <http://metropolis.co.jp/xmg/567/PakDolkBoroScarf.jpg>, [http://www.asianews.it/files/img/COREA\\_DEL\\_NORD\\_-\\_0326\\_-\\_Torcia.jpg](http://www.asianews.it/files/img/COREA_DEL_NORD_-_0326_-_Torcia.jpg), <http://www.ayresome.co.uk/images/1966/nkorea1.jpg>, [http://i.dailymail.co.uk/i/pix/2009/05/18/article-1184238-008C52DC00000258-681\\_468x286.jpg](http://i.dailymail.co.uk/i/pix/2009/05/18/article-1184238-008C52DC00000258-681_468x286.jpg), [http://www.koreajournal.com/Magazine/var/news/storage/images-versioned/71401/1-eng-US/spotlight\\_game1\\_kjarticlemain.jpg](http://www.koreajournal.com/Magazine/var/news/storage/images-versioned/71401/1-eng-US/spotlight_game1_kjarticlemain.jpg)

So what does the man on the street in Seoul make of all of this? He has lived with the threat of military action from the DPRK for all of his life. It is a fact of life that is taken for granted and life goes on. To quote an earlier note; "It is all fate".

The world will be rightly concerned about nuclear proliferation and missile export but the man in Seoul can do little about either. Ultimately, he is worried about the economy, his housing loan, his children's education and his job, with official unemployment at 3.8% (up 0.8% YoY). His son's job prospects do not look too great.

However, he will be looking forward to the World Cup Finals in South Africa. "Daehan Mingook Whiting". (Korea fighting – the chant of the 2002 World Cup held in Korea and Japan).

And the man from PyongYang will believe what he is told.