JOHCM Funds

# Emerging Markets Spotlight

## James Syme, JOHCM Global Emerging Markets Opportunities Fund

*"The day the US dares tease our nation with a nuclear rod and sanctions, the mainland US will be catapulted into an unimaginable sea of fire."*

North Korean ruling party newspaper Rodong Sinmun, 6 August 2017

Followers of our investment views will be aware of our enthusiasm for the South Korean equity market. We have a significant overweight position in the country, as we find the stable currency, attractive equity market valuations and powerful corporate governance reform prospects an enticing top-down story. In addition, the wide and liquid equity universe offers a good number of attractive bottom-up investments to access the country-level opportunity.

However, everybody knows one thing about investing in South Korea, and that thing is North Korea. As the above quotation shows, the rhetoric surrounding the tension (technically, an unfinished war) between North and South is hair-raising, and clearly geopolitical risk on the Korean peninsula is something we have had to get comfortable with in order to like the market.

We believe that one of the main reasons that geopolitics does not rule out investing in South Korea is the fundamental stability of the situation. Whilst the leadership has changed in both Koreas, China and the USA, the broad ideological stances and narrow strategic goals have not. Even with ongoing missile and nuclear weapon tests, the North Korean regime has a theoretical long-term ambition to unify the Koreas under their leadership and a very real near-term ambition to stay in power. South Korea seeks a good relationship with China under the umbrella of the 63-year old mutual defence treaty with the US. China and the US both seek a broadly stable geopolitical environment and, where China is starting to challenge US hegemony in the region, it is more an issue with Taiwan and/or the South China Sea.

It is important to note that the successes of the South Korean economy and equity market have come despite ever-present tension with the North. We can remember being told in the late 1990s that South Korea was uninvestable because of geopolitical risk. In the 20 years to the end of 2017, the MSCI Korea index has delivered a US dollar total return of 1,480%, or 14.8% annualised, massively outstripping both emerging and developed market equities.[1]

More recently, investors in South Korea have had muted reactions to 2017's provocations by the North. On 3 September, when the North tested by far their most powerful nuclear weapon, the MSCI Korea index fell only 2.0% in US dollar terms, while the average Korean market decline on the four long-range missile tests in 2017 was only 0.7%. [1]

There is little evidence that the equity market or currency move with seemingly-problematic strategic developments; we believe this is because a return to a devastating war has always been a highly unlikely but definitely possible outcome, and these new developments are not actually new risks.

We would contrast the stability of the Koreas with a situation that we find far more concerning (and where we currently have no investments): the Middle East. There is a brutal war underway in Yemen, chaos in Iraq and Syria, huge anti-government protests in Iran, a rapid worsening of relations between the various parties in the Israel-Palestine conflict following the US decision to recognise Jerusalem as Israel's capital, a diplomatic crisis in Qatar (with Iran and Turkey backing the Qatari regime), the seeming collapse of the improved relations between the US and Iran, and an aggressive reform programme in Saudi Arabia that some have likened to a coup. Each one of those problems is unfolding dynamically, even chaotically, with complicated interlinkages to the other problems.

Whilst we recognise the risks in South Korea, it is the Middle East where we find geopolitics a barrier to investment at this time, as there is a substantial risk, we feel, of a disastrous range of outcomes.

[1] Source: Bloomberg

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