

The Korea Economic Slice on KBC (Vol. 1.11)

An Exclusive Report from [Korea Business Central](#) and [DS - Financial Market Analysis](#)

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The first ten issues of the Korea Economic Slice explored investments, markets and economic regulation. This week we're shifting the discussion's focus to investors themselves. Leaving institutional investors aside we'd like to explore the world of retail investors in South Korea, or more simply non-professional investors who trade to generate returns on their private capital. To assist us on our journey down the history of "Main Street" Korean investing, we will hear from Mr. Kyung Suk (Alex) Choi, a distinguished retail investing broker, the General Manager at Daewoo Securities Gangnam and an active member of Korea Business Central. Mr. Choi specializes in offering investment opportunities through Daewoo Securities to non-Korean individuals across the globe as well as Korean native investors.

Miracle on the Han River

One facet of Korea that never ceases to impress is the sheer trajectory of growth. The economy was devastated during the Korean War from 1950 to 1953. However, once reconstruction began to take hold from [1962 to 1989](#), South Korea's economy expanded from \$2.7 billion USD to \$230 billion USD (an average GDP growth rate of 8%). Referred to by Koreans as the "miracle on the Han River", the Korean economy took off soon after the post-war reconstruction began. (*Click chart below...*)



In [1962](#) Korea's per capita GDP, the average economic production per person per year, clocked around \$103 USD worth of Won; sitting

a bit worse off than Sudan (\$110) and just above Kenya (\$100). The most recent data from [2006](#) starkly contrasts the prior figures, where Korea now reports \$18,340 USD per capita GDP; sharing ranks behind Greece and ahead of Portugal.

As one might expect, investors became hungry for a piece of the proverbial pie, and to satisfy the cravings investment opportunities started to appear on menus.

The Investing Revolution

Beginning with the formation of the Daehan Stock Exchange in 1956, common shares of Korean firms made it possible to own a piece of the nation's corporations. However, [it wasn't until](#) 1992 that foreign investors were allowed to directly invest on the exchange, known then as the Korea Stock Exchange (KSE).

After a long stint of pure equity markets, investing in stocks transformed into investing in "funds". Funds were [initially legalized](#) in 1969, when the Securities Investment Business Trust Act was signed into law to allow bond funds to be formed. The funds were designed to provide stable financing for the many large scale infrastructure products underway. In 1981

foreign investors were allowed to invest in the funds, but it wasn't until 1998 that "Corporate Type" funds appeared, and allowed investors to invest in a basket of managed stocks. Then in 1996, Korea opened the World to its citizens and removed all restrictions that had previously prevented Korean citizens from investing in foreign stocks or funds.

Ironically the Asian currency crisis of 1997 would end up opening the financial market in Korea and beginning the final leg of the investing revolution. In 1996, private banks had already begun piling into the profitable fund management market. The Korea Exchange Bank (KEB) suffered massive shortfalls, due to its high exposure to foreign exchange activities, causing the firm to [seek the refuge](#) of Lone Star private equity group from Texas, USA.

Now, with a presence of private equity groups as well as an influx of foreign investment banks, Korea began to truly open the faucet of exposure to [investment vehicles](#). In 1994 the KOSPI 200 began to be published and two years later stock index futures were offered on the KSE. One year later, in 1997, stock index options were tradable, and the KOSDAQ was introduced in 1998.

In 2002 equity options were offered and over the next eight years, the soon to be streamlined KRX exchange would introduce Forex futures on USD, Yen, Euros, ETFs, ELWs, the KRX 100, Crude Oil futures, and more.

Aggressive Investing

Whether it was born from the era of the 1990's, when supercharged stock prices made many Koreans wealthy from investing in blue chip Korean stocks, or something inherently different about cultural differences in risk tolerance, Korea's Main Street investing tactics are ruthlessly aggressive. Mr. Choi explains,

"Average Korean investors began investing in stocks twenty years ago. In Korea, investors' time horizon for holding a position ranges from two (2) months to a maximum of ten (10) years,

with a median range of two years, with target returns ranging from 15% to 20% annually."

Mr. Choi helps simplify the investing culture by explaining that the Korean economy is roughly \$1 trillion USD and the KOSPI index makes up \$800 billion (80%) of that total. Breaking down the KOSPI, there are around 34% of foreign investors through Templeton Investments and others, 30% institutional investors, and an average of around 18% of fund holdings, while the rest are direct positions in equities.

However there are a few new young gun products riding into town. Recently introduced Exchange Traded Fund (ETF) and Equity Linked Warrant (ELW) products have been surging in both volume and issuance for the past five years.

ETFs are traded just like stocks, but can be targeted at mimicking any sort of security not otherwise offered on the market. ETFs give retail investors a chance to speculate on commodities, whole indexes, specific industries, and even currencies. ETFs can also be designed to offer leverage, where the fund might track the KOSPI 200 by 300% on a daily basis, or they can make it possible to profit from declining values by following the "inverse" of a certain target.

ELWs are derivative products linked to shares of stock that allow investors increased leverage, inverse exposure, or both

Linking back to Mr. Choi's assessment of Korean investors' expectations and goals, it's not surprising that markets have witnessed surging levels and trading volume in both of these security classes over the past five years.

ELW listings increased in 2009 from 2500 total contracts to 4600 listings by December. Daily trading volume for ELWs more than doubled from 9.8% to 25.1% of the daily KOSPI trading volume, and recently broke the \$1 billion USD average daily volume. Meanwhile, in the last five years the ETF market in Korea has growth from roughly \$2.3 billion USD in 2005 to nearly \$27 billion USD in 2009.

While success in the U.S. is gauged by whether you're beating the S&P 500 over five years, there is clearly a separate approach to investing in Korea. In simple number terms, it seems that any yearly return near 10% is above average for U.S. retail investors, while Korea's Main Street investors are searching for annual yields closer to 20% and shorter time horizons for their cash to be tied up. Is this expectation for higher growth the result of a forty year "rocket pack" GDP trajectory? Are the sums of cash invested representing a smaller portion of a larger savings pile, making the high level of risk exposure more tolerable? Is the shorter time horizon for investments in Korea the result of culturally divergent savings mentalities? While no single strategy is superior, it's very interesting to examine the differences in investing culture and the history behind the market itself. This perspective is certainly useful tackle for any serious investor considering wading out and casting a line into the KRX.

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