

JUNE 2018

POST-SUMMIT THOUGHTS: THE ULTIMATE WINNER?

Denuclearisation, if it progresses, would be a slow and gradual process. On the other hand, if China's involvement in the preparations leading up to the US-North Korea summit results in a more benign outcome in its trade negotiations with the US, this would be a welcomed development by investors.



"It was not easy to get here" Kim Jong Un had indicated at the start of the Singapore summit. The road ahead is likely to be equally challenging. Denuclearisation, if it progresses, would be a slow and gradual process.

The track record of North Korea on this matter falls short; their leaders have failed to deliver on promises to freeze its nuclear weapons program, even after agreeing to concrete plans in 1994, 2007 and 2012. Nonetheless, this summit does give more hope. For a while, markets should function with a lowered tension on this front.

But markets did not appear to be expecting much at the very start.

Comparing the performance of the Korean stock market around the last two Inter-Korea summits in October 2007 and April 2018, investors appear to have reined in their expectations for the June summit (see Fig. 1).

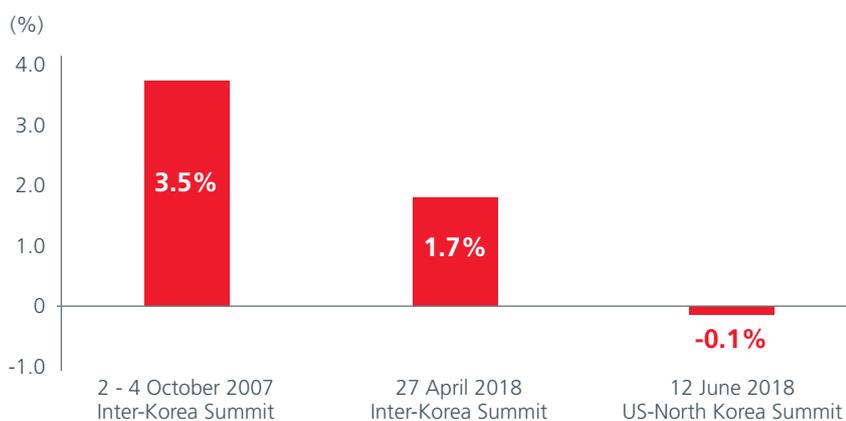
The Korean equity market has historically traded at a deep discount (MSCI Korea 2018F Price to Earnings Ratio: 8.9x¹) versus regional peers (MSCI Asia Pacific ex Japan 2018F Price to Earnings Ratio: 12.8²) with North Korea geopolitical risk one of the key reasons for the discount. Hence, the Korean equity market would be one of the largest beneficiary should geopolitical risks in the Korean Peninsula fade.

The eventual thawing of relations between North and South Korea could also avail the south with a cheap and abundant labour force, as well as access to a 25 million population new market. However, any earnings impact is limited in the near term with the US unlikely to lift economic sanctions anytime soon. We are unlikely to be changing our investment strategies in the light of this event.

Will China emerge as the winner from all of this? Chinese diplomats had travelled to Washington DC and Pyongyang to help facilitate the preparations for the US-North Korea summit. Besides providing the aircraft for the North Korean delegation, China also reportedly provided significant logistical support for the trip. President Trump has publicly indicated, on different occasions, that China could get a better deal on trade, if it cooperates with the US on North Korea. With the strong linkages between global trade and economic growth, a more benign outcome to the US-China trade negotiations will be welcomed by investors. This could indirectly be one of the more positive outcomes arising from the historic summit.

In the longer term, the curtailment of US-South Korea military exercises, as suggested by President Trump could ultimately reduce America presence in the region. This would increase Chinese influence and raise concerns for Japan.

Fig 1. Performance of KOSPI measured from 2 days before each summit to 2 days after³



¹Bloomberg, Citi Research, as at 12 June 2018. ²MSCI, as at 31 May 2018. ³Performance of the 12 June 2018 summit is measured up to end 12 June as 13 June is a market holiday in Korea. Bloomberg, as at 13 June 2018.

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