

Korean Economy & Market Outlook

Dear Shareholders,

My name is Sang Won Kim, and I am the lead Investment Manager of The Korea Fund, Inc. Today, I have the great pleasure of updating you on my views on the Korean economy and stock market following my presentation to you late last year.

Looking back over the past twelve months, Korea stands out as one of the economies that weathered the global financial crisis most effectively. The rise in the Korean stock market is clear evidence of the quickness with which the economic recovery began taking place: the KOSPI soared from 938 in November 2008 to a recent 1718 in Sep 09. In this short audio, I am going to provide you with an update on the current economic situation and deliver a short synopsis on what the Korean economy has in store for long-term investors.

Short term economic outlook

We hold the view that the Korean economy bottomed in 1Q09 and is well positioned to continue sequential growth into early 2010. In 1Q09, the Korean economy posted a surprisingly positive GDP growth of +0.1%, on a seasonally adjusted quarter on quarter basis, followed by 2.6% growth in 2Q09, the fastest growth since 1Q02. Strong earnings from Korean exporters and aggressive global stimulus spending were behind the recovery. In 3Q09, Korean GDP growth has beat the consensus growth forecast by a wide margin gaining 2.9% on a seasonally adjusted quarter on quarter basis. One of the key reasons for these better than expected 3Q09 GDP growth is the persistent strength of IT and Auto exports where Korean companies continue to excel in diversified regions globally. Having said that, given the decidedly low base effect from last year's financial crisis, there is no doubt that year on year growth rates in 4Q will be very robust. Nonetheless, we expect somewhat moderate growth on a quarter on quarter basis in 4Q09 as global stimulus spending and efforts to stabilize the financial system are expected to slow down. However, we believe the risks for the Korean economy and exporters are on the upside, particularly if we see better than expected demand normalization in developed markets.

Going into 4Q09 and beyond, we expect domestic consumption to lead growth while exporters may take a breather from the better than expected growth we saw in 1H09. In July and August 2009, the Korean consumer sentiment index registered a 7-year record high twice in a row. As real private consumption growth tends to follow the consumer sentiment index with a 3-6 month lag, we should start to see strong domestic consumption growth from 4Q09. Furthermore, as Korean consumers enjoy the wealth effect from the stock market rally and the property market rebound in 1H09, we expect to see real income growth in 2010. A better wage and job market environment will also drive consumption growth.

Another factor supporting domestic consumption comes from the recent Korean Won movement. The Korean Won has been appreciating sharply against the USD causing it to fall outside of the 1200 comfort zone level since late September 2009. On the positive side, the rise in the JPY against the USD means that Korean exporters are still relatively competitive against their Japanese counterparts. However, a strong KRW will definitely be a temporary overhang for export driven growth momentum. That said we believe this correction will only be temporary as the Korean exporters' recent success story was not only supported by a weakening currency (driven by price competitiveness) but also by improved product qualities and brand images. In terms of market dynamics, a strong KRW may attract a sizeable amount of foreign capital into the Korean markets as foreigners enjoy currency gains on top of market performance. Together with the strong KRW, increased foreign capital inflow will further boost domestic sentiment translating into real consumption growth. Therefore, on balance, we believe a strengthening KRW will have a positive impact on the Korean economy and market as long as it moves moderately.

Long Term Investment Opportunities

Having discussed the near term constructive view on the Korean economy, we would like to highlight the even more constructive outlook on Korea's long term growth potential. We believe that structural changes will drive Korea into a service-oriented economy whilst retaining its strong export culture. Thus we strongly believe now is the time to invest in the Korean market to fully benefit from such a transition and further exploit the still existing 'Korea Discount' which enables us to buy world class companies at a reduced price.

We believe major long-term growth drivers will come from:

Firstly, the continued strong growth of Korean exports on the back of diversified and balanced trading bases, including fast growing economies such as China and other emerging countries. Korean exporters gained market share during 2009 not just because of the weak KRW but also due to strong product quality and brand images as I mentioned to you earlier. Once global demand normalizes, we believe Korean exporters can largely benefit from an expanded market share in various global regions.

Secondly, the structural change towards a service-driven economy. Korea is still a capital-intensive manufacturing economy. Based on economic development theory, the country still has ample room for stronger growth as economies continue to restructure until they become fully developed. We believe, within the next decade, Korea will become a service oriented industry more geared towards less cyclical and high value added industry structure.

Thirdly, various new business initiatives are being developed by diverse and leading Korean companies that are transforming themselves. With technological strength and capital gained from traditional businesses, Korean companies are already preparing for diverse new business opportunities. Future growth engines will include batteries for Hybrid Electronic Vehicles, OLED -a next generation display technology, alternative energy business encompassing poly silicone business, wind power equipment and so on. There are quite a few business areas where Korean companies are moving ahead of their global counterparts.

Regarding the growth drivers of the stock market, I believe that Korea's fast aging population will become a structural force for the stock market stimulating the shift from household assets to equities. The expanding corporate pension market will also support share prices. In addition, the Korean stock market looks attractive in terms of valuation for long-term investors as traditional discount factors (known as the 'Korea discount') continue to persist; this is evidenced by the resilience of the Korean economy in the current global economic slow-down despite the fact that those factors have begun to change gradually since the Asian crisis. For example, the Korean government has improved regulations to protect minority shareholders over time, and there have been more and more companies establishing more predictable dividend policies with a focus on capital management. Both factors will contribute to narrowing the discount factors for the stock market over time.

Accordingly, I am firmly confident that there will be a sustainable and better upside in investment returns for patient long-term shareholders of Korean companies.

All in all, I expect the Korean economy to recover from the current global recession at a faster speed than markets expect. It should also post higher growth than other developed economies following the stabilization of the global economy in the next several years. As such, I sincerely encourage you to participate in these promising investment opportunities in Asia as you have done successfully so far.

I appreciate you taking the time to listen to my presentation today and would like to thank you, as shareholders of the Korea Fund, for showing continued faith and conviction in the Korean economy. During recent months you have overcome significant and unprecedented challenges and hardships. I will give you a new update on the Korean economy in the not too distant future, but in the meantime I wish you all the best.

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