



TCS > DEFENSE > MISSILE DEFENSE



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Dr. Evil Blackmails Investors

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Alleged sponsor of deadly terrorist activities? Check.

Suspected of building weapons of mass destruction? Check.

Member of the infamous Axis of Evil club? Check.

Has Americans worried about ramifications of war against him? No.



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How big a threat is [North Korea](#) compared to the USSR?

- A larger threat
- About the same
- Not as big a threat

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There's been concern among us about Osama Bin Laden and how Americans have been affected by the war in Afghanistan. And there's been much discussion over Saddam Hussein and what impact a war in Iraq will have on us and our economy. But nobody seems to be very worried about their fellow Axis of Evil comrade, Kim Jong Il and how his antics might affect life as we know it.

Sure, recent press coverage on North Korea has increased exponentially in the wake of Mr. Kim's game of brinksmanship. Mostly, though, it's just been a reporting of the facts and how the situation might play out. Unlike the cases of Afghanistan and Iraq, Americans don't seem to be very worried about how North Korea involves us or our money.

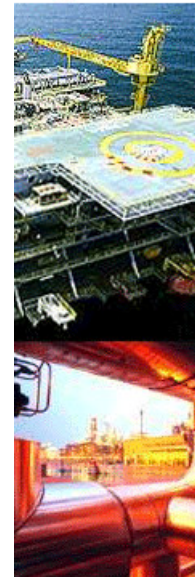
Here's what we know so far: U.S. officials discover the existence of a nuclear weapons program in North Korea, which violates the Nuclear Non-Proliferation Treaty. South Korea, Japan and the U.S. freeze oil shipments to North Korea that had been pledged in 1994 under the so-called Agreed Framework. So, the DPRK (Democratic People's Republic of Korea - North Korea's formal name, although what's democratic about this one-person dictatorship eludes understanding) decides to restart one of its nuclear reactor facilities. UN Inspectors are then expelled from North Korea. Rather than report the DPRK's defiance to the United Nations Security Council, the inspectors simply urge North Korea to comply with the agency's nonproliferation safeguards.

This is when it gets thorny. According to Dr. Chung Min Lee, Professor of International Relations at Yonsei University and member of the South Korean Joint Chiefs of Staff Advisory Committee, there are two key milestones to watch for that would signal a serious escalation to the North Korean crisis: (1) the DPRK's repudiation of the Nuclear Non-Proliferation Treaty and (2) a resumption of long-range missile tests by North Korea. On January 10th, North Korea withdrew from the treaty. The next day, Kim Jong Il threatened to resume testing of long-range missiles if the U.S. failed to take steps to improve relations. So it would seem that this is getting pretty close to being a full blown crisis.

But if Americans aren't concerned about all this, maybe it's because we've seen it before. In fact, the Agreed Framework was supposed to be the resolution of a similar crisis in 1993, when North Korea first threatened to back out of the Nuclear Non-Proliferation Treaty. In that agreement, North Korea consented to UN Inspectors' verifying its compliance with the treaty; the U.S. and its allies agreed to provide oil and some nuclear reactors to North Korea. Crisis averted.

However, there are some important differences this time around. Kim Jong Il knows that America is fully engaged and may have its hands full with the war on terror and a possible war with Iraq. The U.S. is also aware now that the DPRK never complied with the Agreed Framework and suspects North Korea of possessing a few tactical nuclear weapons. Any

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military option would have to factor those elements into the equation. Also, South Korea is much more involved in the diplomacy around this crisis than in 1993. It's not clear yet if this is a good or bad thing: South Korea prefers to limit U.S. involvement to an absolute minimum; North Korea, on the other hand, wants the world stature of dealing directly with the U.S.

Even though the current administration seems to favor a non-military alternative, they are also very conscious of not advocating a solution that smells of appeasement - which in retrospect is how 1994 seemed. The deal back then was pretty awful by any standard. How did it go? *In exchange for violating a global treaty, building nukes while starving your people and threatening war, here's your food aid, fuel and nuclear reactors - and thanks for playing this game of brinkmanship with us!*

Does that mean the crisis will escalate into a bona fide military conflict like the one in Afghanistan and like the one brewing in Iraq? Probably not. But because of some of these different circumstances, this North Korean situation may take longer to resolve than the one in 1993. And if investors have been conscientious about how crises in Afghanistan and Iraq affect their portfolios, then they should be equally diligent in assessing the investment repercussions of the North Korean crisis.

Despite the rise of anti-American sentiment and political tensions, economic activity in Asia may not be significantly affected. An unfortunate - not to mention *unfair* - consequence of the crisis has been a revival of already growing anti-American attitudes in Asia. Even South Korea - where the U.S. has stationed 37,000 troops (since 1953) ready to protect the host country against invasion from over one million North Korean troops - has increased its anti-American views. In fact, South Korean President Roh Moo-hyun was recently elected largely by fanning those views. This paints the U.S. into a difficult corner: If the U.S. goes to war against North Korea, South Korea would be economically and physically devastated. If the U.S. opts for an economic hard-line approach toward North Korea, South Korea would bear the costs of a collapsed North Korea. Either way, it seems that anti-American sentiment would rise throughout the region.

The Environment is creating a weaker dollar - but have no fear. Yes, when America is economically and politically down, the U.S. dollar weakens relative to other currencies. We are seeing this before our eyes. Traditionally, investors would expect a decline in exports - in this case from Asia - to the U.S. But with globalization, the U.S. exchange rate has much less impact now on exports than during the Plaza Accord Era (1985-87) which was the last time the dollar experienced a substantial downward adjustment. Why? Global supply lines and relationships are so much more established, long-term and hedged today. That is, contracts are locked in as currencies fluctuate and, more importantly, OEM's - original equipment manufacturers - increasingly rely on low-cost producers for their components.

Trade amongst the Asian countries continues to grow. Also, domestic demand in Asia has progressively become more driven by growth from within the Asian region. According to Sun Bae Kim, Goldman Sachs Managing Director of Asia-Pacific Economic Research, regional trade in Asia increased from 36% in the mid-80s to 48% in 2000. This is comparable to the intra-regional trade enjoyed by NAFTA. The combination of these factors means that although some investors may be wary of Asian companies with significant imports to the U.S., there is ample reason to believe that these fears are unwarranted.

Instability in Asia-Pacific markets has created investment opportunities. An understandable ramification of North Korean tensions is probable instability in the Asian markets. Most notably, emerging markets may likely feel the effects of regional investor unsteadiness. Their economies are more closely linked with that of Japan and, to a lesser degree, South Korea, both of which are viewed by North Korea as

key U.S. allies in the crisis. In fact, upon announcement of North Korea's withdrawal from the Nuclear Non-Proliferation Treaty, Japan's Nikkei Average gave up all of its gains from the Wall Street rally and ended the day with a loss. Market fears over the incident caused the Japanese Yen to fall to a 3 ½ year low against the Euro, and the benchmark Korea Composite Stock Price Index closed down 2.5% from its intra-day trading high. As savvy investors recognize, however, uncertain times yield attractive opportunities.

South Korean stocks may become undervalued. South Korea boasts a strong and stable economy and one of the most developed telecommunications markets in the world. Daniel Yoo, Seoul Equities Strategist at Salomon Smith Barney notes that corporate fundamentals in South Korea remain sound and expects average earnings per share growth of 19% in 2003. However, tensions in the Korean peninsula could easily continue to depress the South Korean stock market, resulting in undervalued equities.

Kia Motors (00270.KS) is an example of a potentially undervalued stock. Kia owns 27% of the domestic auto market in South Korea, but over 50% of unit sales are shipped overseas - and half of those sales are to America. The company has a recent history of solid operating performances and current market trends appear to favor Kia's product mix. In fact, 42% of its unit sales are derived from higher-margin minivans and SUVs. Now, don't let the recent rumbling regarding SUV safety deter investment from Kia. Even if founded, the concern is over-blown.

An appealing stock with solid earnings is **Samsung Electronics** (05930.KS), South Korea's top electronic company and one of the world's largest semiconductor chipmakers. According to Jonathan Ross, Executive Director of the Asia-Pacific Technology Team at Goldman Sachs, "The winners in an environment of falling prices [for technology hardware] will possess a combination of traits, including a strong market position, a defensible/diverse product and revenue mix, a solid balance sheet, and cost competitiveness". Samsung combines all of these traits, including strong cash flows; the top global market share position in DRAM and SRAM chips, LCD screens and CDMA handsets; and a broad array of products ranging from consumer electronics to telecommunications systems. Particularly in a depressed South Korean stock market, Samsung is a good long-run choice, with an attractive valuation relative to global peers - a 7.77 P/E vs. double-digit global P/E ratios for most of the industry sub-sectors in which Samsung competes.

Asian emerging market stocks may become undervalued. Uneasiness in key Asian markets may spread market jitters to emerging markets in the region. Many of these markets are inextricably tied to that of the majors, including the Japanese, Hong Kong and Chinese stock markets. Since regional economic superpowers China and Japan---where a large ethnic Korean population provides both political and economic support to North Korea---are both heavily involved in the North Korean situation (*though it's not yet apparent if they'll both be on the same side of it*), escalation of the crisis will affect those markets and ripple through regional emerging markets.

Still, there are fundamentally sound stocks in those markets, particularly in the telecommunications industry. In Asia, the telecom industry is well-positioned: it faces less competition than in other regions as a result of healthy wireless consolidation; has less overcapacity; and is probably producing more cash now than at any time in history. State-owned **P.T. Telekomunikasi Indonesia** (TLKM.JK and ADR: TLK) provides both fixed line (65% of 2001 revenues) and cellular (35%) telecommunications service in Indonesia.

The company has stable cash flows and the Indonesian Ministry of Transportation and Communications is ready to allow the company to increase its fixed line tariffs by 15% this year and a further 15% next year. This increase combined with expected lower capital expenditures for the coming year bodes well for the company's intermediate and long-term prospects. Plus, this is my favorite stock in the region as the 6.56% dividend is a great place holder while we sail on these rough waters of international tension and internal political and religious polarization.

South Korea's premier integrated telecommunications provider, **KT Corp.** (30200.KS) is another attractive company in the Asian telecom industry. This company is the leading supplier of fixed-line services in South Korea. With 60% of revenues coming from non-traditional fixed-line sources, the company also boasts the largest number of broadband subscribers in the world - *4.5 million*. That is impressive!

So, should we be more worried or less worried than we actually are about the North Korean crisis? After all, Kim Jong Il does seem to have the prototypical resume of an Axis of Evil leader. And like Osama and Saddam, Kim wants the world to recognize his own importance. Also like the other two, Kim even enjoys a personal loathing from President Bush. But it might be safe for us not to worry, because the main difference with this dictator is that his motives for world attention are driven more by profit than ideology or pure power. Who would've figured someone could actually hold the world ransom with a few nukes? Now all we're waiting for is to hear his formal demand for economic concessions. Wait, let me guess- one *billion* dollars.

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