

6<sup>th</sup> November 2023

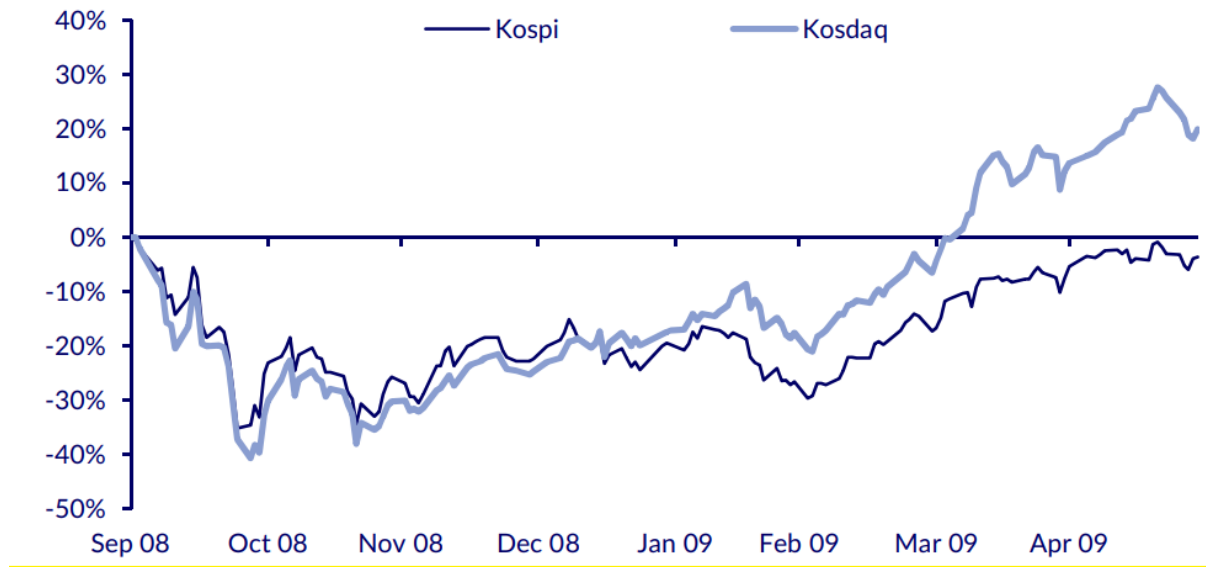
### **South Korea's Sudden Short-selling Ban**

The South Korean market watchdog Financial Services Commission (FSC) shocked the market over the past weekend by announcing a short-selling ban, which is set to last until June 2024. Quoting the FSC, the reason for imposing the ban was to review the short-selling system and promote a "level playing field" for retail and institutional investors as the regulator found two Hong Kong-based investment banks engaged in illegal short-selling earlier in mid-October.

In the past few months, the Korean equity market, and more specifically the once-high-flying Korean EV battery companies experienced a major correction. As a result domestic retail investors started to argue that illegal short-selling was one of the key reasons for Korea's market relative underperformance during the global market correction.

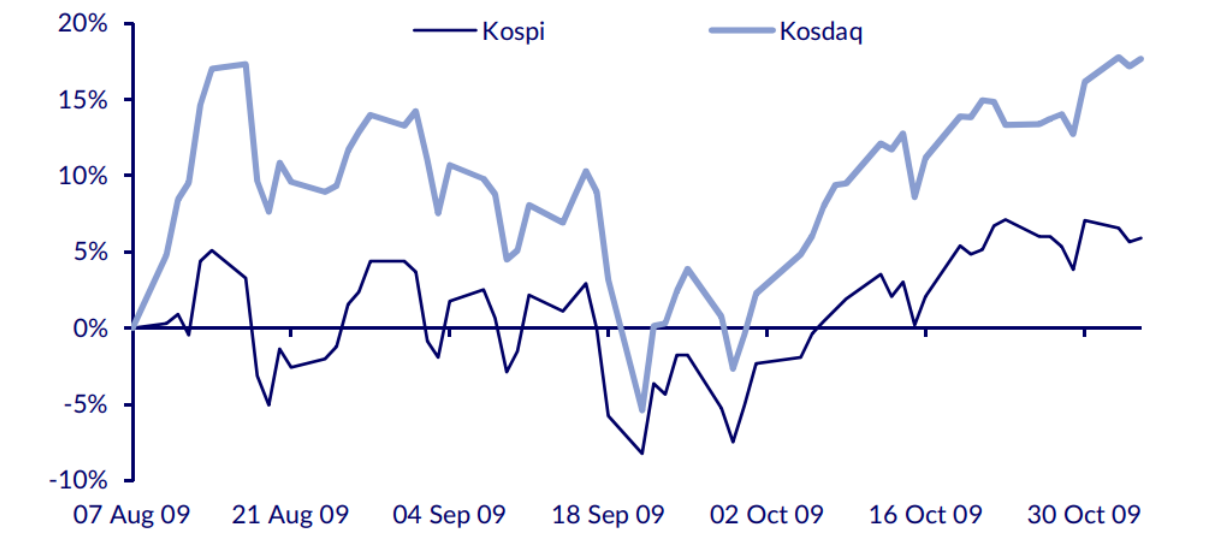
However, many market participants believe that the ban is also highly politically driven. As the Korean general election is around the corner in April 2024 and retail investors now account for over 30% of the voting population, such a move could naturally be interpreted as the ruling party taking action to help gain votes in the upcoming election.

If history is any guide, such a ban is certainly positive for the overall Korean equity market if we examine the previous three short-selling bans imposed by the Korean market regulator, which took place in 2008, 2011 and 2020. The first short-selling ban (October 2008 - May 2009) was imposed during the global financial crisis. During this period the Kospi and Kosdaq indices gained 49% and 91%, respectively, from their respective bottoms until the ban was lifted.



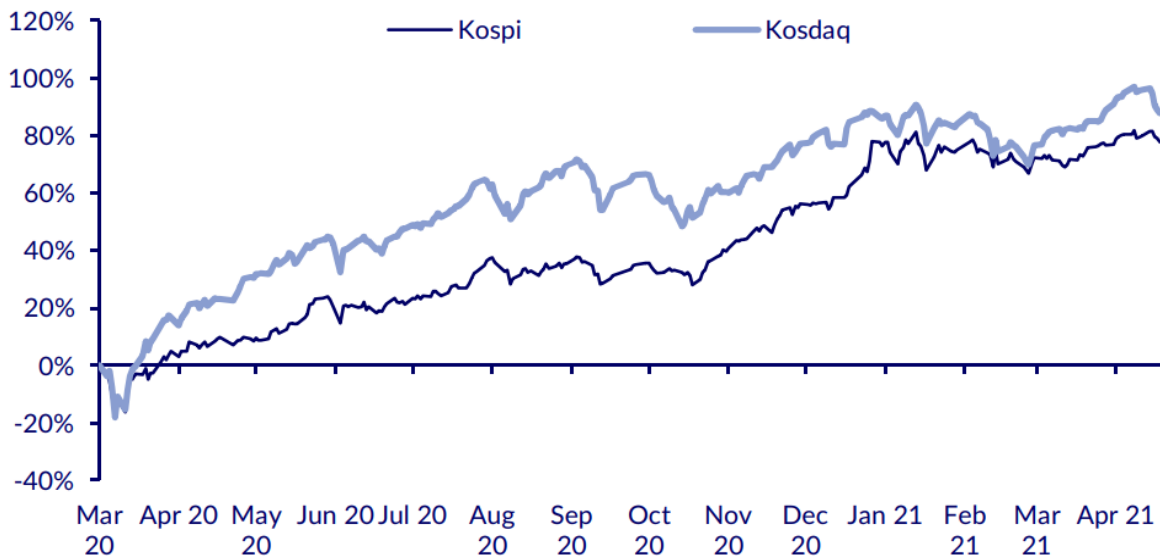
Source: CLSA

In 2011, when the euro-zone was experiencing a debt crisis and the US had its sovereign rating downgraded, the FSC intervened once again by imposing a second short-selling ban. While the 2011 ban only lasted three months (10 August 2011 until 9 November 2011), during this period the Kospi and Kosdaq indices also gained 6% and 18%, respectively.



Source: CLSA

And once again at the start of the global pandemic in 2020, a third short-selling ban (March 2020 to April 2021) was imposed by the FSC to improve market confidence. As a result, the Kospi and Kosdaq indices gained 112% and 122% during this ban period.



Source: CLSA

Despite this newly imposed ban being certainly positive for the country's equity market, such a move would most likely prevent Korea from being included in MSCI developed market indexes for at least a few years. While Korea meets the economic development, size and liquidity criteria that are necessary to gain a developed market status, MSCI has been reluctant to upgrade its status from emerging market to developed market due to accessibility reasons such as FX convertibility and omnibus accounts.

We believe that the current short-selling ban that could be seen as a controversial tool of market intervention will most likely pull Korea even further away from meeting MSCI's developed market criteria and from being included in MSCI developed market indices.

If and when the inclusion of Korea in MSCI developed market indices was to happen one day, it would have profound implications for market participants as ETFs and strategies

that are benchmarked to MSCI indices would have to adjust their exposure accordingly. Emerging market funds would have to exit Korea while developed market strategies would have to add it.

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