

INVESTMENT NOTE

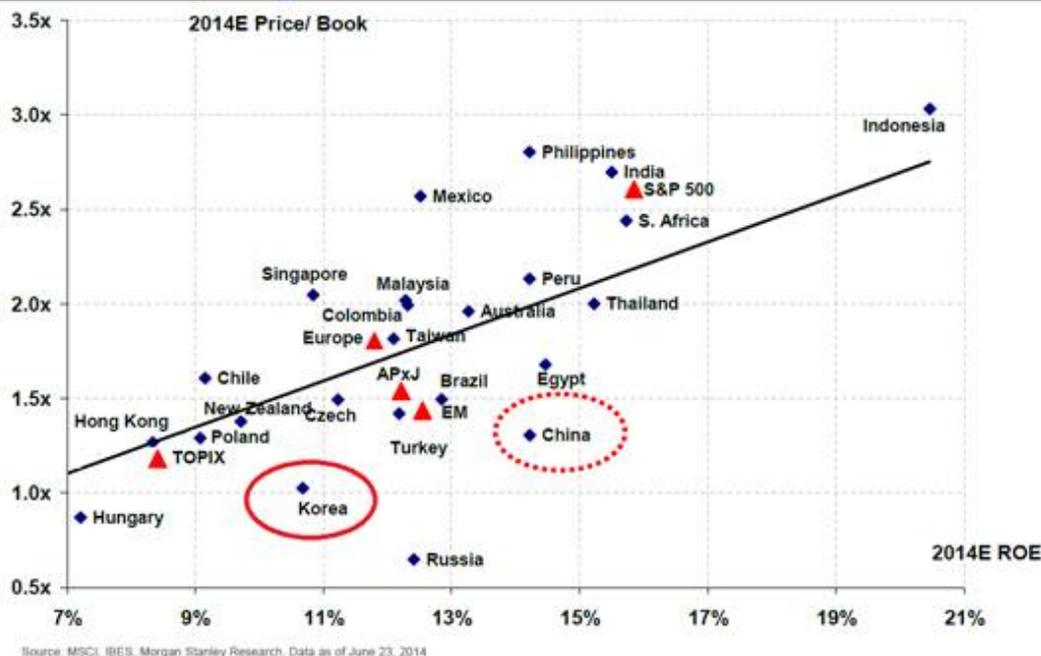
28 JULY 2014

Why it's impossible to ignore the decade-low valuations in Korea

With news flow on Asia typically dominated by the tribulations of China, it is often easy for investors to overlook many of the region's other major markets – particularly Korea says Jonathan Pines, Portfolio Manager of the Hermes Asia ex Japan Equity Fund.

Korea and China are very similar from a valuation perspective, with both markets trading at significant discounts relative to history and to other Asian neighbours, see the chart below.

APxJ/EM Country & Regional Scatter: Consensus 2014E P/B vs. ROE



Korea has been an overweight throughout the lifetime of the Hermes Asia ex Japan Equity Fund. Increasingly attractive from a valuation perspective, the country is now the fund's largest absolute country weight, at 32.7%, as well as the largest relative country overweight position at +12.9%.

Why now for Korea?

Current valuations for Korean stocks are as cheap as they have been at any point over the past decade, and are much more appealing than expensive ASEAN markets.

Korean equities have historically traded at cheap valuations, as the market contains a disproportionate number of cyclical businesses, alongside a relatively low dividend yield due to complicated ownership structures. Korea has recently performed poorly amid weak domestic demand and GDP growth and negative earnings momentum, while the won's recent rise against the yen has also been a headwind for the country's exporters.

It pays to be contrarian

What we do not own in Korea is just as important as what we do. We have no exposure to auto giant Hyundai Motors, semiconductor producer Hynix or internet group Naver Corporation. Of the top 10 Korean benchmark constituents, we only have exposure to Samsung Electronics – a stock we have been reducing.

What do we own? We have found a number of companies in Korea where we believe investors have materially underestimated an earnings recovery. Korea Electric Power Corporation (KEPCO), which is now the second largest stock in our portfolio, is a good example of this.

We first purchased unloved KEPCO, the monopoly responsible for almost all of Korea's electricity generation, at just 0.35x book value. Unfavourable regulation has driven the company into losses for the past five years, pushing its net gearing to 114%. With Korea needing more power supply, the combination of KEPCO's high gearing and rising capex suggests the government must allow the company to become more profitable by raising tariffs – which are still much lower than the OECD average.

Even though Korea is not at the forefront of investor news flow, unlike other regional peers, the country's equity market undoubtedly offers some of today's most compelling bottom-up opportunities in Asia.

The above information does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments.

For further information, please contact:

Hermes Fund Managers

Jeannie Dumas
+44 (0)20 7680 2152
j.dumas@hermes.co.uk

Melanie Bradley
+44 (0)20 7680 2218
m.bradley@hermes.co.uk

Katie Sunderland
+44 (0)20 7680 2315
k.sunderland@hermes.co.uk

Notes to Editors:

Hermes Fund Managers

Hermes is focused on delivering superior, sustainable, risk adjusted returns for our clients – responsibly.

We believe in **Excellence, Responsibility and Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure provides wholesale, institutional and pension fund clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Fixed Income:** Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Alternatives:** Commodities, Hedge Fund Solutions, Infrastructure, Private Equity
- **Equities:** Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan
- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European

Hermes manages assets on behalf of more than 200 clients* across these investment areas with £26.9 billion* assets under management. In Hermes Equity Ownership Services, we have one of the largest engagement resources in the industry, advising on more than £103 billion* of assets.

*Please note the total AuM figure includes £3.5bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.5bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 March 2014.