KDB Daewoo Securities

2016 Stock Market Outlook

Investing in an era of biflation

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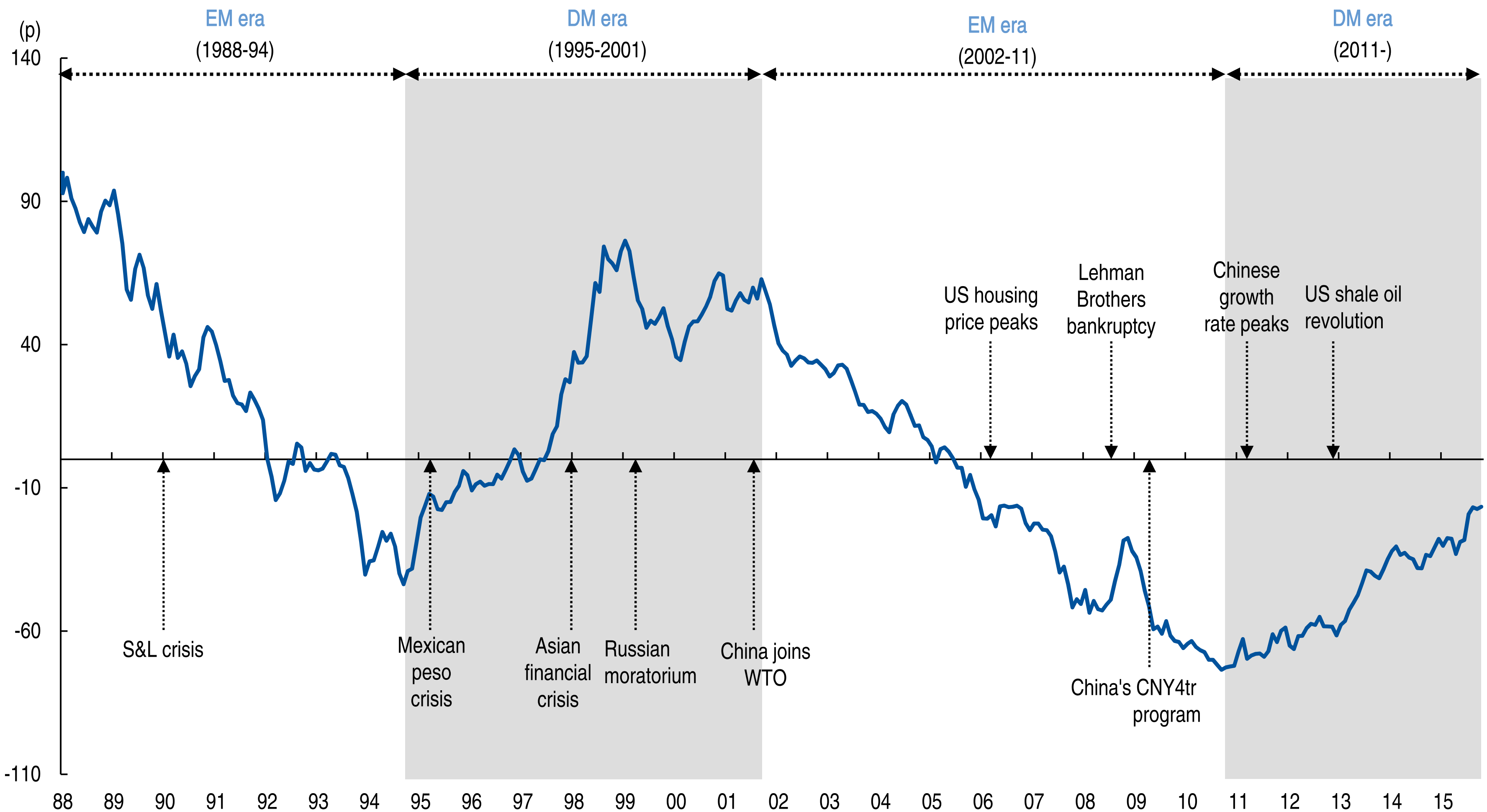
CONTENTS

[Summary] DM-driven bull market

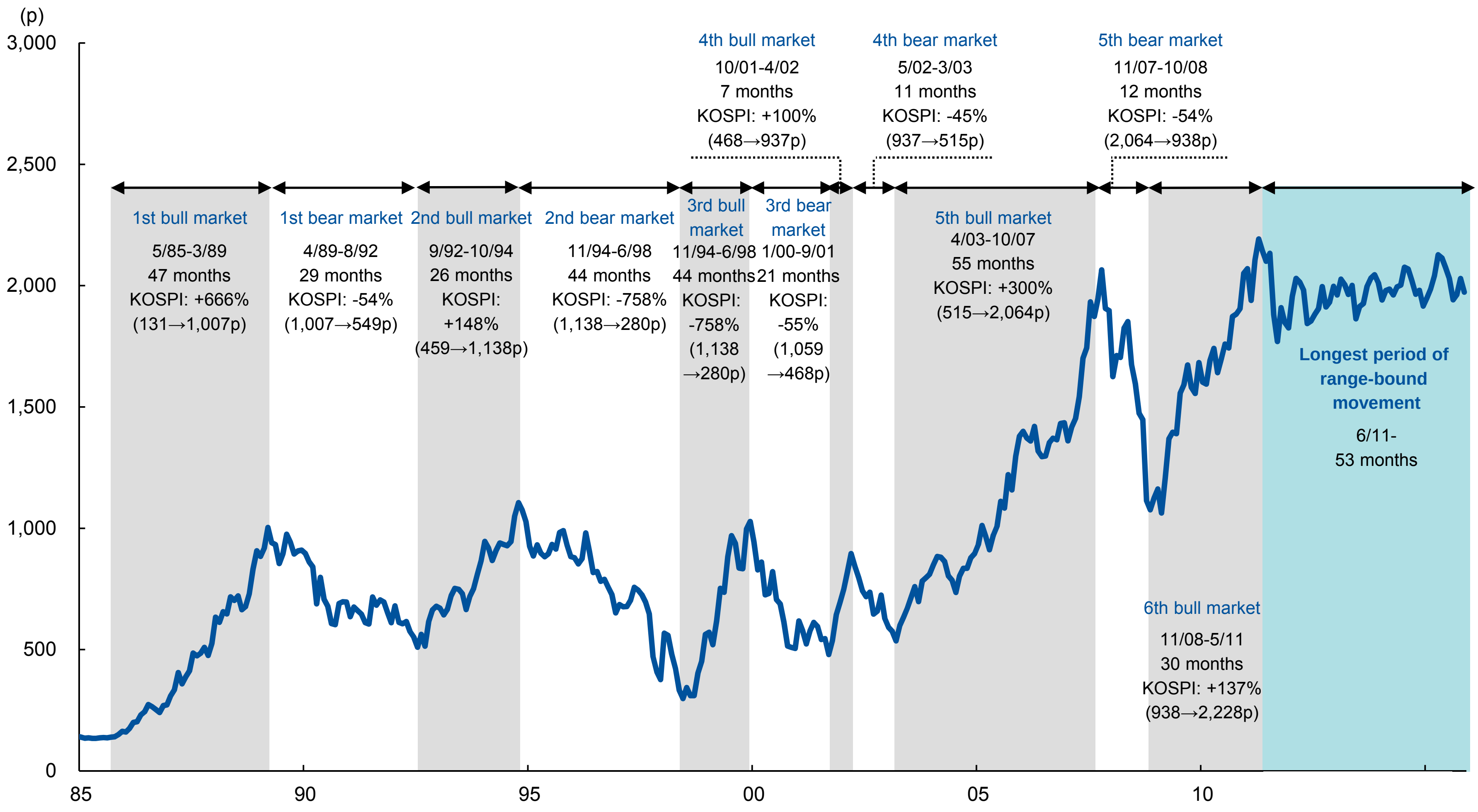
DM stock markets have outperformed their EM counterparts since 2011



Note: Based on the MSCI series
Source: Bloomberg, KDB Daewoo Securities Research

[Summary] KOSPI range-bound since 2011

Longest period of range-bound movement in history



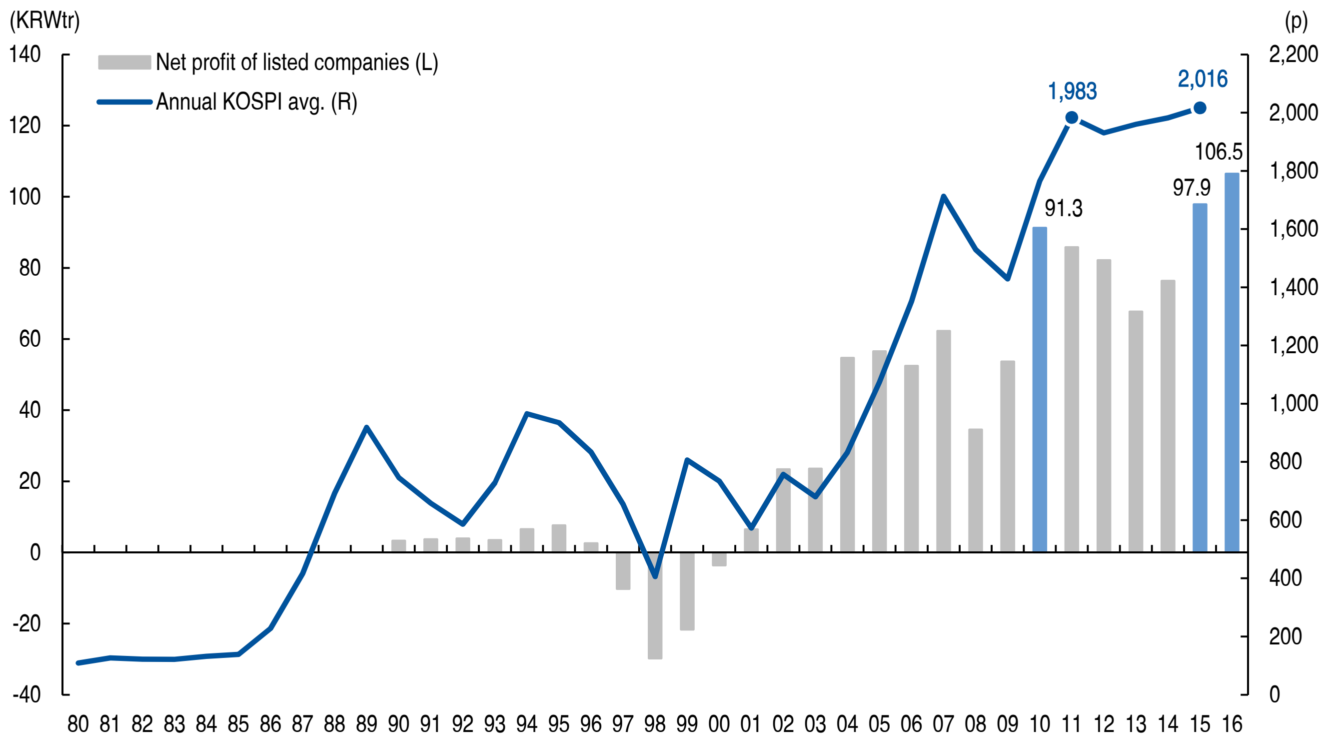
Source: KDB Daewoo Securities Research

I. Corporate earnings

Average KOSPI level to mark a historic high

- KOSPI has been range-bound for over four years, failing time and again to surpass the historic high of 2,228p recorded in May 2011
- However, the annual average KOSPI level has reached a historic high of 2,016p (as of end-October), exceeding the 2,000p mark for the first time
- This is attributable to corporate earnings growth
- Listed firms' net profit in 2015, despite likely earnings shocks in 4Q, is projected to be close to the 2010 level of KRW91tr
- YTD net profit as of 3Q15 is estimated at KRW77tr (including KEPCO's property disposal gains of KRW8tr)

Corporate earnings expected to reach a historic high



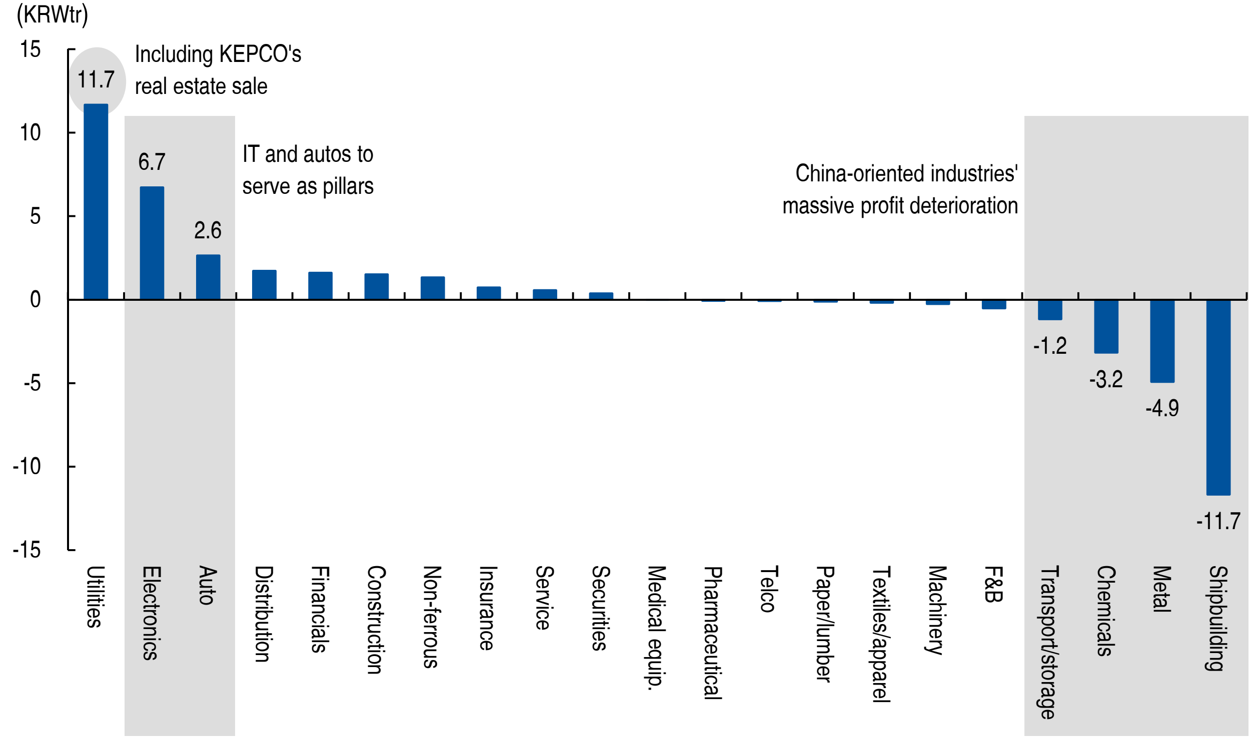
Note: 2015 and 2016 earnings forecasts are based on the market consensus
Source: WISEfn, KDB Daewoo Securities Research

I. Corporate earnings

IT and auto pushed up overall corporate earnings; China-oriented sectors suffered

- IT and auto earnings have grown sharply relative to 2010 levels
- Transportation/warehousing chemicals, steel, and shipbuilding sectors have suffered steep declines

Net profit growth by sector (2015 vs. 2010)



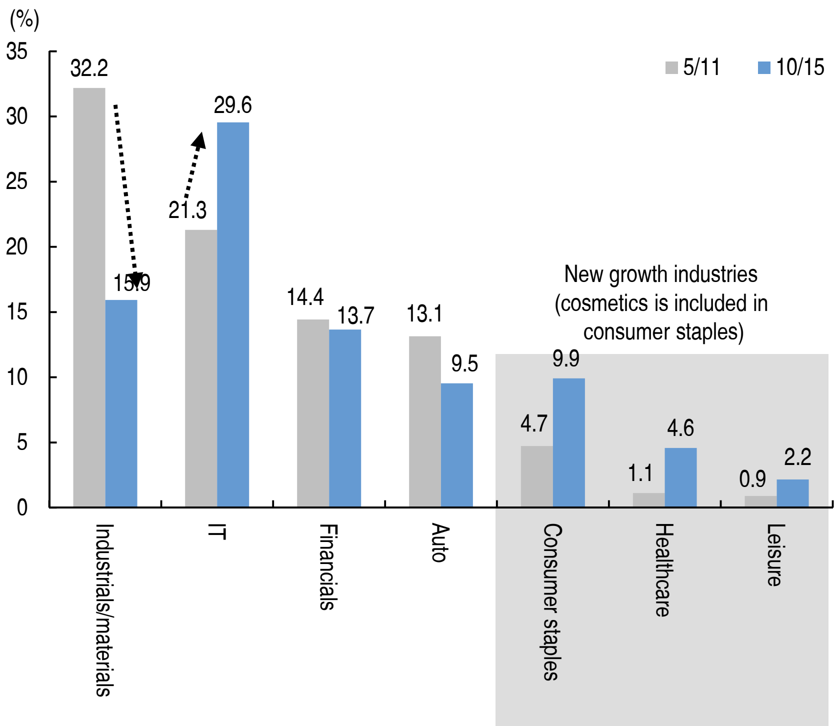
Note: 2015 earnings forecasts are based on the market consensus
Source: WISEfn, KDB Daewoo Securities Research

I. Corporate earnings

Materials/industrial materials and new growth industries have similar KOSPI weights

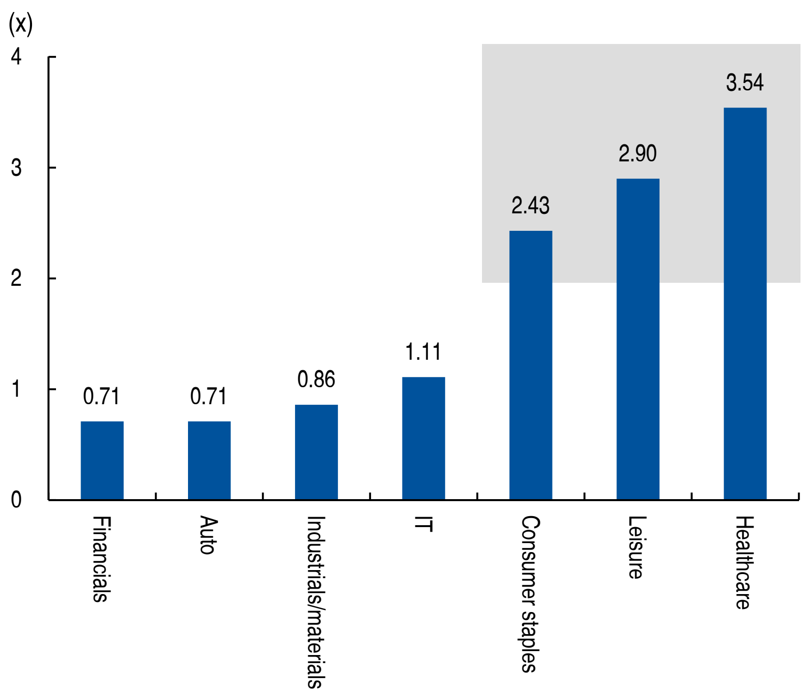
- Composition of the KOSPI (i.e., sector weights) has sharply changed since May 2011; weights of materials and industrial materials have declined markedly, but weight of IT has increased
- Weights of new growth industries, including healthcare, leisure/entertainment, and cosmetics (consumer staples), have also expanded
- As of end-October 2015, the weight of materials/industrial materials (15.9%) is similar to the level of new growth industries (16.7%)

Changes in major sectors' KOSPI weights



Source: WISEfn, KDB Daewoo Securities Research

Major sectors' P/Bs (as of end-October)



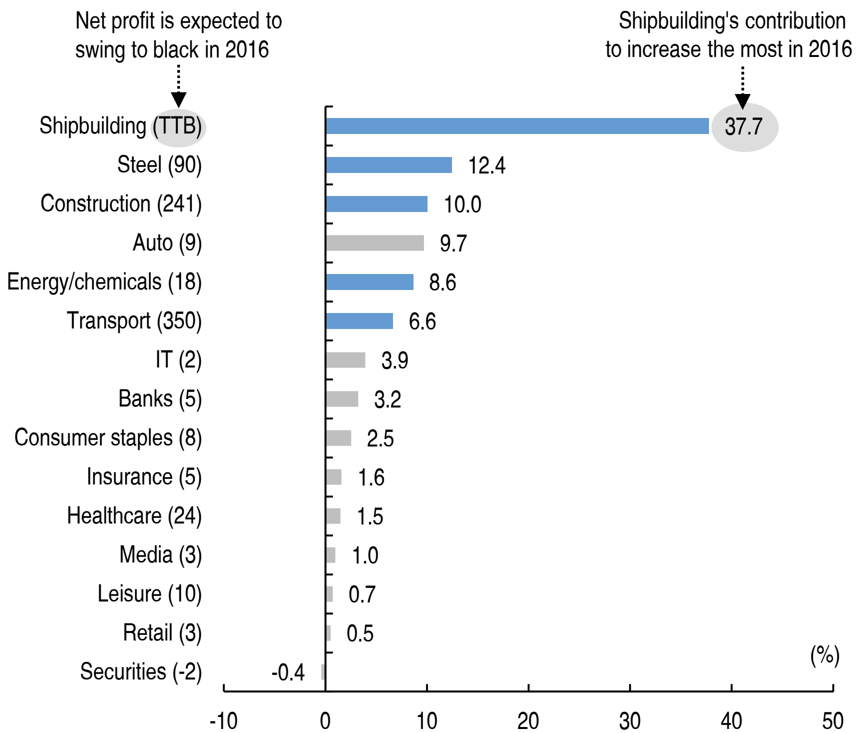
Note: Based on 2015F earnings
Source: WISEfn, KDB Daewoo Securities Research

I. Corporate earnings

2016 earnings growth will require turnaround by materials/industrial materials

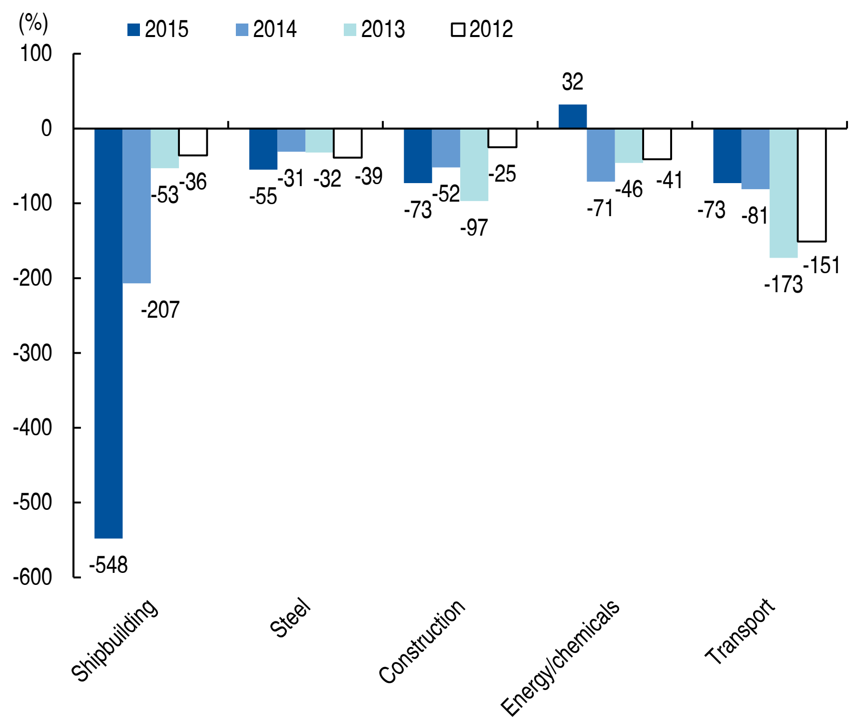
- In 2016, listed firms' net profit is projected to increase 8.8% (market consensus)
- Materials and industrial materials sectors are expected to turn around; shipbuilding, steel, construction, energy, chemicals, and transportation are anticipated to account for 75% of net profit growth in 2016
- However, since 4Q12, these sectors been characterized by earnings shocks followed by too-hasty optimism
- End of earnings shocks vs. structural slowdown

2016 net profit growth outlook by sector



Source: WISEfn, KDB Daewoo Securities Research

Discrepancy between materials/industrial materials earnings forecasts and actual results



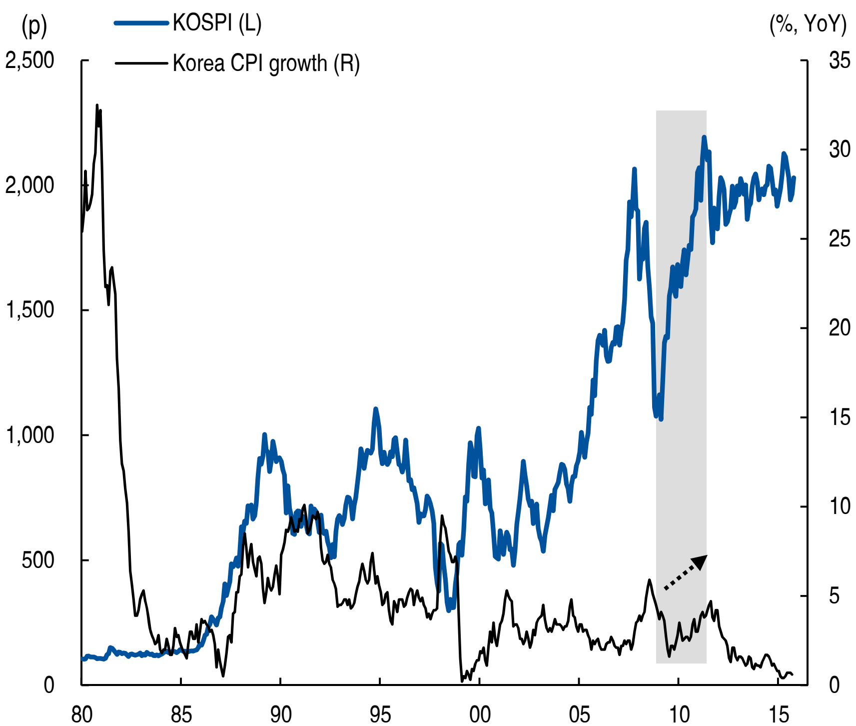
Note: Gap between forecasts made at the end of preceding year and actual results (January-October estimates for 2015 data)
Source: WISEfn, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Gradual inflation is favorable for the stock market

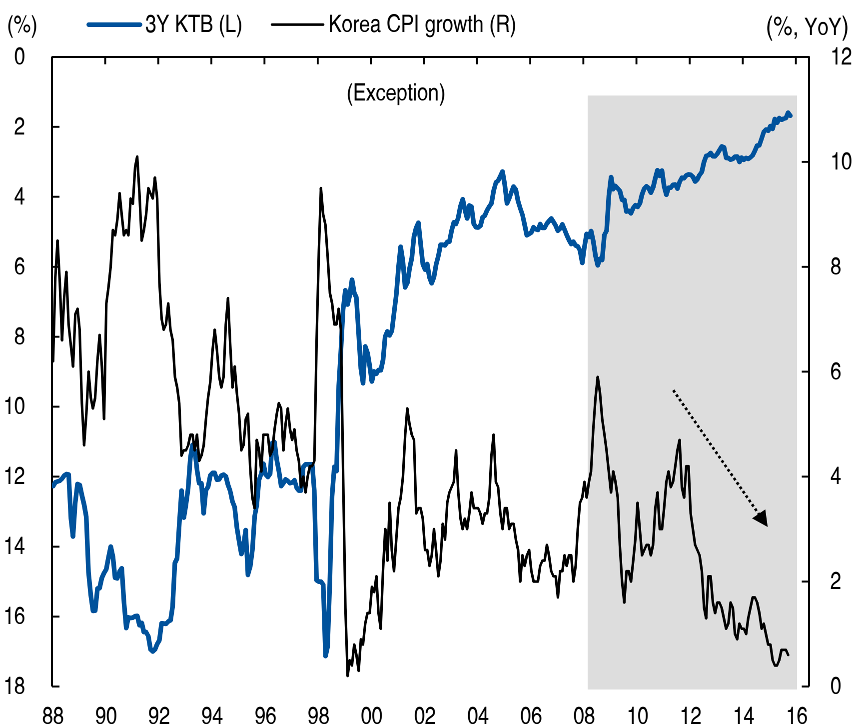
- Gradual inflation is favorable for the stock market, as it indicates improvement in the economy
- Historically, bull markets have often been accompanied by inflation
  (except in the mid-2000s, when China's integration with global markets took off)
- Meanwhile, inflation has a negative impact on the bond market

KOSPI and inflation



Source: BOK, KDB Daewoo Securities Research

KTB yield and inflation



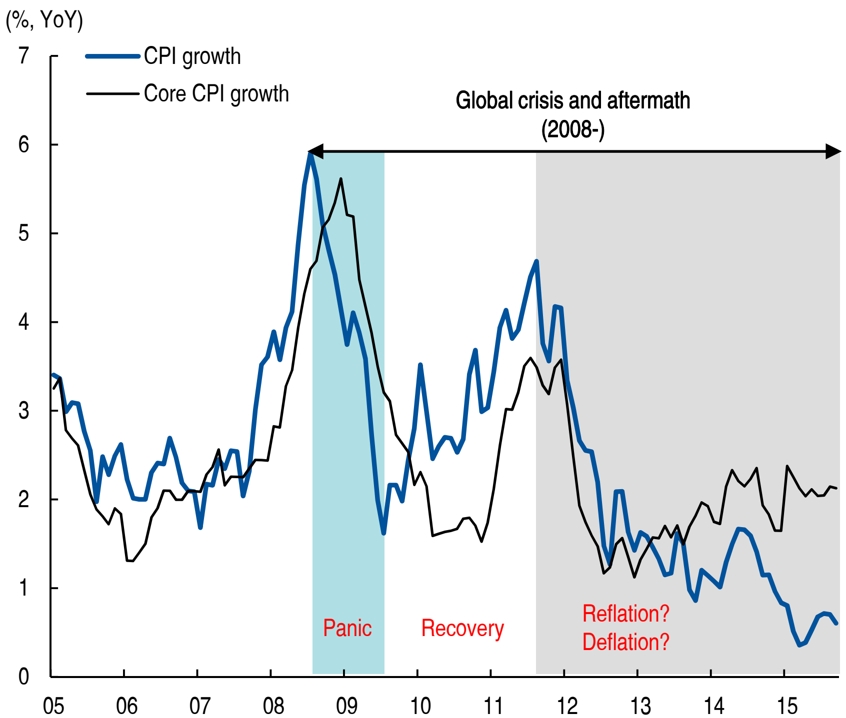
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Deflation vs. hyperinflation

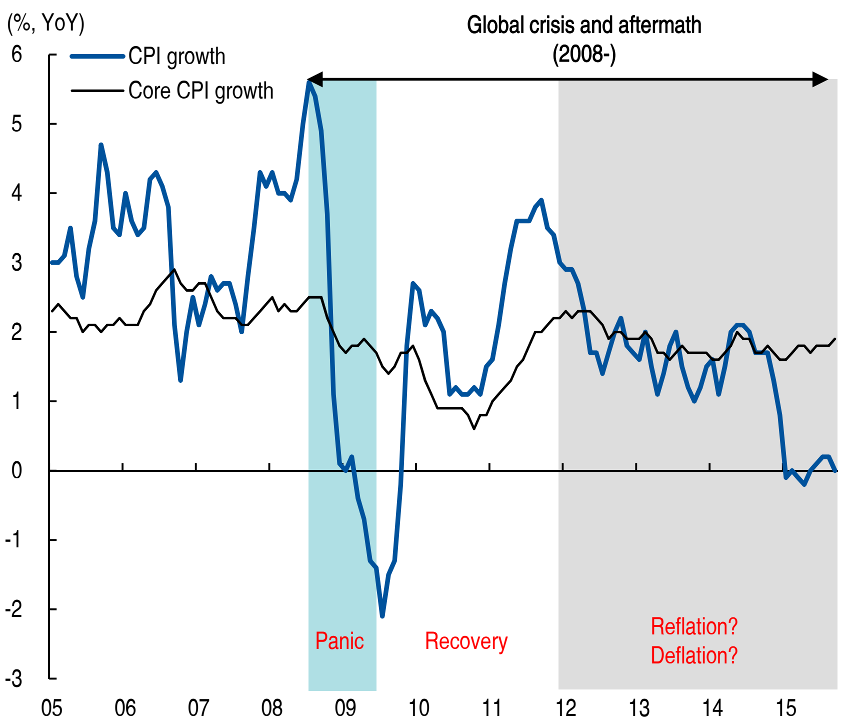
- Pessimism prevailed in the wake of the 2008 global financial crisis, giving rise to 1) the specter of the Great Depression (deflation) and 2) fears that the USD's status as the world's reserve currency would come to an end (hyperinflation)
- Fortunately, neither deflation nor hyperinflation occurred, but the central bank failed to foster moderate inflation
- Since 3Q11, deflationary fears have grown again

Korea's CPI growth has slowed since 3Q11



Source: BOK, KDB Daewoo Securities Research

US CPI growth has been slowing since 3Q11



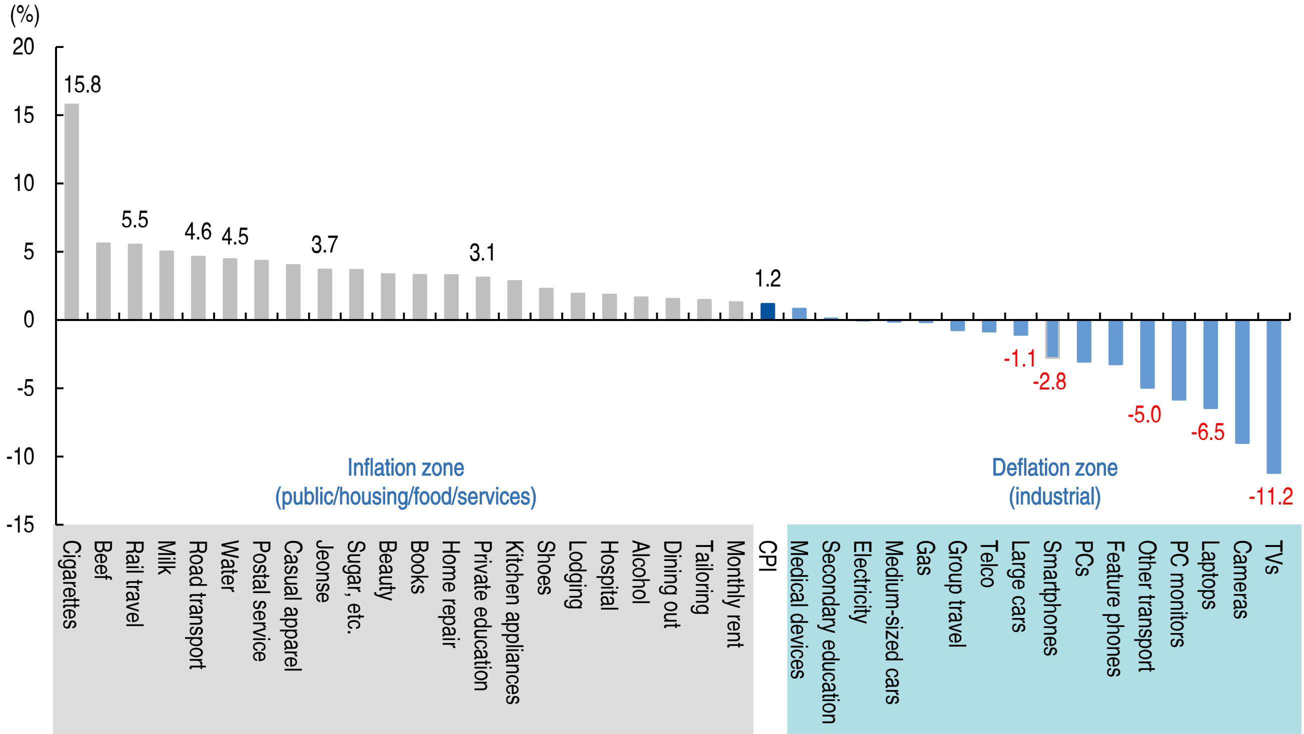
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Coexistence of deflation and inflation

- CPI growth, despite the slowdown since 3Q11, remains stable overall
- Some CPI components are in inflationary territory, while others are facing deflationary pressure; public utilities, housing, and food prices are rising by more than 3% per year, while industrial goods prices are falling sharply
- The prolonged sideways stock market is evidence of KOSPI's heavy reliance on manufacturing

Breakdown of Korea's CPI growth (since August 2011)



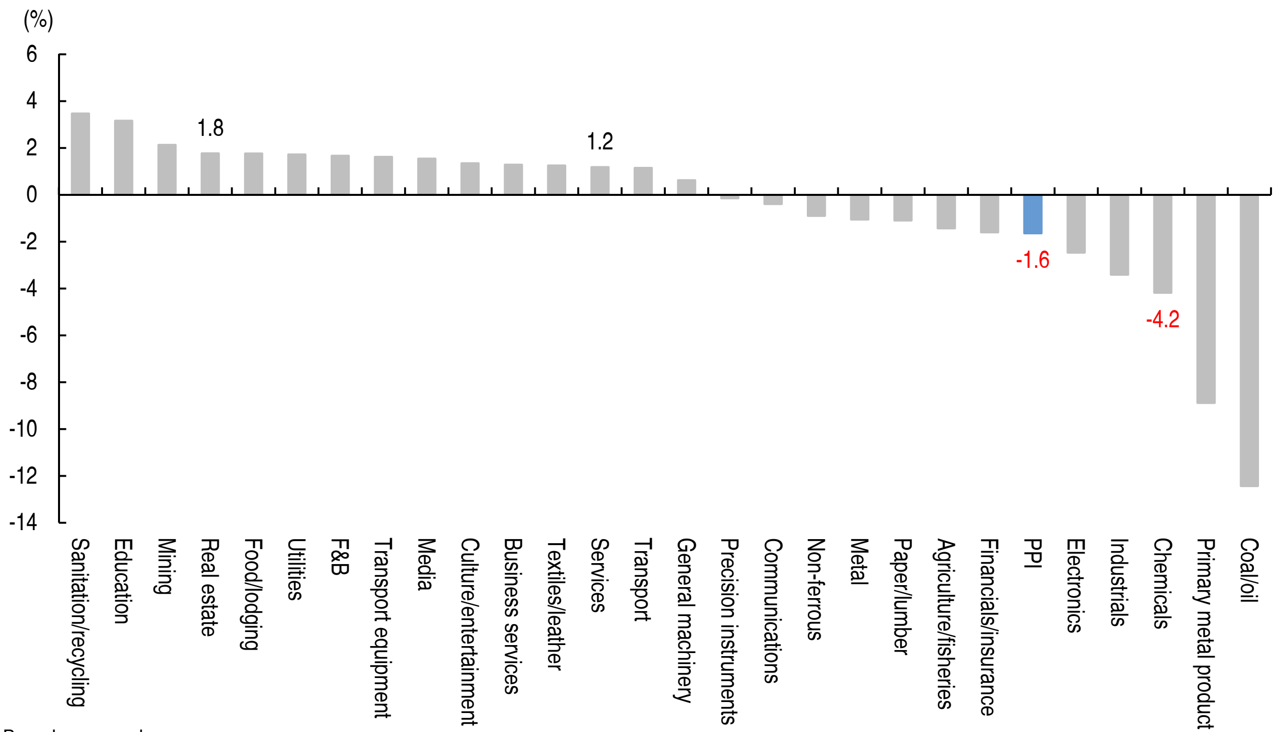
Note: Based on annual averages
Source: BOK, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Industrial goods already facing deflationary pressure

- Producer prices are also showing similar patterns
- Industrial goods are leading the PPI downtrend
- Meanwhile, services price growth remains in positive territory

Korea's PPI growth by component (since August 2011)



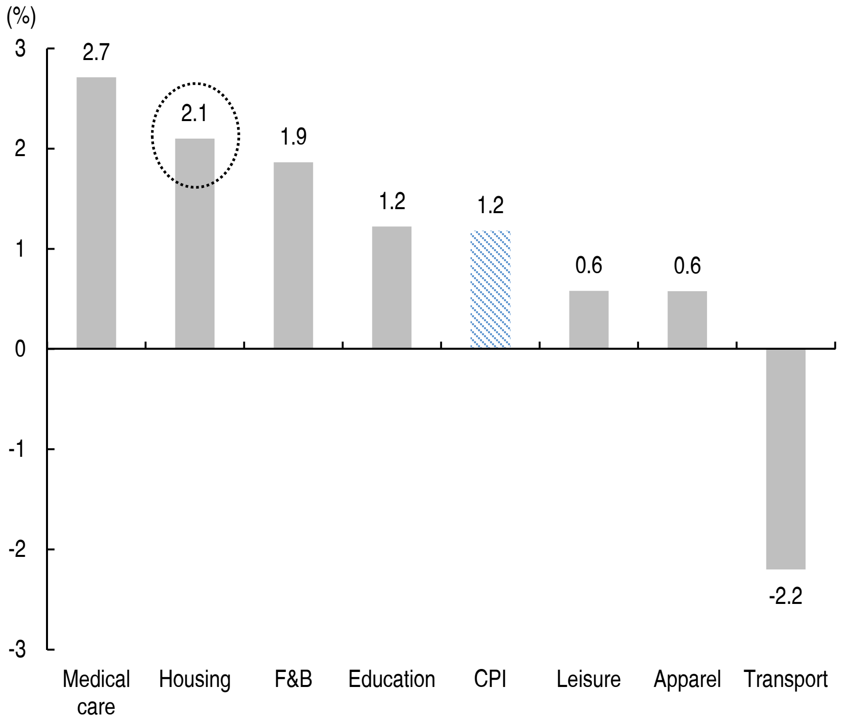
Based on annual averages
Source: BOK, KDB Daewoo Securities Research

Ⅱ. Era of biflation

US also experiencing biflation

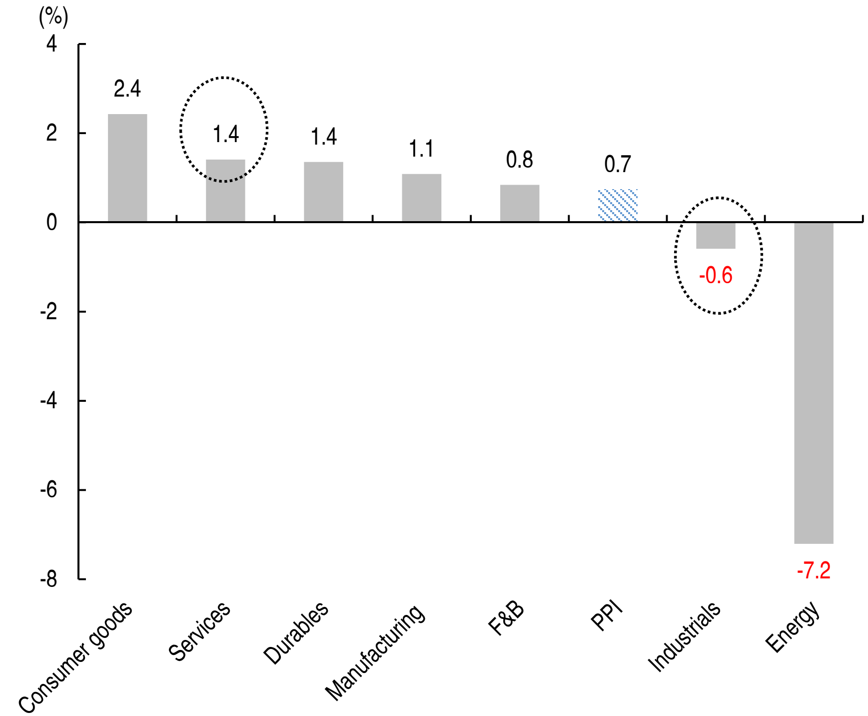
- In the US, services prices are rising while manufacturing prices are falling
- CPI may not have climbed without the contribution from the housing sector (42.1% weight in the US CPI)
- Transportation (including the automotive sector) is experiencing heavy deflationary pressure

US CPI growth (since 3Q11)



Note: Based on annual averages
Source: Bloomberg, KDB Daewoo Securities Research

US PPI growth (since 3Q11)



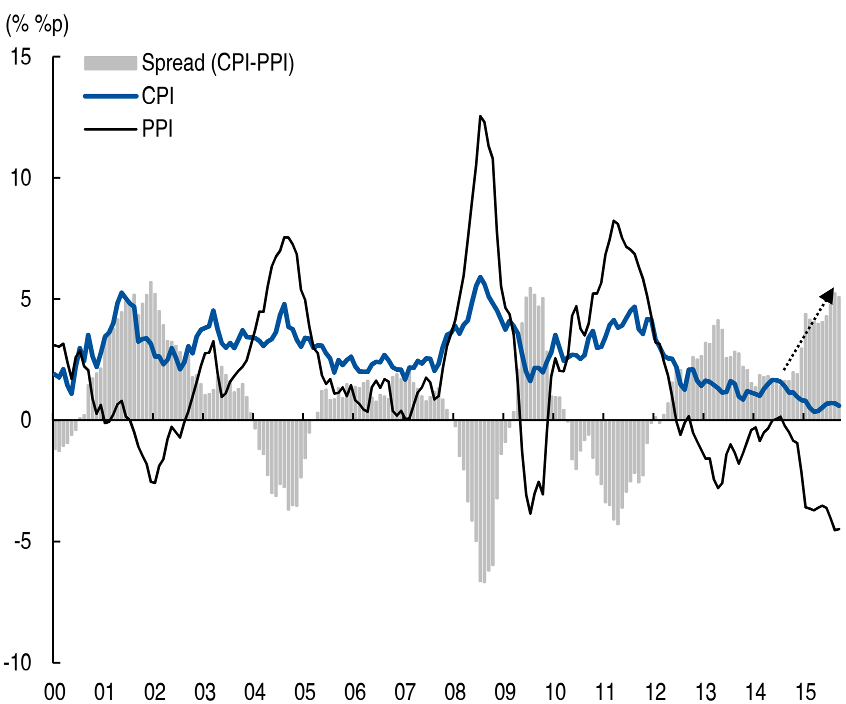
Note: Based on annual averages
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

A sign of deflation? Margins of manufacturers to deteriorate

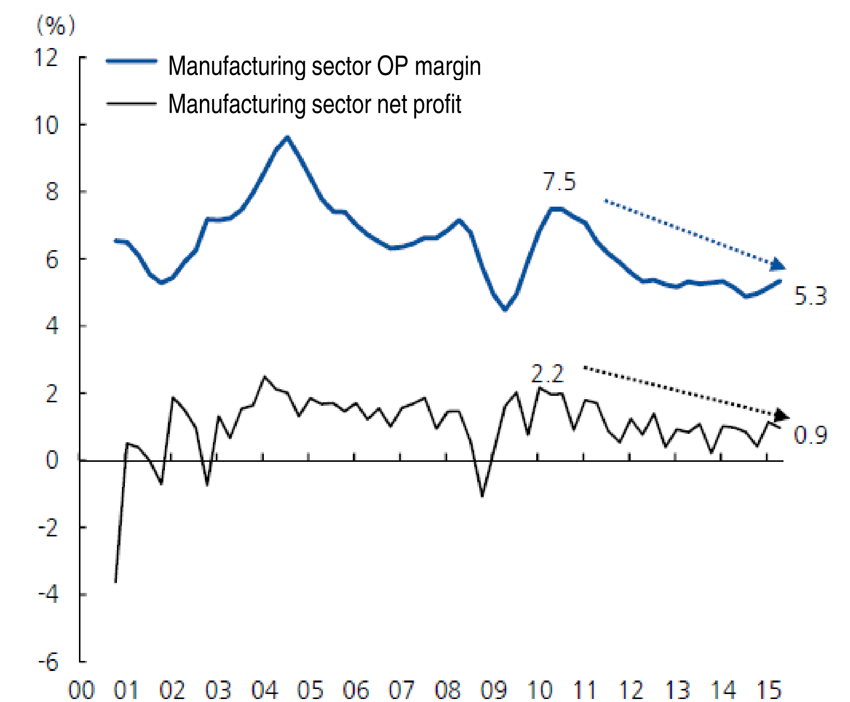
- Fall in commodity prices should hinder inflation
- Falling commodity prices could boost margins of Korean firms; lower commodity prices have a greater impact on PPI growth (corporate costs) than CPI growth (sales prices)
- However, margins of Korean listed manufacturers are forecast to show structural contraction
  → sign of deflation caused by weak demand

Korea: Widening spread between CPI and PPI



Source: Bloomberg, KDB Daewoo Securities Research

Margins of Korean listed manufacturers have weakened since 2010



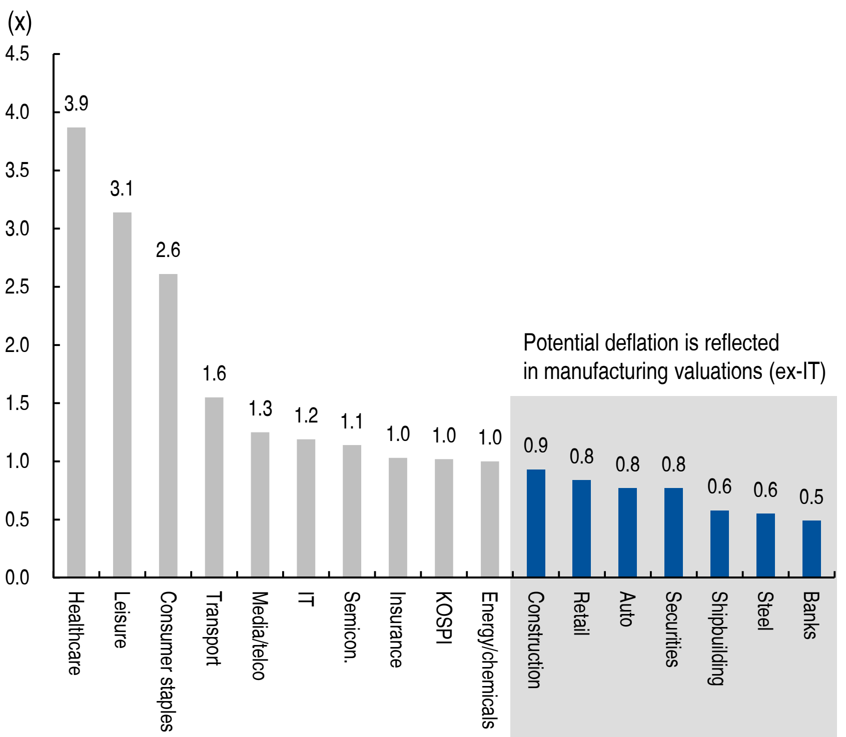
Note: On a four-quarter cumulative basis
Source: WISEfn, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Deflation has already been reflected in valuations of financial and manufacturing shares

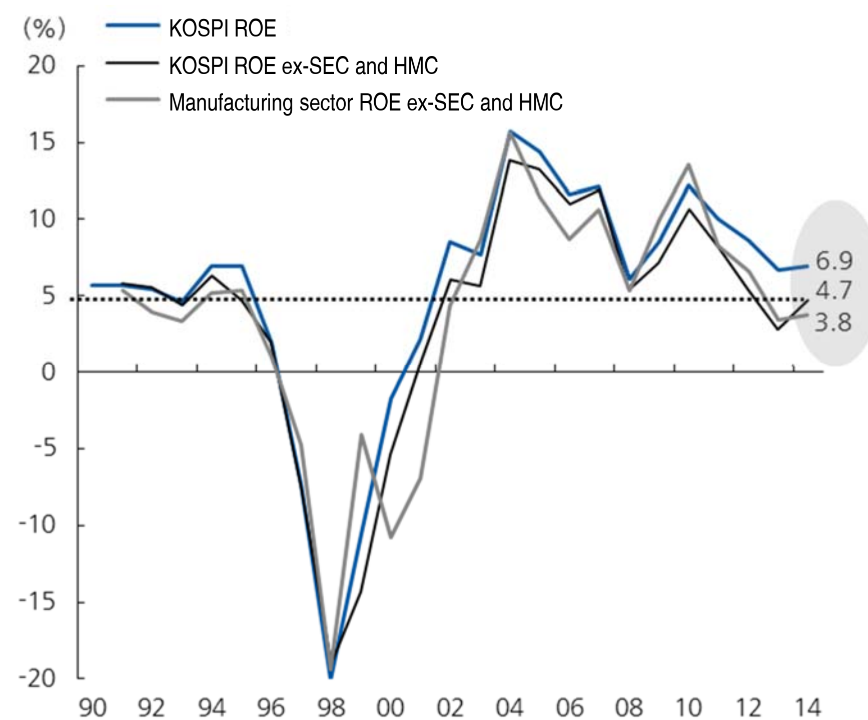
- Market values of Korea's major stocks are mostly below book values; stocks trading below 1x P/B represent 27.9% of overall market cap
- Manufacturers' profitability likely to weaken in the long term; excluding SEC and HMG, manufacturers' ROE was just 3.8% in 2014

Market value < book value for some key Korean sectors



Note: Based on 2015F earnings; as of end-October
Source: WISEfn, KDB Daewoo Securities Research

ROE of Korean listed firms: Profitability to weaken structurally



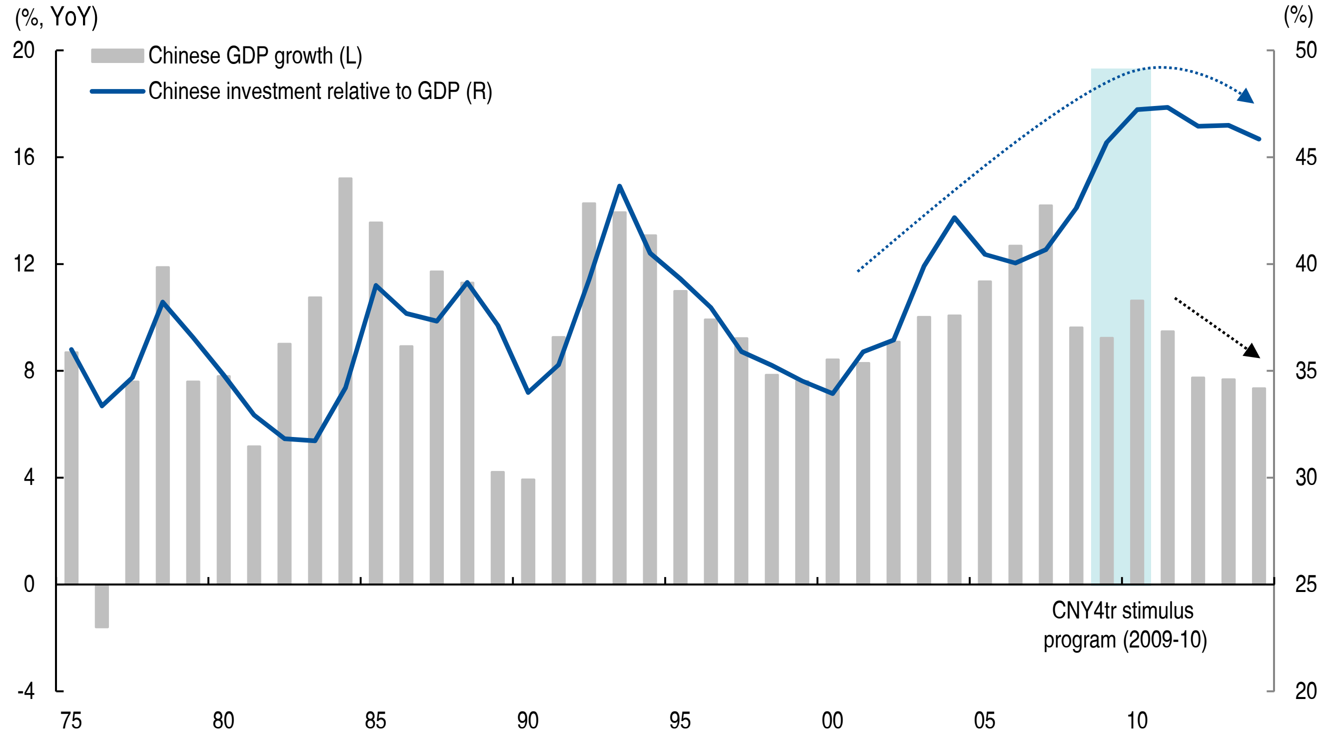
Source: WISEfn, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Concerns over deflation are mostly being fueled by Chinese slowdown

- Major central banks (e.g., Fed, ECB, and BOJ) are encouraging inflation
- Despite ample liquidity, insufficient real demand has kept inflation from rising
- Global CPI growth started slowing in 2H11, when Chinese growth (which had been driven by fixed asset investments) slowed full swing

% of investments in Chinese GDP; Chinese slowdown has driven global demand contraction



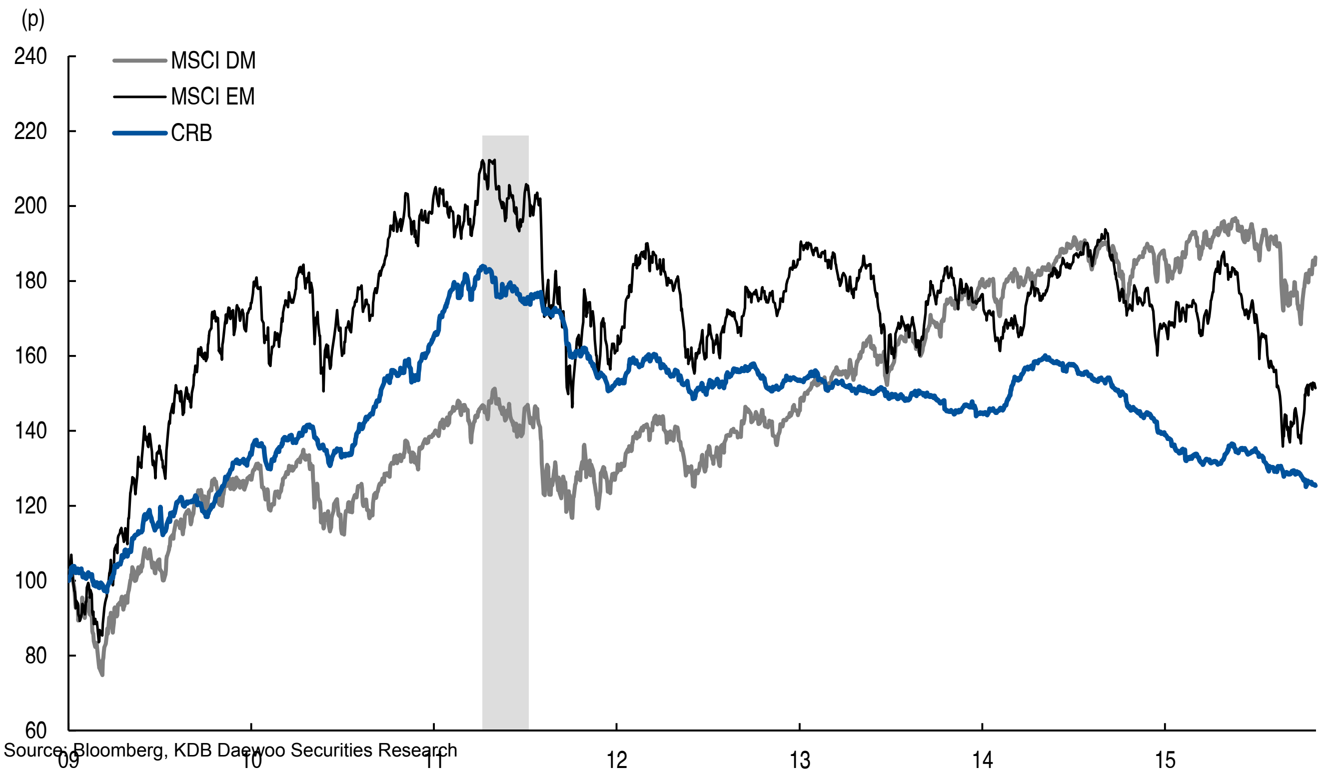
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Chinese economy is a bigger determinant of EM shares than DM monetary policy

- When the Chinese economy peaked in mid-2011, EM equities and commodity prices also rose to new heights; auto, chemicals, and oil refining shares in Korea peaked at the same time
- Despite monetary easing by the Fed, BOJ, and ECB, EM equities retreated; on the other hand, DM equities hit historic highs
- While DM economies are led by services, EM economies are driven by manufacturers
- Recovery of EM stock markets will require a rebound in Chinese economy

MSCI DM and EM indices and international commodity prices



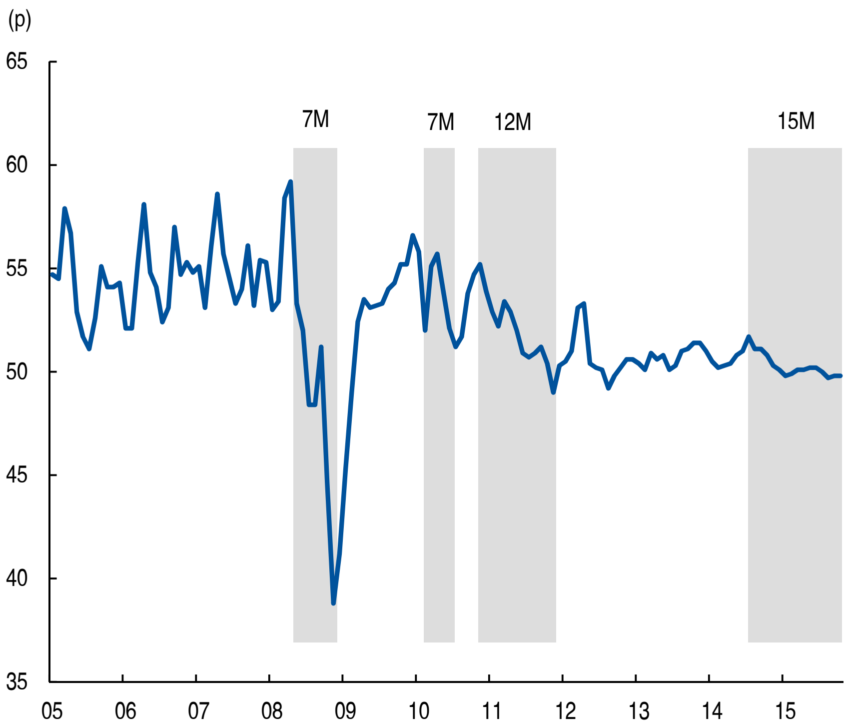
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Chinese economy to start to see a cyclical upturn in late 2015 or early 2016

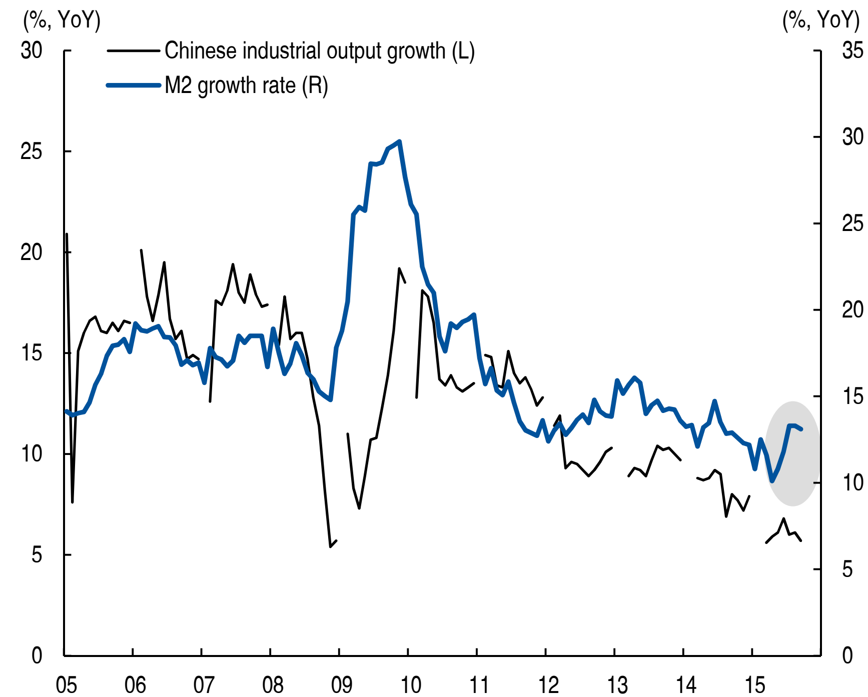
- Chinese economy will likely start to display a cyclical upturn in late 2015 or early 2016
- Chinese manufacturing PMI, which has been experiencing its longest slump in history, is likely to pick up soon
- China's M2 growth, which leads the country's industrial output by one quarter, has recently rebounded, suggesting that an economic recovery is imminent

Current decline in Chinese manufacturing PMI is the longest in history



Source: Bloomberg, KDB Daewoo Securities Research

M2 growth, which leads industrial output, has recently rebounded, suggesting an imminent economic recovery



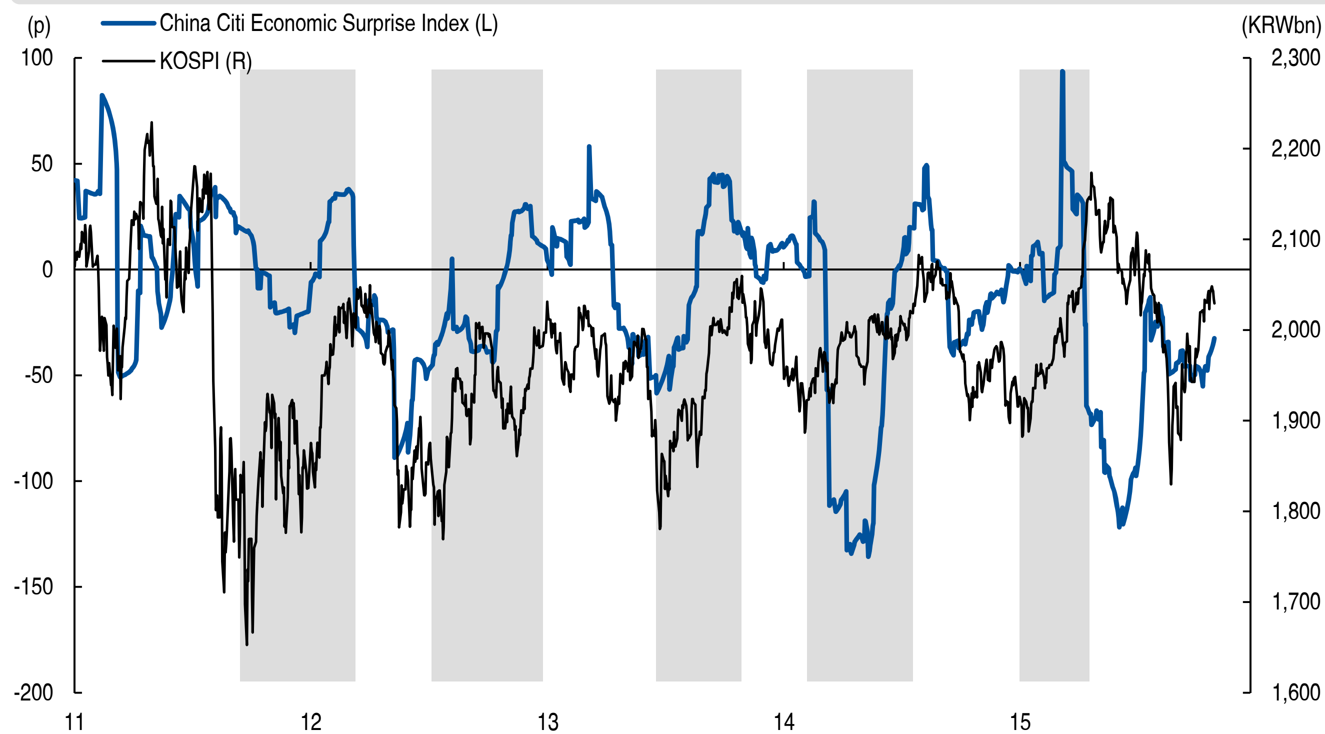
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

KOSPI rallies coincide with Chinese cyclical upturns

- Chinese economy has been mired in a structural slowdown since mid-2011
- Nonetheless, a cyclical economic recovery could occur
- Cyclical upturns in the Chinese economy have been largely responsible for Korean stock market pickups since 2011
- Since 2011, KOSPI rallies have coincided with Chinese economic rebounds (with no exceptions)

KOSPI and China Citi Economic Surprise Index



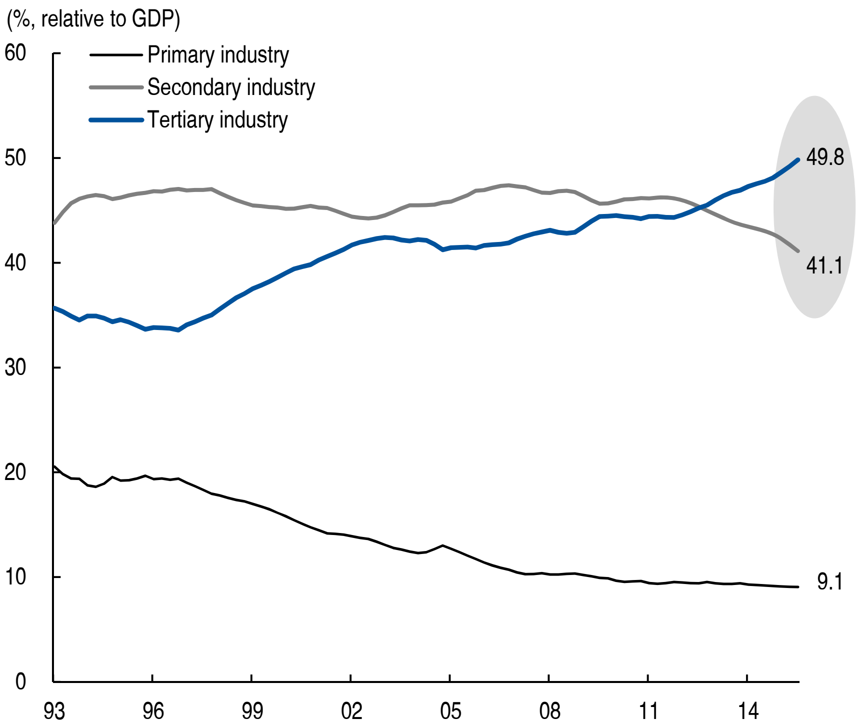
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

China: Services > manufacturing

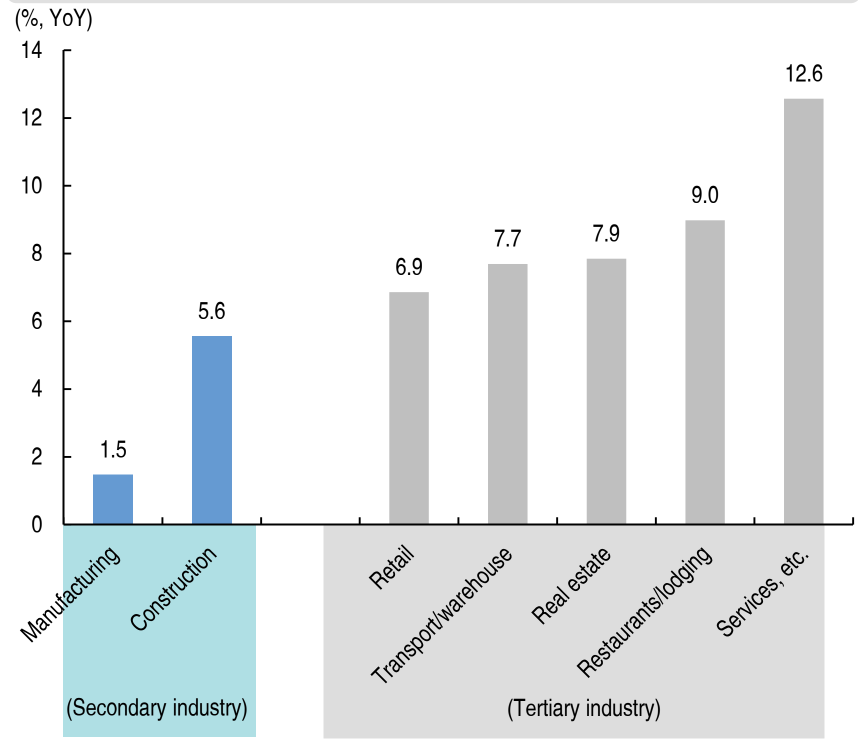
- Chinese economy has recently been characterized by the rapid growth of the services (tertiary) industry and a slowdown in the manufacturing (secondary) industry
- Size of the tertiary industry has exceeded that of the secondary industry since 2013
- Chinese economic growth is currently being driven by the services industry, including restaurants, lodging, real estate, transportation, and warehousing
- Manufacturing growth has been slowing rapidly; solid construction investments have prevented secondary industry growth from plunging

Tertiary industry makes a bigger contribution to China's GDP than secondary industry



Source: Bloomberg, KDB Daewoo Securities Research

China's growth by industry (3Q15)



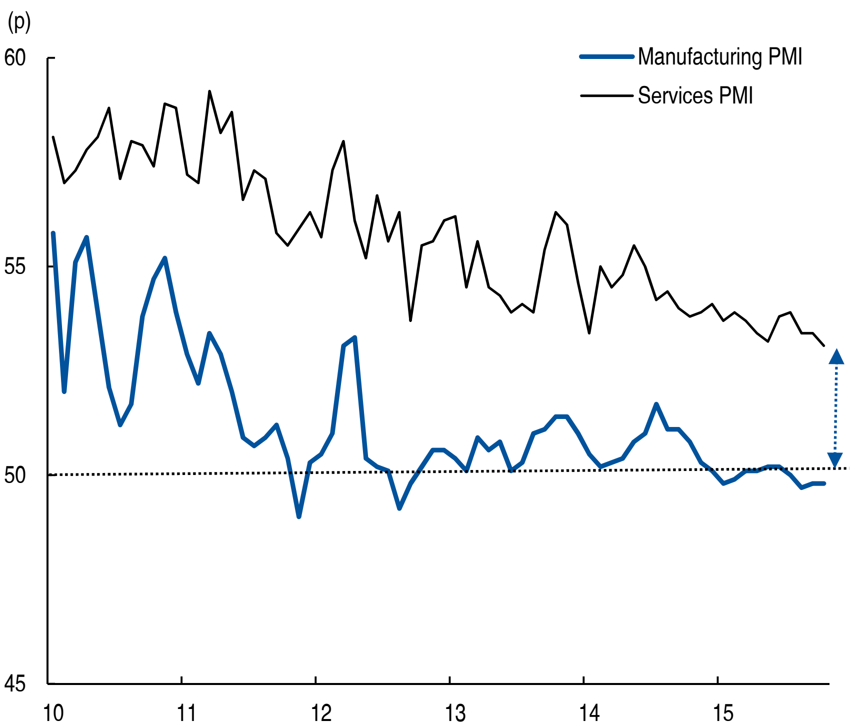
Source: Bloomberg, KDB Daewoo Securities Research

Ⅱ. Era of biflation

Korea's exports to China move in line with the country's secondary industry

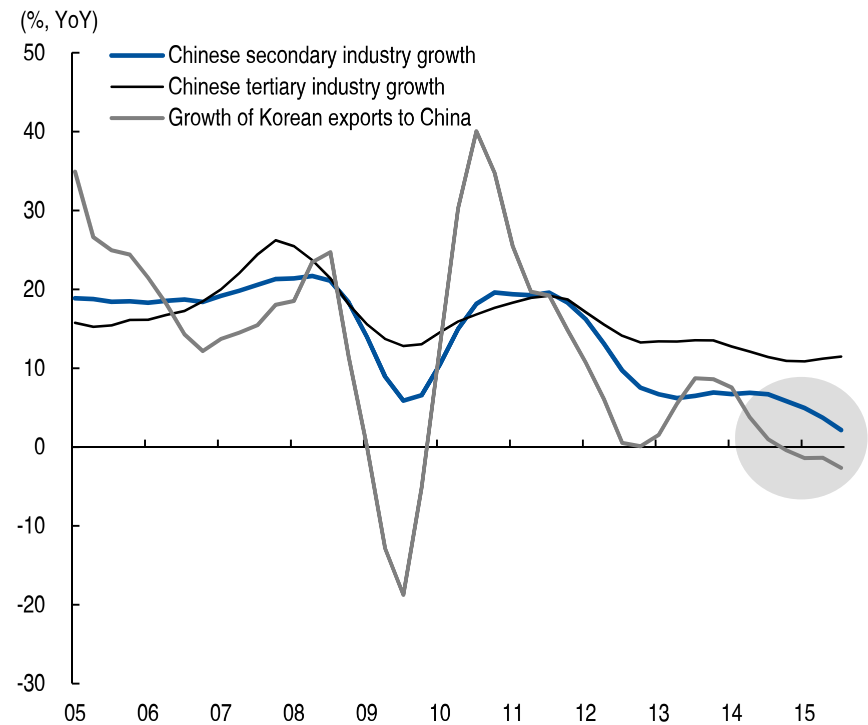
- Chinese PMI, a major leading economic indicator, is solid for services but weak for manufacturing
- But the robust performance of the Chinese services industry yields only modest benefits for other countries
- Indeed, Korea's exports to China move in line with the secondary industry, rather than the tertiary industry

Chinese PMI: Solid for services but weak for manufacturing



Source: Bloomberg, KDB Daewoo Securities Research

Korea's exports to China move in line with the country's secondary industry



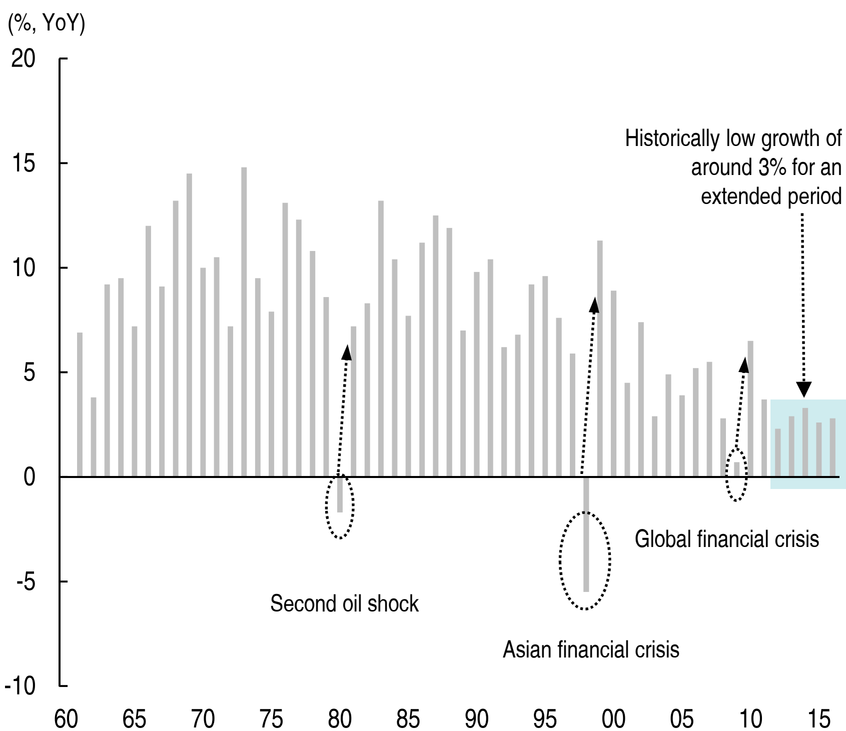
Source: Bloomberg, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Historic-low growth

Supply needs to be cut if demand cannot recover

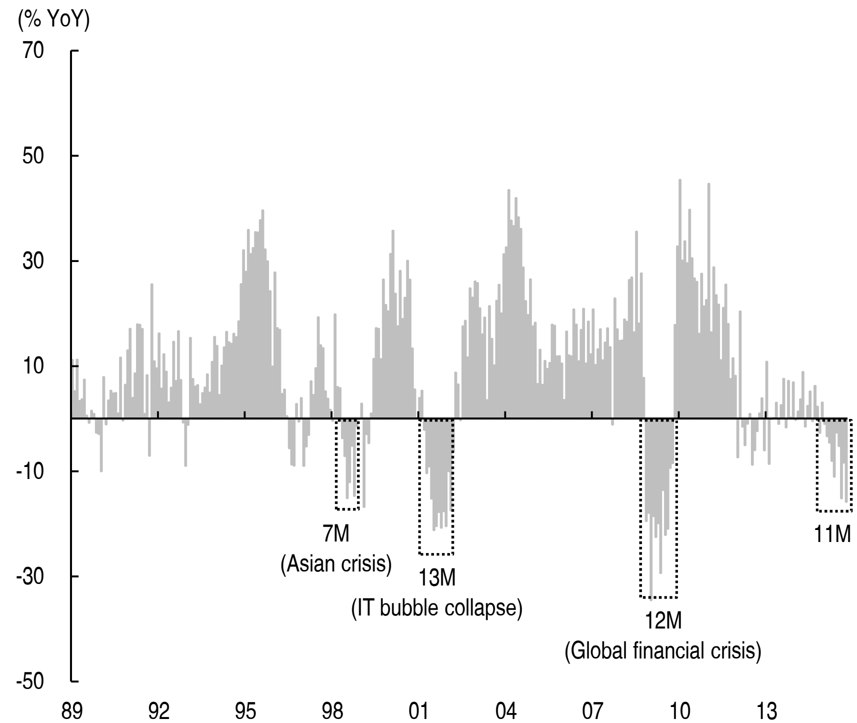
- Korea is displaying historic-low growth
- In the past, we saw v-shaped recoveries after sharp downturns caused by one-off negatives
- There have been no devastating slumps recently, but the protracted slowdown has weighed on the economy (since 2H11)
- Some companies may not survive the prolonged downturn

Protracted GDP growth slowdown in Korea



Source: BOK, KDB Daewoo Securities Research

Korean exports have declined for 10 straight months



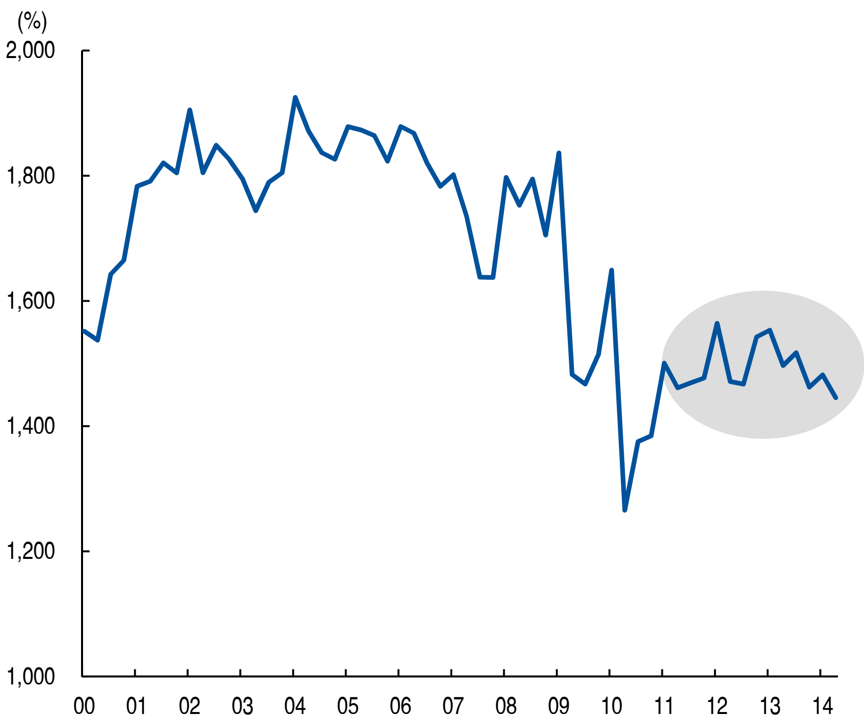
Source: Korea Customs Service, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: SMEs

SME restructuring to be led by banks

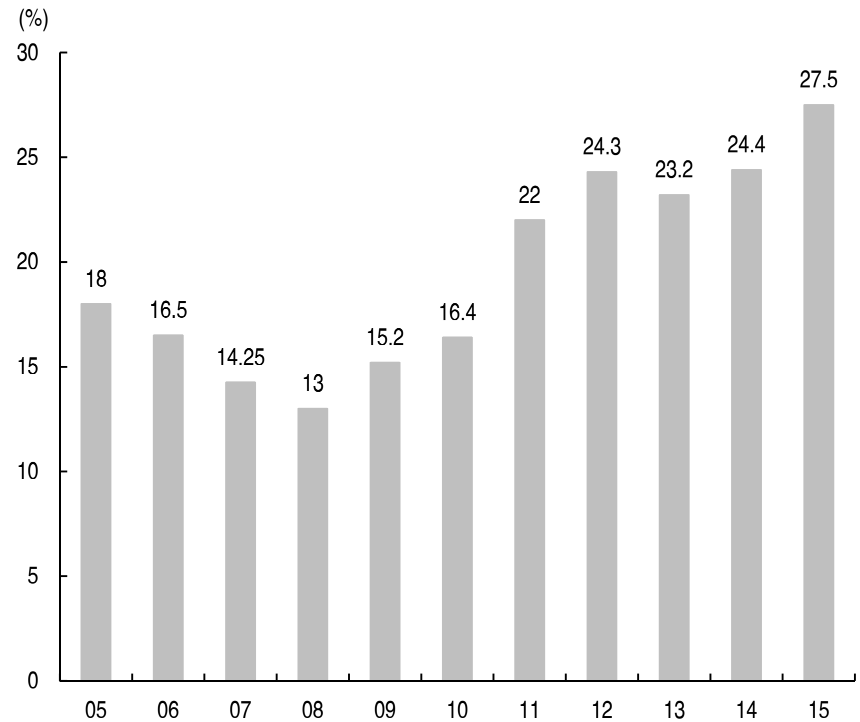
- Many SMEs could be driven out of business amid Korea's longest slowdown in history
- Receivables and inventory turnover have weakened
- 27.5% of all manufacturers (16% of total market cap) have interest coverage ratios below one and borrowings at least five times higher than EBITDA (high-risk firms)
- Restructuring of SMEs is anticipated to be led by banks

Turnover (receivables + inventory) of listed manufacturing firms



Source: WISEfn, KDB Daewoo Securities Research

Proportion of high-risk firms among listed firms



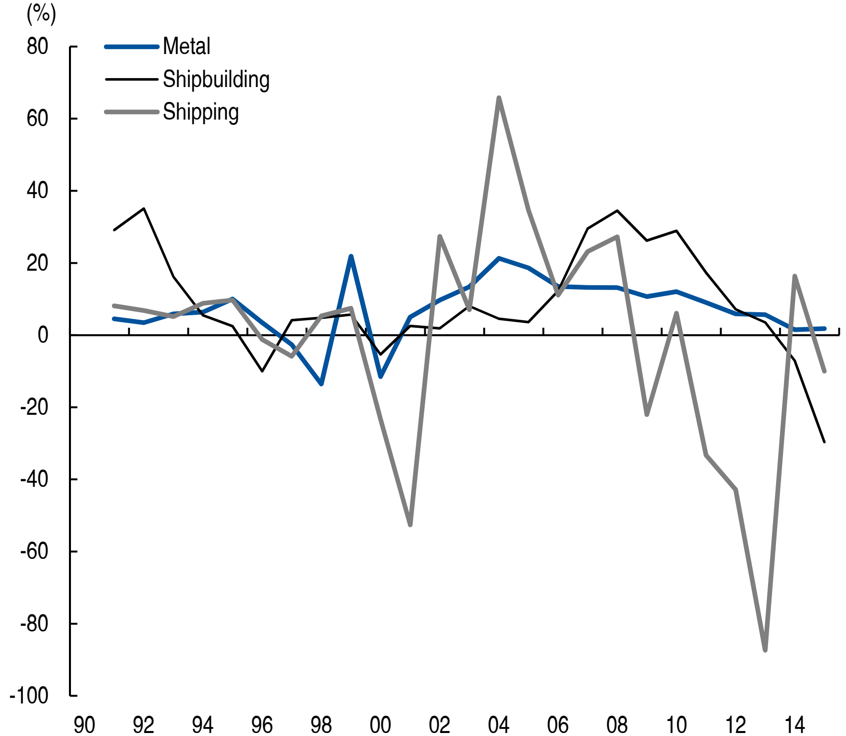
Note; Interest coverage ratio below one and borrowings at least five times higher than EBITDA
Source: WISEfn, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Steel/shipbuilding/shipping

Restructuring target: Steel/shipbuilding/ shipping companies (China plays)

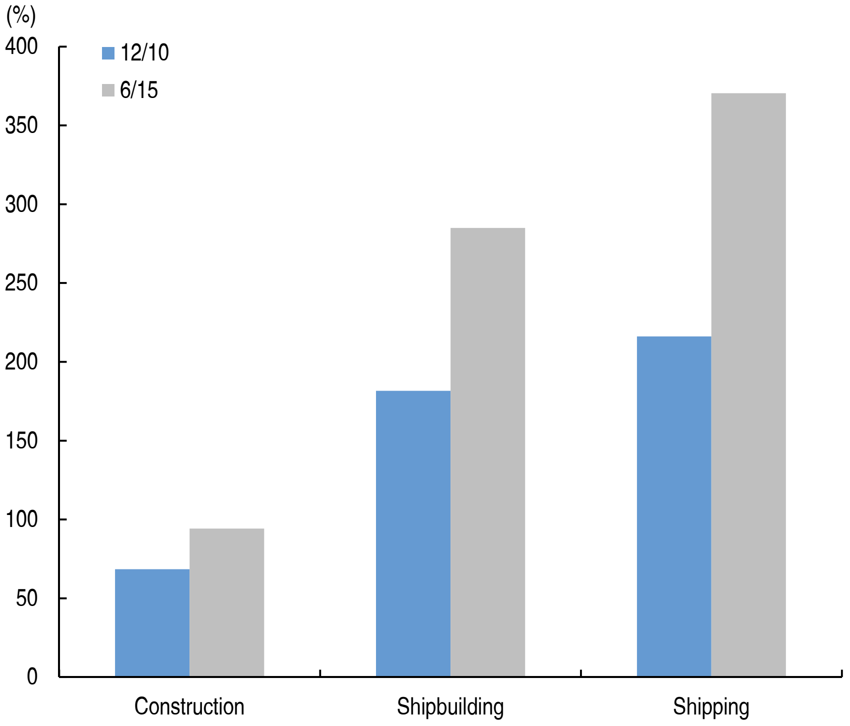
- Restructuring of large corporations should once again be led by the government (as in the 1980s and 1990s), with the government providing financial support to large companies
- Initial restructuring targets are expected to be steel/shipbuilding/shipping companies: M&As (with financial authorities providing guidelines)

Steel/shipbuilding/shipping firms showing secular ROE declines



Source: WISEfn, KDB Daewoo Securities Research

Debt-to-equity ratio has risen



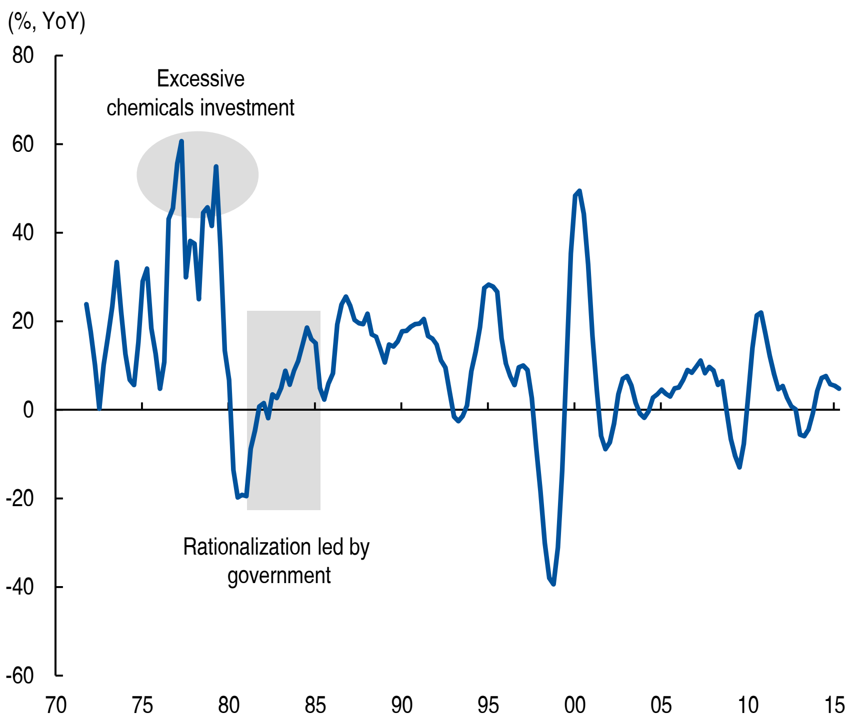
Source: WISEfn, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Large corporate groups

Korean government led industry restructuring in 1980s

- In Korea, restructuring of large corporate groups has been led by the government
- Following large-scale investments in heavy/chemicals industries in the early 1970s, a global recession occurred, triggered by the 1973 oil crisis → excess capacity had to be reduced
- Government-led restructuring in the early 1980s continued until the economy started to grow on the back of low interest rates, a weak USD, and low oil prices; during the restructuring, the government protected infant industries and encouraged the shutdowns of insolvent firms

Capex growth in Korea (excessive investments in the 1970s)



Source: BOK, KDB Daewoo Securities Research

Industry restructuring in 1980s

Announcement	Policy targets	Details
Feb. 1981	Rationalization of automotive industry	Merger between Kia Motors and Dong-A Motor
Dec. 1983	Shipping M&As	No. of shippers reduced to 20 (from 70)
Oct. 1984	Restructuring Act (insolvent firms)	Merger between shipping companies and construction firms operating overseas (financial support from the BOK)
Jul. 1986	Selection of promising infant industries and smokestack industries	Infant: Auto, heavy construction equipment, diesel engine, heavy electric machinery Smokestack: Textiles and iron alloys ➔ new entrants banned for three years from both infant and smokestack industries
Sep. 1986	Shutdown of 28 insolvent firms	Shutdown/sale of insolvent firms (led by government)

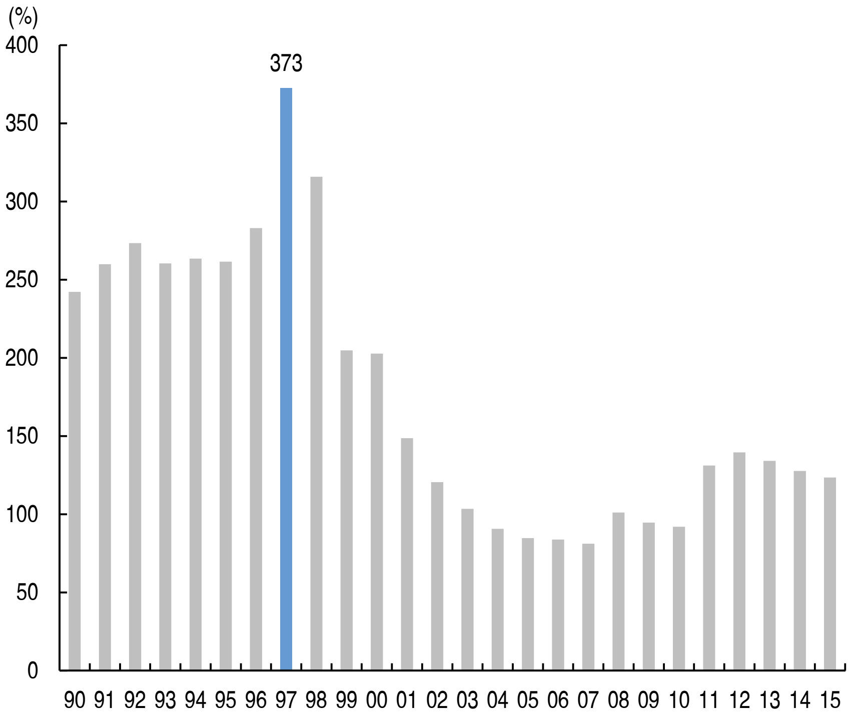
Source: KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Large corporate groups

Shortly after the Asian financial crisis broke out, Korean government led massive reforms

- Korean government carried out massive economic reforms shortly after the Asian financial crisis broke out
- Key was restructuring of conglomerates (led by the government)
- Restructuring of conglomerates changed the Korean economic structure

Debt ratio of Korean listed firms: Excessive leverage shortly before the Asian financial crisis erupted



Source: WISEfn, KDB Daewoo Securities Research

Government-led economic reforms

Sector	Details
Semiconductor	Hyundai Semiconductor acquired LG Semiconductor
Petrochemicals	Daelim Industrial acquired Hanwha Petrochemical
Oil refining	Hyundai Oilbank acquired Hanwha Energy
Ship engines	Hankook Heavy Industries acquired the power plant division of Hyundai Heavy Industries
Railway	Hyundai, Daewoo, and Hanjin established an integrated entity
Airlines	Hyundai, Daewoo, and Samsung established an integrated entity

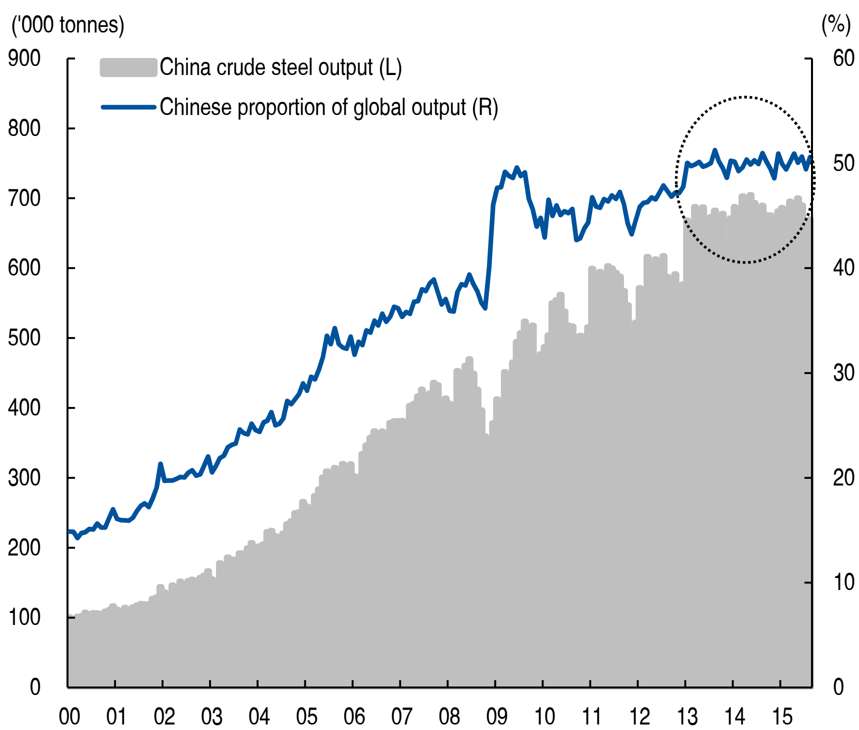
Source: KDB Daewoo Securities Research

Ⅲ. Restructuring overview: China is the culprit behind oversupply

Global oversupply to ease only after China carries out restructuring

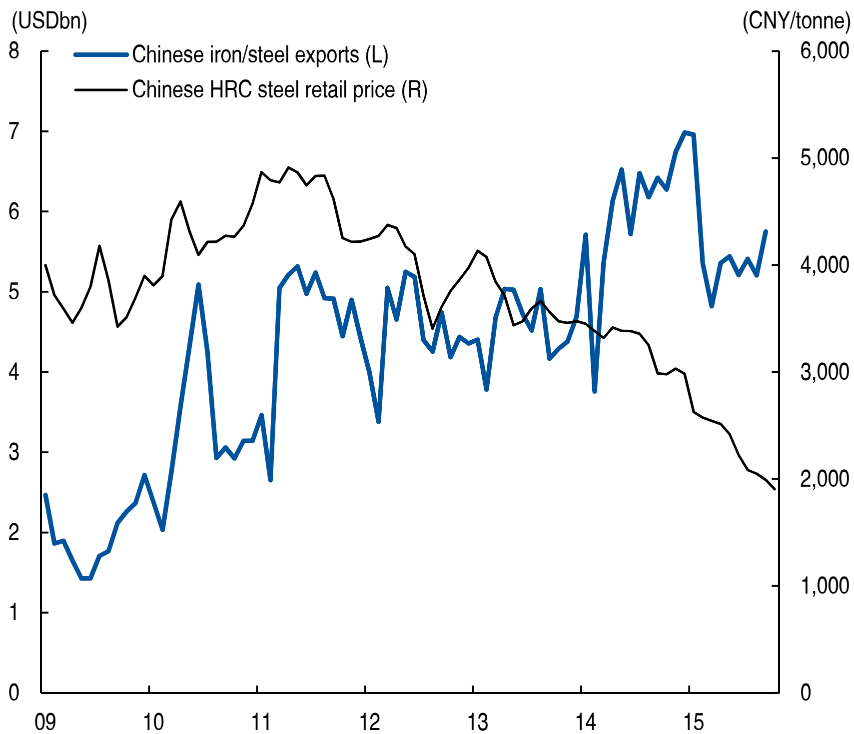
- If oversupply eases with restructuring, share prices should receive a boost
- The culprit behind global oversupply is China
- Chinese government identified nine sectors (e.g., steel, cement, and shipbuilding) as facing oversupply; however, pace of restructuring is slow
- Rather, China's efforts to ease domestic oversupply by boosting exports are posing a burden to other countries (steel); as for IT (including LCD and semiconductor), Chinese firms' expansion are raising concerns over intense competition
- Intensity of Chinese industrial restructuring will be reflected in progress of SOE restructuring

Global crude steel output and Chinese proportion



Source: Bloomberg, KDB Daewoo Securities Research

Chinese steel exports and domestic retail price



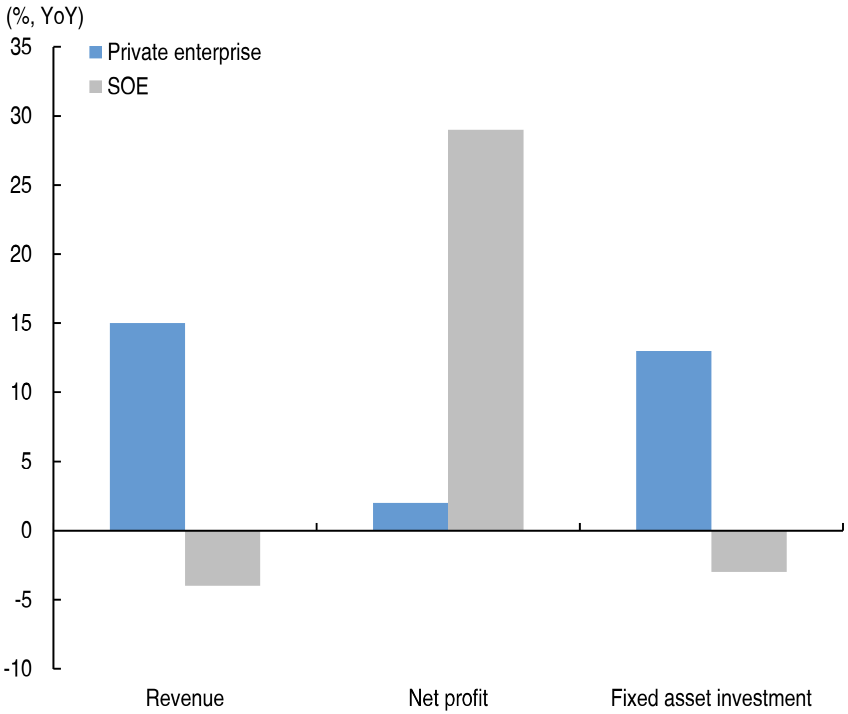
Source: Bloomberg, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: China is the culprit behind oversupply

Ownership structure reform holds the key

- Restructuring of SOEs to be key component of Chinese reforms; out of the 500 largest companies in China, 293 firms are owned by the state
- Most SOEs engage in large-scale operations, causing global oversupply
- Under the Chinese SOE restructuring program, employee ownership is preferred over full privatization, influenced by voices of modern leftists who are cautious about excessive capitalism
- Even if government-led reforms are carried out, major changes are unlikely to be seen unless ownership structure reform takes place

Earnings of private firms and SOEs (1H15)



Source: Wind, KDB Daewoo Securities Research

Chinese SOE reform plans (August 24, 2015)

	Details
Issue	Dividing SOEs into public-interest companies and commercial firms
Ownership structure	Partial or full disposal of SOEs to private firms; partial stake sales in strategically important industries such as utilities, energy, and telco
M&A deals	Improving global competitiveness by pursuing M&A deals between major strategically important industries
Corporate culture	Grant BOD right to elect management; introduction of merit-based compensation
Monitoring	Establishment of a watchdog agency

Source: State Council of the People's Republic of China

Ⅲ. Restructuring overview: Cash reserves gaining traction

Focus on companies with ample cash reserves

- With ongoing deflationary pressure on tangible assets, importance of conventional assets is diminishing
- Cash reserves will likely draw attention: amid deflationary pressures, holding cash could be advantageous even during industry restructuring
- Companies listed in the table below hold ample cash reserves and boast stable financial ratios

Companies with substantial cash reserves

Stock	Ticker	Sector	Market cap (KRWbn)	Cash reserves (KRWbn)	Cash reserves/ market cap	Current ratio (%)	Debt ratio (%)	P/B (x)	Dividend yield estimate (%)
Seoyon	007860 KS	Auto parts	275	316	1.15	110	146	0.29	1.2
CKH Food & Health	900120 KQ	Supplements	356	378	1.06	997	17	0.66	0.0
Samil Enterprise	002290 KQ	Construction	32	31	0.98	610	19	0.63	1.0
S&C Engine	900080 KQ	Auto parts	156	146	0.94	671	9	0.44	0.0
China Great Star	900040 KQ	Textiles/apparel	280	260	0.93	378	32	0.64	0.0
Daewon Sanup	005710 KQ	Auto parts	121	100	0.82	163	95	0.66	1.9
Bukook Steel	026940 KS	Metal/minerals	59	45	0.77	492	21	0.55	2.5
CS Holdings	000590 KS	Metal/minerals	92	66	0.71	572	17	0.39	0.0
Hyundai E&C	000720 KS	Construction	3,853	2,364	0.61	171	171	0.54	1.4
Dong-Ah Geological Engineering Company	028100 KS	Construction	92	55	0.60	169	89	0.67	2.2
SJM Holdings	025530 KS	Auto parts	80	41	0.51	544	24	0.37	3.7
Wooshin Systems	017370 KS	Auto parts	62	31	0.51	124	125	0.60	0.5
Incheon City Gas	034590 KS	Utilities	152	74	0.49	185	91	0.99	3.6

dividend is as of 2014

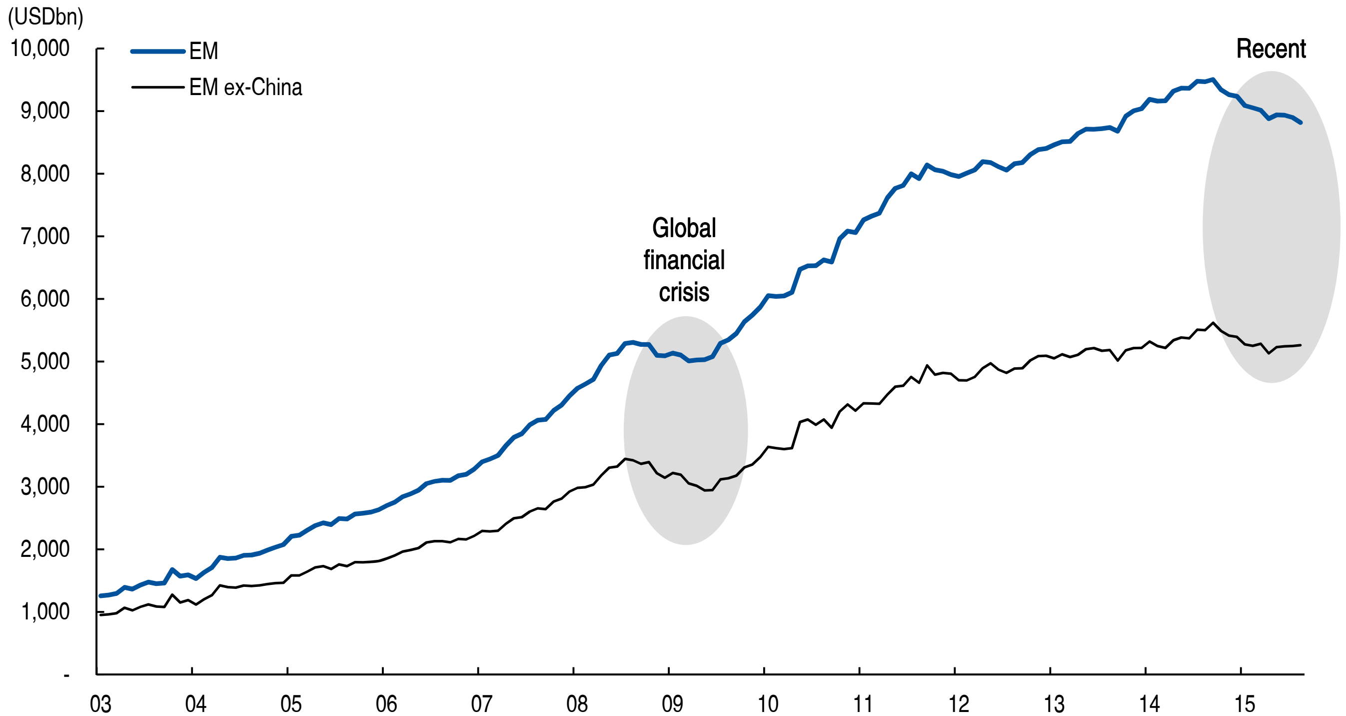
Source: Bloomberg, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Shrinking F/X reserves in EM economies

F/X reserves are contracting in EM economies

- F/X reserves have recently been contracting in EM economies
- Payment-driven reserve contraction is being seen for the first time since the 2008 global crisis
- Reserves in EM economies have recently declined 8.5% from the historic-high level seen in 2014 (USD9.5tr → USD8.6tr)
- Reserves in China, resource-rich nations (e.g., Middle East, Latin America), and Southeast Asian countries are quickly shrinking

F/X reserves in EM nations trending down for the first time since the 2008 global crisis



Source: Bloomberg, KDB Daewoo Securities Research

Ⅲ. Restructuring overview: Shrinking F/X reserves in EM economies

F/X reserves are quickly decreasing in EM economies

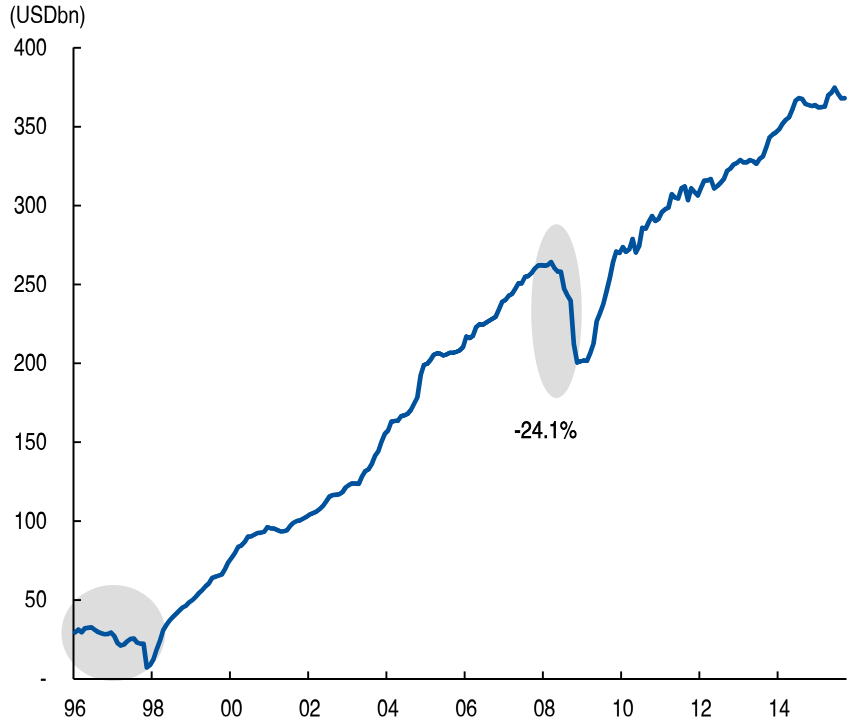
- F/X reserves were more than 10% below historic-high levels as of September 2015
- Reserves in Southeast Asian countries (e.g., Thailand, Malaysia) are quickly shrinking
- Reserves in emerging economies expanded; however, it should be noted that the 2008 currency crisis was triggered by a quick short-term contraction of reserves
- Greater exposure to the global economy is one of risks

Changes in F/X reserves in major EM economies (USDbn)

Country		Historic-high	September 2015	Change
China		3,993	3,514	-11.9%
Resource-rich countries	Saudi Arabia	731	656	-10.2%
	Russia	496	322	-35.0%
	Algeria	193	157	-18.6%
	Mexico	196	176	-7.6%
	Libya	119	78	-33.8%
Southeast Asia	Singapore	277	251	-9.4%
	Thailand	182	148	-18.7%
	Malaysia	136	89	-34.6%
	Indonesia	124	101	-15.4%
Korea		374	368	-1.7%

Source: Bloomberg, KDB Daewoo Securities Research

Korean F/X reserves



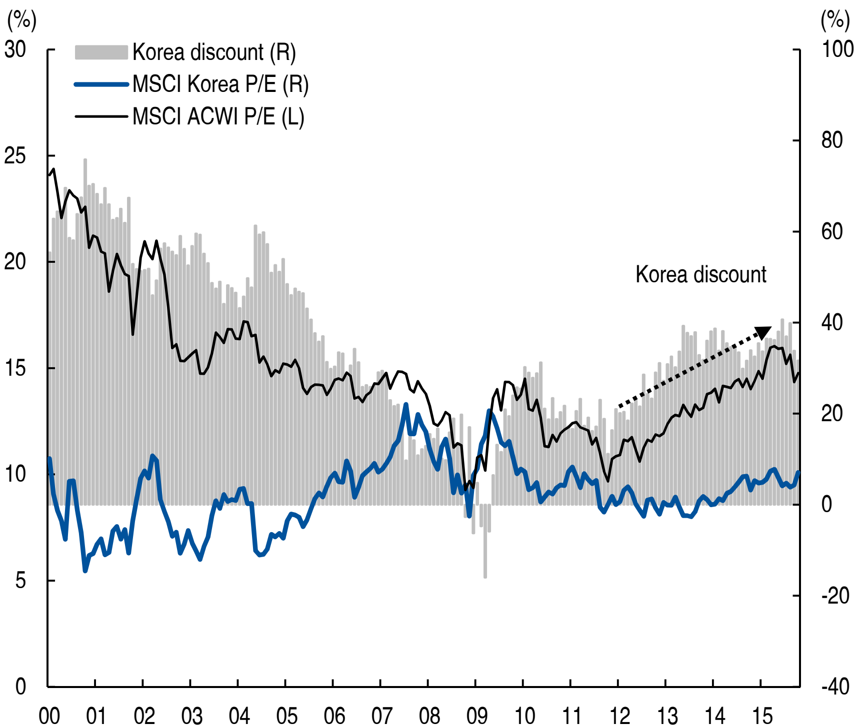
Source: CEIC, KDB Daewoo Securities Research

Ⅳ. Shareholder return policies to provide support

Lack of shareholder-friendly policies → Korea discount

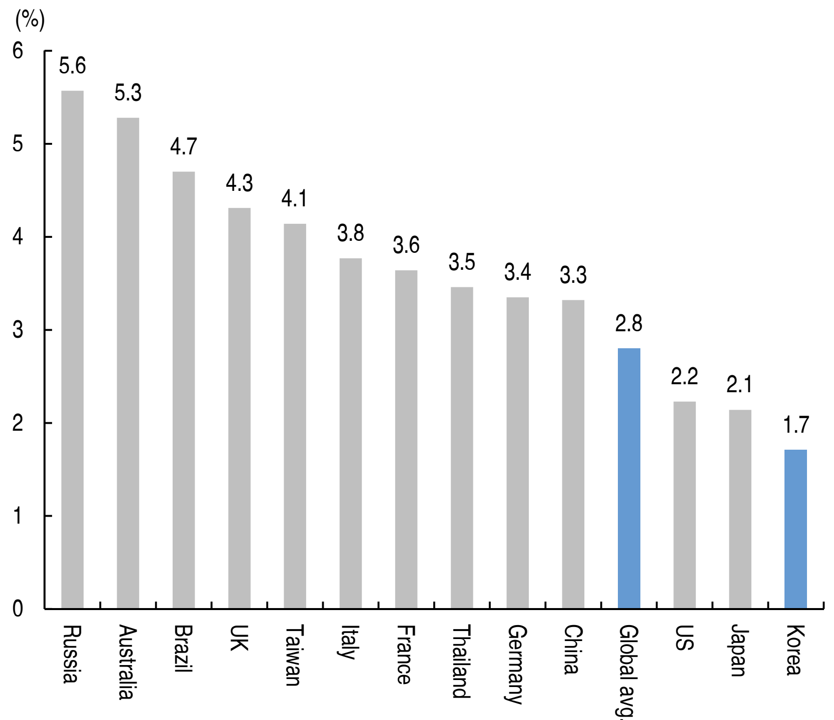
- Korean stocks' valuation discount has recently expanded
- Although EM stocks are discounted overall, the Korean stock market is particularly discounted
- Low dividend yields are one of the major drivers

Korea discount is on the rise



Source: Thomson Reuters, KDB Daewoo Securities Research

Korea has lowest dividend yield among major countries



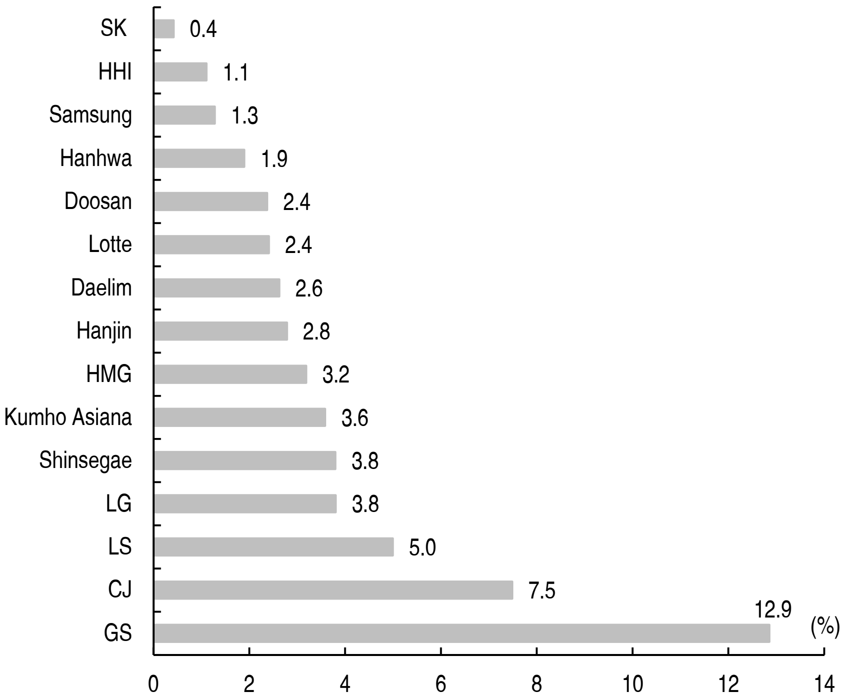
Note: As of October 2015
Source: Thomson Reuters, KDB Daewoo Securities Research

Ⅳ. Shareholder return policies to provide support

Large conglomerates are expected to shift to shareholder-friendly policies

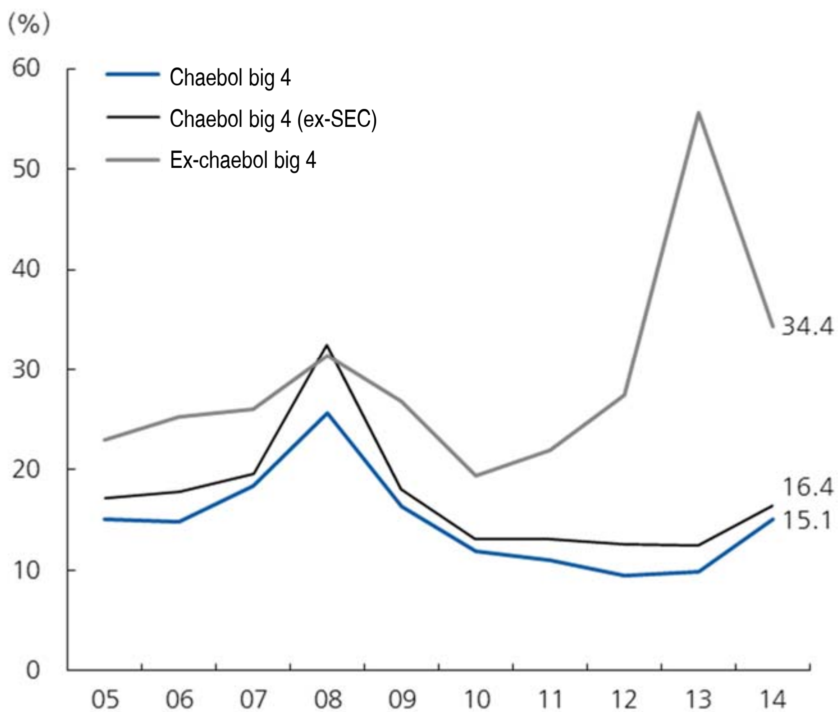
- In Korea, conglomerates are notorious for low dividend payouts
- Low payout ratios are attributable to the fact that major shareholders hold relatively low stakes; in order to maximize profits, it has traditionally more effective for major shareholders to pursue related-party transactions with affiliated firms in which they hold large stakes
- However, large conglomerates will likely increase shareholder returns, given 1) regulations on related-party transactions, 2) the introduction of an excess cash reserve tax, 3) rising market calls for dividend payout growth, and 4) close monitoring of ownership succession efforts

Stakes held by major shareholders and related parties



Note: As of April 1, 2015
Source: FTC, KDB Daewoo Securities Research

Dividend payout trends of large conglomerates



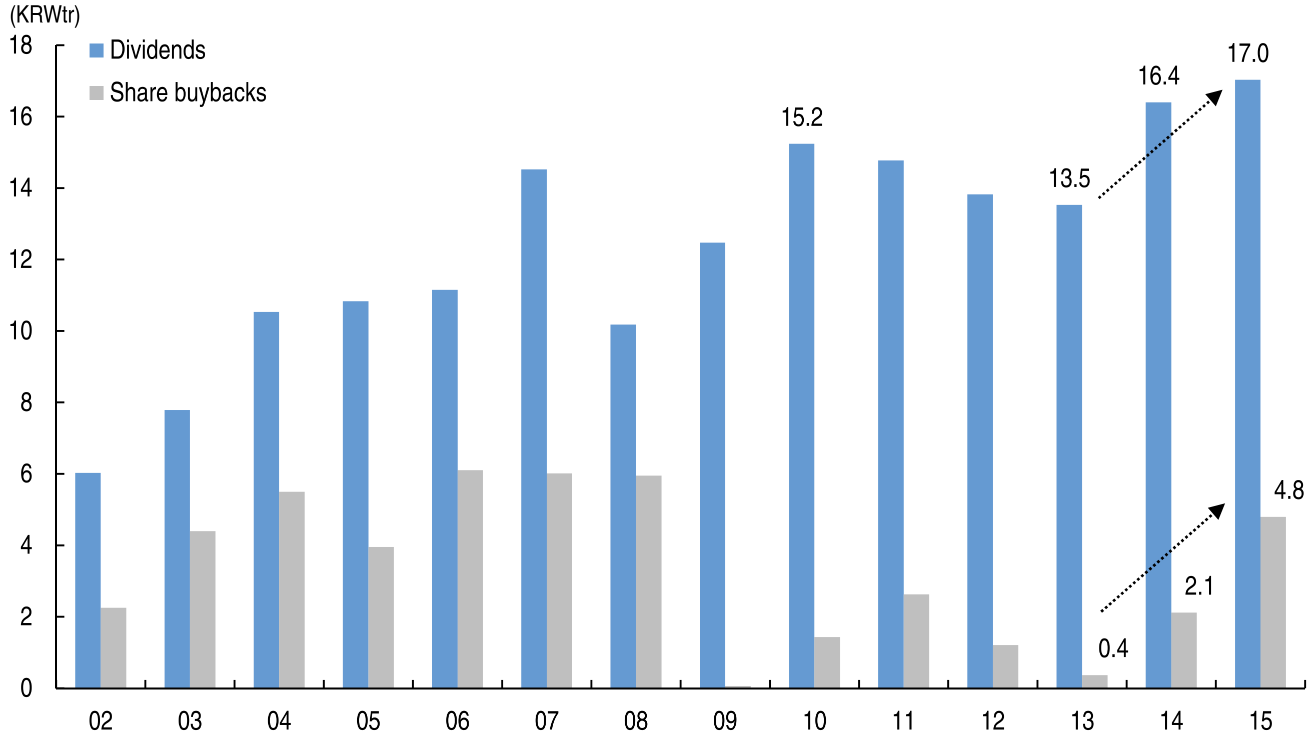
Note: Top four chaebols are Samsung, HMG, SK, and LG
Source: WISEfn, KDB Daewoo Securities Research

Ⅳ. Shareholder return policies to provide support

Listed firms have become more shareholder-friendly since 2014

- Since 2014, listed firms have expanded shareholder return, although their earnings have not yet improved full swing
- This change appears mainly attributable to 1) the introduction of the excess cash reserve tax and 2) rising demand for social responsibility
- It is significant that the Samsung Group has been leading the way in expanding shareholder return
- Large companies prefer share buybacks to higher dividend payout due to controlling shareholders' low stakes; share buybacks followed by cancellation will raise controlling shareholders' stakes

Listed Korean firms' cash dividends and share buybacks: Expanded since 2014

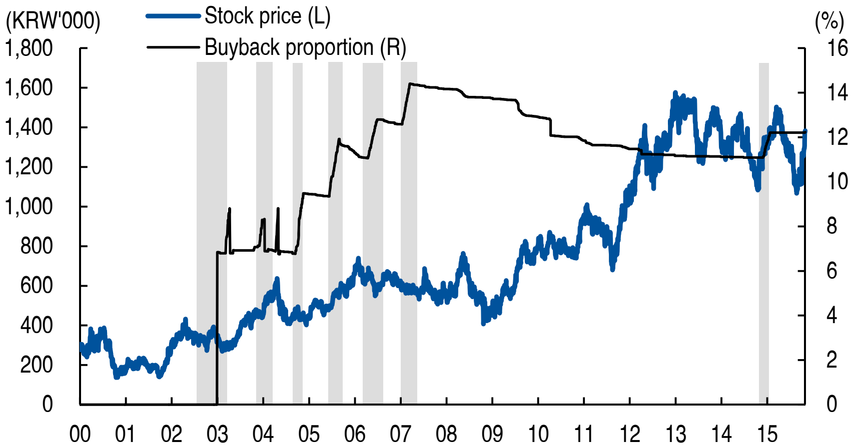


Notes: 2015 share buyback amount (excluding SEC's buyback) is cumulative figure as of end-October; 2015 cash dividend is a forecast
Source: WISEfn, KDB Daewoo Securities Research

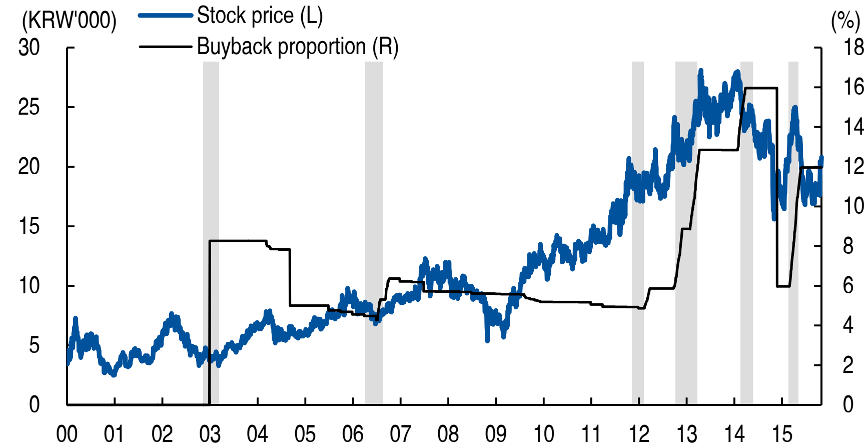
Ⅳ. Shareholder return policies to provide support

Samsung Group affiliates' share buybacks → downside support to stocks

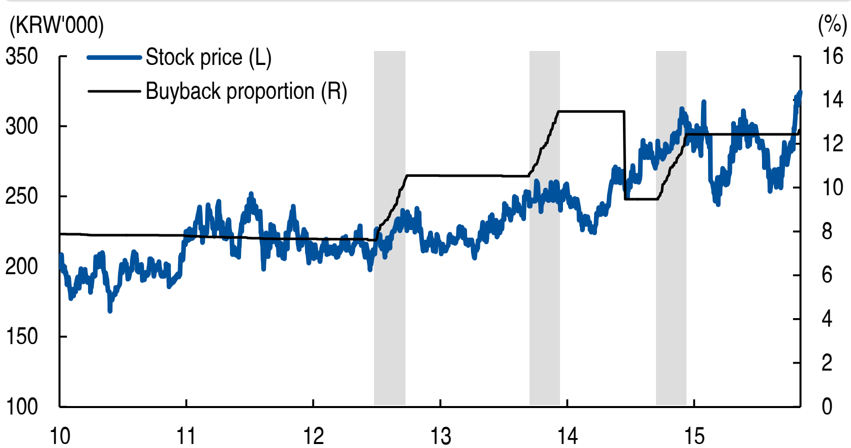
Samsung Electronics



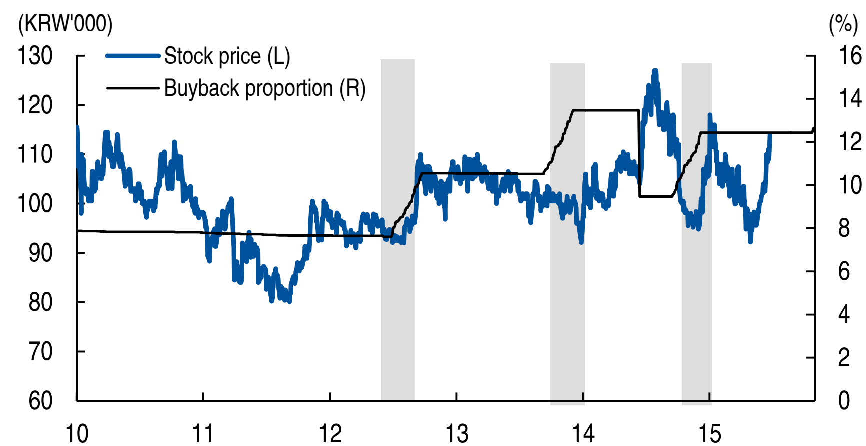
Cheil Worldwide



Samsung F&M



Samsung Life



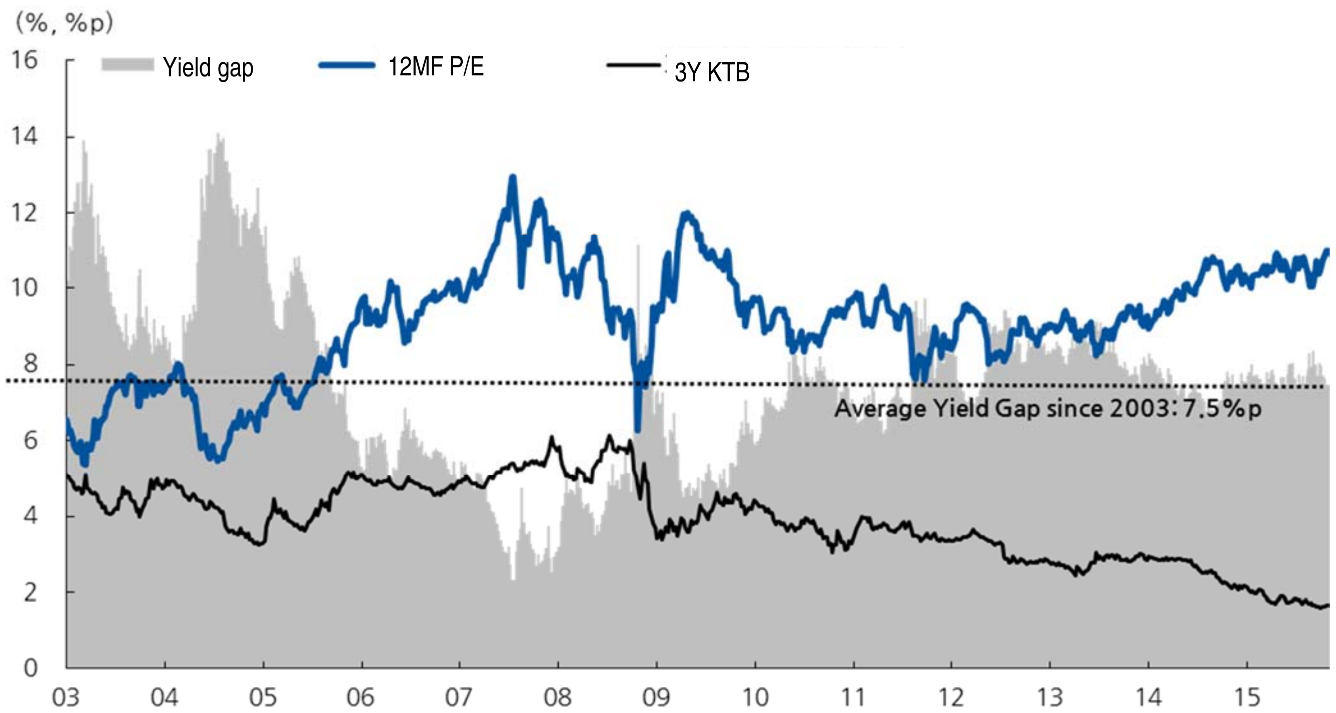
Source: WISEfn, KDB Daewoo Securities Research

Ⅴ. KOSPI target and top picks

Upper end of 2016 KOSPI target range: 2,150p

- As of end-October, KOSPI yield gap stood at 7.5%p (12MF P/E: 10.92x, 3Y KTB yield: 1.65%; KOSPI: 2,030p)
- Average KOSPI yield gap since 2003 is also 7.5%p
- KOSPI of 2,050p appears to be equilibrium level
- Upper end of our 2016 KOSPI target range is 2,150p; key factors: 1) potential re-rating arising from expansion of shareholder returns and 2) the index's range-bound movements over the past four years (when there have been no fundamental macro changes)

KOSPI P/E and yield gap



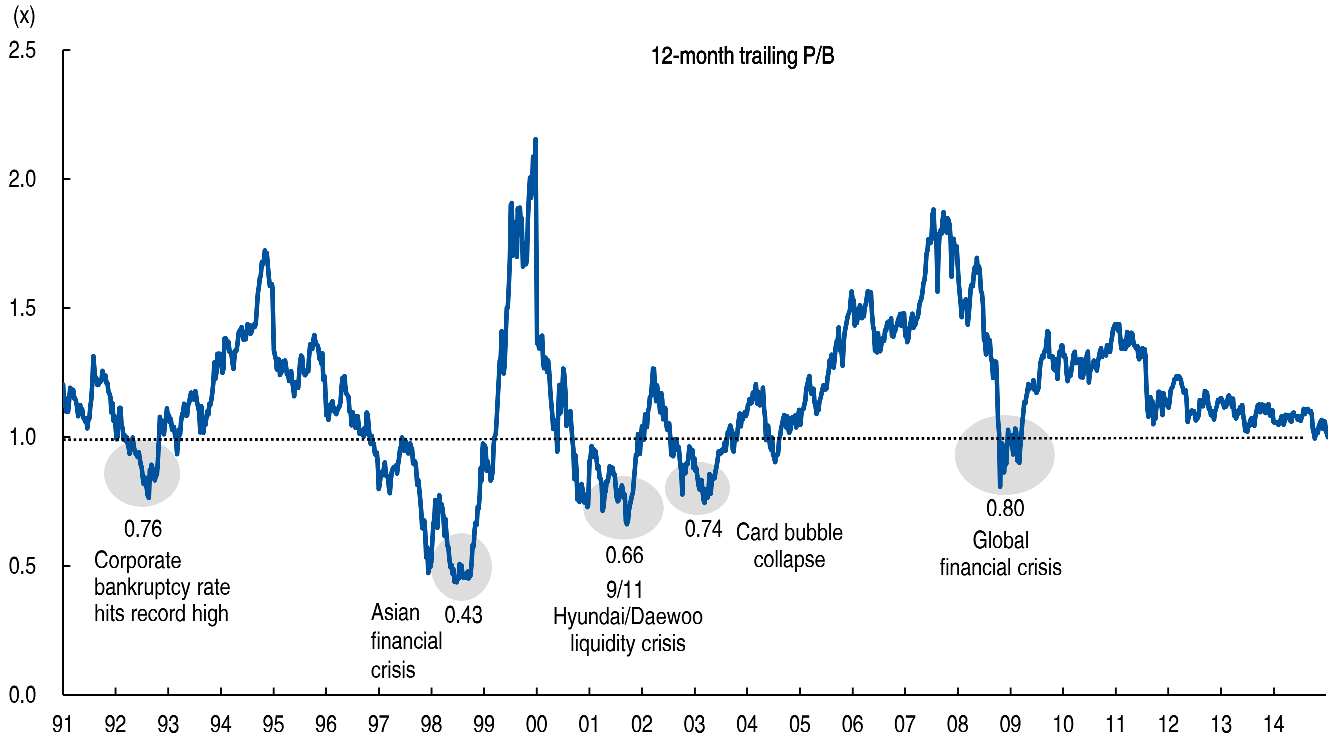
Source: WISEfn, KDB Daewoo Securities Research

Ⅴ. KOSPI target and top picks

Lower end of 2016 KOSPI target range: 1,700p

- KOSPI P/B of 1x offers good buying opportunity for long-term investors; historically, however, the KOSPI has fallen below book value whenever systemic risks have arisen (as of end-June 2015, the KOSPI P/B of 1x was equivalent to 1,842p)
- Concerns over potential systemic risks to continue in 2016; ongoing Chinese economic slowdown, possible EM financial crisis (Southeast Asia, Russia, Brazil, etc.), and Korea's restructuring risk
- The lower bound of our 2016 KOSPI target range is 1,700p

KOSPI trailing P/B has fallen below 1x whenever systemic risks have arisen



Source: KDB Daewoo Securities Research

Ⅴ. KOSPI target and top picks

	Revenue (KRWbn)		OP (KRWbn)		NP (KRWbn)		ROE (%)		P/E (x)		P/B (x)		Dividend yield (2015F, %)	Notes
	15F	16F	15F	16F	15F	16F	15F	16F	15F	16F	15F	16F		
SEC (005930 KS)	200,937 (-2.5)	211,987 (+5.4)	27,188 (+8.6)	27,785 (+2.1)	20,764 (-10.4)	21,872 (+5.3)	12.2	11.7	11.1	10.5	1.2	1.1	1.8	Share buyback; stable business portfolio
AmorePacific (090430 KS)	4,774 (+23.2)	6,271 (+31.3)	781 (+38.4)	1,051 (+34.5)	608 (+60.4)	767 (+26.1)	19.4	20.4	45.2	35.9	8.0	6.7	0.3	Diversified business portfolio via overseas expansion; solid earnings growth to continue
NAVER (035420 KS)	3,247 (+17.7)	3,616 (+11.3)	801 (+5.6)	964 (+20.3)	548 (+20.7)	690 (+25.9)	26.6	26.0	37.2	29.5	6.3	5.2	0.2	Mobile revenue growth to accelerate; expenses related to new businesses to decrease
KT&G (033780 KS)	4,354 (+5.8)	4,456 (+2.3)	1,367 (+16.6)	1,300 (-4.9)	1,053 (+27.4)	954 (-9.4)	17.7	14.7	15.1	16.7	2.3	2.2	3.1	Domestic sales and exports of tobacco and red ginseng to grow; high dividend yield
LG Corp. (003550 KS)	10,156 (+2.9)	10,440 (+2.7)	1,293 (+23.0)	1,423 (+10.0)	1,037 (+22.7)	1,113 (+7.3)	8.3	8.3	11.8	10.9	0.9	0.8	1.4	High growth potential of the EV business; profitability at the electronics unit to improve
Dongbu Insurance (005830 KS)	10,570 (+6.2)	11,175 (+5.7)	685 (+34.8)	746 (+8.9)	468 (+17.0)	490 (+4.7)	13.1	12.3	9.0	8.6	1.1	0.9	2.7	Stable net asset growth; ROE to remain high
Hyundai E&C (000720 KS)	18,858 (+8.4)	20,580 (+9.1)	1,030 (+7.4)	1,190 (+15.5)	446 (+6.1)	542 (+21.5)	7.9	9.0	8.8	7.2	0.7	0.7	1.7	Earnings to grow; undervalued
Cheil Industries (030000 KS)	2,846 (+6.7)	3,051 (+7.2)	138 (+8.6)	158 (+14.4)	107 (+4.9)	121 (+13.1)	12.6	13.8	22.2	19.7	2.1	2.0	-	Expansion into the Chinese market
Dong-A ST (170900)	575 (+1.2)	623 (+8.3)	58 (+20.8)	69 (+19.0)	42 (+23.5)	51 (+21.4)	8.4	9.5	23.7	19.6	1.9	1.8	0.8	Earnings improvement; revaluation of new drug candidates

Source: KDB Daewoo Securities Research

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