



Perspective from
Franklin Templeton
ETFs

The “Korea discount” is shrinking. What happens next?



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South Korea's equity market has rarely lacked a good story. What it has lacked—until recently—is consistent investor conviction. After its striking rally through 2025 and into early 2026, the market has forced investors to reconsider what it long dismissed as “cheap for a reason.” Of course, just as the narrative began to turn, geopolitics intervened earlier this year. The Iran conflict—and resulting spike in energy prices—has been a reminder of a vulnerability that never fully receded. For an economy that imports most of its fuel, such shocks can feed quickly into industrial costs, pressure margins and unsettle foreign investment flows. This is not a new constraint, however. And we feel there's reason to believe that this is more a manageable cost of doing business for South Korea, rather than a structural limitation.

One way to look at this: if energy is constraining, technology is increasingly a release valve. South Korea sits at a critical junction in the global artificial intelligence (AI) buildout, specifically in terms of the physical infrastructure that enables the buildout. Its dominance in memory, particularly high-bandwidth memory essential for AI workloads, positions South Korea as a key beneficiary of the shift from experimentation to deployment. In that sense, we believe the country's traditional strengths—capital intensity, manufacturing depth and engineering scale—are being revalued.

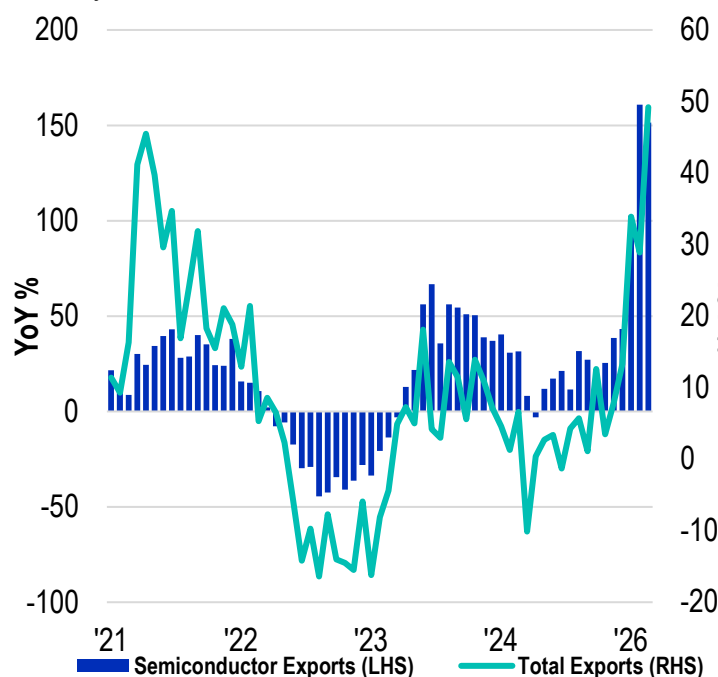
Recent export data underscore the shift. South Korea's exports surged, rising roughly 48% year-over-year in March, up from an already strong 29% increase in February.¹ Semiconductor shipments led the advance, with chip exports more than doubling amid sustained global demand for AI-related hardware and firmer memory pricing.

That strength has translated into market performance. The Korea Composite Stock Price Index (KOSPI) returned roughly 42% in mid-April, significantly outperforming both broad emerging markets and the S&P 500 Index.²

South Korea's Exports Led by Semiconductors

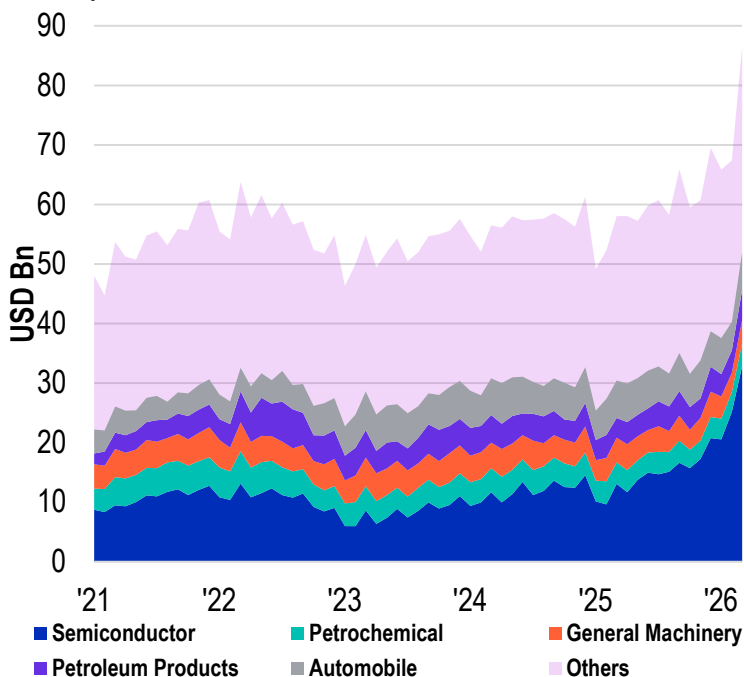
South Korea's Exports

January 31, 2021 to March 31, 2026



South Korea's Export Composition

January 31, 2021 to March 31, 2026



Semiconductors remained South Korea's largest export category, as its share of total exports rose from 8.7% in January 2021 to 32.8% in March 2026.

Sources: Bloomberg, Ministry of Trade, Industry and Energy.

Flows tell a more nuanced story. Over the past year, South Korea-focused equity ETFs have attracted strong inflows, reflecting a decisive reversal from prior underweight positioning. More recent activity suggests a pause rather than a retreat, in our view. Inflows cooled as investors locked in gains and reassessed risk amid renewed geopolitical tensions. However, South Korea-focused ETFs still held roughly US\$94 billion in total assets as of mid-April, with year-to-date net inflows of about US\$21 billion.³

In our view, this reflects more than just positioning—AI is not simply a thematic overlay; it is driving real revenue acceleration across the semiconductor complex and, increasingly, adjacent industrial sectors. We believe South Korea's advantage lies in applying AI to the physical economy.

An underappreciated export cycle

Alongside the AI narrative is a quieter, but increasingly important, theme: defense.

By some measures, South Korea now ranks among the top five global arms exporters, supplying everything from artillery systems to advanced vehicles. Its rise has been rapid. Exports have more than doubled over the past decade, giving the country an estimated 3% to 6% share of the global arms trade.⁴ For European investors in particular, this is not an abstract story. Germany and other NATO-aligned countries are actively increasing defense spending, creating sustained demand for reliable, scalable suppliers.

This tracks with a broader global trend: Security spending is entering what many analysts believe to be a multi-year expansion cycle, with spillover effects across industrial supply chains. For South Korea, defense exports provide diversification, which is something the semiconductor cycle often lacks. They offer longer-duration contracts, geopolitical relevance and a different earnings cadence. In our view, this dual exposure—to AI infrastructure and defense—helps explain why South Korea's recent rally may be more durable than in past cycles.

The real question: Can governance close the gap?

We are encouraged that the “Korea discount”—the persistent valuation gap relative to global peers—has narrowed. But we also caution that it has not disappeared. As recent analysis suggests, the ultimate driver of a sustained re-rating is not AI or defense, but governance and capital allocation.

Proposed reforms targeting shareholder returns—such as treasury-share cancellations and improved dividend frameworks—are designed to address long-standing concerns around capital efficiency. There are also early signs that behavior may have begun shifting. Shareholder-return policies are becoming more visible, with increased buyback activity and a modest improvement in payout discipline at the margin. Participation in the government's “value-up” framework has also expanded, helping firms articulate clearer return targets and capital allocation strategies.

Indicators suggest South Korean corporates are now becoming more attuned to global capital markets. Some are exploring overseas listings and taking steps to bring valuations more in line with international peers—moves that suggest a growing focus on liquidity, investor access and valuation comparability. At the same time, these moves underscore a familiar trade-off: balancing investment for growth with the potential risk of shareholder dilution in cases where expansion is funded through new equity issuance.

Still, markets are skeptical of intent without execution. Companies must demonstrate consistent behavior: higher and more predictable payouts, disciplined buybacks and clearer governance structures. We will continue to watch for a shift from episodic actions to more standardized capital allocation frameworks.

Endnotes

1. Sources: Ministry of Trade, Industry and Resources, Bloomberg Economics.
2. Source: Bloomberg, as of April 15, 2026. The KOSPI is the representative, market-capitalization-weighted index of all common shares traded on the Korea Exchange. Past performance is not an indicator or a guarantee of future performance. Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.
3. Source: Morningstar, as of April 14, 2026.
4. Source: “Can the growth trend in South Korea's arms industry last?” Stockholm International Peace Research Institute. December 10, 2025.

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