



Strategy

Medium-term buying opportunities emerging

Key message

The Taiex has recently come under selling pressure again on a slew of negatives, including escalating US AI chip export restrictions, surging US Treasury yields, and the Israel-Hamas war. Investors should not fear these negatives, as they have to a certain extent already been priced in and earnings projections are set to be revised up, which will spur a Taiex bull run. For the near-term, we prefer corporations that have posted impressive earnings or are benefiting from government policies.

Escalating US AI chip export restrictions have already been priced in to a certain extent

The Biden administration announced on October 17 wider restrictions on AI chip exports to China, which will take effect in 30 days. Judging by the US AI chip restrictions implemented a year ago, we expect aggressive pull-in demand from Chinese manufacturers before the effective date and that AI server chip makers will seek alternative solutions that comply with the new rules. In the wake of the first set of AI chip restrictions put in place last year, the Taiex bottomed within 11 days and climbed back to where it was before the decline, indicating the effect of the restrictions on the Taiex was short-lived. US Bureau of Industry and Security (BIS) officials stated that if the semiconductor sector is able to design a “tamper-proof” mechanism to prevent systems embedded with a maximum of 256 AI chips from being strung together and made into a supercomputer for military use, then AI chip exports to China can continue.

Falling Treasury yields usually bring funds back to stock markets

While US Treasury yields have climbed structurally of late on term premiums, we expect them to fall as the current Fed rate hikes draw to a close. Since 1990, whenever Treasury yields started falling from their peaks, the Taiex posted respective average returns of 4.2%, 1.5%, and 3.6% within one, two, and three months, suggesting falling Treasury yields bode well for stock markets. The Fed’s latest dot plot foretells that the current rate uptrend will stop by the end of the year.

Israel-Hamas war will have little effect on equities, unless it triggers a war involving larger nations

The Israel-Hamas conflict has heightened geopolitical risk in the Middle East and has rapidly increased risk-aversion sentiment within global stock markets. That said, non-economic events, such as wars and terrorist attacks of all sizes since WWII, have had very limited effect on stock markets, unless they led to conflicts between larger nations. Since WWII, only six conflicts, including the Japanese attack on Pearl Harbor (1941), the North Korean invasion of South Korea (1950), the Cuban Missile Crisis (1962), the Vietnam War (1968), the invasion of Kuwait by Iraq (1990), and the September 11 attacks (2001), caused the S&P 500 to plummet by over 5%, due to the involvement of major nations. The remaining 21 such events had little effect on global stock markets. Specifically, stock markets required one month to more than six months to fully recover in the aftermath of the conflicts involving large countries, while only a few days or weeks were needed in the case of small conflicts.

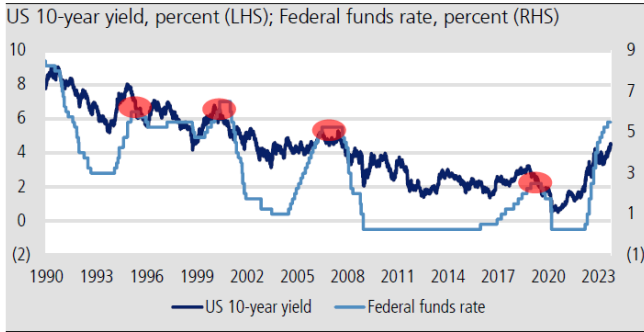
Taiex to rally over medium- to long-term during the upcoming earnings upcycle

TSMC’s (2330 TT, NT\$544, OP) analyst meeting on October 19 indicated that sector-wide inventory adjustments are ending and early signs of recovery have emerged. We predict 3Q23 earnings will surprise on the upside as two-thirds of tech firms will beat on sales growth and forex gains. In addition, smooth inventory digestion, AI server/PC replacement demand, and decent macroeconomics will usher in a wave of upward revisions to projected earnings, which will bring an end to the earnings downcycle that began in 2H22 and support a medium- to long-term bull run for the Taiex.

Valuation & Action

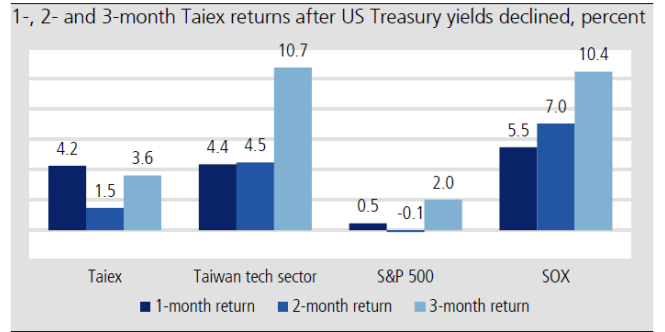
The Taiex has recently come under selling pressure again on a slew of negatives, including escalating US AI chip export restrictions, surging US Treasury yields, and the Israel-Hamas war. Investors should not fear these negatives, as they have to a certain extent already been priced in and earnings projections are set to be revised up, which will spur a Taiex bull run. For the near-term, we prefer corporations that have posted impressive earnings or are benefiting from government policies. Our top picks are Gigabyte Technology (2376 TT, NT\$247, OP), Auras Technology (3324 TT, NT\$312, OP), Accton (2345 TT, NT\$511, OP), Elite Material (2383 TT, NT\$413, OP), UMC (2303 TT, NT\$48.3, OP), LuxNet (4979 TT, NT\$158, OP), MediaTek (2454 TT, NT\$816, OP), Novatek Microelectronics (3034 TT, NT\$429, OP), Nanya Technology (2408 TT, NT\$67.8, OP), Waffer Technology (6235 TT, NT\$125, OP), and Chung-Hsin Electric & Machinery Manufacturing (1513 TT, NT\$100, OP).

Figure 1: Falling US Treasury yields good for Taiex near-term



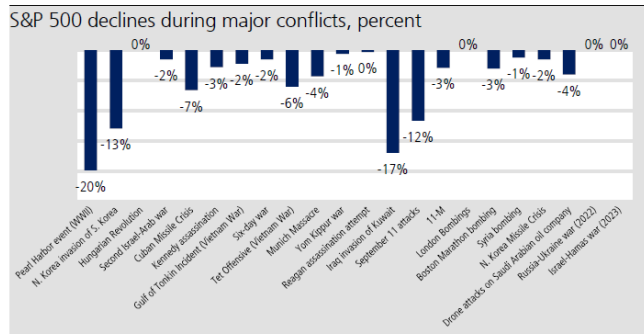
Source: Bloomberg; KGI Research

Figure 2: Taiex returns usually positive within 1-3 months of US Treasury yields starting to fall from their peaks



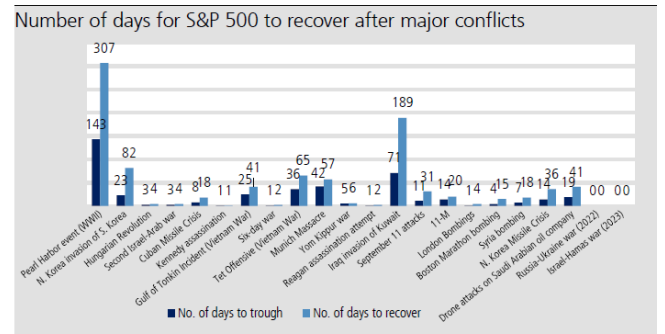
Source: Bloomberg; KGI Research

Figure 3: Stock markets are usually resilient, unless conflicts erupt involving large nations



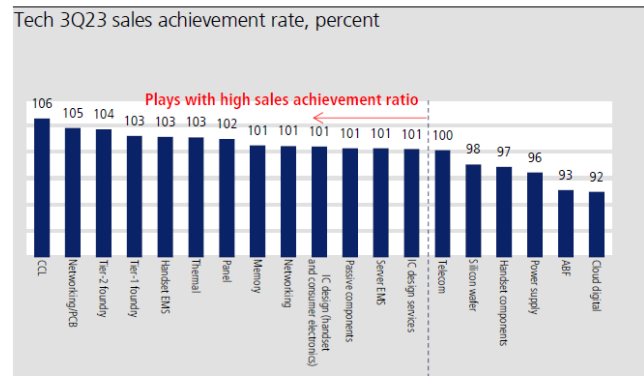
Source: Bloomberg; KGI Research

Figure 4: Stock markets usually recover rapidly, unless conflicts erupt involving large nations



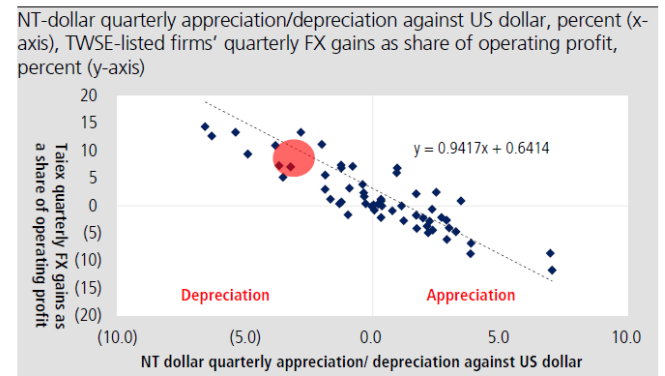
Source: Bloomberg; KGI Research

Figure 5: Tech firms had high sales achievement rates in 3Q23



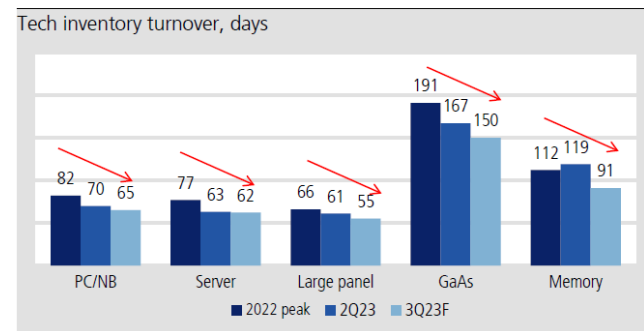
Note: 3Q23 sales achievement ratio refers to 3Q23 sales results, versus 3Q23 sales forecasts
Source: TEJ; KGI Research

Figure 6: Forex gains to add 7% to 3Q23F operating profit



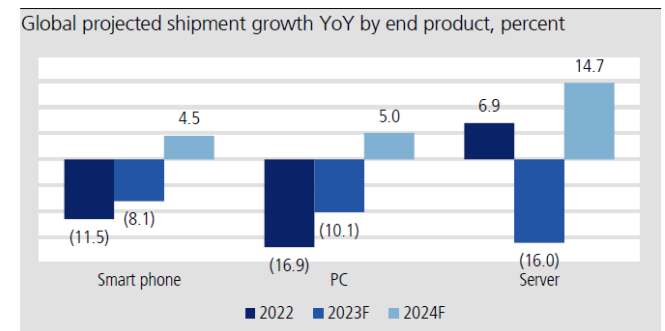
Source: TEJ; KGI Research

Figure 7: Tech inventory down markedly from 2022 peak

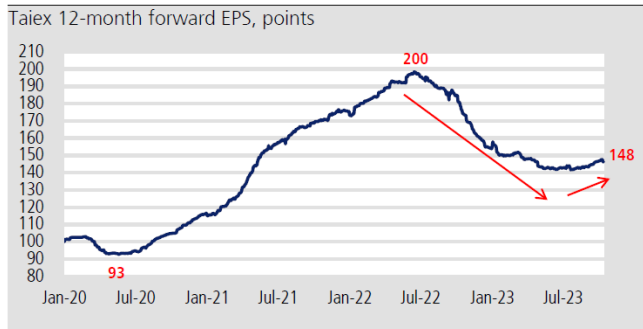


Source: TEJ; KGI Research

Figure 8: 2024F handset, PC, & server replacement cycle

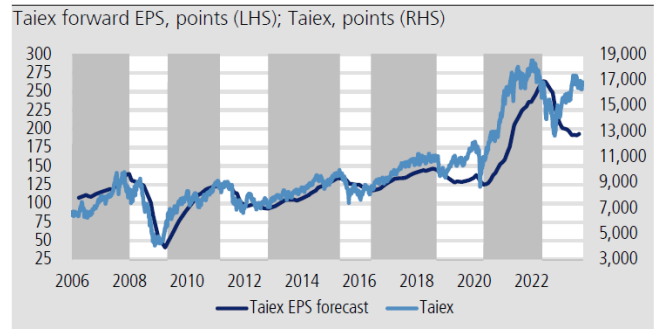


Source: KGI Research

Figure 9: Upward revisions to Taix earnings likely

Note: January 2, 2020 = 100

Source: Bloomberg; KGI Research

Figure 10: Corporate earnings upward revision periods coincide with Taix bull runs

Note (1): January 2006 = 100

(2): Shaded areas are corporate earnings upward revision periods

Source: Bloomberg; KGI Research

Figure 11: Taix & subsector earnings growth projections

	2022	2023F		2024F			2022	2023F		2024F	
		KGI forecast	Consensus	KGI forecast	Consensus			KGI forecast	Consensus	KGI forecast	Consensus
Optical communication	Turned profitable	91.3	91.3	197.9	197.9	Petrochemicals	(63.1)	(63.6)	(47.3)	173.5	83.7
ABF	102.5	(59.9)	(64.5)	73.9	73.8	Steel	(75.4)	(33.6)	(69.5)	168.8	140.8
Networking PCB	56.1	(23.2)	(21.3)	70.4	70.3	Shoe-making	100.0	(50.0)	(41.4)	65.9	51.2
IC design and service	94.8	8.3	5.5	51.8	47.5	Auto parts	52.8	(14.1)	(14.3)	53.4	43.3
Networking	239.5	25.3	38.5	51.4	66.2	Heavy electrical	(1.9)	30.3	45.8	33.3	32.7
CCL	(7.7)	(0.7)	(2.1)	47.0	49.5	Industrial automation	5.2	(12.6)	(11.6)	27.8	25.6
Server EMS	(9.3)	(1.5)	2.3	44.3	46.7	Tourism	(46.5)	170.5	174.5	26.6	24.5
Passive components	(0.8)	(27.2)	(25.8)	34.6	31.4	Bicycle	(12.7)	(25.0)	(29.5)	21.9	26.7
Thermal	50.6	10.0	15.4	32.6	20.1	Food	(2.9)	116.9	121.6	20.6	15.4
Handset EMS	(2.1)	(15.7)	(11.7)	27.0	23.3	Aerospace	135.4	39.0	29.9	17.7	18.1
Cloud digital	16.3	15.4	(14.2)	25.9	21.6	Apparel	32.1	(12.0)	(15.2)	12.0	18.4
First-line foundry	70.4	(25.5)	(23.2)	25.2	22.1	Cement	(50.7)	47.0	39.2	7.5	8.6
Power supply	15.1	6.9	7.7	23.8	21.4	Finance	(49.9)	55.8	48.7	6.4	8.8
iPhone components	28.4	(35.8)	(35.8)	23.8	22.9	Food	(13.6)	28.2	39.6	5.9	(4.3)
IC design (handset/consumer electronics)	(2.9)	(36.9)	(38.6)	18.9	22.1	Airlines	(37.8)	253.9	230.5	(51.2)	(49.5)
Second-tier foundries	51.6	(38.6)	(38.2)	5.3	5.9	Container shipping	19.7	(95.4)	(95.5)	Turned unprofitable	(74.1)
Telecom	2.6	6.1	8.3	4.2	4.0						
Silicon wafer	29.5	20.5	14.9	2.6	3.0						
Memory	(36.0)	Turned unprofitable	Turned unprofitable	Turned profitable	Turned profitable						
TFT	Turned unprofitable	Remained unprofitable	Remained unprofitable	Remained unprofitable	Remained unprofitable						
Technology	17.8	(22.4)	(23.1)	26.8	28.0						
Non-tech	(12.0)	(69.2)	(68.0)	22.8	15.9						
Taix	(2.4)	(28.2)	(30.0)	22.8	21.9						

Note: In order of KGI projected 2024 earnings change YoY

Source: Bloomberg; KGI Research

Figure 12: Comparison – Taix valuations

	Forward PB(X)									Forward PE(X)							
	Forward 1-year	2023	2024	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward 1-year	2023	2024	5-year average	10-year average	20-year average	2007 peak	2008 bottom	
Taix	1.66	1.80	1.61	1.70	1.60	1.61	2.28	0.95	16.38	19.28	15.71	14.86	14.81	17.12	21.73	8.80	
Taix excl. TSMC	1.36	1.47	1.32	1.39	1.38	1.46	2.22	0.89	16.57	19.54	16.06	14.45	14.77	15.97	22.71	8.06	

Source: KGI Research

Figure 13: Our top picks

Company	Code	Investment rating	3Q23 achievement rate (%)	Target price (NT\$)	Mkt cap (US\$m)	Share price (NT\$)	Change +/- (%)	EPS (NT\$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)	
								2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
Gigabyte	2376 TT	Outperform	116	360.0	5,155	261.5	37.7	9.42	14.25	27.8	18.4	4.3	4.0	16.1	22.6	2.2	3.3
AURAS	3324 TT	Outperform	114	400.0	851	310.5	28.8	13.61	18.42	22.8	16.9	4.4	3.9	19.9	23.8	1.9	2.6
Accton	2345 TT	Outperform	110	450.0	9,136	526.0	(14.4)	15.25	17.94	34.5	29.3	12.0	10.2	37.9	37.5	1.5	1.9
EMC	2383 TT	Outperform	106	140.0	1,743	130.0	7.7	8.01	9.33	16.2	13.9	2.5	2.3	16.1	19.0	4.2	4.6
UMC	2303 TT	Outperform	105	545.0	4,428	418.0	30.4	15.13	22.24	27.6	18.8	5.7	5.0	21.7	28.5	2.0	3.1
LuxNet	4979 TT	Outperform	100	56.0	18,687	48.2	16.2	4.59	4.82	10.5	10.0	1.7	1.5	16.5	16.1	3.5	4.1
MTK	2454 TT	Outperform	102	210.0	626	152.5	37.7	3.51	10.47	43.4	14.6	11.6	6.5	30.9	57.0	0.3	0.3
Novatek	3034 TT	Outperform	100	956.0	40,922	825.0	15.9	45.15	56.26	18.3	14.7	3.3	3.2	17.0	22.0	6.4	7.4
NTC	2408 TT	Outperform	101	510.0	8,113	430.0	18.6	37.45	39.26	11.5	11.0	3.9	3.6	34.5	34.5	7.0	7.4
Waffer	6235 TT	Outperform	97	85.0	6,811	70.9	19.9	(2.10)	2.83	(33.7)	25.1	1.3	1.2	(3.7)	5.1	0.4	1.8
CHEM	1513 TT	Outperform	97	175.0	476	154.0	13.6	8.42	11.34	18.3	13.6	2.6	2.4	14.7	18.5	3.2	4.5

Source: KGI Research

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