

Strategy

Stocks & bonds rally on Fed pivot to rate cuts

Key messages

1. Historically, both stocks and bonds have rallied during the period between the end of a Fed rate hike cycle and the first rate cut. We are now in such an environment.
2. The manufacturing new-orders-to-inventory ratio has exceeded one for six straight months, indicating restocking is on the way.
3. We forecast the Taiex will challenge a peak of 18,000 points in 1Q24, and hit 20,000 points by the end of the year.

Stocks and bonds always rally in the period between the end of a Fed rate hike cycle and the first rate cut - this time will be no exception

The Fed released extremely dovish guidance at the latest FOMC meeting on December 14. This has prompted the market to expect the commencement of a Fed rate-cut cycle in 2Q24F, denoting this as a period between the end of a rate hike cycle and the first rate cut. Historically, stocks and bonds have rallied during such a period, a bullish sentiment sparked by anticipation of monetary policy loosening. If this phenomenon does replicate, we should be optimistic about stock and bond performance before the first rate cut. Since the 1990s, there have been six periods in which the Fed ended rate hikes to start for rate cuts. Excepting 2000, when the S&P 500 plummeted 8% on the dotcom bubble burst, the other five periods all saw the index soar, with the smallest rise being 12%, while the largest hit 33%. US 10-year Treasury yields tumbled during all six periods, falling by a range of 74-220bps.

Perhaps investors will be concerned about the rally being caused by rate-cut expectations, as they had been priced in, to a certain extent, by the stock and bond markets. This concern may be overwrought, as the S&P 500 has rallied just 4.4% since the interest rate peaked on July 26 and the Treasury yield has hovered around 3.9%, a far cry from the historic minimum rise of 12% for the index and the historic minimum decline of 74bps for the Treasury yield.

Stock market performance hinges on the economy after Fed begins rate cuts

While having almost always rallied after the Fed ends rate hikes and prepares to begin rate cuts, stock market performance has varied widely after the Fed actually started to cut. The key is the economy. If the economy moves toward a soft landing, stock market bullishness continues, as in 1995 and 1998. If the economy slips into a recession, the stock market turns bearish, as in 1989, 2001 and 2007. Some market participants worry that if the Fed keeps the federal funds rate higher for excessively long, US consumption will eventually be hit, leading to a recession. Nonetheless, we predict a US soft landing in 2024 as a base scenario, foreseeing the current stock bull run extending past the Fed cuts. Our rationale is based on the assumption of a preemptive Fed cut as soon as possible, and the fact that the Biden administration is maintaining its expansionary fiscal policy.

Manufacturing new-orders-to-inventory ratio greater than 1 for 6 months, a clear sign of restocking

The service sector, which has benefitted from post-pandemic “revenge consumption”, could cool off in 2024, in the aftermath of rate hikes. By contrast, the manufacturing sector, having gone through inventory adjustment for over 18 months, is at the start of a restocking cycle. Its new-orders-to-inventory ratio has exceeded one for six consecutive months, indicating the positive phenomenon of order increases and inventory decreases in tandem. This presages expanded manufacturing activity over the next three to six months, supporting a Taiex bull run.

Valuation & Action

Historically, both stocks and bonds have rallied during the period between the end of a rate hike cycle and the first rate cut. We are now in such an environment. We therefore forecast the Taiex to challenge a peak of 18,000 points in 1Q24, and hit 20,000 points by the end of the year. Our top picks are Chung-Hsin Electric & Machinery (1513 TT, NT\$117.5, OP), Evergreen Aviation Technologies Corp (2645 TT, NT\$110.5, OP), Evergreen Aviation, DPI (4572 TT, NT\$168.5, OP), CTCI (9933 TT, NT\$42.2, OP), TSMC (2330 TT, NT\$585, OP), Elite Material (2383 TT, NT\$366.5, OP), Alchip (3661 TT, NT\$336.5, OP), Compeq (2313 TT, NT\$72, OP), Auras (3324 TT, NT\$342.5, OP), Chenbro (8210 TT, NT\$261, OP) and HD Renewable Energy (6873 TT, NT\$123, OP)..

Figure 1: Stocks and bonds have always rallied between the end of the Fed rate hike cycle & the first Fed rate cut

Stock and bond market movements from Fed rate-hike cycle end to first Fed rate cut

Date of rate hike peak	Date of first rate cut	S&P500 (points)			10-year US Treasury yield(%)		
		Date of rate hike peak	Date of first rate cut	Rate of return	Date of rate hike peak	Date of first rate cut	Changes
1989/2/24	1989/6/5	287	322	12%	9.4	8.4	(1.01)
1995/2/1	1995/7/6	470	554	18%	7.7	6.0	(1.63)
1997/3/25	1998/9/29	789	1,049	33%	6.8	4.6	(2.20)
2000/5/16	2001/1/3	1,466	1,348	-8%	6.4	5.2	(1.27)
2006/6/29	2007/9/18	1,273	1,520	19%	5.2	4.5	(0.72)
2018/12/19	2019/7/31	2,507	2,980	19%	2.8	2.0	(0.74)

Source: Bloomberg; KGI Research

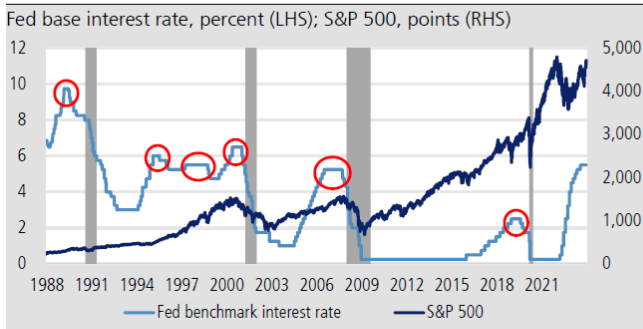
Figure 2: Period between end of rate hike cycles and rate cuts typically sees a rally in anticipation of monetary policy loosening

Taiex and US stock index returns between rate hike cycle end and first rate cut, percent

Date of rate hike peak	Date of first rate cut	Taiex	Taiwan tech stocks	S&P500	SOX
1989/2/24	1989/6/5	33		12	
1995/2/1	1995/7/6	(13)		18	78
1997/3/25	1998/9/29	(12)	42	33	(16)
2000/5/16	2001/1/3	(44)	(51)	(8)	(36)
2006/6/29	2007/9/18	35	36	19	12
2018/12/19	2019/7/31	11	14	19	37

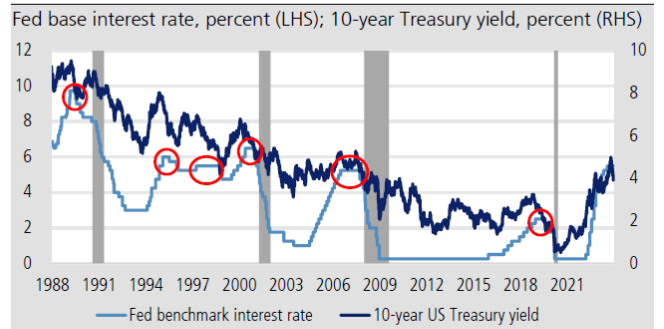
Source: Bloomberg; KGI Research

Figure 3: Stocks rally between end of rate hike cycle & first rate cut



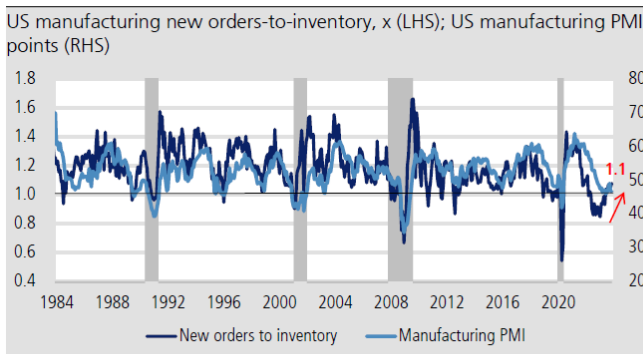
Note: Shaded areas are US recessions; red circles are periods between Fed rate-hike cycle end and first rate cut
Source: Bloomberg; KGI Research

Figure 4: Bonds perform well between end of rate hike cycle & first rate cut



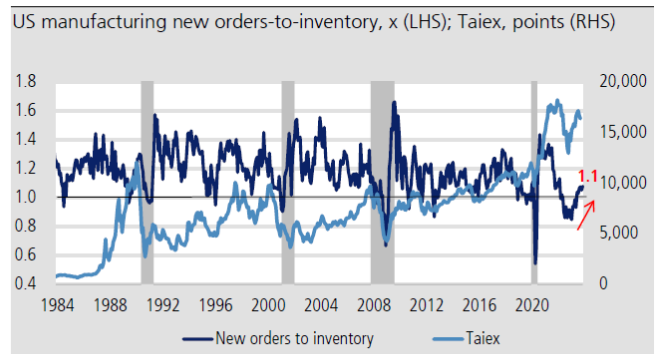
Note: Shaded areas are US recessions; red circles are periods between Fed rate-hike cycle end and first rate cut
Source: Bloomberg; KGI Research

Figure 5: Manufacturing new-orders-to-inventory over 1 for 6 straight months, a clear sign of restocking



Note: Shaded areas are US recessions
Source: Bloomberg; KGI Research





Figure 6: Manufacturing restocking & bullish stock market in tandem



Note: Shaded areas are US recessions
Source: Bloomberg; KGI Research

Figure 7: We forecast a 1Q24 Taiex peak at 18,000 points, and a 4Q24 peak at 20,000

2024F Taiex movements and positive/negative factors

	1Q24	2Q24	3Q24	4Q24
Index movement				
Positives	(1) PC and handset demand recovery (2) Manufacturing extending inventory replenishment since 4Q23 (3) The January Effect and policies supporting a bull run before the presidential elections (4) Apple launches new product (5) Dividend payout announcement	(1) Nvidia introduces the new server chip (2) China new Android handsets launch (3) European and US CBs to commence interest rate cuts sequentially	(1) AI PC production in small quantities (2) iPhone 16 Drives New Product Stocking (3) Massive cash dividend release (4) Intel introduces the new server platform Birch Stream	(1) AI PC ramp up (2) Market's expectation of PC replacement in the following year (3) Seasonal accounting effect
Negatives	(1) Results from the Taiwan presidential elections affect cross-strait relations (2) 2023 annual report check (3) BOJ ending its negative interest rate policy	(1) End demand enters slow season (2) Post-pandemic Revenue Spending Cools Down (3) Moody's updates credit rating for US debts (4) 1Q24 results check (May 15)	(1) 2Q23 corporate results check (August 14) (2) Cash dividend evaporation index	(1) Uncertainties prior to the US presidential elections (2) 3Q24 corporate results check (November 14)
Peak/trough	18,000/17,000	17,600/17,000	17,500/16,600	20,000/17,400
End-quarter closing point	17,400	17,100	17,400	19,800

Source: KGI Research

Figure 8: Taiex 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
Taiex	1.80	1.96	1.75	1.70	1.60	1.61	2.28	0.95	17.86	20.12	16.83	14.90	14.83	17.11	21.73	8.80
Taiex excl. TSMC	1.48	1.61	1.44	1.39	1.38	1.46	2.22	0.89	18.17	20.71	17.66	14.49	14.78	15.97	22.71	8.06

Source: KGI Research

Figure 9: Our top picks

Company	Code	Investment rating	Target price (NT\$)	Mkt cap (US\$mn)	Share price (NT\$)	Change +/- (%)	EPS (NT\$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)	
							2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
TSMC	2330 TT	Outperform	703.0	484,673	585.00	20.2	31.29	39.06	18.7	15.0	4.4	3.6	25.3	26.5	2.1	2.2
EMC	2383 TT	Outperform	550.0	4,008	366.50	50.1	16.88	23.07	21.7	15.9	5.0	4.4	24.1	29.3	2.6	3.5
Alchip	3661 TT	Outperform	3520.0	7,983	3365.00	4.6	44.75	70.36	75.2	47.8	16.0	12.7	23.6	32.3	0.7	1.1
COMPEQ MANUFACT	2313 TT	Outperform	100.0	2,742	72.00	38.9	3.84	6.40	18.7	11.2	2.1	1.9	11.4	17.4	2.1	3.6
AURAS	3324 TT	Outperform	445.0	972	342.50	29.9	15.86	21.09	21.6	16.2	4.8	4.1	23.0	26.6	2.0	2.7
Chenbro	8210 TT	Outperform	265.0	1,006	261.00	1.5	7.75	14.73	33.7	17.7	5.9	5.1	18.2	30.6	1.5	2.9
CHEM	1513 TT	Outperform	135.0	1,889	117.50	14.9	3.86	8.46	30.5	13.9	3.4	2.9	12.6	22.8	2.1	4.7
EGAT	2645 TT	Outperform	157.0	1,322	110.50	42.1	5.00	5.23	22.1	21.1	3.8	3.7	17.0	17.7	4.3	4.5
DPI	4572 TT	Outperform	230.0	210	168.50	36.5	7.10	7.66	23.7	22.0	3.1	2.8	13.9	13.3	2.1	2.3
CTCI	9933 TT	Outperform	53.0	1,082	42.20	25.6	2.46	3.55	17.2	11.9	1.9	1.8	11.0	15.5	4.7	6.7
HDRE	6873 TT	Outperform	162.0	393	123.00	31.7	7.10	11.72	17.3	10.5	2.3	2.0	16.1	20.8	3.3	4.9

Source: KGI Research

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