

2025 Taiwan strategy

Rally to continue, but with limited upside; more Taiex volatility ahead

Key messages

1. AI frenzy to keep Taiex afloat in 2025F, with index to peak at 25,500.
2. Be aware of inflection points in 1Q25F, and accumulate shares during pullbacks. We forecast the Taiex will trough at 20,000.
3. Range-trading to be best strategy in 2025, versus buy-and-hold in 2023-24.
4. Our main theme for 2025F Taiex investment is “AI for electronics, MAGA for non-electronics”. We recommend 25 counters.

AI frenzy to keep Taiex afloat in 2025, but further index upside will be limited, with increased volatility

The emergence of generative AI boosted Taiex returns to around 30% in 2023-24, outperforming most major bourses. Moving forward, as large CSPs continue aggressive AI investment, driving rapid growth in AI server demand in 2025-26F, we believe the Taiex will continue a bull run in 2025F. That said, as gains in the Taiex index and valuations have almost reached historic peaks, which, coupled with decelerating earnings growth due to a high 2024 base and lackluster demand in non-AI sectors, will cap accumulated index upside on a full-year basis. We estimate the Taiex will peak at 25,500 in 2025, implying 2025F PE of 19x, and will trough at 20,000, for 2025F PE of 15x.

US achieved an economic soft landing; liquidity injection to steer China away from worst-case economic scenario

After more than one year of interventions and adjustments, the US Fed pulled off an economic soft landing. In 2025, we believe the US job market will stay resilient, and support robust consumption demand. The AI arms race and tax cuts proposed by US President-elect Trump will likely stimulate US businesses to raise capex. Against this backdrop, we believe 2025F US economic performance will converge to a soft landing. China is still battling against turmoil stemming from the bursting of the housing bubble and rising US-China tensions, but as the central government rolled out aggressive stimulus policies to revitalize the market, and will likely opt for expansionary fiscal policies, we do not expect China to be a drag to global end-market demand. Historically, a growing economy and interest rate cuts are both favorable to stocks, especially those of the tech, communication services and consumer discretionary sectors, which are sensitive to high interest rates. That said, Trump’s business tax cuts, deportation of illegal immigrants, and raising of import tariffs could create conditions for a resurgence of inflation, consequently forcing the Fed to re-adjust its rate cut policy. As such, we have to stay alert and fine-tune our investment strategies accordingly.

Be aware of inflection points in 1Q25F; accumulate shares during pullbacks; range-trading to be best strategy in 2025

Although the Taiex will extend its bull run in 2025F, the greatest upside will derive from drastic swings rather than index peaks. We project the Taiex to peak in 1Q25F and trough in 3Q25F, so we recommend investors stay aware of inflection points in 1Q25F, with an eye to seasonality, earnings growth slowdowns, peak valuations, the rate cut cycle coming to an end, and risks stemming from Trump.

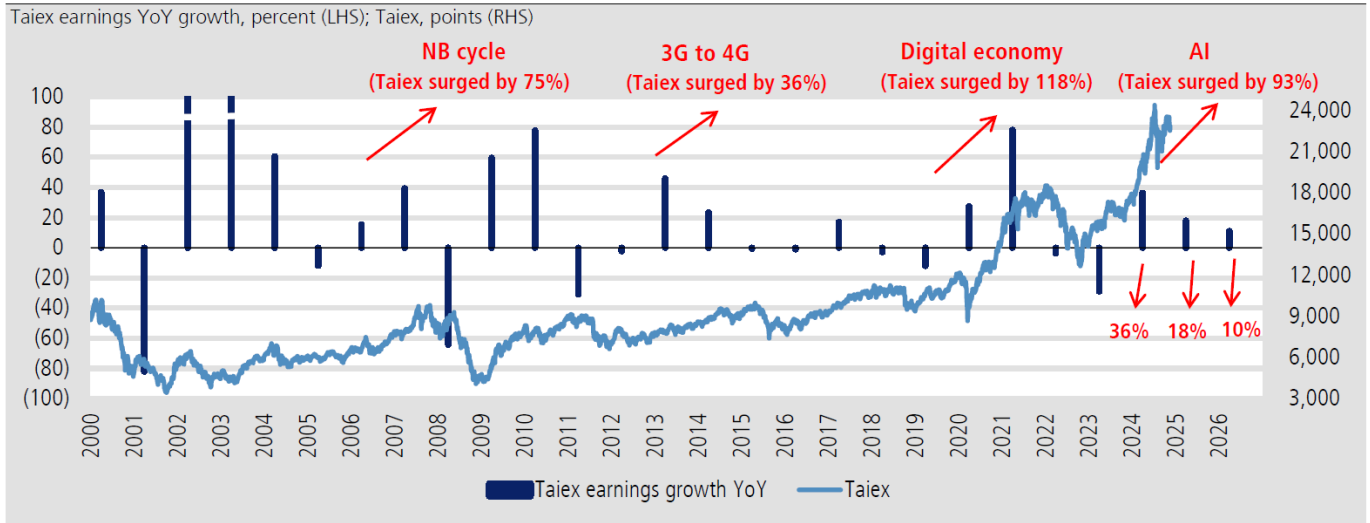
Conclusion & top picks

Our main theme for 2025F Taiex investment is “AI for electronics, MAGA for non-electronics.” For the electronics industry, AI plays will have the clearest visibility. We have to focus on counters with a PEG below 1, as their valuations do not yet fully reflect the earnings growth from exceeded sales expectations in 2024, and further AI gains will materialize in 2025F. AI ASIC are presenting an excellent business opportunity on rising demand for customization, driven by specific AI applications. Additionally, gaming PCs will enter a replacement cycle, which happens every 2-3 years, thanks to new graphics cards. For non-electronics, we are upbeat about sectors that will benefit from Trump’s proposed policies (MAGA), including aerospace, industrial automation, heavy electrical, and generic drugs. Finally, we recommend investors engage counters with high yields for asset allocation, as the Taiex will see inflection points in 1Q25F, creating space for both aggressive and defensive trading strategies. Our top picks are: TSMC (2330 TT), WinWay (6515 TT), MPI (6223 TT), M31 (6643 TT), Hon Hai Precision (2317 TT), Quanta Computer (2382 TT), Asia Vital Components (3017 TT), Delta Electronics (2308 TT), Elite Material (2383 TT), Gold Circuit Electronics (2368 TT), Unimicon (3037 TT), Accton (2345 TT), Visual Photonics Epitaxy (2455 TT), MediaTek (2454 TT), Faraday (3035 TT), Alchip (3661 TT), Andes (6533 TT), Asustek (2357 TT), Drewloong Precision (4572 TT), Hiwin (2049 TT), Fortune Electric (1519 TT), Lotus Pharmaceutical (1795 TT), Cathay FHC (2882 TT), CTBC FHC (2891 TT), and Uni-President Enterprises (1216 TT).

Top picks

Company	Code	Share price (12/7) (NT\$)	Target price (NT\$)	Change +/- (%)
TSMC	2330 TT	1000.0	1450.0	45.0
WinWay	6515 TT	1170.0	1655.0	41.5
MPI	6223 TT	760.0	915.0	20.4
M31	6643 TT	680.0	955.0	40.4
Hon Hai	2317 TT	196.5	290.0	47.6
QCI	2382 TT	286.5	400.0	39.6
AVC	3017 TT	630.0	885.0	40.5
DELTA	2308 TT	386.0	512.0	32.6
EMC	2383 TT	467.5	595.0	27.3
GCE	2368 TT	186.5	255.0	36.7
Unimicon	3037 TT	150.0	205.0	36.7
Accton	2345 TT	658.0	700.0	6.4
VPEC	2455 TT	163.0	202.0	23.9
MTK	2454 TT	1250.0	1700.0	36.0
Faraday	3035 TT	217.0	305.0	40.6
Alchip	3661 TT	2160.0	3345.0	54.9
Andes	6533 TT	361.5	480.0	32.8
Asustek	2357 TT	594.0	810.0	36.4
DPI	4572 TT	154.0	195.0	26.6
Hiwin	2049 TT	227.5	294.0	29.2
FE	1519 TT	553.0	800.0	44.7
Lotus Pharm	1795 TT	279.5	600.0	114.7
Cathay FHC	2882 TT	66.5	80.0	20.3
CTBC FHC	2891 TT	37.7	42.0	11.4
Uni-President	1216 TT	86.5	94.0	8.7

Figure 1: AI frenzy to sustain TaieX bull market through 2025F, while slowing earnings growth may cap index upside



Source: TEJ; KGI Research

Figure 2: Our top picks

	Company	Code	Investment rating	Target price (NT\$)	Mkt cap (US\$m)	Share price (NT\$)	Change +/- (%)	EPS (NT\$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)		EPS YoY (%)		PEG (x)	
								2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
AI (PEG<1)	TSMC	2330 TT	Outperform	1450.0	797,930	1000.0	45.0	45.23	57.87	22.1	17.3	6.1	4.9	30.4	31.5	1.6	1.8	39.9	27.9	0.6	0.6
	WinWay	6515 TT	Outperform	1655.0	1,266	1170.0	41.5	34.91	50.26	33.5	23.3	8.7	6.3	29.4	31.2	2.2	3.2	158.7	44.0	0.2	0.5
	MPI	6223 TT	Outperform	915.0	2,204	760.0	20.4	23.27	30.44	32.7	25.0	7.6	5.8	25.7	26.4	1.6	2.2	67.1	30.8	0.5	0.8
	M31	6643 TT	Outperform	955.0	875	680.0	40.4	8.02	13.64	84.8	49.9	11.2	10.4	15.4	26.0	1.0	1.6	(26.4)	77.9	(3.2)	0.6
	Hon Hai	2317 TT	Outperform	290.0	83,988	196.5	47.6	11.50	14.48	17.1	13.6	1.7	1.6	10.4	12.4	3.1	3.9	12.2	25.9	1.4	0.5
	QCI	2382 TT	Outperform	400.0	34,051	286.5	39.6	14.58	19.03	19.6	15.1	5.6	5.2	29.3	35.8	4.1	5.3	41.7	30.5	0.5	0.5
	AVC	3017 TT	Outperform	885.0	7,514	630.0	40.5	21.40	31.61	29.4	19.9	9.2	7.5	34.1	41.6	1.7	2.5	54.6	47.7	0.5	0.4
	DELTA	2308 TT	Outperform	512.0	30,851	386.0	32.6	15.56	18.97	24.8	20.3	4.3	3.9	18.8	20.1	2.0	2.5	21.0	22.0	1.2	0.9
	EMC	2383 TT	Outperform	595.0	4,967	467.5	27.3	27.05	33.14	17.3	14.1	5.3	4.6	32.6	35.2	3.5	4.3	69.7	22.5	0.2	0.6
	GCE	2368 TT	Outperform	255.0	2,822	186.5	36.7	12.03	15.79	15.5	11.8	5.3	4.5	34.7	41.1	3.2	4.0	67.7	31.2	0.2	0.4
AI (ASIC)	Unimicron	3037 TT	Outperform	205.0	7,039	150.0	36.7	4.32	12.78	34.7	11.7	2.4	2.1	7.1	19.3	1.2	3.4	(45.0)	195.8	(0.8)	0.1
	Accton	2345 TT	Outperform	700.0	11,360	658.0	6.4	19.17	23.33	34.3	28.2	12.9	11.1	39.8	42.3	2.0	2.3	20.1	22.2	1.7	1.3
	VPEC	2455 TT	Outperform	202.0	927	163.0	23.9	3.72	5.29	43.8	30.8	9.0	8.1	21.4	27.6	2.0	2.8	52.8	42.1	0.8	0.7
	MTK	2454 TT	Outperform	1700.0	61,603	1250.0	36.0	67.16	70.24	18.6	17.8	5.1	4.8	28.0	27.4	5.5	5.4	38.7	4.6	0.5	3.8
Gaming PC	Faraday	3035 TT	Outperform	305.0	1,740	217.0	40.6	4.18	8.78	51.9	24.7	4.2	3.8	9.4	16.2	1.3	2.8	(32.2)	112.4	(1.6)	0.2
	Alchip	3661 TT	Outperform	3345.0	5,350	2160.0	54.9	80.98	83.60	26.7	25.8	4.8	4.4	23.8	17.7	1.9	1.9	92.7	4.2	0.3	6.2
	Andes	6533 TT	Outperform	480.0	563	361.5	32.8	(1.80)	3.97	N.M.	90.9	3.9	3.7	(1.9)	4.2	0.0	0.2	(10.5)	N.A.	N.A.	N.A.
MAGA (Make America Great Again)	Asustek	2357 TT	Outperform	810.0	13,575	594.0	36.4	47.81	45.02	12.4	13.2	1.8	1.7	14.5	13.1	6.0	5.7	123.0	(5.8)	0.1	(2.3)
	DPI	4572 TT	Outperform	195.0	185	154.0	26.6	7.14	7.81	21.6	19.7	3.1	3.0	14.5	15.4	3.8	4.1	15.0	9.3	1.4	2.1
	Hiwin	2049 TT	Outperform	294.0	2,477	227.5	29.2	6.84	8.94	33.3	25.4	2.2	2.1	6.8	8.5	1.3	1.7	18.9	30.8	1.8	0.8
High Dividend Yield	FE	1519 TT	Outperform	800.0	4,886	553.0	44.7	14.30	22.83	38.7	24.2	19.9	15.2	61.8	78.2	2.0	3.0	59.3	59.7	0.7	0.4
	Lotus Pharm	1795 TT	Outperform	600.0	2,286	279.5	114.7	19.04	29.18	14.7	9.6	3.6	2.8	26.2	32.9	2.0	3.1	21.8	55.0	0.7	0.2
	Cathay FHC	2882 TT	Outperform	80.0	30,015	66.5	20.3	7.60	6.68	8.8	10.0	1.2	1.0	14.6	11.0	4.5	4.5	118.9	(12.1)	0.1	(0.8)
	CTBC FHC	2891 TT	Outperform	42.0	22,760	37.7	11.4	3.53	3.59	10.7	10.5	1.6	1.4	15.9	14.0	4.9	4.9	23.6	1.6	0.5	6.6
	Uni-President	1216 TT	Outperform	94.0	15,123	86.5	8.7	3.89	4.70	22.3	18.4	3.8	3.7	17.4	20.3	3.7	4.5	20.4	20.9	1.1	0.9

Source: KGI Research

The ongoing AI frenzy will continue to shore up the Taiex in 2025F, but as index gains and valuation are already close to previous peaks when a paradigm shift took place in the tech industry, we do not expect the index upticks in 2025 to be as strong as those in 2023-24.

AI frenzy to keep Taiex afloat in 2025F, but further index upside will be limited

The emergence of generative AI in 2H23 prompted major global CSPs to engage in an AI arms race, creating tremendous demand for AI servers. As a result, the Taiex underwent a bull run and outperformed most major bourses in 2023-24. Looking ahead, with Nvidia (US) striving to deliver AI chip upgrades every year and with large CSPs arguing that the risk of under-investment in AI is far greater than that of over-investment, we believe AI server demand will continue to grow rapidly in 2025-26F, helping sustain a Taiex rally in 2025F. That said, we would remind investors that the Taiex has advanced by as much as 93% since 2022, with PE peaking at 21x during the ongoing AI boom. Compared to previous bull runs triggered by paradigm shifts in the tech industry, we believe the current gains and valuations are already close to historic highs. As such, while we expect the Taiex to remain buoyant in 2025F, we do not believe the accumulated rise of the index on a full-year basis will exceed the levels in 2023-24. We estimate the Taiex will peak at 25,500 points in 2025F, implying a 2025F PE of 19x. For reference, the index closed up almost 30% in 2023, and will likely repeat the same jump in 2024F.

A paradigm shift in the tech industry can always drive decent earnings growth for two consecutive years among most Taiex constituents. We believe the current AI frenzy will do the same by prompting Taiex earnings to grow by 36% and 18% YoY in 2024-25F, respectively. However, we think earnings growth will decelerate, likely to 10% YoY, in 2026F due to the high base. Generally speaking, share prices tend to rise the most when corporate earnings are rebounding from a trough; and as earnings growth decelerates, shares often stagnate. As such, while we expect the Taiex to remain in a bull run in 2025F, we believe further upside for the index will be limited, and that we are more likely to see individual stocks advance rather than the index as a whole climbing significantly.

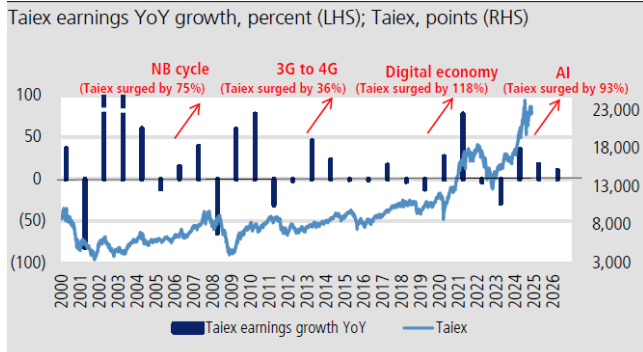
Generative AI is quickly reshaping the tech industry, allowing related suppliers to deliver marked earnings growth so far in 2024. The top beneficiaries are AI server suppliers, including semiconductor component vendors that have enjoyed structural business opportunities stemming from the build-out of computing power, as the content value of semiconductors in an AI server is 10x higher than that in a general server. Within the semiconductor supply chain, advanced packaging service providers stand out as major beneficiaries alongside GPU design houses and foundries. Other suppliers of high-bandwidth memory, ABF substrate, testing interface, baseboard management controller (BMC), silicon photonics, fan-out panel level packaging (FOPLP), and semiconductor materials and equipment are also riding on enormous opportunities rarely seen before. In addition to semiconductors, the content value of other components in an AI server has also increased significantly from a general server. In the case of thermal module, the increase in content value is 10x, and it is 7x for power supply, 6-7x for PCB and server rail, 5x for fan and storage memory, 4-5x for CCL and 4x for chassis.

Given robust demand for AI servers, we predict that global server shipments will grow 5%, 10% and 5% YoY in 2024-26F, versus a 19% decline in 2023, with server production output value surging with a 25% higher CAGR in the same period thanks to rising penetration of AI server, which we estimate will climb from 11% in 2023 to 14%, 17% and 19% in 2024-26F. The AI servers referenced here include those equipped with AI GPUs, FPGAs, and ASICs.

As AI server installations reach a large-enough scale, generative AI will become available on more terminal devices with various applications. Based on this assumption, we expect AI-powered PCs and handsets to be the new driving force for the consumer market next year. We estimate global PC shipments will grow 1%, 6% and 4% YoY in 2024-26F, reversing consecutive declines in 2022-23, driven in part by the launch of AI PC and by upcoming termination of technical support for Win 10 from October 14, 2025, which we believe will create substantial replacement demand for commercial PC. As for smartphone, we expect global shipments to grow 1%, 5% and 1% YoY in 2024-26F, also reversing consecutive declines in 2022-23. While the emergence of generative AI could stimulate PC and handset replacement demand, we note that this happening hinges on the maturation and diversity of AI application scenarios and, more importantly, on actual user experiences.

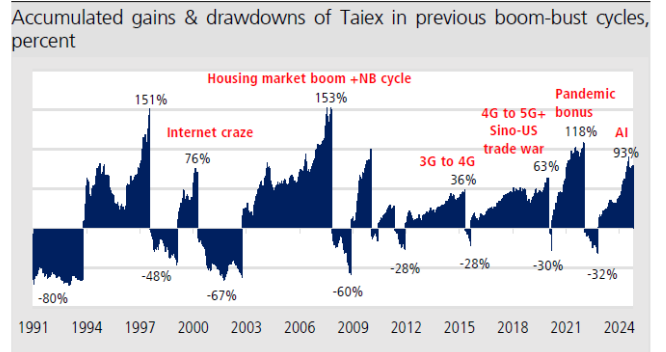
AI doesn't just bring about shipments growth for PC and handset makers. We think the component spec upgrades that come with it, including those of high-speed transmission IC, transmission interface connector, memory, thermal module, PMIC and touch IC, are worth monitoring. As AI PCs are required to process more data at the same time, they need more advanced high-speed transmission ICs (e.g. from Thunderbolt 3 and USB 3 to Thunderbolt 4/5 and USB 4) for charging, data and video/ audio transmission, and the transmission interface also needs to advance to PCIe 4.0/5.0 from 3.0. DRAM specs will also be upgraded to DDR5, and more powerful cold plates will replace traditional thermal tubes to provide better cooling for AI PCs.

Figure 3: AI frenzy will continue to drive a Taiex rally in 2025F, but as earnings growth slows, upside will be limited



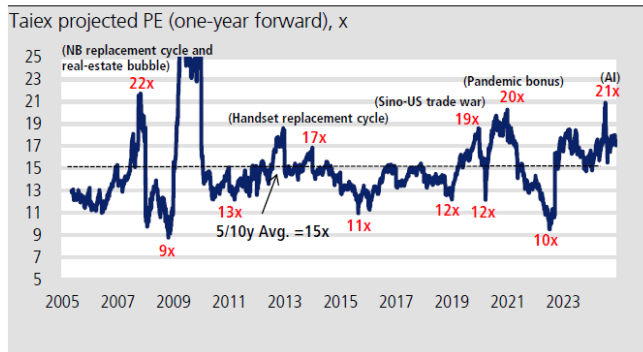
Source: TEJ; KGI Research

Figure 4: Taiex gains & valuation already close to previous peaks when paradigm shift took place in tech industry



Source: TEJ; KGI Research

Figure 5: Taiex PE as high as 21x on AI frenzy; close to historic peak



Source: TEJ; KGI Research

Figure 6: Taiex valuation & corresponding index level

2025F PE (x)	Equivalent index level (points)	2026F PE (x)	Equivalent index level (points)
15x	20,284	15x	22,353
16x	21,637	16x	23,844
17x	22,989	17x	25,334
18x	24,341	18x	26,824
19x	25,694	19x	28,314
20x	27,046	20x	29,805
21x	28,398	21x	31,295

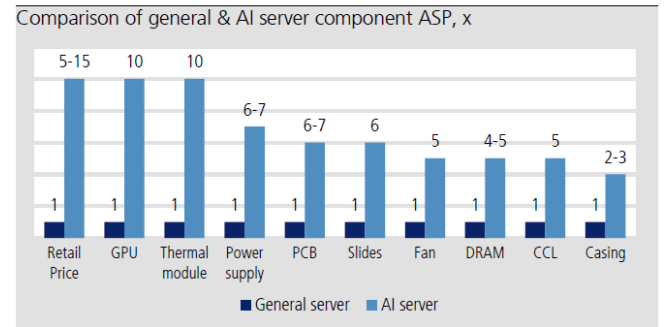
Source: TEJ; KGI Research

Figure 7: AI server penetration to rise from 11% in 2023 to 19% in 2026F

Shipments ('000 units)	2022	2023	2024F	2025F	2026F
AI server	877	1,180	1,678	2,153	2,530
General server	12,938	10,010	10,072	10,772	11,041
Total server	13,815	11,190	11,750	12,925	13,571
Change YoY (%)	2022	2023	2024F	2025F	2026F
AI server		35	42	28	18
General server		(23)	1	7	2
Total server		(19)	5	10	5
Shipments weighting (%)	2022	2023	2024F	2025F	2026F
AI server	6	11	14	17	19
General server	94	89	86	83	81
Total server	100	100	100	100	100

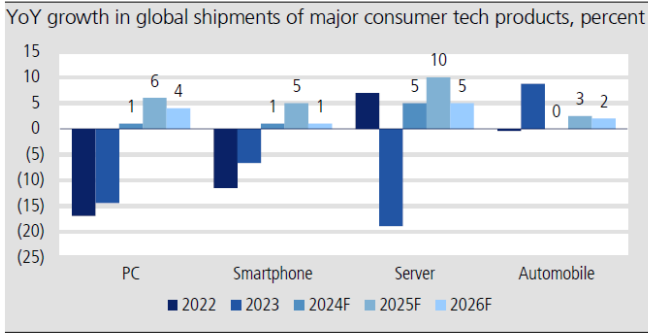
Source: KGI Research

Figure 8: AI server demand to drive component spec upgrades



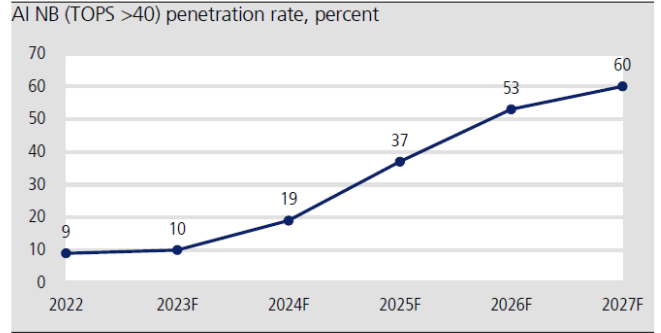
Source: KGI Research

Figure 9: AI to create replacement demand for PC, handset & server in 2025F



Source: KGI Research

Figure 10: AI PC penetration to pick up substantially from 2024F



Source: KGI Research

Figure 11: Taiex subsector earnings forecasts & valuations

Tech	Earning YoY (%)				Forecast PE (x)		Non-tech	Earning YoY (%)				Forecast PE (x)	
	2022	2023	2024F	2025F	2024F	2025F		2022	2023	2024F	2025F	2024F	2025F
Server EMS	(1.7)	3.7	25.6	27.8	19.1	14.7	Cement	(50.7)	31.4	(9.8)	10.2	19.7	17.5
Thermal	34.5	20.5	53.9	54.6	31.3	18.9	Food	(13.6)	6.8	20.4	20.9	22.3	18.4
Power supply	15.1	2.4	10.7	21.5	22.1	18.2	Apparel	32.1	(11.0)	21.9	12.0	19.9	17.7
ABF	102.5	(68.1)	(58.7)	266.3	287.8	14.4	Footwear makers	100.0	(45.2)	19.8	12.2	22.0	19.6
Optical communication	-	63.4	34.7	30.1	39.9	30.7	Auto parts	52.8	(24.7)	69.3	17.9	15.4	14.2
IC design service	94.8	5.3	31.4	19.7	41.2	29.2	Industrial automation	5.2	(14.2)	11.7	15.3	27.1	22.2
Networking PCB	56.1	(22.8)	67.7	31.2	15.5	11.8	Bicycle	(12.7)	(44.8)	(0.8)	28.2	21.1	16.5
Networking	77.3	15.2	6.2	20.8	29.5	15.9	Steel	(75.4)	(89.0)	(34.7)	406.8	55.7	N.M.
CCL	(7.7)	8.2	69.7	22.5	17.3	14.1	Tourism	(46.5)	176.4	4.2	12.1	16.1	13.6
Tier-one foundry	70.4	(17.5)	39.9	27.9	22.1	17.3	Food	(2.7)	92.7	(3.1)	27.6	18.1	13.7
Second-tier foundries	51.6	(33.3)	(18.5)	(5.2)	19.5	19.5	Aerospace	135.4	21.3	6.8	26.2	22.3	16.0
Handset components	28.4	(36.7)	32.6	12.1	11.5	11.7	Airlines	(37.8)	185.5	47.6	(36.8)	9.4	16.1
Telecom	2.6	13.7	0.0	5.6	30.2	28.7	Heavy electrical	(1.9)	41.4	39.4	21.7	27.1	20.6
IC design (handset/consumer)	(2.9)	(32.6)	30.2	4.7	16.4	15.6	Green energy	56.9	90.1	12.8	65.7	26.2	15.6
Handset EMS	(26.5)	4.1	18.7	0.7	13.5	13.4							
Cloud digital	16.3	17.1	15.4	19.6	27.9	22.3							

Source: KGI Research

Over the past year, the Fed's pursuit of a soft landing has largely been achieved, and we expect this to remain the primary scenario for 2025. While China's economy struggles to escape the challenges stemming from the real estate bubble burst, more aggressive fiscal policies from Beijing could help mitigate the risk of sharp economic downturns.

Soft landing for US economy; liquidity injection to steer China away from worst-case economic scenario

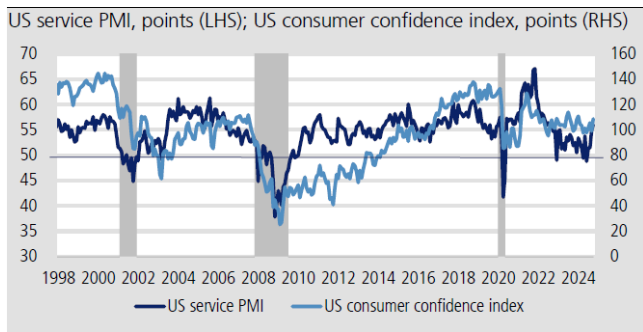
A US economic soft landing, which the Fed has pursued over the past year, whereby inflation eases without hurting the job market too much, has been achieved. We believe the US job market will remain resilient in 2025F, supporting robust consumption demand. Meanwhile, the AI arms race and tax cuts proposed by Trump will likely stimulate US businesses to raise capex further. Against this backdrop, we believe the 2025F US economic performance will continue to center around a soft landing.

While over the past six months the market has been concerned that Fed rate cuts would entail an economic recession, we note that historically this isn't always the case. In fact, the odds of an economic soft landing after rate cuts are relatively high. To be clear, the Fed tends to cut interest rates when: (1) the economy is heading into or is on the brink of a recession, in which case the Fed is forced to take action; and (2) it aims to re-adjust or normalize monetary policies. Looking at the previous nine rate cut cycles since the 1970s, we find that in five of them the US economy makes a soft landing six months after the first rate cut, while only four rate cut cycles are followed by an economic recession six months after they are initiated. Since the Fed announced the first rate cut in September this year, the US economy has so far remained resilient, indicating that an economic soft landing has been achieved. While we believe the situation will remain the same in 2025F, investors should monitor closely the impact on US inflation and consumption of business tax cuts, the deportation of illegal immigrants and higher import tariffs.

China's economy has slowed over the past year due to property market doldrums and escalated trade tensions. However, the stock market has rebounded and the housing market has stabilized since the end of September, when the central bank launched an

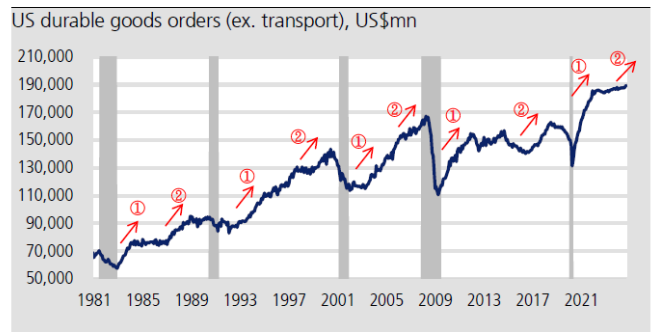
aggressive monetary policy and market bailout measures. In 2025F, while the central bank's current market bailout policy is unlikely to pull China's economy out of the doldrums caused by the burst of the property market bubble, a more aggressive fiscal policy should help the economy stave off the risk of deeper downside. In the past, the Beijing government's expansionary fiscal policy has always been able to boost lending, effectively replenishing liquidity and reinvigorating economic activity. The credit impulse is the weighting of new credit issued in domestic GDP and an important leading indicator of a nation's credit cycle. A rising credit impulse is generally accompanied by the start of an economic recovery. China, being the world's second largest economy, only after the US, accounts for a hefty portion of global end demand. If China can stop its economy from slipping further, the global economy as a whole will enjoy a positive effect. China now accounts for a respective 52%, 32%, 25% and 16% of the global raw materials, automobile, smartphone and PC markets.

Figure 12: Consumption resilience supporting economic soft landing in US



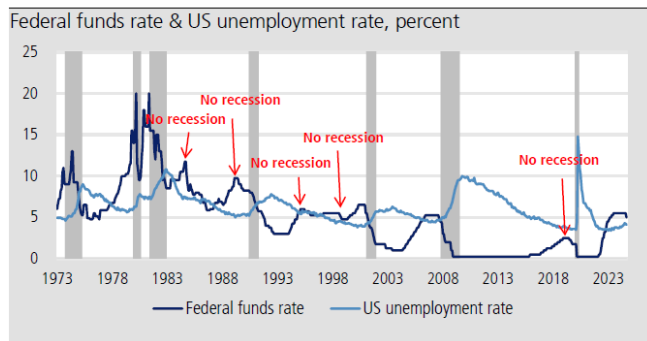
Note: Shaded areas are US recession periods
Source: Bloomberg; KGI Research

Figure 13: AI arms race & Trump's tax cuts to boost US corporate capex



Note: Shaded areas are US recession periods
Source: Bloomberg; KGI Research

Figure 14: Fed rate cuts do not necessarily presage recession



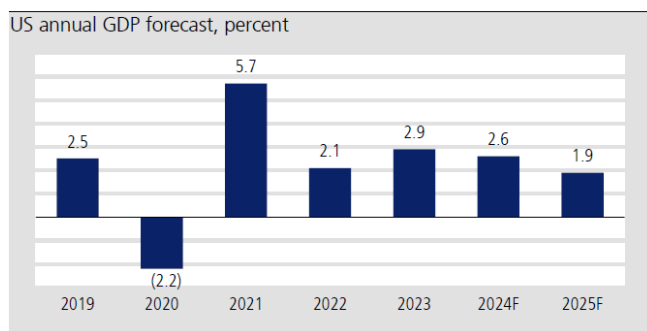
Note: Shaded areas are US recession periods
Source: Bloomberg; KGI Research

Figure 15: US economy in recession four times & not in recession five times after first rate cut

Date of first Fed cut	Economic performance 6 months after rate cut	Recession start day (defined by NBER)
1973/9/3	Recession	1973/11/30
1979/12/3	Recession	1980/1/31
1984/10/2	No recession	No recession
1989/6/5	No recession	Jul-90
1995/7/6	No recession	No recession
1998/9/29	No recession	No recession
2001/1/3	Recession	2001/3/31
2007/9/18	Recession	2007/12/31
2019/7/31	No recession	Feb-20

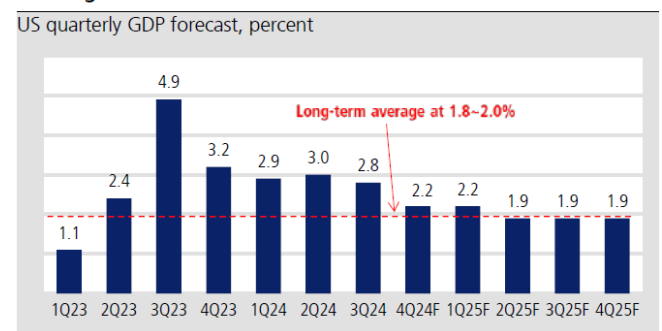
Source: Bloomberg; KGI Research

Figure 16: US economic soft landing expected in 2025F



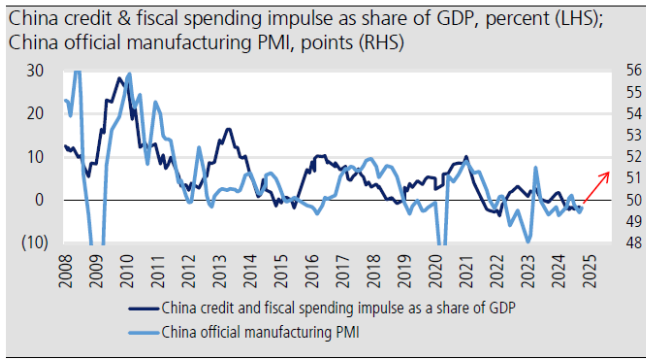
Source: Bloomberg; KGI Research

Figure 17: US economy to slow slightly in 1H25F, but soft landing will be achieved in 2025F



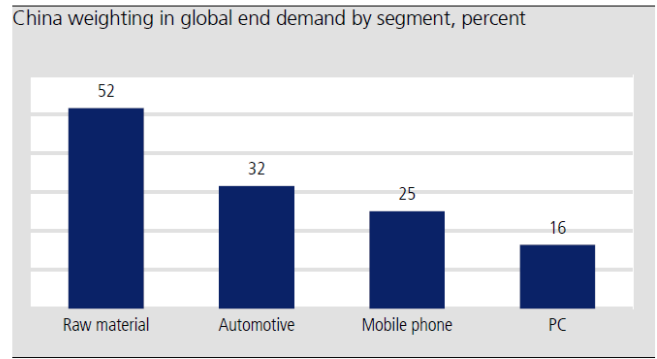
Source: Bloomberg; KGI Research

Figure 18: Previous fiscal expansion reinvigorated China's economy



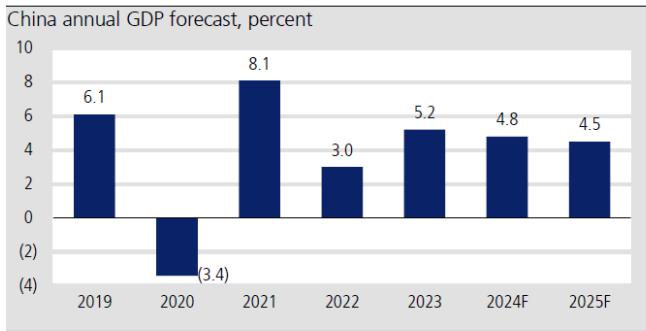
Source: Bloomberg; KGI Research

Figure 19: China accounts for large portion of global end demand



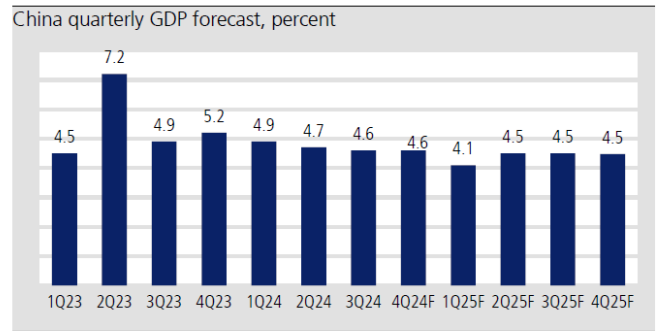
Source: KGI Research

Figure 20: China economy could stave off steep downside risk in 2025



Source: Bloomberg; KGI Research

Figure 21: China economy could stave off steep downside risk in 2025



Source: Bloomberg; KGI Research

We expect additional Fed rate cuts of 75-100bps. Historically, cutting interest rates has helped sustain risk asset rallies during non-recessionary periods. While Trump's aggressive policies could affect inflation and rate cuts, there are uncertainties in regard to the extent and timing of policy implementation, with a time lag. So we are Neutral for now and will adjust our position later.

Rate cuts boost risk asset rallies during non-recessionary periods; inflation could disrupt rate cut trend

In September this year, the Fed started a preemptive interest rate cut cycle, as allowed by inflationary conditions, initially by 50bps and then by 25bps in November, in a bid to prevent prolonged high interest rates from depressing or impacting the US economy. Using the balance approach model, we predict the Fed will have room for 75-100bps more cuts before current high interest rates return to the optimal level, or neutral interest rate level, (i.e. level that balances economic growth and inflation). Historically, cutting interest rates has sustained risk asset rallies during non-recessionary periods, with the global cumulative return for three, six, and twelve months averaging a respective 7%, 12%, and 15% following the first rate cut.

Nine financial market changes since 1970 after the Fed started a rate cut cycle indicate that, in non-recessionary periods, rate cuts have been positive for stock markets, with the S&P 500 three-, six- and twelve-month cumulative return averaging a respective 7%, 12%, and 15% after the first cut. During recessions, rate cuts have, since 1970, had negative effects on stock markets, with the S&P 500 average three-, six- and twelve-month return down 6%, 7%, and 10% following the first cut. All this means stock markets ultimately reflected the state of the economy at the time.

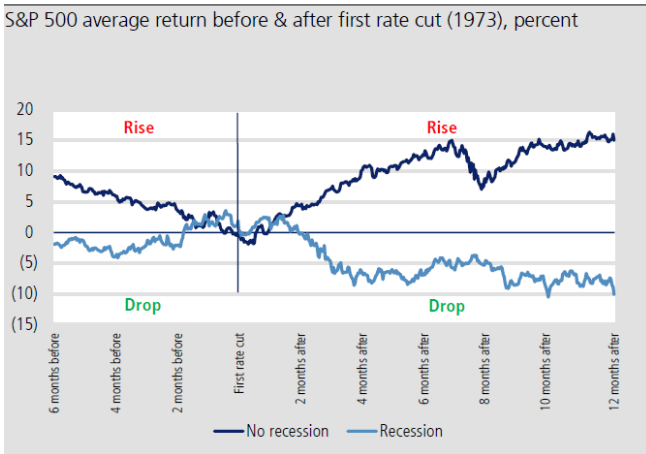
Steady economic expansion is inherently beneficial to private consumption and corporate investment and in turn underpins corporate earnings and stock market performance. If the Fed appropriately lowers interest rates during expansion, besides increasing incentives for consumption and investment and driving the economy into an upcycle, interest rate cuts will spur stock investment sentiment, especially in interest rate sensitive plays. According to our records, the tech, communication services and consumer discretionary sectors have outperformed during non-recessionary periods, whereas consumer staples, healthcare and high-dividend stocks have been more defensive than the broader market during recessions.

With 2025F looking to enjoy steady economic expansion and lower funding costs, we predict funds will chase tech, communication services and consumer discretionary shares.

The Fed maintaining a loose monetary policy will also ease cash outflows from emerging markets. This is because rate cuts usually lessen the US dollar’s interest rate advantage, prompting money to flow from the US to higher-yielding assets in other countries, which pressures the greenback and leads emerging Asian currencies to appreciate. Emerging markets other than China are shallow-dish markets, where stocks fluctuate easily on global fund movements. In 2025F, as Fed rate cuts will dampen the attractiveness of US dollar-denominated assets, global investors will start looking at emerging markets with strong potential. The Taiex now ranks third by weighting in the MSCI emerging market index, at around 18%, only after China’s 22% and India’s 20%. Global fund allocation strategies have faced major adjustments in the wake of US rate cuts. Taiwan’s and India’s stock markets will attract more fund allocation on earnings growth potential, as the former will continue to benefit from the AI frenzy and the latter from infrastructure projects.

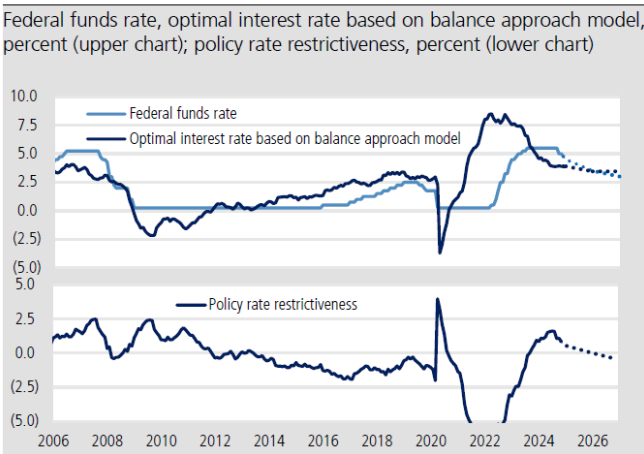
Although the Fed started a rate reduction cycle in September this year due to its success in containing inflation, the market is worried about Trump’s corporate tax cuts, the deportation of undocumented migrants and high tariffs after his presidential inauguration in January 2025, which could spark a comeback of inflation and affect the Fed’s rate cut policy. That said, we hold a neutral view for now and will adjust our position as appropriate, since the extent and timing of the implementation of Trump’s policies are areas of uncertainty, and it will take time for those policies to filter through the economy.

Figure 22: Rate cuts lift stock markets in non-recessionary periods



Source: Bloomberg; KGI Research

Figure 23: We expect additional 75-100bps of rate cuts



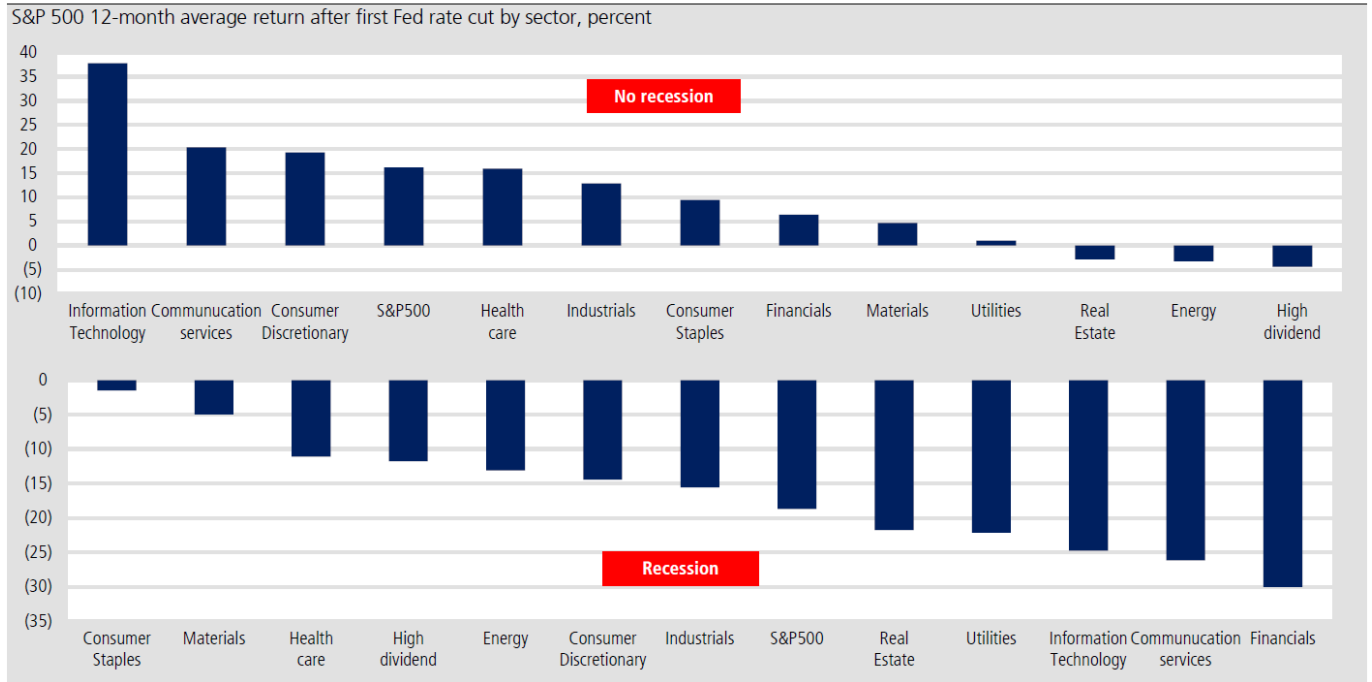
Source: Bloomberg; KGI Research

Figure 24: Stock & bond market changes after first Fed rate cut

Announcement of first rate cut	Accumulated return of S&P 500 Index					Changes in 10-year Treasury yield (bp)				
	1M after	2M after	3M after	6M after	12M after	1M after	2M after	3M after	6M after	12M after
Average gain "without" economic recession	1%	4%	7%	12%	15%	-25	-25	-22	-32	-25
Average gain "with" economic recession	1%	0%	-6%	-7%	-10%	-7	-5	29	-30	57

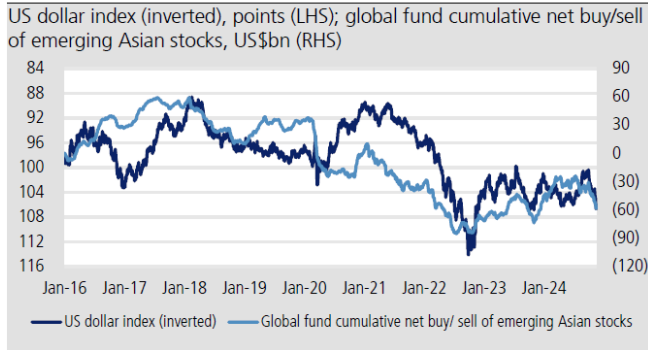
Note: Non-recession refers to non-recession six months within the first rate cut
Source: Bloomberg; KGI Research

Figure 25: After first Fed rate cut, tech, communication services & consumer discretionary shares outperform during non-recessionary periods; consumer staples, healthcare, & high-dividend stocks are more defensive than broader market during recessions



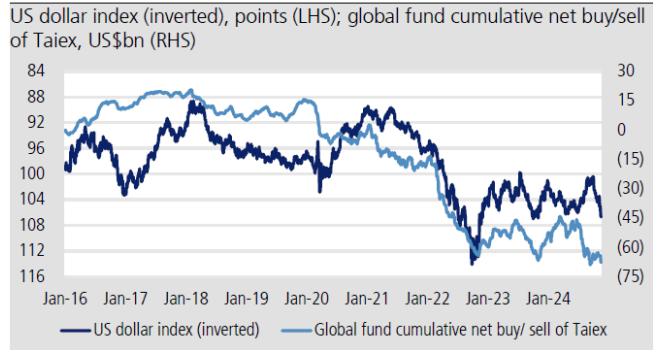
Source: Bloomberg; KGI Research

Figure 26: US dollar movements often dominate global fund preferences for emerging Asian stocks



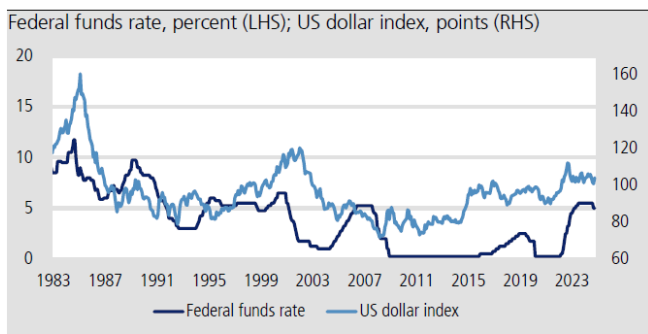
Note: Starting point is January 2016
Source: Bloomberg; KGI Research

Figure 27: US dollar movements often dominate global fund preferences for the Taiex



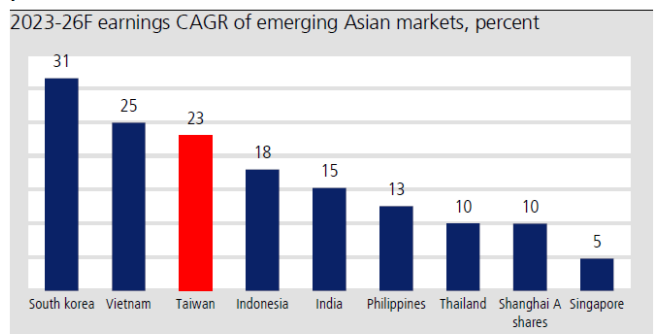
Note: Starting point is January 2016
Source: Bloomberg; KGI Research

Figure 28: Fed rate cuts often weaken the US dollar



Source: Bloomberg; KGI Research

Figure 29: Taiex earnings growth higher than most Asian peers



Source: Bloomberg; KGI Research

Since 2020, domestic funds in Taiwan stocks have successfully fended off enormous sell-off pressure from FINI thanks to active market participation, resulting in Taiwan stocks becoming more resistant to downtrends and riding uptrends. Looking forward, downside risk for Taiwan stocks, especially drastic swings driven by Trump, will be underpinned if this trend remains intact.

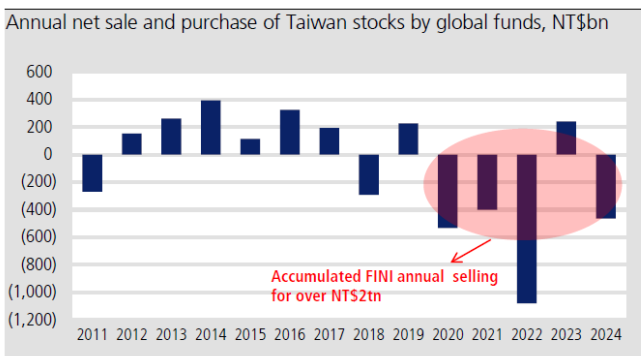
Injection of domestic funds into Taiwan stock market to help offset FINI sell-off pressure, which will help mitigate 2025F Taixex downside risk

FINI have divested over NT\$2.0tn from the Taixex since 2020. However, during this period, domestic funds flowing into Taiwan’s stock market have helped offset enormous FINI sell-off pressure thanks to active investor participation, resulting in Taiwan stocks becoming resistant to downtrends and riding uptrends. In 2025, the uncertainty of US President-elect Trump’s policies may result in market correction or variables in the economy, such as inflation or interest rate cuts, which would lead to severe market fluctuations. We expect downside risk for Taiwan stocks to be mitigated by the injection of domestic funds into Taiwan’s stock market.

Global funds divested from the Taixex significantly in 2020-24, except for slight overbuying in 2023. Overselling was due to uncertainty caused by the COVID-19 pandemic, intensifying cross-strait geopolitical risks, aggressive rate hikes by the US Fed, and asset rebalancing caused by excessive Taiwan stock rallies. Although the aforementioned risks have been mitigated, Trump’s potential high global tariff policy would be a new concern in 2025 as it could significantly impact the global economy and trade. However, it remains to be seen if the policy will be fully implemented.

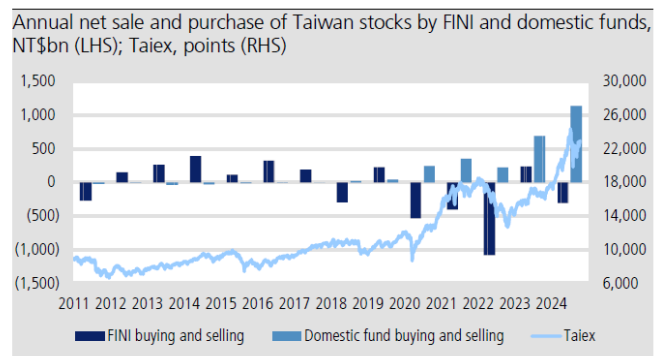
Domestic funds actively participating in the Taixex during the Sino-US trade war in 2018 and during the COVID-19 pandemic in 2020 resulted in FINI flowing back into Taiwan’s stock market. This was followed by a post-pandemic Taixex rally and a high interest rate environment, which gradually led to structural changes in asset allocation by the Taiwanese people, which turned to high-yield wealth management products, such as high-dividend and bond ETFs, as well as overseas bonds, as life insurance policies with low interest rates became unattractive. According to our data, the total bank savings of Taiwanese people has increased by NT\$1.5-2.0tn per year since 2020, while life insurance policy income has decreased by more than NT\$1.0tn each year. We accordingly estimate that the aforementioned NT\$2.0-3.0tn per year is being heavily invested in Taiwan stocks and related high-yield wealth management products. We believe that this trend will continue, helping to mitigate downside risk for the Taiwan stock market in 2025.

Figure 30: FINI have divested over NT\$2.0tn from the Taixex since 2020



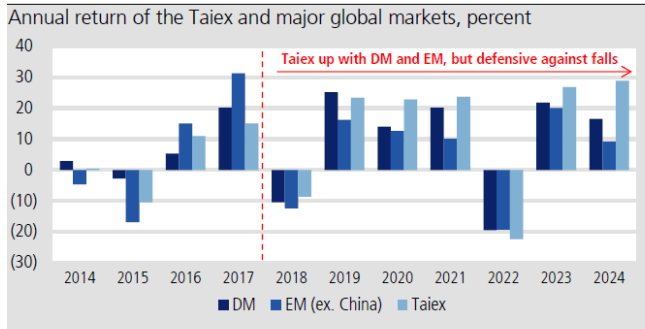
Note: Data compiled as of November 2024
Source: TEJ; KGI Research

Figure 31: Domestic funds in Taiwan’s stock market have helped offset enormous FINI sell-off pressure



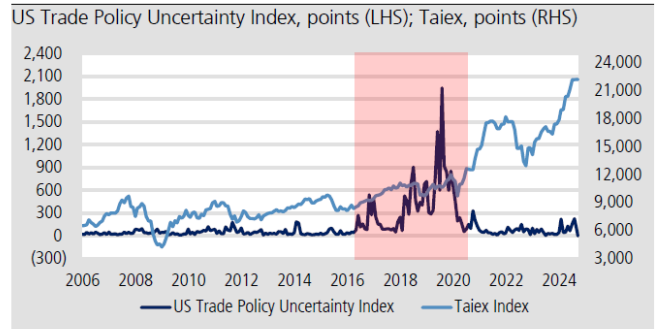
Note: Estimated domestic buying and selling based on changes in domestic onshore equity funds in Taixex.
Note: Data compiled as of October 2024
Source: TEJ; KGI Research

Figure 32: Taiwan stocks have become more resistant to downtrends & have ridden uptrends during market rallies



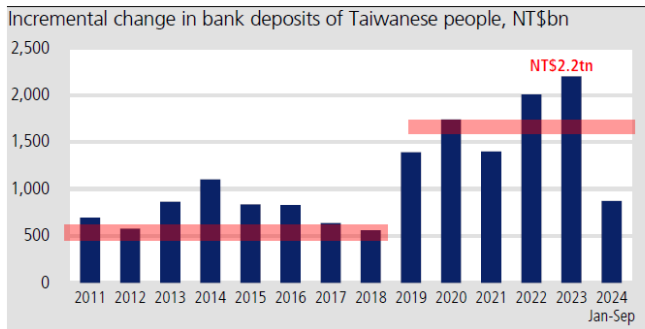
Source: Bloomberg; KGI Research

Figure 33: Sino-US trade war during Trump administration in 2017-2020 led to drastic TaieX volatility, but stock market bullishness was unaffected



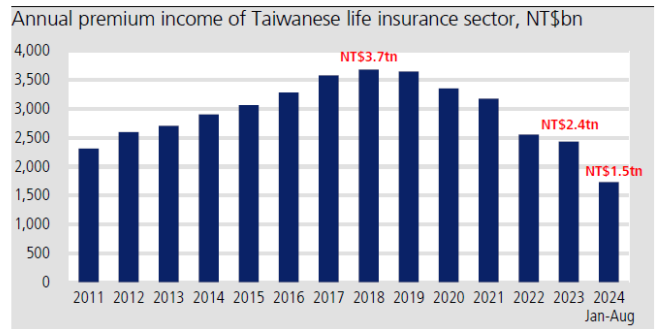
Source: Bloomberg; KGI Research

Figure 34: Total bank savings of Taiwanese people increased by NT\$1.5-2.0tn per year since 2020 due to foreign fund inflows & a solid economy



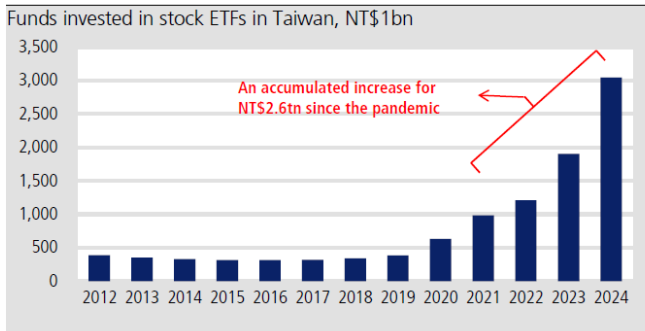
Source: TEJ; KGI Research

Figure 35: Premium income fell more than NT\$1.0tn due to wealth management changes by Taiwanese people



Source: Insurance Bureau; KGI Research

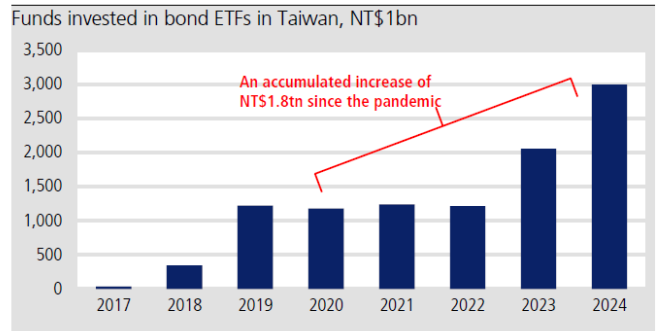
Figure 36: Amount of Taiwanese money invested in stock ETFs has grown by NT\$2.6tn since 2020



Note: Data compiled as of September 2024

Source: TEJ; KGI Research

Figure 37: Amount of Taiwanese money invested in bond ETFs has grown by NT\$1.8tn since 2020



Note: Data compiled as of September 2024

Source: TEJ; KGI Research

We are upbeat as the Taiex will extend the bull run since 2023-24 in 2025F, and will challenge a peak of 25,500, but risks brought about by US President-elect Trump and other factors will lead to drastic market volatility.

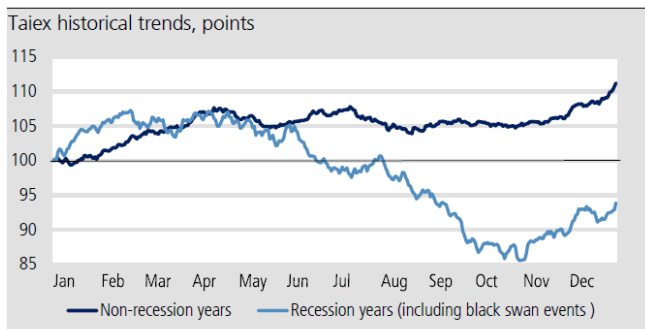
Taiex to challenge peak of 25,000-26,000 in 2025F, but risks brought about by US President-elect Trump & other factors will lead to drastic market volatility

We are upbeat as the Taiex bull run since 2023-24 will extend into 2025F, mainly reflecting stable expansion of the global economy and the strong profitability of tech stocks due to the AI arms race. However, we expect drastic volatility driven by US President-elect Trump's radical policies and remarks. We believe downside risk for the Taiex will be mitigated by active participation of domestic funds. We forecast the Taiex will challenge a peak of 25,500 points (19x 2025F average EPS) and will trough at 20,000 points (15x 2025F average EPS) in 2025.

We expect the Taiex to maintain the historical smile curve trend, that is, to rally in 1Q25 and 4Q25, and undergo seasonal revisions in 2Q-3Q25. After Trump officially takes office in the White House, his radical economic and trade policies and shocking remarks will lead to violent fluctuations in the market. Trump's corporate tax cuts, forced deportations, high tariffs, and other policies will trigger short-term inflation and hamper the Fed's interest rate cut cycle throughout 2025F if all policies are implemented. The resurgence of inflation and the obstruction of the interest rate cut cycle will lead to higher US bond yields, thereby weakening the valuation of the stock market.

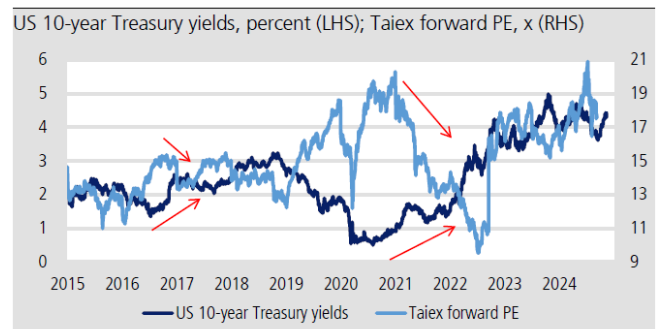
We analyzed Taiex trends since 1990. If the global economy developed steadily and avoided falling into a recession in each year, Taiwan's stock market would usually follow a smile curve, peaking once in the first half and second half of each year, and bottoming in the second to third quarter during a mid-term correction. If the global economy fell into a recession or encountered a black swan event, Taiwan's stock market would take the shape of a reverse checkmark, with a bear run emerging after a peak in the first half. A decent rebound eventually appeared before the end of the year. In 2025, we believe that as long as the economy maintains a soft landing, Taiwan's stock market will have a high probability of forging a smile curve, but the risks posed by Trump will likely increase Taiex fluctuations in 2Q-3Q25.

Figure 38: Taiex experienced smile curves during non-recession years; Taiex followed reverse check mark pattern in recessionary years, including black swan events



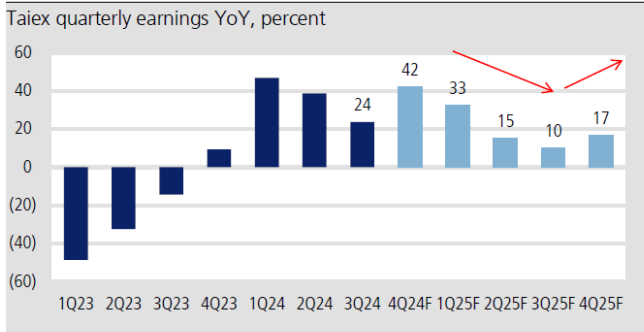
Note: Recessionary years (including black swan events) were 1990, 1997, 2000, 2001, 2008, 2009, 2011, 2015, 2020, and 2022.
Source: TEJ; KGI Research

Figure 39: Higher US bond yields to weaken Taiex valuations



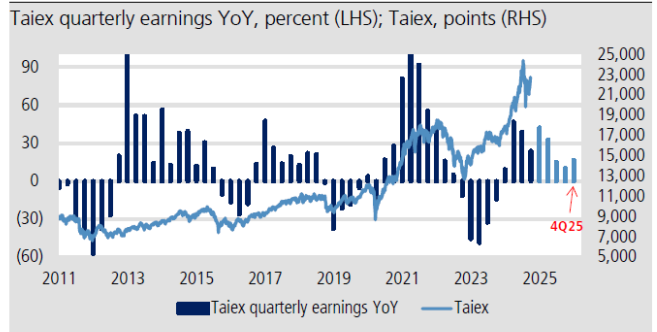
Source: Bloomberg; KGI Research

Figure 40: Earnings growth to slow in 2Q25F on high base, but will regain strength in 4Q25F on iPhone 17 pull-in demand



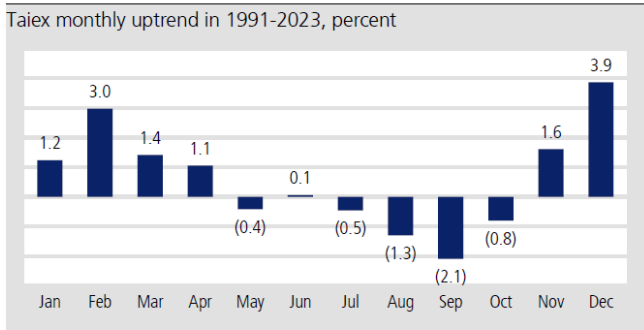
Source: TEJ; KGI Research

Figure 41: Strength of earnings growth directly affects index volatility & often serves as key factor in index turning points



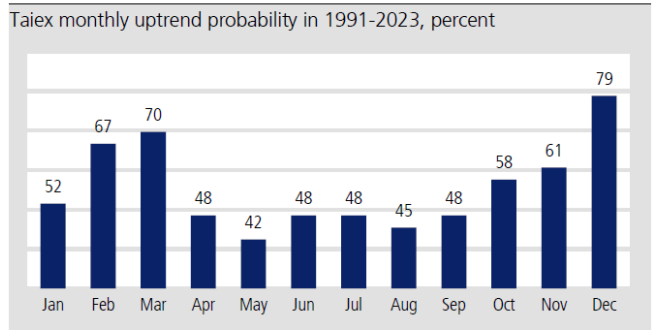
Source: TEJ; KGI Research

Figure 42: Taix to be bolstered by seasonality, leading to a smile curve



Source: TEJ; KGI Research

Figure 43: Taix to be bolstered by seasonality, leading to a smile curve



Source: TEJ; KGI Research

Figure 44: Comparison – Taix valuations

	Forward PB(X)								Forward PE(X)							
	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom
Taix	2.07	2.23	2.07	1.75	1.63	1.63	2.28	0.95	17.08	19.48	16.52	15.12	14.96	17.08	21.73	8.80
Taix excl. TSMC	1.50	1.61	1.50	1.41	1.39	1.47	2.22	0.89	16.56	18.23	16.11	14.81	14.93	16.00	22.71	8.06

Source: TEJ; KGI Research

Our main theme for 2025F Taix investment is “AI for electronics, MAGA for non-electronics”. We recommend 25 counters.

Our top picks

Our main theme for 2025F Taix investment is “AI for electronics, MAGA for non-electronics.” For the electronics industry, AI plays will have the clearest visibility. We have to focus on counters with a PEG below 1, as their valuations do not yet fully reflect the earnings growth from exceeded sales expectations in 2024, and further AI gains will materialize in 2025F. AI ASIC are presenting an excellent business opportunity on rising demand for customization, driven by specific AI applications. Additionally, gaming PCs will enter a replacement cycle, which happens every 2-3 years, thanks to new graphics cards. For non-electronics, we are upbeat about sectors that will benefit from Trump’s proposed policies (MAGA), including aerospace, industrial automation, heavy electrical, and generic drugs. Finally, we recommend investors engage counters with high yields for asset allocation, as the Taix will see inflection points in 1Q25F, creating space for both aggressive and defensive trading strategies. Our top picks are: TSMC (2330 TT), M31 (6643 TT), WinWay (6515 TT), MPI (6223 TT), Hon Hai Precision (2317 TT), Quanta Computer (2382 TT), Asia Vital Components (3017 TT), Delta Electronics (2308 TT), Elite Material (2383 TT), Gold Circuit Electronics (2368 TT), Unimicon (3037 TT), Accton (2345 TT), Visual Photonics Epitaxy (2455 TT), MediaTek (2454 TT), Faraday (3035 TT), Alchip (3661 TT), Andes (6533 TT), Asustek (2357 TT), Drewloong Precision (4572 TT), Hiwin

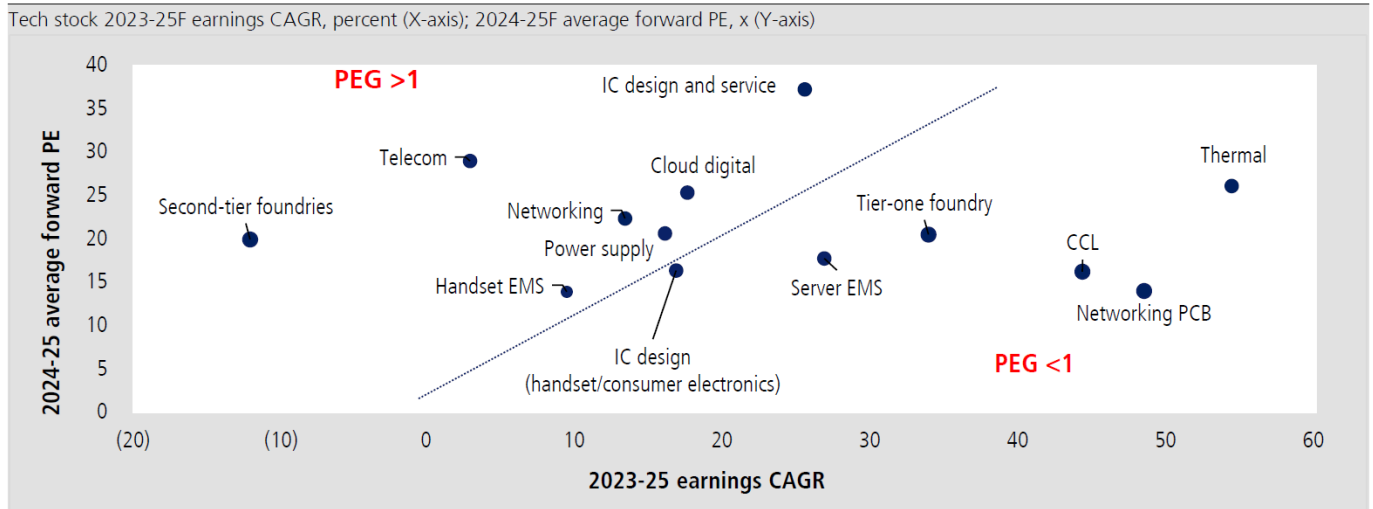
(2049 TT), Fortune Electric (1519 TT), Lotus Pharmaceutical (1795 TT), Cathay FHC (2882 TT), CTBC FHC (2891 TT), and Uni-President Enterprises (1216 TT).

Figure 45: Our top picks

	Company	Code	Investment rating	Target price (NTS)	Mkt cap (US\$m)	Share price (NTS)	Change +/- (%)	EPS (NTS)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)		EPS YoY (%)		PEG (x)	
								2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
AI (PEG<1)	TSMC	2330 TT	Outperform	1450.0	797,930	1000.0	45.0	45.23	57.87	22.1	17.3	6.1	4.9	30.4	31.5	1.6	1.8	39.9	27.9	0.6	0.6
	WinWay	6515 TT	Outperform	1655.0	1,266	1170.0	41.5	34.91	50.26	33.5	23.3	8.7	6.3	29.4	31.2	2.2	3.2	158.7	44.0	0.2	0.5
	MPI	6223 TT	Outperform	915.0	2,204	760.0	20.4	23.27	30.44	32.7	25.0	7.6	5.8	25.7	26.4	1.6	2.2	67.1	30.8	0.5	0.8
	M31	6643 TT	Outperform	955.0	875	680.0	40.4	8.02	13.64	84.8	49.9	11.2	10.4	15.4	26.0	1.0	1.6	(26.4)	77.9	(3.2)	0.6
	Hon Hai	2317 TT	Outperform	290.0	83,988	196.5	47.6	11.50	14.48	17.1	13.6	1.7	1.6	10.4	12.4	3.1	3.9	12.2	25.9	1.4	0.5
	QCI	2382 TT	Outperform	400.0	34,051	286.5	39.6	14.58	19.03	19.6	15.1	5.6	5.2	29.3	35.8	4.1	5.3	41.7	30.5	0.5	0.5
	AVC	3017 TT	Outperform	885.0	7,514	630.0	40.5	21.40	31.61	29.4	19.9	9.2	7.5	34.1	41.6	1.7	2.5	54.6	47.7	0.5	0.4
	DELTA	2308 TT	Outperform	512.0	30,851	386.0	32.6	15.56	18.97	24.8	20.3	4.3	3.9	18.8	20.1	2.0	2.5	21.0	22.0	1.2	0.9
	EMC	2383 TT	Outperform	595.0	4,967	467.5	27.3	27.05	33.14	17.3	14.1	5.3	4.6	32.6	35.2	3.5	4.3	69.7	22.5	0.2	0.6
	GCE	2368 TT	Outperform	255.0	2,822	186.5	36.7	12.03	15.79	15.5	11.8	5.3	4.5	34.7	41.1	3.2	4.0	67.7	31.2	0.2	0.4
	Unimicron	3037 TT	Outperform	205.0	7,039	150.0	36.7	4.32	12.78	34.7	11.7	2.4	2.1	7.1	19.3	1.2	3.4	(45.0)	195.8	(0.8)	0.1
	Accton	2345 TT	Outperform	700.0	11,360	658.0	6.4	19.17	23.33	34.3	28.2	12.9	11.1	39.8	42.3	2.0	2.3	20.1	22.2	1.7	1.3
VPEC	2455 TT	Outperform	202.0	927	163.0	23.9	3.72	5.29	43.8	30.8	9.0	8.1	21.4	27.6	2.0	2.8	52.8	42.1	0.8	0.7	
AI (ASIC)	MTK	2454 TT	Outperform	1700.0	61,603	1250.0	36.0	67.16	70.24	18.6	17.8	5.1	4.8	28.0	27.4	5.5	5.4	38.7	4.6	0.5	3.8
	Faraday	3035 TT	Outperform	305.0	1,740	217.0	40.6	4.18	8.78	51.9	24.7	4.2	3.8	9.4	16.2	1.3	2.8	(32.2)	112.4	(1.6)	0.2
	Alchip	3661 TT	Outperform	3345.0	5,350	2160.0	54.9	80.98	83.60	26.7	25.8	4.8	4.4	23.8	17.7	1.9	1.9	92.7	4.2	0.3	6.2
	Andes	6533 TT	Outperform	480.0	563	361.5	32.8	(1.80)	3.97	N.M.	90.9	3.9	3.7	(1.9)	4.2	0.0	0.2	(10.5)	N.A.	N.A.	N.A.
Gaming PC	Asustek	2357 TT	Outperform	810.0	13,575	594.0	36.4	47.81	45.02	12.4	13.2	1.8	1.7	14.5	13.1	6.0	5.7	123.0	(5.8)	0.1	(2.3)
MAGA (Make America Great Again)	DPI	4572 TT	Outperform	195.0	185	154.0	26.6	7.14	7.81	21.6	19.7	3.1	3.0	14.5	15.4	3.8	4.1	15.0	9.3	1.4	2.1
	Hiwin	2049 TT	Outperform	294.0	2,477	227.5	29.2	6.84	8.94	33.3	25.4	2.2	2.1	6.8	8.5	1.3	1.7	18.9	30.8	1.8	0.8
	FE	1519 TT	Outperform	800.0	4,886	553.0	44.7	14.30	22.83	38.7	24.2	19.9	15.2	61.8	78.2	2.0	3.0	59.3	59.7	0.7	0.4
High Dividend Yield	Lotus Pharm	1795 TT	Outperform	600.0	2,286	279.5	114.7	19.04	29.18	14.7	9.6	3.6	2.8	26.2	32.9	2.0	3.1	21.8	55.0	0.7	0.2
	Cathay FHC	2882 TT	Outperform	80.0	30,015	66.5	20.3	7.60	6.68	8.8	10.0	1.2	1.0	14.6	11.0	4.5	4.5	118.9	(12.1)	0.1	(0.8)
	CTBC FHC	2891 TT	Outperform	42.0	22,760	37.7	11.4	3.53	3.59	10.7	10.5	1.6	1.4	15.9	14.0	4.9	4.9	23.6	1.6	0.5	6.6
	Uni-President	1216 TT	Outperform	94.0	15,123	86.5	8.7	3.89	4.70	22.3	18.4	3.8	3.7	17.4	20.3	3.7	4.5	20.4	20.9	1.1	0.9

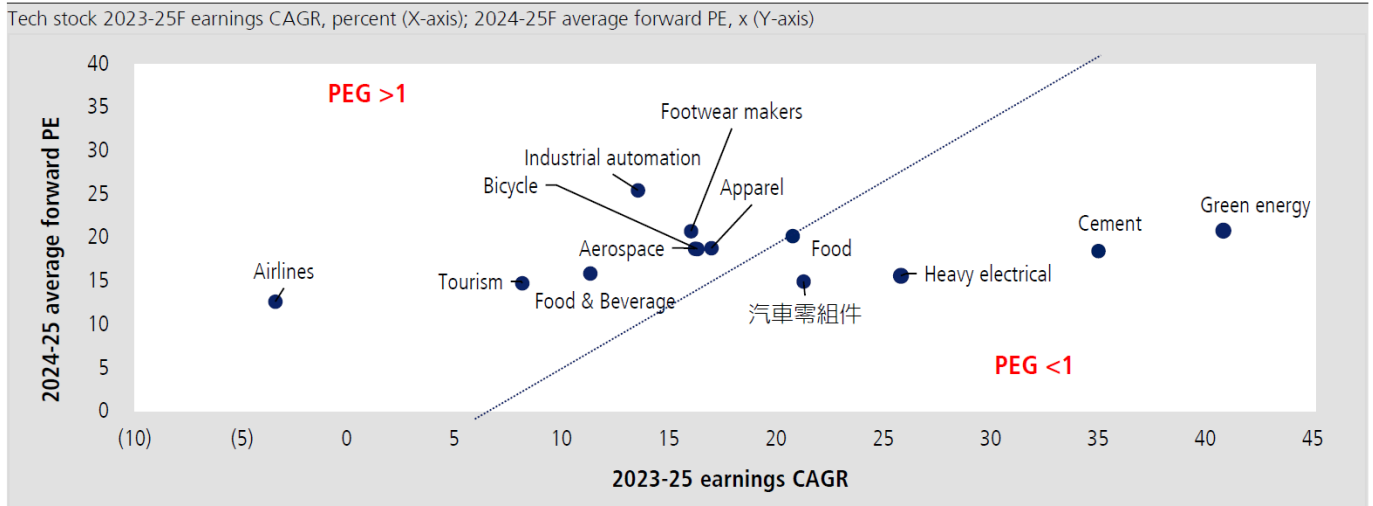
Source: KGI Research estimates

Figure 46: Top tech picks are AI supply chain stocks with PE < 1, as strong earnings growth is as yet underpriced



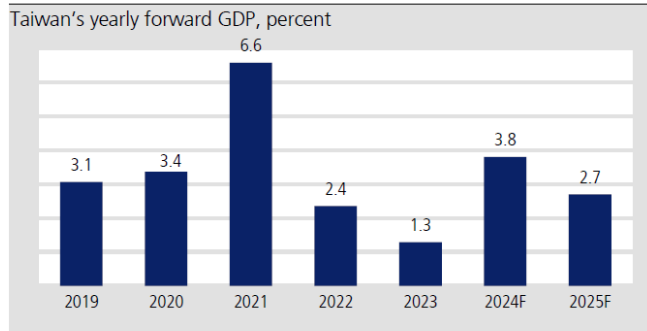
Source: KGI Research estimates

Figure 47: Top non-tech picks are aerospace, heavy electrical, industrial automation, & generic drug plays benefiting from MAGA trend



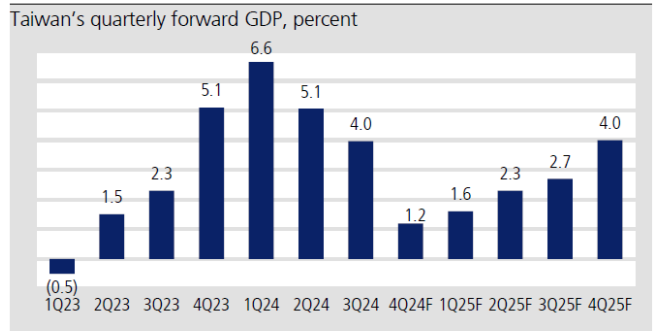
Source: KGI Research estimates

Figure 48: 2024-25F GDP growth of a respective 3.8% & 2.7%



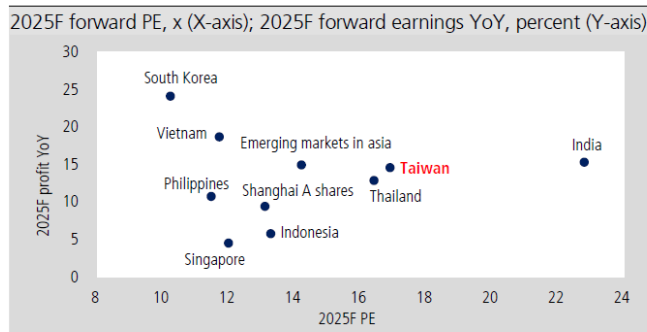
Source: TEJ; KGI Research estimates

Figure 49: 2025F GDP to increase QoQ



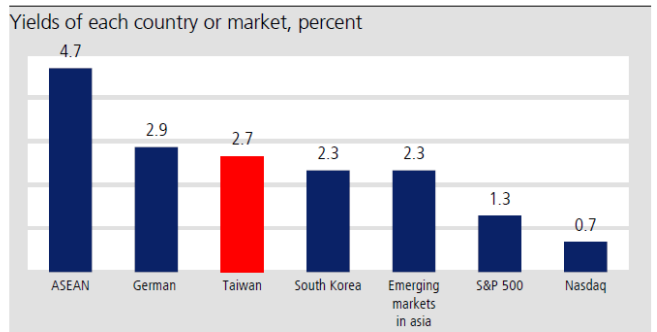
Source: TEJ; KGI Research estimates

Figure 50: Taiex valuation is average among Emerging Asia



Source: Bloomberg; KGI Research

Figure 51: Taiex yield is in upper-middle range among global stock markets



Source: Bloomberg; KGI Research

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