

Strategy

Tariff-triggered pullback may create good entry point

Key message

1. Trump is using tariffs as a tool to get what he wants. The final result, in terms of tariffs, may not be as severe as many have imagined.
2. Canada and Mexico were the first targets of the present trade war. In hindsight, local stock pullbacks made for a good entry point.
3. For short-term trading, we suggest investors focus on beneficiaries which will benefit from Trump policies, have some immunity to trade wars, and offer high cash yields.

Event

Global stock and forex markets have undergone major swings again as Donald Trump, the US President, announced on February 7 that he would impose reciprocal tariffs against multiple countries this week. Frightening as tariffs may seem, we believe any resulting pullbacks of the Taiex in the near future could be good entry points for investors.

Analysis

Previous trade wars initiated by Trump weren't as devastating as many had feared. From the perspective of Trump, tariffs are only means to force other countries into negotiations for the purpose of protecting the interest of the US. As long as other countries are willing to give way, those tariffs will be reduced or even revoked, as recent cases with Canada, Mexico and Japan showed. Last week, Trump also mentioned Taiwan as a target for additional tariffs. In response, Taiwan's economic ministry sent a special delegation to visit the US and discuss semiconductor tariffs with the Trump administration. Overall, we believe tariffs are only a modus operandi for securing US interests. On the condition that the counterparties of the US are willing to concede, the final result, in terms of tariffs, won't be as severe as many have imagined. In our view, Trump is a typical upholder of realism and mercantilism. During his first term, he approved arms sales of US\$18.3bn to Taiwan in 2017-21, the most of all US presidents, when tensions between Taiwan and China were de-escalating. This speaks volumes about his personality as a deal seeker.

Canada & Mexico were the first targets of tariffs; in hindsight, local stock pullbacks made for a good entry point. Trump made it clear for the first time on November 25, 2024, that he would immediately impose a 25% tariff on imported goods from Canada and Mexico when he took office. The announcement of collecting tariffs from the two neighboring countries was the last thing the market expected that the president-elect would do, and it resulted in short-term pullbacks of in the Canadian and Mexican stock markets. However, in retrospect, those pullbacks created good engagement opportunities. The Canadian stock market suffered a drawdown of 3.9% when the threat of tariffs was first announced, before bottoming after one month. Likewise, the Mexican stock market fell by as much as 2.7% and bottomed out in about one month. To date, the two bourses have recovered fully from the threat of a trade war. Exports to the US account for 20-30% of Canadian and Mexican GDP, respectively, and a trade war would be extremely detrimental to their economies. That being said, their stock markets seem to have survived the negative news, and we think the same may happen to the Taiex.

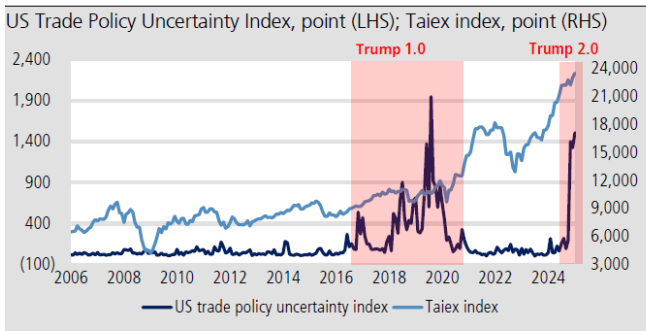
The current trade war may be different from the previous one; US inflation, Fed policy and global economy are key factors to watch. In 2018 when Trump raised tariffs, he was mainly targeting imports from China, especially non-essential goods like steel and solar products. Back then, inflation in the US was low, and thus the impact of additional tariffs on inflation was limited. However, with inflation and interest rates both hovering at high levels in the US, trade wars could have a more profound and direct impact on businesses and consumers. US core PCE arrived at 2.8% in December 2024. Although it had declined significantly from the 2022 peak of 5.6%, the easing of inflation has been stagnant for six months, and inflation is well above the Fed's long-term target of 2%. While the Fed's policy rate is still over the neutral rate by 25-50bps, we note that further rate cuts won't be announced before the US labor market deteriorates or inflation readings decline. If Trump really raises tariffs across the board, a recurrence of high inflation will be inevitable, hurting demand and paving the way for deflation over the long run. In the face of additional tariffs, suppliers that are unable to pass on extra costs will suffer deteriorating profitability, and those that can transfer costs to downstream clients and end-consumers may do so to protect themselves temporarily.

However, as inflation picks up, hurting overall demand, the profitability of these exporters will still be undermined. For reference, when the US imposed comprehensive tariffs in the 1920s and 1930s, total consumer demand fell by a respective 50% and 70%.

Conclusion & top picks

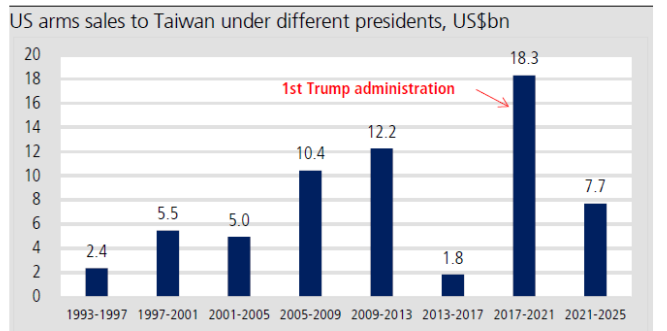
Due to the pressure test of tariff threats, we suggest investors focus on firms that will benefit from Trump’s policies, have some immunity to trade wars, and offer high cash yields for short-term trading, including Hiwin Technologies (2049 TT, NT\$344.5, OP), Drewlong Precision (4572 TT, NT\$155, OP), Fortune Electric (1519 TT, NT\$516, OP), Lotus Pharmaceutical (1795 TT, NT\$276.5, OP), Bora Pharmaceuticals (6472 TT, NT\$858, OP), Cathay Financial Holding (2882 TT, NT\$68.5, OP), CTBC FHC (2891 TT, NT\$40.5, OP) and Uni-President Enterprises (1216 TT, NT\$79.1, OP). For long-term investors, we believe AI stocks which could survive a trade war would offer decent returns.

Figure 1: Trade wars in Trump’s second term have created market volatility



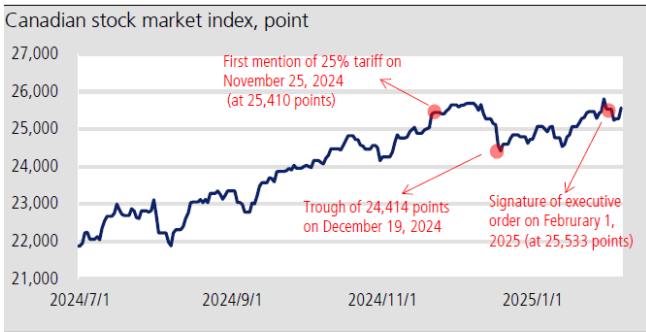
Source: Bloomberg; KGI Research

Figure 2: Of all US presidents, Trump approved the most arms sales to Taiwan



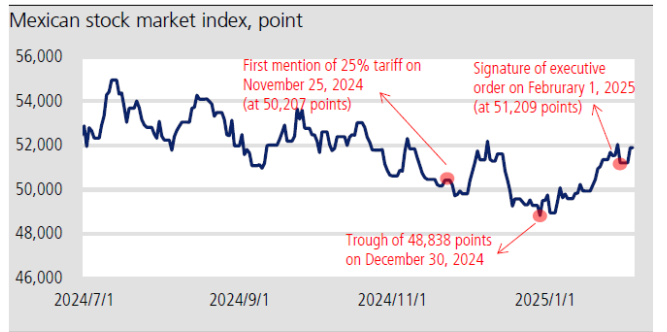
Source: Taiwan Presidential Office; Central News Agency; Liberty Times; KGI Research

Figure 3: Canada’s TSX fell by as much as 3.9% when Trump first mentioned tariffs, but bottomed out after one month



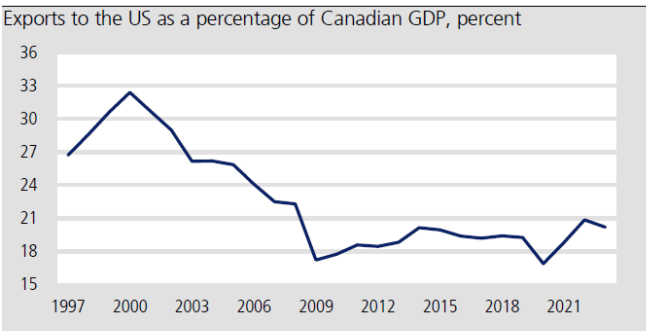
Source: Bloomberg; KGI Research

Figure 4: The Mexican stock index fell by as much as 2.7% when Trump first mentioned tariffs, but bottomed out one month later



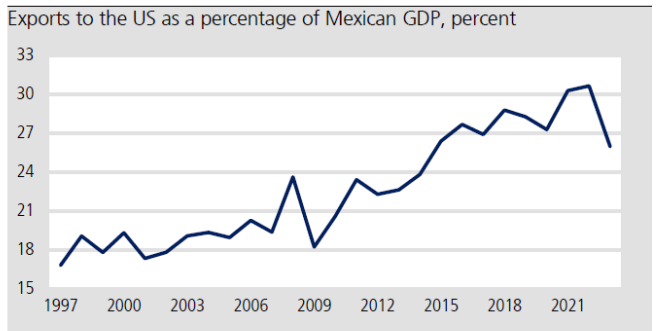
Source: Bloomberg; KGI Research

Figure 5: Exports to the US contribute about 20% of Canadian GDP, so tariffs would be detrimental



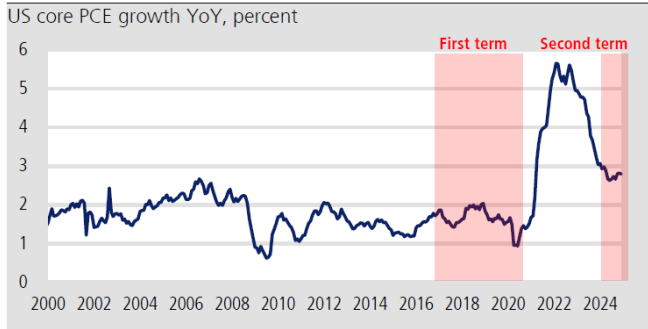
Source: BCA; KGI Research

Figure 6: Exports to the US account for almost 30% of Mexican GDP, so tariffs could be extremely harmful



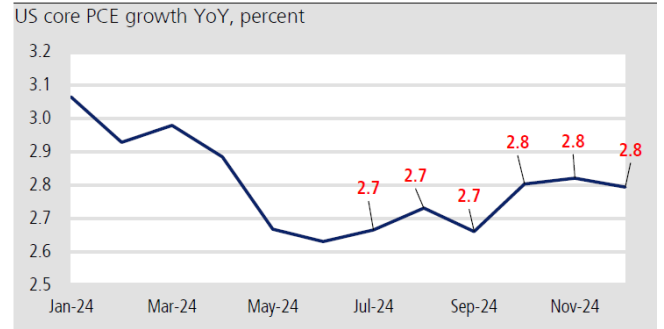
Source: BCA; KGI Research

Figure 7: Current US inflation is very different then during Trump's first term



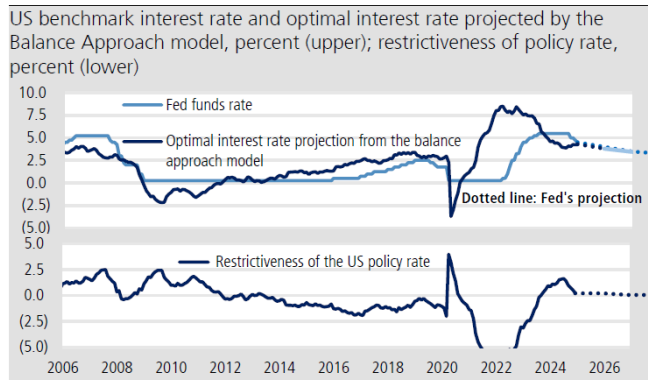
Source: Bloomberg; KGI Research

Figure 8: US inflation has been stagnant for six months



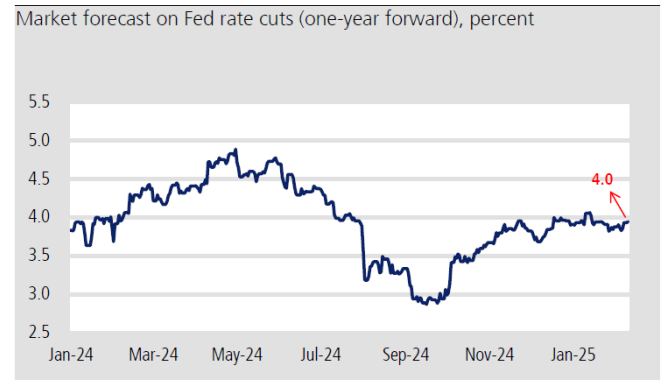
Source: Bloomberg; KGI Research

Figure 9: According to the Balance Approach model, there is room for 25-50bps of Fed rate cuts, but whether or not that will come to pass depends on the US labor market & inflation



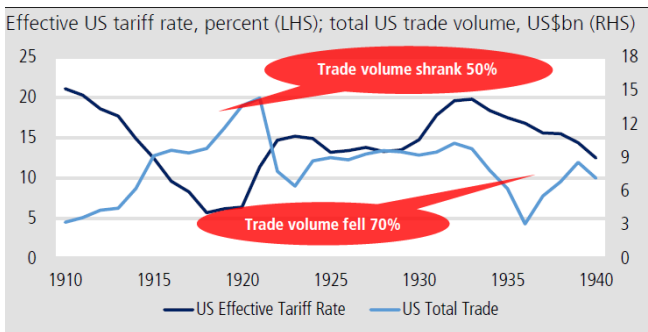
Source: Bloomberg; KGI Research

Figure 10: Consensus set projected policy rate at 4.0%, implying rate cuts of 25-50bps from current level, pending declining employment & inflation in the US



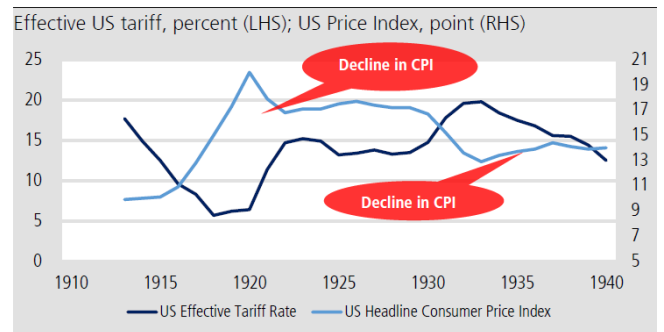
Source: Bloomberg; KGI Research

Figure 11: US trade volumes shrank by 50% & 70%, respectively, when it raised tariffs across the board in the 1920s & 1930s



Source: US International Trade Commission; KGI Research

Figure 12: Broad-based tariffs in the 1920s & 1930s led to a contraction in total demand, which in turn capped product prices



Source: US International Trade Commission; KGI Research

Figure 13: Taiex sub-sector earnings forecasts and 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	25.8	28.7	18.4	13.9	Cement	(50.7)	31.4	(9.8)	10.2	18.6	16.5
Thermal	34.5	20.5	52.3	63.2	28.2	16.2	Food	(13.6)	6.8	20.4	20.9	20.4	16.8
Power supply	15.1	2.4	10.7	21.5	22.9	18.9	Petrochemicals	(63.1)	(50.6)	(39.8)	65.1	41.9	21.7
ABF	102.5	(68.1)	(58.7)	266.3	313.9	14.4	Apparel	32.1	(11.0)	21.9	12.0	20.8	18.5
Optical communication	-	63.4	34.7	30.1	58.4	44.9	Footwear makers	100.0	(45.2)	19.8	12.2	20.6	18.3
IC design and service	94.8	5.3	29.8	21.0	51.6	37.4	Auto parts	52.8	(24.7)	70.0	17.8	15.9	16.0
Networking PCB	56.1	(22.8)	67.7	37.7	18.3	13.3	Industrial automation	5.2	(14.2)	11.7	15.3	37.7	30.6
Networking	77.3	15.2	9.8	26.0	31.6	17.1	Bicycle	(12.7)	(44.8)	(0.8)	28.2	21.1	16.5
CCL	(7.7)	8.2	79.4	24.5	21.8	17.5	Container shipping	19.7	(94.4)	615.6	(46.0)	3.9	7.9
Tier-one foundry	70.4	(17.5)	39.9	32.2	24.5	18.6	Steel	(75.4)	(89.0)	(34.7)	406.8	50.8	N.M.
Second-tier foundries	51.6	(33.3)	(22.3)	(5.7)	18.9	18.9	Tourism	(46.5)	176.4	4.2	12.1	16.3	13.9
Handset components	28.4	(36.7)	38.7	12.1	11.9	12.4	Food	(2.7)	92.7	(3.5)	27.5	18.9	14.3
Telecom	2.6	13.7	0.0	5.6	29.6	28.3	Aerospace	135.4	21.3	6.8	26.2	22.7	16.3
IC design (handset/consumer electronics)	(2.9)	(32.6)	30.1	5.1	19.2	18.0	Airlines	(37.8)	185.5	47.6	(36.8)	9.4	16.1
Handset EMS	(26.5)	4.1	18.7	0.7	13.9	13.8	Heavy electrical	(1.9)	41.4	39.4	21.7	25.4	19.3
Cloud digital	16.3	17.1	15.4	19.6	31.4	24.9	Green energy	56.9	90.1	12.8	65.7	25.9	15.4

Source: KGI Research

Figure 14: Taiex valuation comparison

	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
Taiex	2.11	2.35	2.11	1.76	1.64	1.63	2.28	0.95	17.19	20.48	17.19	15.16	14.99	17.08	21.73	8.80
Taiex excl. TSMC	1.48	1.64	1.48	1.42	1.39	1.47	2.22	0.89	16.43	18.57	16.43	14.87	14.97	16.01	22.71	8.06

Source: TEI, KGI Research

Figure 15: 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 (%)	
								2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F
Stocks which will benefit from Trump policies	Hiwin	2049 TT	Outperform	294.0	3,717	344.5	(14.7)	6.84	8.94	50.4	38.5	3.4	3.2	6.8	8.5	0.9	1.1
	DPI	4572 TT	Outperform	195.0	184	155.0	25.8	7.14	7.81	21.7	19.9	3.1	3.0	14.5	15.4	3.7	4.1
	FE	1519 TT	Outperform	800.0	4,519	516.0	55.0	14.30	22.83	36.1	22.6	18.6	14.2	61.8	78.2	2.1	3.2
	Lotus Pharm	1795 TT	Outperform	600.0	2,241	276.5	117.0	19.04	29.18	14.5	9.5	3.5	2.8	26.2	32.9	2.0	3.2
Bora	6472 TT	Outperform	1045.0	2,707	858.0	21.8	39.84	45.51	21.5	18.9	6.6	4.9	36.3	29.9	1.0	1.0	
High cash yields	CTBC Holding	2891 TT	Outperform	42.0	23,964	40.1	4.9	3.53	3.59	11.3	11.2	1.7	1.4	15.9	14.0	4.6	4.6
	Cathay Holdings	2882 TT	Outperform	80.0	30,645	68.5	16.8	7.60	6.68	9.0	10.3	1.2	1.1	14.6	11.0	4.4	4.4
	Uni-President	1216 TT	Outperform	94.0	13,707	79.1	18.8	3.89	4.70	20.4	16.8	3.5	3.4	17.4	20.3	4.0	4.9
	Asustek	2357 TT	Outperform	810.0	15,064	665.0	21.8	47.81	45.02	13.9	14.8	2.0	1.9	14.5	13.1	5.4	5.1
Alltop	3526 TT	Outperform	350.0	560	285.0	22.8	16.44	20.35	17.3	14.0	6.5	6.5	37.7	47.1	5.7	7.2	
Long-term investors	TSMC	2330 TT	Outperform	1450.0	877,869	1110.0	30.6	45.25	59.84	24.5	18.5	6.8	5.4	30.6	32.7	1.4	1.6
	Alchip	3661 TT	Outperform	3345.0	8,676	3525.0	(5.1)	80.98	83.60	43.5	42.2	7.8	7.1	23.8	17.7	1.1	1.2
	MTK	2454 TT	Outperform	1700.0	73,758	1510.0	12.6	66.92	71.58	22.6	21.1	6.0	5.7	27.7	27.6	4.6	4.5
	ELASER	3450 TT	Outperform	330.0	1,504	338.5	(2.5)	3.66	11.01	92.6	30.8	12.2	10.3	13.6	36.4	0.6	1.8
Accton	2345 TT	Outperform	760.0	13,228	773.0	(1.7)	19.61	25.25	39.4	30.6	15.0	12.5	40.5	44.6	1.7	1.9	

Source: KGI Research

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