

Strategy

Bullish Taiex to persist post-election

Key messages

1. China unlikely to respond aggressively in response to the presidential election.
2. The winning party will ride the AI economic boom after the election.
3. The result of the election will only affect cross-strait and energy policy.

China unlikely to respond aggressively in response to the election

Taiwan's presidential election will be held on January 13. The last opinion polls published on January 3 indicated stable support for the Democratic Progressive Party (DPP, or 'green camp') candidate, Lai-Hsiao, ahead of Hou-Jaw of the Kuomintang (KMT, or 'blue camp') and Ko-Wu of the Taiwan People's Party (TPP or 'white camp'). Votes from undecided voters will play a significant role in the final result, as support for the blue and green parties is almost evenly matched in some of the last polls. The Economist declared Taiwan to be the most dangerous place on Earth (Cover, May 1, 2021 edition), nearly three years ago, drawing attention to the cross-strait situation, in which tensions have steadily been heightened. As a result, investors around the globe are deeply concerned about the presidential election. However, we believe it to be very unlikely that China will launch an invasion of Taiwan as a result of the election, no matter which party wins, as Taiwan has already experienced three transfers of power between ruling parties. In 2000 and 2016, the ruling parties turned from blue to green, and in 2008, from green to blue. Although cross-strait relations were less harmonious, when the DPP won Taiwan's presidency in 2000 and 2016 China did not initiate a war, and only launched military drills to threaten Taiwan. Since Lai (DPP) stands for the continuity of cross-strait policies pursued by President Tsai, Chinese authorities have no reason to use force. In light of the situation created by the Russian invasion of Ukraine, Chinese authorities will have to carefully weigh the costs and benefits of using force against Taiwan.

Winning party will ride the AI economic boom post-election

Taiwan is a hub for the manufacturing of high tech products. During the past three transfers of the presidency between parties, the Taiex was not significantly affected after the elections, but cyclical changes within the tech stock were a key factor. Examples are the NB replacement cycle in 2005-07, the smartphone replacement cycle in 2013-15, the China-US trade war in 2016-2018, and the spike in demand for tech products during the COVID-19 pandemic in 2020-2021. As the AI frenzy has just begun, AI PC and AI smartphone adoption will bear fruit this year or next year. We think that the ruling party will be able to ride the AI economic boom after the election. Benefiting from this AI frenzy, and a recovery in the manufacturing sector, the profitability of Taiex-listed companies will surge by over 20% in 2024-25F. We remain positive that Taiex bullishness will continue, and the index will hit 20,000 points in 4Q24F. However, we should also be wary of seasonal pullback in 2Q-3Q24F, with a possible low point of 16,600 points. We suggest investors buy on dips, if a slump after the election or a pullback emerges.

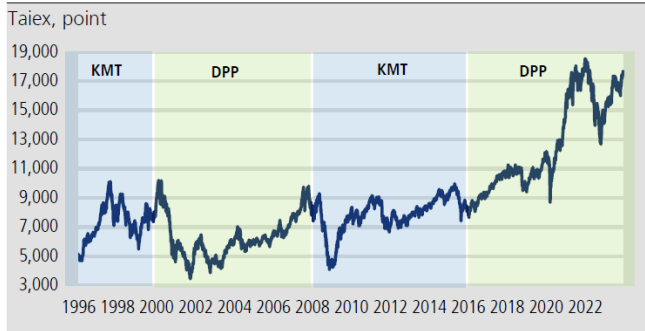
Election results will only affect cross-strait & energy policies

Although long-term tech stock trends will not be affected by the election results, cross-strait and energy policies will be affected. On cross-strait issues, the DPP aims to build national defense, and maintain the status quo in the Taiwan Strait. In terms of energy policy, the party aims for a nuclear-free energy grid. The KMT's cross-Taiwan Strait policy is "opposition to Taiwanese independence and the 'one country, two systems' political formula", while having no objection to nuclear energy. Maintaining Taiwan's self-reliance and peace is the cross-Taiwan Strait policy for the white camp, while the party also believes that Taiwan should not phase out nuclear energy. Therefore, military engineering, green energy, and heavy electrical shares will respond bullishly if the DPP wins the election. Tourism, the hotel industry and aviation will benefit from a KMT win.

Valuation & Action

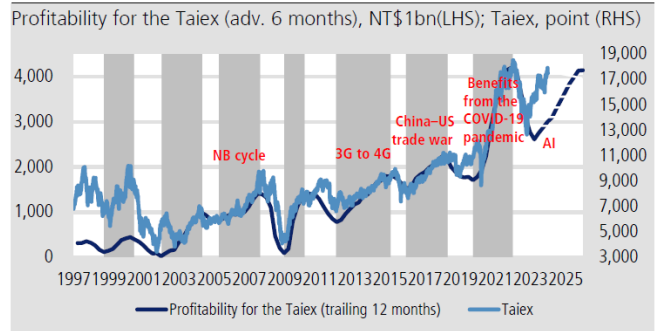
The winning candidate will be able to ride the AI economic boom after the election, which will support stock market bullishness. However, certain sectors will be affected by two opposite cross-strait and energy policies from the green and blue parties. Military engineering, green energy, and heavy electrical stocks may see a bullish trend if the DPP wins the election. Tourism, the hotel industry and aviation will benefit if the KMT wins.

Figure 1: Taiex not impacted by transfers of power



Source: TEJ; KGI Research

Figure 2: Tech cyclical trends the key factor for the Taiex



Note: Shaded areas are earnings upward revision cycles
Source: TEJ; KGI Research

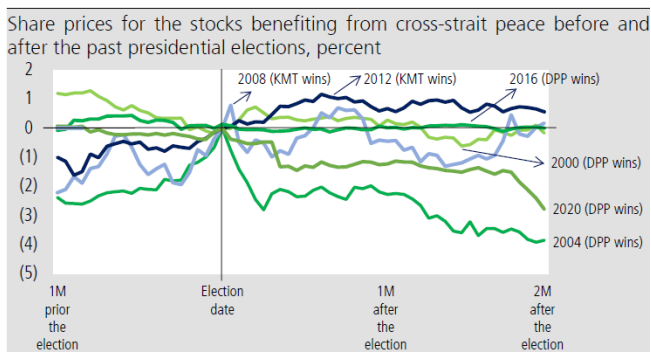
Figure 3: We remain positive that Taiex bullishness will continue; reason to be wary of seasonal pullback in 2Q-3Q24F

2024F Taiex movements and positive/negative factors

	1Q24	2Q24	3Q24	4Q24
Index movement	➔	➔ ➔	➔ ➔ ➔	➔
Positives	<ul style="list-style-type: none"> (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 	<ul style="list-style-type: none"> (1) Nvidia introduces the new server chip (2) China new Android handsets launch (3) European and US CBs to commence interest rate cuts sequentially 	<ul style="list-style-type: none"> (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 	<ul style="list-style-type: none"> (1) AI PC ramp up (2) Market's expectation of PC replacement in the following year (3) Seasonal accounting effect
Negatives	<ul style="list-style-type: none"> (1) Results from the Taiwan presidential elections affect cross-strait relations (2) 2023 annual report check (3) BOJ ending its negative interest rate policy 	<ul style="list-style-type: none"> (1) End demand enters slow season (2) Post-pandemic Revenge Spending Cools Down (3) Moody's updates credit rating for US debts (4) 1Q24 results check (May 15) 	<ul style="list-style-type: none"> (1) 2Q23 corporate results check (August 14) (2) Cash dividend evaporation index 	<ul style="list-style-type: none"> (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

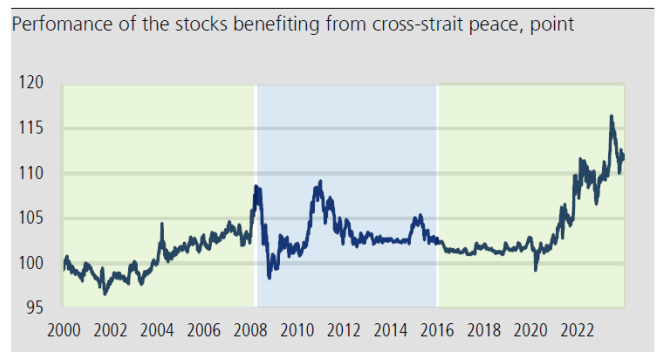
Source: KGI Research

Figure 4: Cross-strait peace confidence will be bolstered if KMT wins the election



Source: TEJ; KGI Research

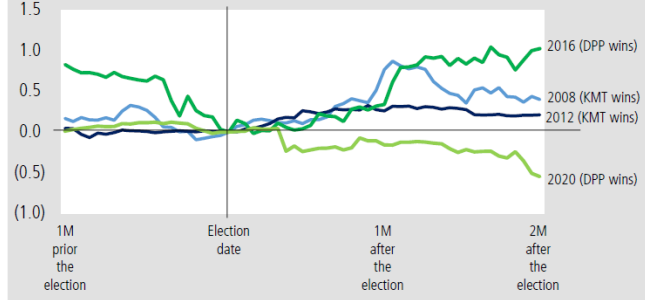
Figure 5: Tourism, hospitality, aviation stocks hinge on profitability



Source: TEJ; KGI Research

Figure 6: Geopolitically dependant stocks will be boosted if DPP wins the election

Share prices for the stocks which benefit from geopolitical issues before and after the past presidential elections, percent



Source: TEJ; KGI Research

Figure 7: DPP policy beneficiaries' performance hinges on profitability

Performance of geopolitical-benefited stocks, point



Source: TEJ; KGI Research

Figure 8: The result of the Taiwan presidential election will determine cross-strait and energy policies

Campaign policies	DPP (Lai-Hsiao)	KMT (Hou-Jaw)	TPP (Ko-Wu)
Cross-strait policy	Strengthen national defense and maintain the cross-strait status quo	Opposition to Taiwanese independence and the "one country, two systems" political formula	Maintain Taiwan's self-reliance and cross-strait peace
Energy policy	Materialize a non-nuclear homeland and actively develop renewable energy	No objection to nuclear energy	No objection to nuclear energy
Industry policy	Develop semiconductor, AI, military engineering, security control, and communication	Actively participate in global regional integration and renegotiate ECFA	Strive to join regional organizations such as the RCEP

Source: KGI Research

Figure 9: 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	1.76	1.96	1.76	1.70	1.60	1.61	2.28	0.95	16.87	20.17	16.87	14.92	14.85	17.11	21.73	8.80
Taiex excl. TSMC	1.44	1.61	1.44	1.39	1.38	1.46	2.22	0.89	17.74	20.81	17.74	14.53	14.80	15.98	22.71	8.06

Source: KGI Research and KGI estimates

Figure 11: 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
Beneficiaries if the DPP wins	DPI	4572 TT	Outperform	230.0	210	166.50	38.1	7.10	7.66	23.5	21.7	3.1	2.7	13.9	13.3	2.1	2.3
	EGAT	2645 TT	Outperform	157.0	1,276	105.50	48.8	5.00	5.23	21.1	20.2	3.6	3.6	17.0	17.7	4.5	4.7
	Shinfox Energy	6806 TT	Outperform	137.0	726	104.00	31.7	2.26	7.60	46.0	13.7	2.1	1.8	4.6	14.3	1.0	3.4
	HDRE	6873 TT	Outperform	162.0	418	129.50	25.1	7.10	11.72	18.2	11.1	2.4	2.1	16.1	20.8	3.1	4.6
	FE	1519 TT	Outperform	500.0	2,896	343.50	45.6	8.48	14.25	40.5	24.1	15.8	11.4	45.0	54.9	1.7	2.9
	SEEC	1503 TT	Outperform	163.0	1,993	118.50	37.6	4.60	6.52	25.8	18.2	1.9	1.8	7.9	10.2	1.9	2.8
Beneficiaries if the KMT wins	FDC	2748 TT	Outperform	93.0	292	85.50	8.8	2.95	4.67	29.0	18.3	4.2	4.0	14.7	22.5	2.7	4.4
	My Humble House	2739 TT	Outperform	68.0	188	63.50	7.1	4.26	3.78	14.9	16.8	5.8	4.3	47.9	29.3	0.0	0.0
	Wowprime	2727 TT	Outperform	416.0	712	261.00	59.4	18.40	19.82	14.2	13.2	6.7	6.5	44.3	49.3	5.9	6.7
	EVAAIR	2618 TT	Outperform	38.0	5,676	32.55	16.7	4.33	3.69	7.5	8.8	1.8	1.6	24.8	18.9	6.7	5.7

Source: KGI Research and KGI estimates

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