

## Strategy

### DPP wins presidency; Taixex to stay strong on AI trend

#### Key messages

1. Defense, green energy and heavy electrical stocks to rally after the DPP won the presidential election.
2. Tourism, hotels, airlines and ECFA beneficiaries may fall victim to sell-offs by disappointed investors.
3. Taixex will continue to benefit from AI proliferation regardless of the DPP's victory in the presidential election.

#### Defense, green energy and heavy electrical sectors to rally after Lai win

Taiwan's presidential and legislative elections on January 13 concluded with the Democratic Progressive Party's (DPP) William Lai elected as president, while the Kuomintang (KMT) took the most seats in the parliament, and the Taiwan People's Party (TPP) secured its position as the critical minority in the legislature. The cross-strait policy of the DPP has been to "strengthen national defense while maintaining the status quo". By winning a third consecutive presidential term, we believe the DPP will be able to maintain its policy of building military aircraft and vessels in-house, boding well for defense and aerospace stocks. Also, as the DPP remains committed to a nuclear-free homeland policy, we think it will continue to provide policy support to the green energy and heavy electrical equipment industries. That said, with the DPP losing its majority in the legislature, it will be more difficult for the new president to pass laws and implement his policies. Mr. Lai may have to include members of the opposition parties or independents when appointing ministers and other high-ranked officials, to show that he is willing and able to work across party lines to achieve his legislative goals.

#### Tourism stocks, hotels, airlines and ECFA beneficiaries to come under pressure

In his first international press conference following his electoral victory on January 13, the president-elect said he intends to continue the cross-strait policies of the current administration, and will strive to maintain peace and stability in the region. He made it clear that he hopes to engage in exchanges and cooperation with China, but that has to be carried out on the premises of parity and dignity, meaning that both sides should treat each other as equals, and with respect. In our view, while Mr. Lai vows to develop cross-strait relations based on the foundation of the current administration, there has been a lack of trust between the DPP and the Chinese government. Against such a backdrop, cross-strait relations are more likely to remain chilled, rather than warm, in the coming four years. If China continues its propaganda and military threats, and endeavors to further squeeze Taiwan's space in the international community, chances are that cross-strait relations will only deteriorate further. The tourism and hospitality sectors, including hotels and airlines, are vulnerable to impacts from poor cross-strait relations. Also, beneficiaries of the Early Harvest List of the Cross-Strait Economic Cooperation Framework Agreement (ECFA), such as the petrochemical, textile, machine tool, and auto parts sectors, may be negatively affected if Beijing decides to revoke tariff concessions.

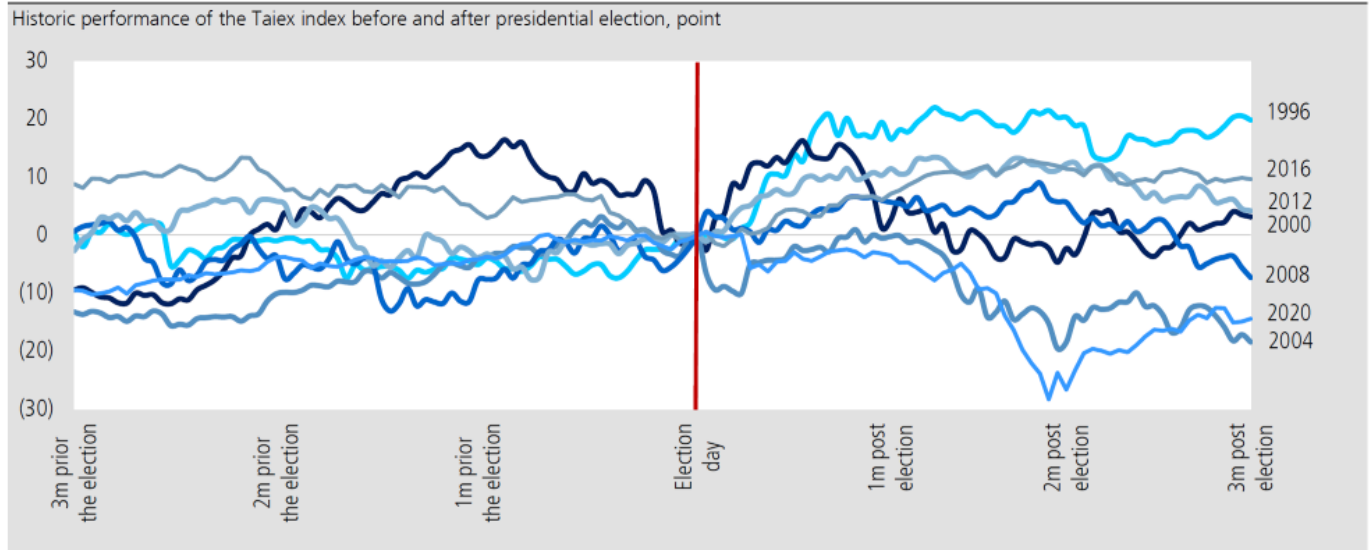
#### Taixex will stay strong on AI proliferation

Taiwan has undergone multiple transitions between parties in government, and while the cross-strait relations tend to worsen when the DPP is in power, the actual impact of cross-strait tensions on Taiwan's foreign direct investment (FDI) has been limited. We attribute this resilience to Taiwan's well-rounded semiconductor supply chain, and leading position in tech product manufacturing. During the past eight years, when the DPP was the ruling party, FDI to Taiwan increased, indicating that Taiwan's strength in semiconductor manufacturing outweighs geopolitical concerns, from the perspective of investors. In the coming four years, the odds of the cross-strait relations changing for the better seem low, but the proliferation of AI applications won't materialize without the support of advanced foundries and AI server supply chains in Taiwan. As such, we remain upbeat about Taiwan's FDI outlook. The AI bandwagon will continue to provide structural, and long-term growth momentum to the Taixex, which we estimate will see earnings grow about 20% YoY in 2024-25F, thanks to increasing AI proliferation and a recovery in the manufacturing sector. We believe the Taixex will continue to advance, and if the index pulls back sharply after the presidential election, or in mid-2024, it will be a golden opportunity for investors to engage. We estimate the Taixex may rise to a high of 20,000 in 4Q24F, although seasonal pullbacks to as low as 16,600 are possible in 2Q-3Q24F.

#### Valuation & Action

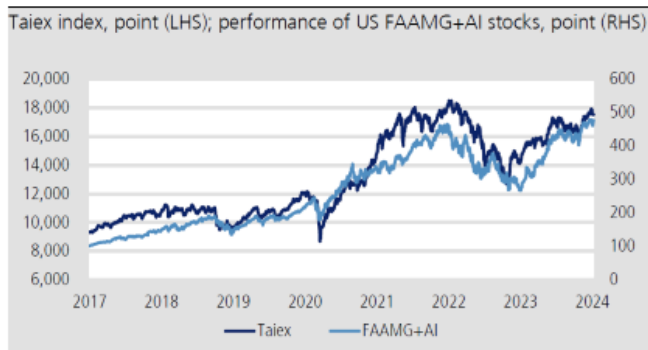
We expect defense, green energy, and heavy electrical stocks to rally after the DPP won the presidential election. On the other hand, tourism, hotels, airlines and ECFA beneficiaries may fall victim to sell-offs by disappointed investors. If the Taixex plunges as a result of post-election geopolitical risks, we believe investors should take the opportunity to engage, in order to benefit from future rallies driven by the AI megatrend.

**Figure 1: Historically, there's a 70% chance that the Taiex will rise one month after Taiwan's presidential election**



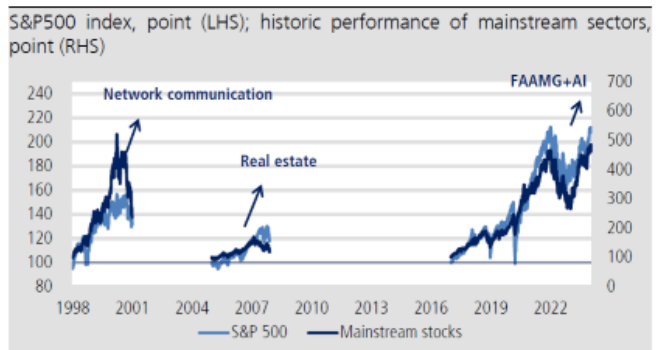
Note: We use previous presidential election dates as the base of zero  
Source: Bloomberg; KGI Research

**Figure 2: Taiex will remain in an uptrend on AI proliferation**



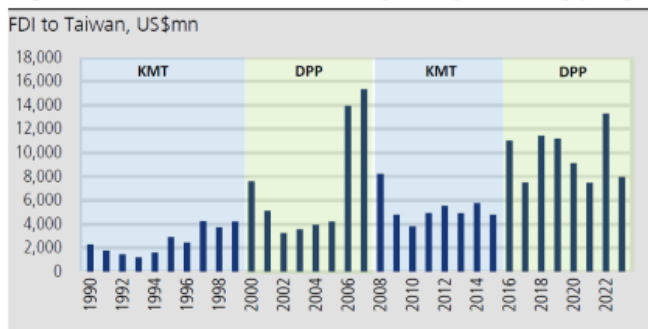
Note: Performance of US FAAMG+AI stocks include Apple, Microsoft, Google, Amazon, Meta, Nvidia and AMD on a weighted basis  
Source: Bloomberg; KGI Research

**Figure 3: Stock markets to advance on AI proliferation**



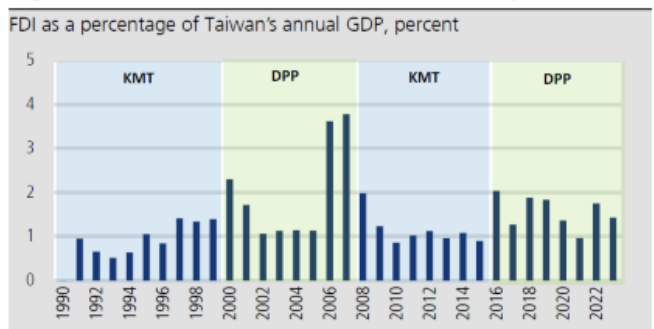
Note: Internet was the mainstream sector in 2000, followed by property in 2007 and FAAMG+AI in 2024.  
Source: Bloomberg; KGI Research

**Figure 4: Taiwan's FDI unaffected by change in ruling party**



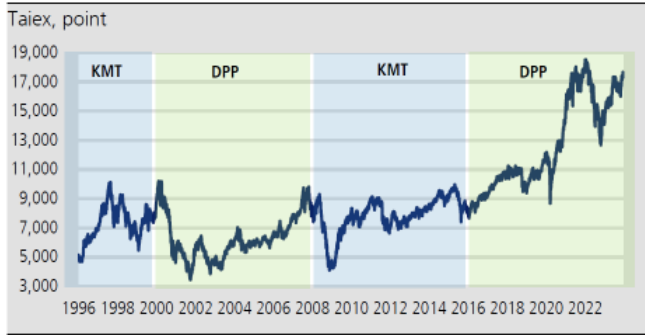
Note: Data as of January-September, 2023  
Source: Ministry of Economic Affairs; KGI Research

**Figure 5: FDI to Taiwan has been on the rise in past 2 terms**



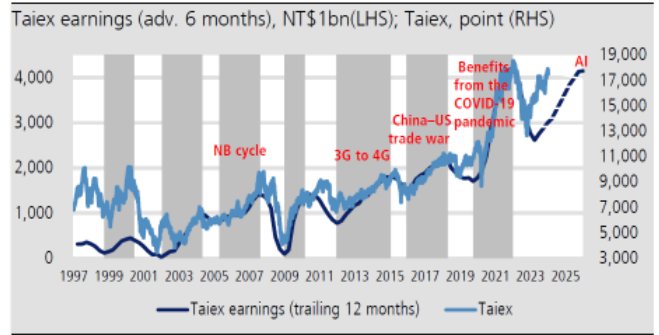
Note: Data as of January-September, 2023  
Source: Ministry of Economic Affairs; KGI Research

**Figure 6: Taiex not impacted by transfers of power**



Source: TEJ; KGI Research

**Figure 7: Tech cyclical trends the key factor for the Taiex**



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

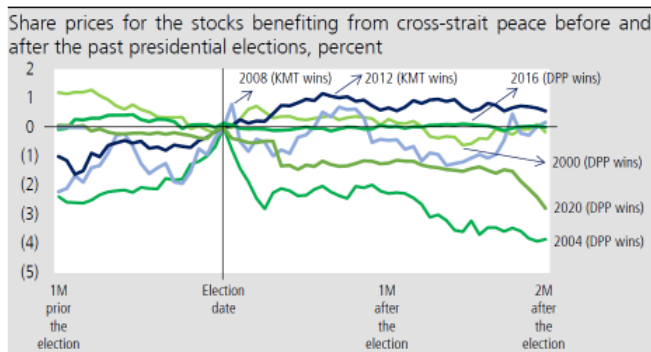
**Figure 8: We remain positive that Taiex bullishness will continue; reason to be wary of seasonal pullback in 2Q-3Q24F**

2024F Taiex movements and positive/negative factors

	1Q24	2Q24	3Q24	4Q24
<b>Index movement</b>	➔	➔ ➔	➔ ➔ ➔	➔
<b>Positives</b>	(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
<b>Negatives</b>	(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 Revenge 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)
<b>Peak/trough</b>	18,000/17,000	17,600/17,000	17,500/16,600	20,000/17,400
<b>End-quarter closing point</b>	17,400	17,100	17,400	19,800

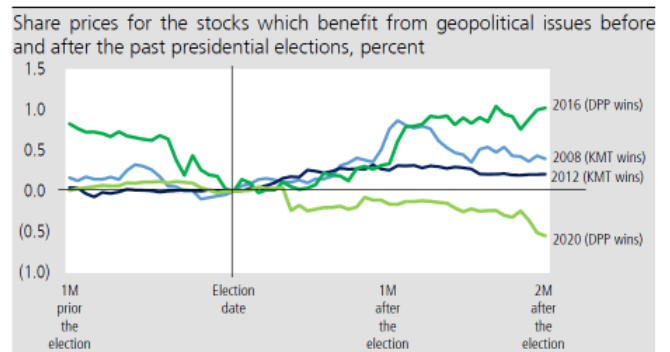
Source: KGI Research

**Figure 9: Tourism related stocks may see sell-offs**



Source: TEJ; KGI Research

**Figure 10: Geopolitically dependant stocks will be boosted**



Source: TEJ; KGI Research

**Figure 11: 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	1.75	1.95	1.75	1.70	1.60	1.61	2.28	0.95		16.82	20.10	16.82	14.93	14.85	17.11	21.73	8.80
Taiex exd.	1.44	1.61	1.44	1.39	1.38	1.46	2.22	0.89		17.65	20.70	17.65	14.54	14.80	15.98	22.71	8.06
TSMC																	

Source: KGI Research and KGI estimates

**Figure 12: Current forward PB of Taixex at 1.75x**


Source: TEJ; KGI Research

**Figure 13: Current forward PE of Taixex at 16.8x**


Source: TEJ; KGI Research

**Figure 14: Our top picks**

	Company	Code	Investment rating	Target price (NTS)	Mkt cap (US\$mn)	Share price (NTS)	Change +/- (%)	EPS (NTS)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)	
								2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
Beneficiaries by the DPP policy	DPI	4572 TT	Outperform	230.0	199	158.50	45.1	7.10	7.66	22.3	20.7	2.9	2.6	13.9	13.3	2.2	2.4
	EGAT	2645 TT	Outperform	157.0	1,260	104.50	50.2	5.00	5.23	20.9	20.0	3.6	3.5	17.0	17.7	4.5	4.7
	Shinfox Energy	6806 TT	Outperform	137.0	720	103.50	32.4	2.26	7.60	45.8	13.6	2.1	1.8	4.6	14.3	1.0	3.4
	HDRE	6873 TT	Outperform	162.0	420	130.50	24.1	7.10	11.72	18.4	11.1	2.4	2.2	16.1	20.8	3.1	4.6
	FE	1519 TT	Outperform	500.0	3,110	370.00	35.1	8.48	14.25	43.7	26.0	17.0	12.3	45.0	54.9	1.6	2.7
	SEEC	1503 TT	Outperform	163.0	1,962	117.00	39.3	4.60	6.52	25.5	18.0	1.9	1.8	7.9	10.2	2.0	2.8
AI supply chain	QCI	2382 TT	Outperform	310.0	28,727	231.00	34.2	10.13	13.43	22.8	17.2	5.0	4.8	22.6	28.4	3.5	4.6
	Inventec	2356 TT	Outperform	53.0	5,902	51.10	3.7	1.57	2.42	32.6	21.1	3.0	2.9	9.4	14.1	2.5	3.8
	EMC	2383 TT	Outperform	550.0	4,215	381.50	44.2	16.88	23.07	22.6	16.5	5.2	4.5	24.1	29.3	2.5	3.4
	AURAS	3324 TT	Outperform	445.0	959	333.00	33.6	15.86	21.09	21.0	15.8	4.7	4.0	23.0	26.6	2.1	2.7
	LuxNet	4979 TT	Outperform	210.0	685	151.00	39.1	3.51	10.47	43.0	14.4	11.5	6.4	30.9	57.0	0.3	0.3
	Parade	4966 TT	Outperform	1250.0	2,942	1125.00	11.1	25.42	49.87	44.3	22.6	4.5	3.8	10.5	17.9	1.1	2.2
	Faraday	3035 TT	Outperform	445.0	3,373	421.50	5.6	6.37	12.65	66.1	33.3	11.3	9.0	17.7	30.1	0.8	1.5

Source: KGI Research and KGI estimates

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