

Strategy

Potential for downturn passes; consolidation to offer opportunities for increasing stock exposure

Key message

1. Stock markets tend to rally during US Fed rate cut cycles, provided that the US economy is not in a recession.
2. The Taixex will stage a solid rebound when uncertainty surrounding the US presidential election is resolved.
3. We recommend sectors like the AI and iPhone supply chains, gaming, e-paper, foldable handsets, financials and high-yield stocks.

Taixex has survived multiple uncertainties

Despite a myriad of uncertainties over the past month, including August data on the US labor market, the launch of the iPhone 16 series, the US presidential debate and the September FOMC meeting, the Taixex has navigated against all headwinds. With the US Federal Reserve (Fed) announcing a rate cut of 50bps at the September FOMC meeting, as a remedial adjustment for a 25bps cut which should have happened in July, market concerns about an economic recession have dissipated significantly, boding well for the Taixex. Since the 1990s, whenever the Fed cuts interest rates by 50bps or above in one go, the US economy is usually in, or on the brink of a recession.

Stock markets tend to rally on Fed rate cut cycles, absent an economic recession

We look back on the performance of financial markets during the nine Fed rate cut cycles since the 1970s, and notice that stock performances are a mixed bag. However, when we take into consideration whether the economy is undergoing a recession or not, we find a very different picture. Put simply, rate cuts are favorable to stock markets when the economy is not in a recession, with stock returns averaging 1% one month after the first rate cut of a rate cut cycle, followed by average returns of 4%, 7% and 12%, respectively, two months, three months, and six months after the cut. However, during economic recessions, rate cuts correlate negatively for stocks, with average returns arriving at 1%, 0%, -6% and -7%, respectively, over the same periods. This means stock performance is eventually determined by economic fundamentals. The question investors should ask now is whether the present rate cut cycle will happen during or absent an economic recession. Based on the latest readings of multiple indicators, we think the odds of a recession-free rate cut cycle are higher, which means the Taixex is more likely to advance in the coming six months. That said, as uncertainty surrounding the US labor market and presidential election continues, we expect the Taixex to consolidate in the near future.

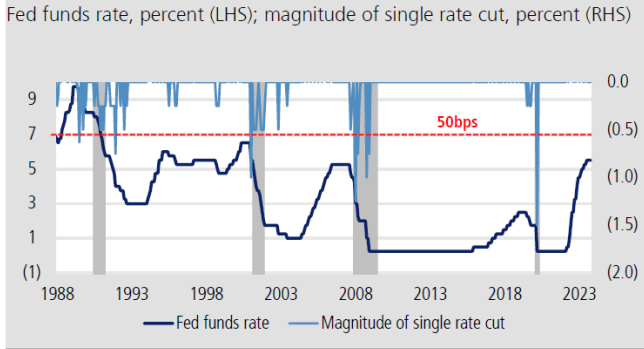
Taixex to stage a solid rebound once the US presidential election is over

In our view, the US presidential election is the final challenge facing the Taixex in 2024, as the result of the election will decide long-term trade policies in the US. We also look at data compiled since the 1970s, and find that stock markets tend to be extremely volatile 2-3 months before a presidential election takes place, which is often followed by a rebound after the election. Based on past patterns and a neck-and-neck competition between Trump and Harris, we do not expect the Taixex to rebound substantially before the election is over. Nevertheless, we suggest long-term investors engage during the pre-election consolidation. In our scenario analysis, we conclude that the Taixex will gain on solid fundamentals regardless of who prevails in the election. However, a meltdown of the Taixex could transpire if Trump causes political turmoil after losing the election.

Valuation & Action

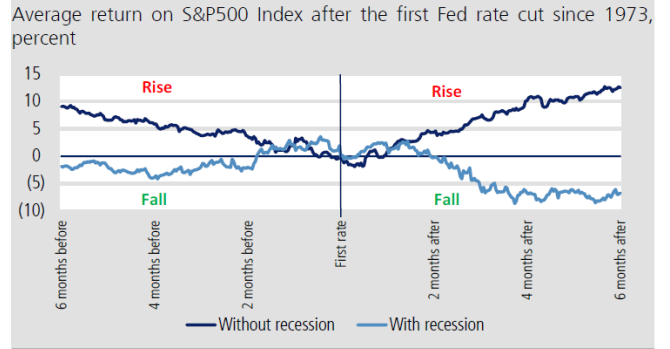
The Taixex has survived multiple uncertainties over the past month, and the only major headwind facing the market is the US presidential election. We believe the potential for a downturn has passed, although the Taixex will only rebound substantially after the final major uncertainty is resolved. Long-term investors are advised to accumulate stocks during pre-election consolidation, and we recommend sectors such as the AI and iPhone supply chains, gaming, e-paper, foldable handsets, financials and high-yield stocks.

Figure 1: Historically, when the Fed cuts interest rates by at least 50bps in one go, the US economy is usually in, or on the brink of, a recession



Note: Shaded areas indicate US economic recessions
Source: Bloomberg; KGI Research

Figure 2: Rate cuts without an economic recession tend to benefit stock markets over the long run



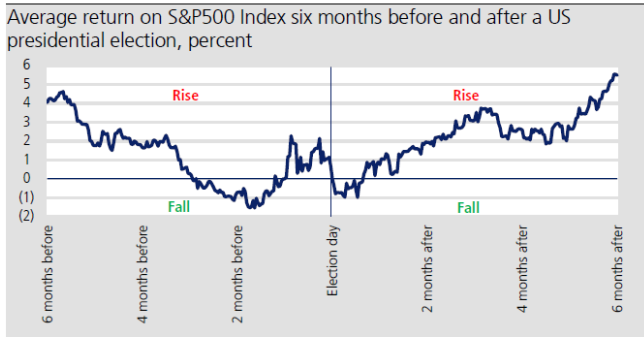
Source: Bloomberg; KGI Research

Figure 3: Changes in bond & stock markets after the first Fed rate cut of a rate cut cycle

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	1M after	2M after	3M after	6M after
Average gain "without" economic recession	1%	4%	7%	12%	-25	-25	-22	-32
Average gain "with" economic recession	1%	0%	-6%	-7%	-7	-5	29	-30

Note: By "without recession" we mean the US economy did not enter a recession within six months after a first rate cut announcement by the Fed
Source: Bloomberg; KGI Research

Figure 4: Stock markets tend to be volatile 2-3 months before a US presidential election



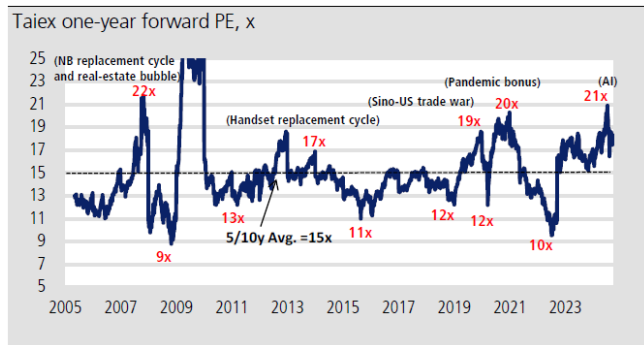
Source: Bloomberg; KGI Research

Figure 5: Scenario analysis for 2024 US presidential election

Possible scenarios	Implication	Taiex performance
Scenario 1: Trump wins	Global trade to be hurt by higher tariffs	Fall before rising
Scenario 2: Trump loses but refuses to concede	Political turmoil or even a civil war	Major fall
Scenario 3: Harris wins	Continuation of existing economic and trade policies	Rise

Source: Bloomberg; KGI Research

Figure 6: Taiex is valued at 18x PE, above long-term average of 15x PE



Source: TEJ; KGI Research

Figure 7: Taiex valuation & corresponding index level

2024-25F average PE (x)	Equivalent index level (point)	25F PE (x)	Equivalent index level (point)
15x	17,777	15x	19,198
16x	18,962	16x	20,478
17x	20,147	17x	21,758
18x	21,332	18x	23,038
19x	22,518	19x	24,318
20x	23,703	20x	25,598
21x	24,888	21x	26,878

Source: TEJ; KGI Research

Figure 8: 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	2.05	2.17	2.01	1.73	1.62	1.62	2.28	0.95	18.29	20.22	17.22	15.17	14.99	17.11	21.73	8.80
Taiex excl. TSMC	1.50	1.59	1.47	1.40	1.39	1.46	2.22	0.89	17.10	18.94	16.54	14.82	14.95	16.02	22.71	8.06

Source: KGI Research

Figure 9: 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 (%)		
							2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2023	2024F	2025F
TSMC	2330 TT	Outperform	1290.0	777,739	960.0	34.4	41.67	51.73	23.0	18.6	5.9	4.8	28.1	28.6	1.4	1.7	1.9
Hon Hai	2317 TT	Outperform	265.0	76,592	176.5	50.1	11.25	15.26	15.7	11.6	1.6	1.5	10.2	13.1	3.1	3.4	4.6
Kaori	8996 TT	Outperform	460.0	1,143	402.0	14.4	7.60	15.99	52.9	25.1	13.0	9.4	25.0	43.6	1.0	1.0	2.1
DELTA	2308 TT	Outperform	528.0	31,769	391.5	34.9	15.27	19.54	25.6	20.0	4.4	3.9	18.5	20.6	1.6	1.9	2.5
Largan	3008 TT	Outperform	3880.0	10,862	2605.0	48.9	185.77	194.02	14.0	13.4	1.9	1.7	14.2	13.5	2.6	3.6	3.7
COMPEQ MANUFACT	2313 TT	Outperform	97.0	2,644	71.0	36.6	5.47	6.98	13.0	10.2	2.0	1.8	15.8	18.3	2.1	3.1	3.9
VPEC	2455 TT	Outperform	220.0	826	143.0	53.8	4.15	5.80	34.5	24.6	7.7	6.9	23.6	29.5	1.5	2.4	3.4
MSI	2377 TT	Outperform	212.0	4,526	171.5	23.6	12.46	15.80	13.8	10.9	2.7	2.4	20.2	23.5	3.1	4.4	5.6
Asustek	2357 TT	Outperform	665.0	13,203	569.0	16.9	41.48	41.58	13.7	13.7	1.7	1.6	12.6	12.2	3.0	5.5	5.5
EIH	8069 TT	Outperform	335.0	10,735	300.0	11.7	7.97	11.94	37.7	25.1	6.6	6.1	18.1	25.2	1.7	1.7	2.6
Fositek	6805 TT	Outperform	1000.0	1,739	812.0	23.2	18.96	35.60	42.8	22.8	10.7	8.8	26.6	42.4	1.3	1.3	2.4
E.S.F.H	2884 TT	Outperform	30.0	13,917	27.9	7.7	1.55	1.66	18.0	16.7	1.8	1.6	10.1	10.0	3.9	3.9	4.3
SMP	6121 TT	Outperform	460.0	2,046	354.0	29.9	28.77	32.61	12.3	10.9	1.8	1.7	15.2	16.5	5.8	5.8	6.5
Chicony	2385 TT	Outperform	202.0	3,918	165.0	22.4	13.16	13.79	12.5	12.0	2.9	2.6	23.4	22.5	5.6	5.6	5.9

Source: KGI Research

All the above named KGI analyst(s) is SFC licensed person accredited to KGI Asia Ltd to carry on the relevant regulated activities. Each of them and/or his/her associate(s) does not have any financial interest in the respectively covered stock, issuer and/or new listing applicant.

Disclaimer

All the information contained in this report is not intended for use by persons or entities located in or residing in jurisdictions which restrict the distribution of this information by KGI Asia Limited ("KGI") or an affiliate of KGI. Such information shall not constitute investment advice, or an offer to sell, or an invitation, solicitation or recommendation to subscribe for or invest in any securities or investment products or services nor a distribution of information for any such purpose in any jurisdiction. In particular, the information herein is not for distribution and does not constitute an offer to sell or the solicitation of any offer to buy any securities in the United States of America, or to or for the benefit of United States persons (being residents of the United States of America or partnerships or corporations organised under the laws of the United States of America or any state, territory or possession thereof). All the information contained in this report is for general information and reference purpose only without taking into account of any particular investor's objectives, financial situation or needs. Such information is not intended to provide professional advice and should not be relied upon in that regard.

Some of KGI equity research and earnings estimates are available electronically on www.kgi.com.hk. Please contact your KGI representative for information. The information and opinions in this report are those of KGI internal research activity. KGI does not make any representation or warranty, express or implied, as to the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. The information and opinions contained in this report are subject to change without any notice. No person accepts any liability whatsoever for any loss however arising from any use of this report or its contents. This report is not to be construed as an invitation or offer to buy or sell securities and/or to participate in any investment activity. This report is being supplied solely for informational purposes and may not be redistributed, reproduced or published (in whole or in part) by any means for any purpose without the prior written consent of KGI. Members of the KGI group and their affiliates may provide services to any companies and affiliates of such companies mentioned herein. Members of the KGI group, their affiliates and their directors, officers and employees may from time to time have a position in any securities mentioned herein.