Strategy

Bull run to continue; watch for undervalued stocks

Key messages

1. Taiex to hit new highs in 1Q24F and challenge 20,000 points by end-2024F. We recommend investors be wary of greater volatility around the 19,000-point level.

2. Rate-cut effect, AI frenzy and FINI re-engagement to underpin Taiex uptrend.

3. Top picks: (1) cheap AI stocks; and (2) stocks with troughing fundamentals and valuations below five-year average.

Don't leave the party too early

The Taiex has been hitting new highs since the CNY holiday ended. While faced with profit-taking pressure near term, we expect the index to again breach historial highs before the end of 1Q24F and challenge 20,000 points by the end of the year. However, we recommend investors tread carefully around the 19,000-point level, when greater volatility or a market correction could emerge.

Fed to cut rates within six months, boosting fund-spurred risk appetite

Historically, stock and bond markets have always risen during the six months before a Fed rate-cut cycle starts, on expectations of a fund-driven rally. Although the timing of the Fed starting to lower rates this year will be affected by inflation, it is bound to do so within the next six months. We predict the first rate reduction will be before June, weakening the US dollar and strengthening FINI willingness to invest in the Taiex. Looking at stock and bond performance during the six months before the six rate-cut cycles since the 1980s, we note that the probability of a positive return on stocks in the one, three and six months before the first rate reduction was a respective 100%, 67% and 67%, versus a 100% probability if the systemic risks in 1998 and 2001 are excluded (the first one triggered by the crash of Long Term Capital Management, and the second by the dotcom bubble burst). For 10-year Treasury bonds, the probability of a positive return was 100% across the said periods.

The higher Nvidia's shares go, the lower its PE, hinting at explosive earnings of AI shares

Despite the surge in Nvidia (US) shares since last May, when the company announced stronger-than-expected results, projected PE has been falling, as consensus 12-month forward EPS has soared from US$5 to over US$20. This means robust demand for generative AI has sparked a 'buy first, win first' sentiment among Big Tech, putting earnings of AI-related hardware suppliers, led by Nvidia, at the explosive growth stage. Last May, when Nvidia's shares first started to jump, they traded at a forward PE of 63x, versus the current 32x, which is still well below the levels seen before any previous market crash. US mainstream benchmark shares have typically traded near a forward PE of 100x amid a robust bull run, such as Polaroid, a Nifty Fifty stock in the 1970s, and Cisco in the 2000 internet era, of which PEs were a respective 95x and 100x at the time. Recently, we have seen generative AI usher in more killer models and apps, such as OpenAI's (US) Sora, which can model words into images for a maximum of one minute, and Samsung's (KR) S24 handset, which offers instant text translation, meaning generative AI apps are increasingly having an impact on daily lives and being monetized.

Taiex boasts cheapest AI shares globally, will attract FINIs to re-engage

Taiwan has a monopoly in the global advanced AI chip market and enjoys an over 90% market share in AI server production worldwide. Persistent bullishness on Nvidia and FAAMG, the global benchmark of AI stocks, will benefit Taiwan's AI supply chains across the board, where valuations are 20x or below, well below Nvidia's 32x and Supermicro's (US) 36x. Cheap stocks like these will attract FINIs to re-engage the Taiex.

Valuation & Action

We expect the Taiex will continue to hit new highs in 1Q24F and potentially breach the 20,000-point mark by the end of the year. However, we recommend investors be wary of greater volatility around the 19,000-point level and target: (1) cheap AI stocks; and (2) stocks with troughing fundamentals and valuations below the five-year average. Our top picks are: TSMC (2330 TT, NT$681, OP), Quanta (2382 TT, NT$236, OP), Wistron (3231 TT, NT$118.5, OP), Compeq (2313 TT, NT$72.9, OP), Auras (3324 TT, NT$445, OP), Gold Circuit (2368 TT, NT$259.5, OP), Elite Materials (2383 TT, NT$492.5, OP), Winbond (2344 TT, NT$27.7, OP), Luxnet (4979 TT, NT$164.5, OP), Win Semiconductors (3105 TT, NT$161, OP), Makalot (1477 TT, NT$374.5, OP), Hiwin (2049 TT, NT$258, OP), Waffer Technology (6235 TT, NT$107.5, OP), and Merida (9914 TT, NT$194.5, OP).

Figure 1: Stocks & bonds always rise during the six months before the first rate cut

Stock and bond market changes before first Fed rate cut

First rate-cut date	S&P 500 return (%)			10-year Treasury yield change (%)			Background
	1 month before	3 months before	6 months before	1 month before	3 months before	6 months before	
1989/6/5	4.7%	9.6%	15.8%	-0.64	-0.89	-0.62	
1995/7/6	3.4%	9.4%	20.3%	-0.05	-1.07	-1.83	
1998/9/29	2.1%	-8.7%	-6.3%	-0.50	-0.87	-0.98	Crash of Long Term Capital Management
2001/1/3	1.7%	-6.2%	-8.9%	-0.39	-0.69	-0.84	Dotcom bubble burst
2007/9/18	5.1%	0.5%	5.9%	-0.21	-0.66	-0.11	
2019/7/31	0.5%	2.2%	10.1%	-0.01	-0.53	-0.67	
Probability of rise	100%	67%	67%	100%	100%	100%	

Source: Bloomberg; KGI Research

Figure 2: FINI more willing to re-engage Taiex as US dollar weakens

US dollar index (inverted), points (LHS); FINI net buy/ sell of Taiex, US$bn (RHS)
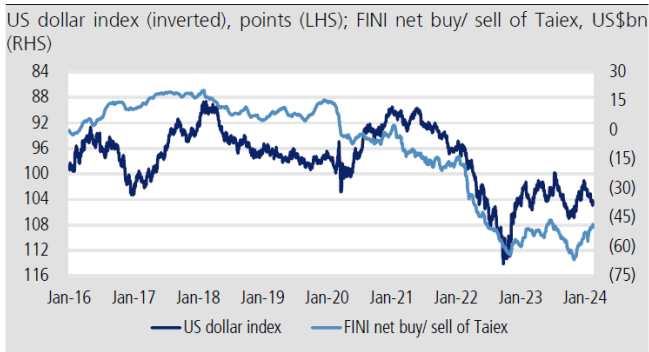
Source: Bloomberg; KGI Research

Figure 3: FINI started restocking Taiex & Kospi shares aggressively in 4Q23
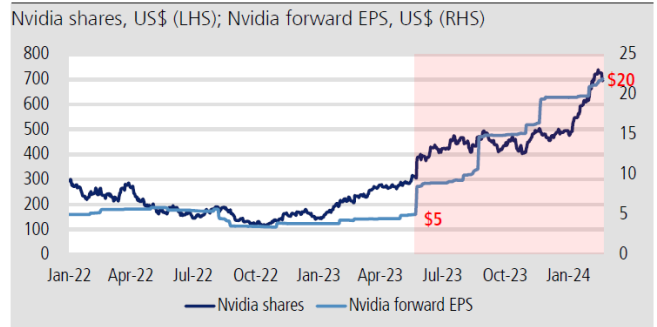
FINI net buy/ sell since 2023, US$bn
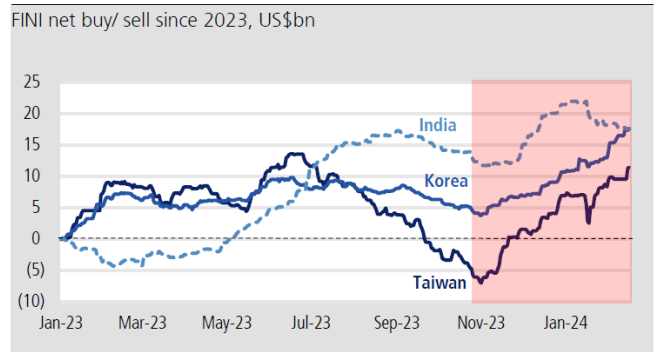
Source: Bloomberg; KGI Research

Figure 4: Nvidia's PE falling on surging share price, suggesting earnings are at an explosive stage

Nvidia shares, US$ (LHS); Nvidia forward PE, x (RHS)
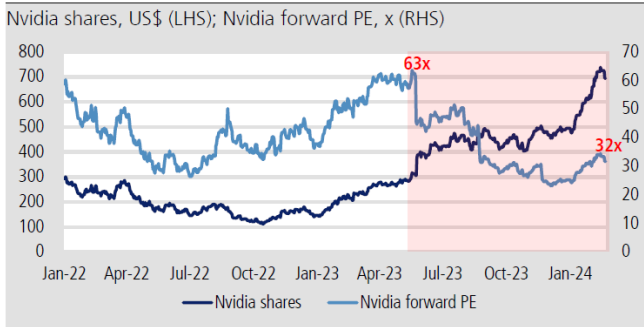
Source: Bloomberg; KGI Research

Figure 5: Nvidia's 12-month forward EPS raised from US$5 to US$20

Nvidia shares, US$ (LHS); Nvidia forward EPS, US$ (RHS)

Source: Bloomberg; KGI Research

Figure 6: PEs of mainstream US stocks always toppish in strong bull markets; current PE of FAAMG+AI still well below historical levels

US market and mainstream stock PE peaks, x

Nifty Fifty	1972 P/E	Tech's Four Horsemen	Mar-20 P/E	Real Estate	Oct-07 P/E	FAAMG+AI	Now P/E
Coca-Cola	46	Intel	41	Equity Residential (EQR)	375	Nvidia	32
MacDonalds	71	Cisco	100	Simon Property Group, Inc. (S	57	Amazon	34
Texas Instrument	40	Dell	57	Alexandria Real Estate Equitie	52	AMD	38
IBM	36	Microsoft	51	CBRE Group Inc (CBRE)	26	Microsoft	35
Xerox	46					Apple	27
Polaroid	95					Alphabet	20
						Facebook	23
S&P500 Index	19		28		17		24
10-year Treasury yield	6.5%		6.2%		4.6%		4.3%

Source: Bloomberg; KGI Research

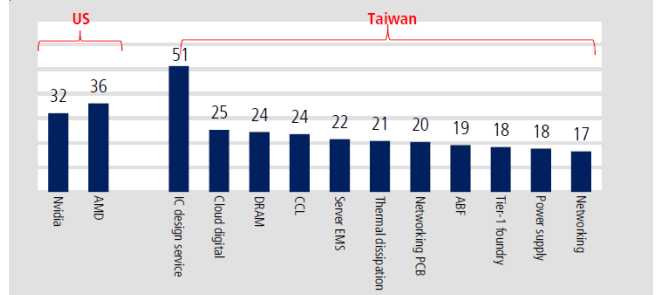**Figure 7: Taiwan AI server shares much cheaper than Supermicro**

PE of global AI server makers, x
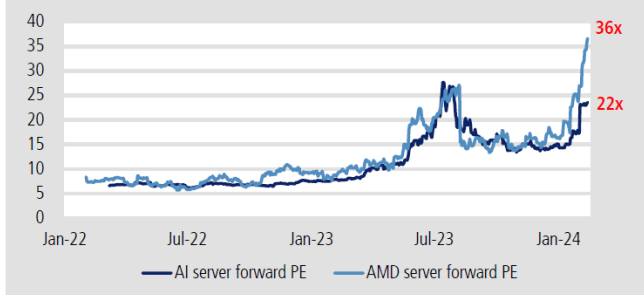
Source: Bloomberg; KGI Research

Figure 8: Valuations of Taiwan AI-related shares undemanding (except IC designers)

Forward PE of global AI-related segments, x

Source: Bloomberg; KGI Research

Figure 9: Taiex to hit 20,000 points by end-2024F; investors should be wary of greater volatility (or correction) around 19,000 points

2024F Taiex movement & positive/ negative factors

	1Q24	2Q24	3Q24	4Q24
Index movement	⬈	⬈ ⬊	⬈ ⬊ ⬈	⬈
Positives	(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
Negatives	(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) 2Q24 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)

Source: KGI Research and KGI estimates

Figure 10: Projected earnings growth YoY – Taiex & sub-indices

		2022	KGI forecast 2023F	KGI forecast 2024F	Consensus 2023F	Consensus 2024F	Forecast PE(x) 2023F	Forecast PE(x) 2024F
Tech	Networking	239.5	53.6	82.4	58.7	75.7	21.5	16.7
	Networking PCB	56.1	(17.6)	75.5	(18.5)	73.5	22.4	19.0
	IC design and service	94.8	5.9	46.6	7.2	44.7	72.8	49.2
	Server EMS	(9.3)	9.1	42.7	9.6	42.6	33.1	21.5
	ABF	102.5	(69.2)	41.1	(69.5)	52.8	343.0	19.7
	CCL	(7.7)	10.8	36.7	9.0	50.0	30.0	21.9
	Passive components	(0.8)	(24.7)	30.2	(22.5)	27.8	13.6	10.5
	Handset components	28.4	(35.5)	27.6	(34.9)	23.8	15.6	12.0
	Thermal	50.6	19.7	27.6	19.1	23.8	26.2	20.5
	Cloud digital	16.3	18.5	19.0	17.8	18.2	33.8	26.4
	First-line foundry	70.4	(17.5)	18.0	(19.0)	20.0	21.2	18.0
	IC design (handset/consumer electronics)	(2.9)	(32.6)	17.1	(35.5)	23.9	21.3	17.8
	Handset EMS	(2.1)	(7.2)	12.1	(5.0)	14.4	12.5	11.1
	Power supply	15.1	4.2	6.8	5.1	15.7	19.6	18.2
	Telecom	2.6	8.5	1.9	6.9	10.3	28.2	27.4
	Silicon wafer	29.5	25.1	(7.9)	25.2	(9.6)	12.7	13.8
	Second-tier foundries	51.6	(33.3)	(11.6)	(36.1)	(13.0)	13.4	16.1
Non-tech	Steel	(75.4)	(62.9)	381.8	(91.0)	667.3	78.7	14.2
	Green energy	56.9	69.7	76.0	91.7	54.0	29.3	13.4
	Petrochemicals	(63.1)	(50.6)	52.6	(39.5)	41.3	51.4	28.2
	Shoe-making	100.0	(44.2)	48.6	(42.4)	37.4	32.2	21.6
	Auto parts	52.8	(20.6)	46.6	(19.4)	42.8	20.8	13.6
	Heavy electrical	(1.9)	41.3	43.3	42.7	39.5	34.2	23.0
	Industrial automation	5.2	(13.2)	28.6	(12.3)	23.8	36.8	26.2
	Tourism	(46.5)	175.9	25.0	165.2	15.4	19.3	14.8
	Food	(2.9)	102.3	19.9	106.1	15.7	17.5	14.5
	Bicycle	(12.7)	(35.3)	17.4	(36.1)	18.0	23.4	19.3
	Aerospace	135.4	36.7	16.9	29.0	14.9	2.0	20.9
	Apparel	32.1	(8.8)	11.6	(10.4)	17.0	25.2	22.7
	Food	(13.6)	23.4	10.1	23.9	5.1	20.3	18.5
	Cement	(50.7)	31.4	(9.3)	20.0	10.9	17.3	18.6
	Airlines	(37.8)	227.7	(22.3)	209.8	(32.8)	10.1	15.2
	Container shipping	19.7	(92.9)	(92.4)	(93.3)	(46.8)	N.A.	N.A.
	Technology	17.8	(20.9)	23.0	(19.6)	24.0		
	Non-tech	(12.0)	(67.2)	12.5	(67.4)	13.2		
	Taiex	(3.7)	(28.4)	19.4	(34.4)	22.3		

Note: Ranking based on our 2024F earnings growth
Source: Bloomberg; KGI Research

Figure 11: Taiex - Valuations

	Forward PB(X) Forward 1-year	2023	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward PE(X) Forward 1-year	2023	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom
Taiex	1.87	2.08	1.87	1.73	1.71	1.60	1.61	2.28	0.95	17.95	21.45	17.95	14.82	14.96	14.87	17.11	21.73	8.80
Taiex excl. TSMC	1.48	1.66	1.48	1.37	1.39	1.38	1.46	2.22	0.89	17.96	21.66	18.02	14.61	14.65	14.86	16.01	22.71	8.06

Source: KGI Research

Figure 12: Taiex forward PB at 1.87x, vs. five-year average of 1.71x

Source: TEJ; KGI Research
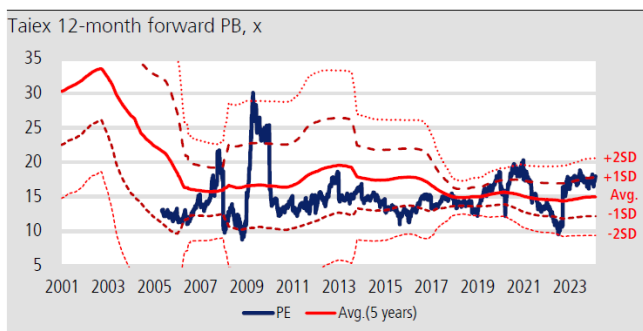
Figure 13: Taiex forward PE at 18.0x, vs. five-year average of 15.0x

Source: TEJ; KGI Research
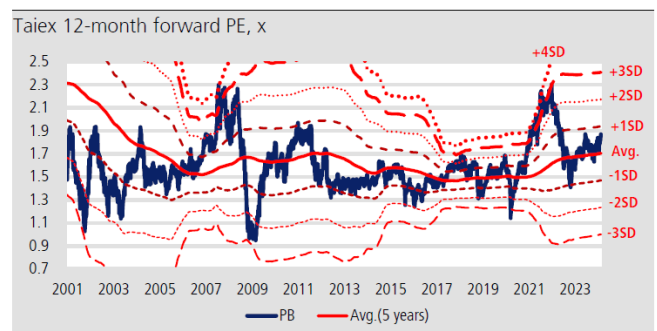
Figure 14: Our top picks

	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
Cheap stocks	TSMC	2330 TT	Outperform	688.0	561,518	681.00	1.0	32.34	38.15	21.1	17.9	5.0	4.2	26.0	25.6	1.7	2.0
	QCI	2382 TT	Outperform	310.0	28,985	236.00	31.4	10.13	13.43	23.3	17.6	5.2	4.9	22.6	28.4	3.4	4.5
	Wistron	3231 TT	Outperform	140.0	10,926	118.50	18.1	4.08	6.03	29.0	19.6	3.2	2.9	11.3	14.9	2.2	3.2
	Compeq	2313 TT	Outperform	100.0	2,763	72.90	37.2	3.84	6.40	19.0	11.4	2.1	1.9	11.4	17.4	2.1	3.6
	AURAS	3324 TT	Outperform	445.0	1,266	445.00	0.0	15.86	21.09	28.1	21.1	6.2	5.4	23.0	26.6	1.5	2.0
	GCE	2368 TT	Outperform	275.0	4,058	259.50	6.0	7.65	13.42	33.9	19.3	8.3	6.8	25.3	38.7	1.2	2.1
	EMC	2383 TT	Outperform	550.0	5,374	492.50	11.7	16.88	23.07	29.2	21.3	6.7	5.9	24.1	29.3	1.9	2.6
	WEC	2344 TT	Outperform	33.0	3,682	27.70	19.1	(0.29)	1.25	(95.5)	22.2	1.2	1.2	(1.2)	5.5	0.0	3.6
	LuxNet	4979 TT	Outperform	210.0	737	164.50	27.7	3.51	10.47	46.8	15.7	12.5	7.0	30.9	57.0	0.3	0.3
Low valuations with fundamentals troughing	Win	3105 TT	Outperform	190.0	2,170	161.00	18.0	(0.19)	6.45	(851.0)	25.0	2.1	2.0	(0.2)	8.1	0.0	2.4
	Makalot	1477 TT	Outperform	424.0	2,880	374.50	13.2	16.37	17.68	22.9	21.2	5.8	5.6	25.5	26.9	4.0	4.3
	Hiwin	2049 TT	Outperform	278.0	2,902	258.00	7.8	6.06	9.94	42.6	26.0	2.5	2.4	6.1	9.5	1.0	1.7
	Waffer	6235 TT	Outperform	205.0	660	107.50	90.7	4.51	7.88	23.8	13.6	5.4	4.3	24.2	35.3	1.7	2.9
	MIC	9914 TT	Outperform	200.0	1,849	194.50	2.8	7.50	11.12	25.9	17.5	2.7	2.6	10.7	15.1	2.4	3.5

Source: KGI Research and KGI estimates

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