

## Strategy

### Taiex at record high, but investors shouldn't chase market

#### Key message

1. The Taiex hit a record high on favorable rate cut expectations, but such expectations could flip and hurt the market in the blink of an eye.
2. 1Q24 corporate earnings suggest most businesses, except AI-related firms, are still struggling with tepid operations, as they were in 4Q23. Meanwhile, expectations for AI stocks are too high, and any further share price upside will be limited. Recent Taiex gains have been mainly driven by a handful of large-cap stocks, which is a sign that the ongoing rally is nearing its end.
3. Our top picks are high-yield plays and undervalued stocks.

#### **The Taiex has hit a record high on rate cut expectations, but these expectations could also be detrimental to the market**

After undergoing drastic swings in April, the Taiex has hit a record high again, mainly as a dovish statement by US Fed Chair Powell provided a boost to investors' short-term risk appetite. That said, we do not think investors should chase the market solely because rate cut expectations appear favorable, as inflation is hard to predict, and there's no telling when such expectations could flip and hurt the market. 1Q24 corporate earnings and 2Q24 guidance suggest most businesses, except AI-related firms, are still struggling with tepid operations, as they did in 4Q23. Put simply, the ongoing recovery of the manufacturing sector has been, and will remain, lukewarm. In addition, investors' expectations for AI stocks are too high, to the extent any further share price upside will be limited. Recent Taiex gains have been mainly driven by a handful of large-cap stocks and laggard plays, which is a sign that the ongoing rally is nearing its end.

#### **4Q23-1Q24 results suggest weakness across the board, except for AI-related firms**

Based on 1Q24 results and 2Q24 guidance, we have come to the conclusion that most Taiex businesses, except AI-related firms, are still struggling with lackluster operations, as they were in 4Q23. Within our coverage universe, about 60% of subsectors have seen downward revisions to 2024 consensus earnings, while only 30% have been upgraded, and 10% remain unchanged. Within the tech sector, subsectors that have suffered the most significant 2024 consensus earnings downgrades are, in descending order based on magnitude of revision, ABF, handset assembly, networking, networking PCB, tier-2 foundries, IC design, and silicon wafers, implying that end-demand recovery has been anemic, despite the fact that demand for networking equipment in Europe, as well as for PC, handsets, and consumer electronics, is bottoming or has already bottomed. Only a small fraction of tech subsectors have seen earnings upgrades, namely CCL, server assembly, and tier-1 foundries, which have benefitted from robust pull-in demand for AI servers.

As for non-tech subsectors, in descending order based on magnitude of revision, steel, petrochemicals, green energy, heavy electrical, catering, auto parts, and industrial automation have suffered the most significant consensus earnings cuts, mainly on economic slowdown in China. The few non-tech subsectors that have seen upward consensus earnings revisions are container shipping, airlines, bicycles, food, and tourism. Container shippers have benefitted from rising geopolitical tensions, while the other subsectors have been buoyed by solid consumption demand in Taiwan.

#### **Expectations for AI-related firms too high; further share price upside to be limited**

Although AI bellwethers AMD (US) and Nvidia (US) have recently revised up earnings guidance, the revisions failed to meet overly high consensus expectations, thus triggering a sell-off. We do not expect Nvidia's upcoming earnings results or 2024 Taipei Computex to stimulate positive market sentiment as they did in 2023. Furthermore, Taiex-listed AI stocks have been re-rated substantially over the past year thanks to the AI frenzy, with current valuations already far above their five-year historic averages. We believe it will take a much stronger catalyst to drive up share prices as valuations are already stretched. The Taiex PE is now at 19x, above its historic average of 15x by more than one standard deviation. As such, we believe further upside, if any, will be limited.

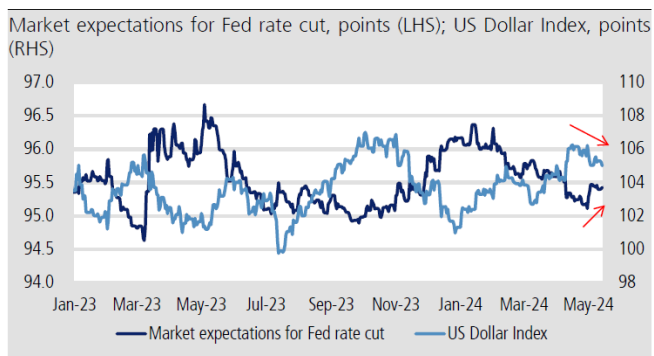
### Recent Taiex gains driven by a handful of stocks, a sign that the rally is near an end

Recent Taiex gains have been mainly driven by a handful of large-cap stocks and laggard plays, which is a sign that the ongoing rally is nearing its end. During market swings in April, we saw on multiple occasions that advancing stocks were outnumbered by declining shares, and sometimes the differential was as broad as over a thousand. When there are more stocks declining than advancing on a daily basis, and the gap is widening rapidly and the broad-market index is at a high level, this usually means the market rally is about to end. Notably, a small number of large-cap stocks and financial plays have been recent outperformers in the Taiex. As financial stocks are typically laggards, the fact that they are now a major driving force for the Taiex, which is already at a high level, is clearly a warning sign that the rally is nearing its end.

### Valuation & Action

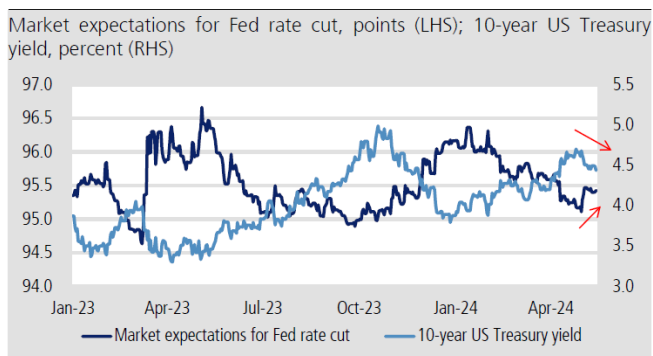
We do not recommend chasing the market at the current level, despite the fact that the Taiex has hit a record high on favorable rate cut expectations, as: (1) rate cut expectations can make or break the rally; (2) 1Q24 results suggest most businesses, except AI-related firms, are still struggling with lukewarm operations, as they did in 4Q23; (3) market expectations for AI stocks are too high, and further share price upside will be limited; and (4) recent Taiex gains have been mainly driven by a handful of large-cap stocks, and this is a sign that the rally will soon end. We believe it would be safer for investors to opt for defensive trading by focusing on stocks that either offer high yields or are undervalued, including EVAAIR (2618 TT, NT\$37 ,N), Chicony (2385 TT, NT\$191.5 ,OP), CTBC Holding (2891 TT, NT\$37.5 ,OP), KTB (2809 TT, NT\$60 ,OP), Catcher (2474 TT, NT\$232.5 ,N), UMC (2303 TT, NT\$52.1 ,OP), SMP (6121 TT, NT\$405 ,N), Primax (4915 TT, NT\$95.2 ,OP), Novatek (3034 TT, NT\$591 ,N), Alltop (3526 TT, NT\$241.5 ,OP).

**Figure 1: US Dollar Index has declined on rising rate cut expectations**



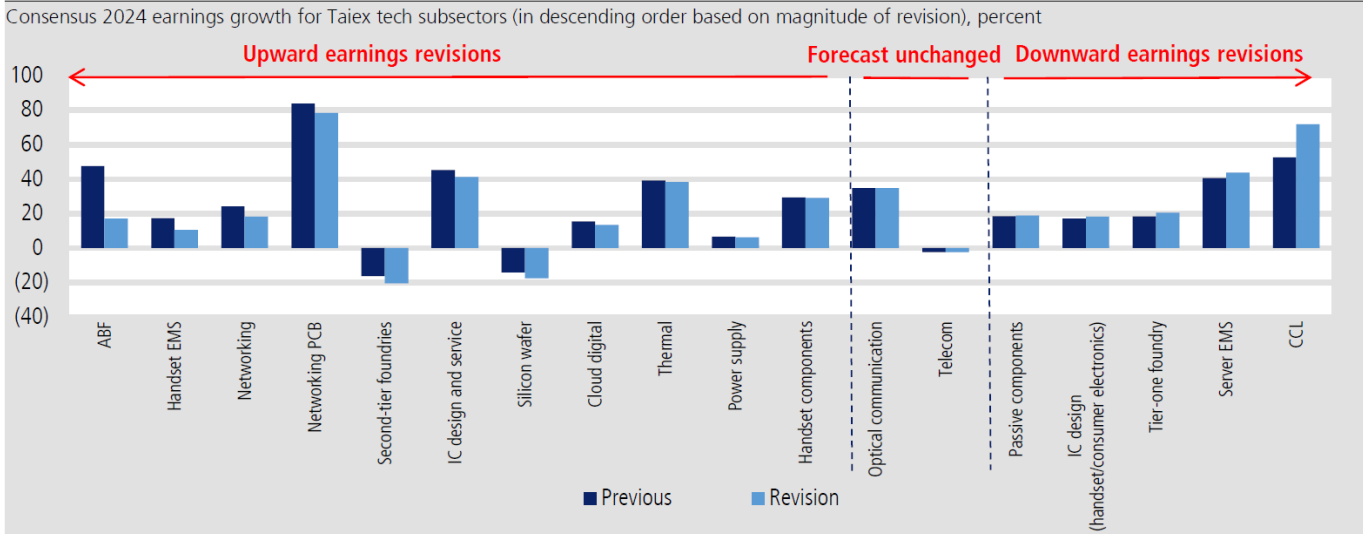
Source: Bloomberg; KGI Research

**Figure 2: US Treasury yields have pulled back on rising rate cut expectations**



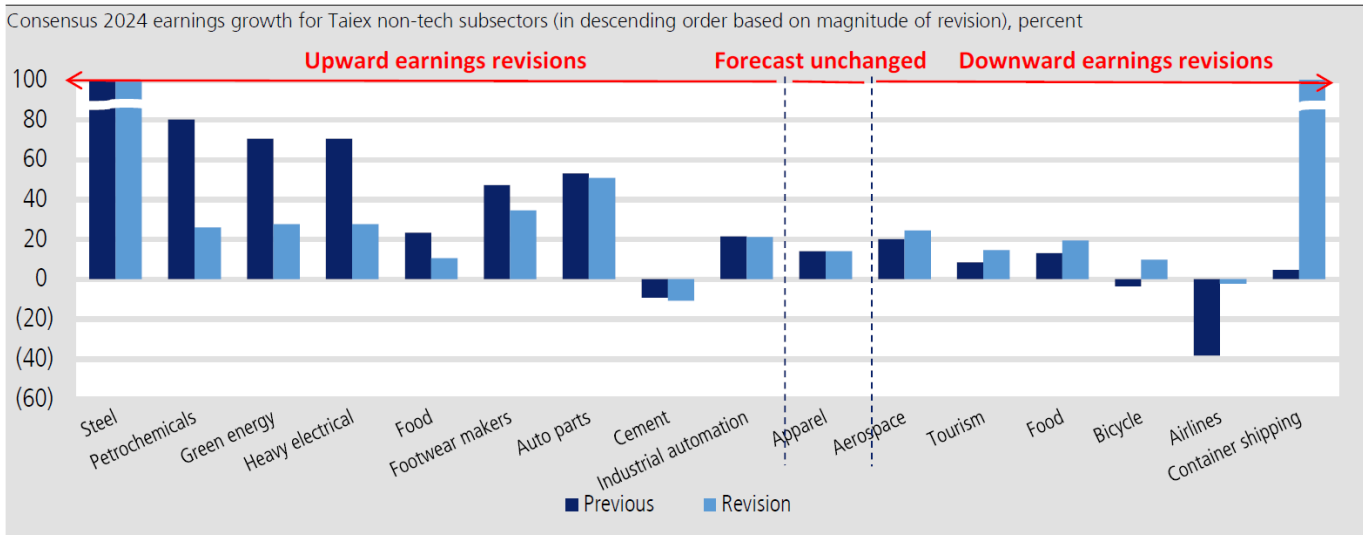
Source: Bloomberg; KGI Research

**Figure 3: Over 60% of Taix tech subsectors have seen 2024 consensus earnings cuts during 1Q24 earnings season**



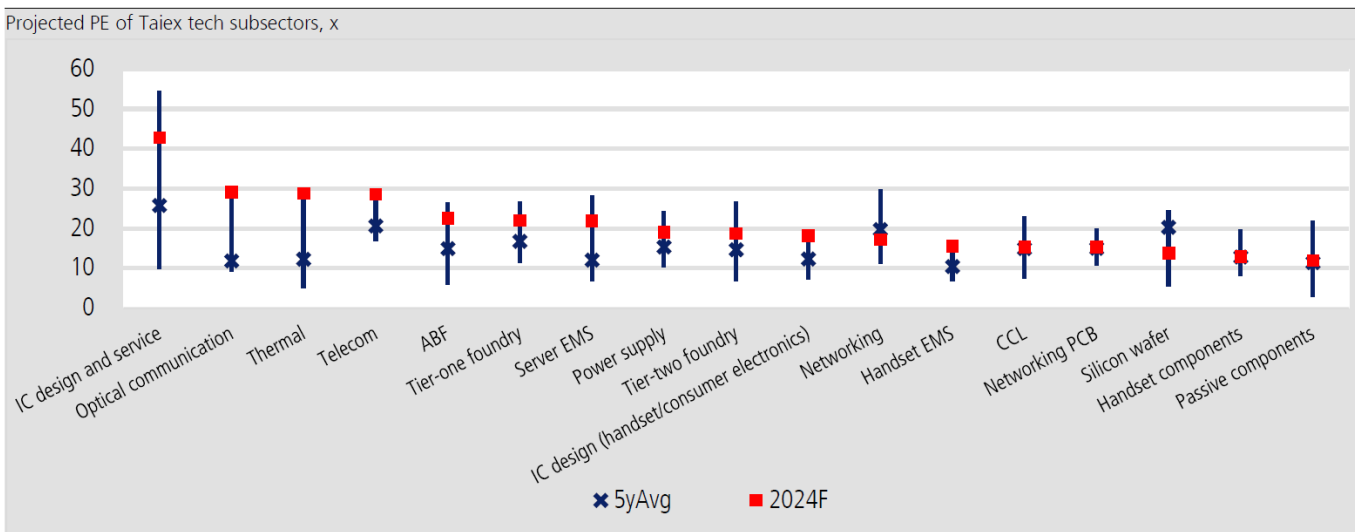
Source: Bloomberg; TEJ; KGI Research

**Figure 4: Within non-tech sector, almost 60% of subsectors have seen 2024 consensus earnings cut during 1Q24 earnings season**



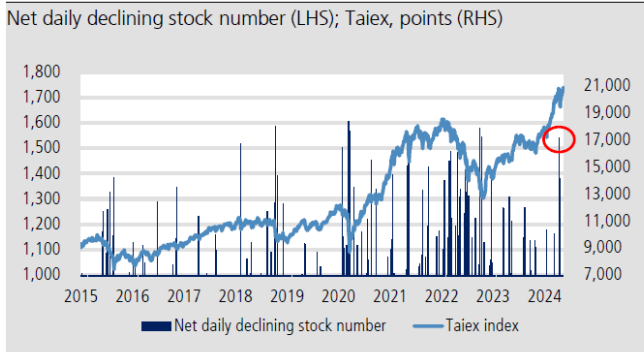
Source: Bloomberg; TEJ; KGI Research

**Figure 5: Valuations of Taix AI stocks are far above their five-year historic averages**



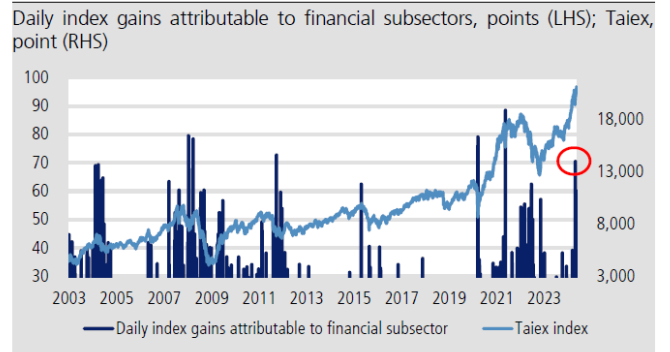
Source: Bloomberg; TEJ; KGI Research  
Note: In descending order based on 2024F PE.

**Figure 6: Surge in net daily declining stock number, while the broad-market index is at high level, usually means rally will soon end**



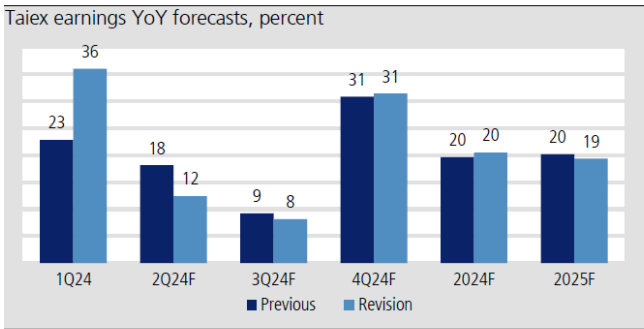
Source: TEJ; KGI Research  
Note: Net daily declining stock number refers to difference between declining stock number and advancing stock number

**Figure 7: When financial stocks become driving force for Taixex, while the broad-market index is at high level, usually means rally will soon end**



Source: TEJ; KGI Research  
Note: Daily index gains attributable to financial subsector only calculates intra-day Taixex gains contributed by financial stocks

**Figure 8: Taixex 1Q24 earnings beat expectations, but 2Q-3Q24F earnings have been slightly revised down**



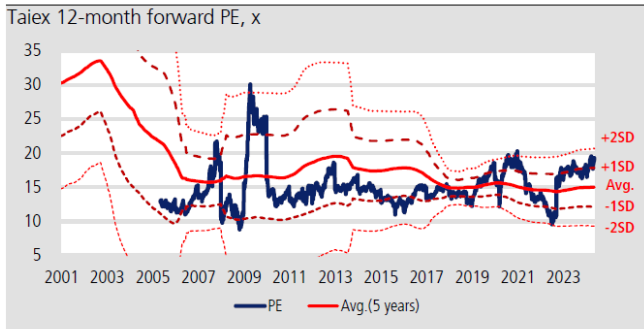
Source: TEJ; KGI Research

**Figure 9: Taixex earnings forecasts by sector**

Earnings YoY (%)	2020	2021	2022	2023	2024F	2025F
Taixex	42.9	41.8	16.9	(20.9)	22.5	19.3
Taixex (excl. TSMC)	38.1	60.4	(11.7)	(24.4)	27.7	22.8
Taixex (excl. Financial)	38.4	32.9	28.6	(21.0)	19.9	18.5
Tech (excl. TSMC&Panel)	31.2	49.6	3.7	(24.4)	22.0	21.2
Financial	3.4	45.9	(50.4)	29.3	23.6	(2.1)
Cyclical non-tech	(15.6)	186.7	(16.1)	(68.7)	27.5	9.6
Taixex	21.3	78.3	(5.0)	(27.3)	20.5	19.4
Taixex (excl. TSMC)	14.7	97.2	(21.5)	(31.0)	21.6	20.8

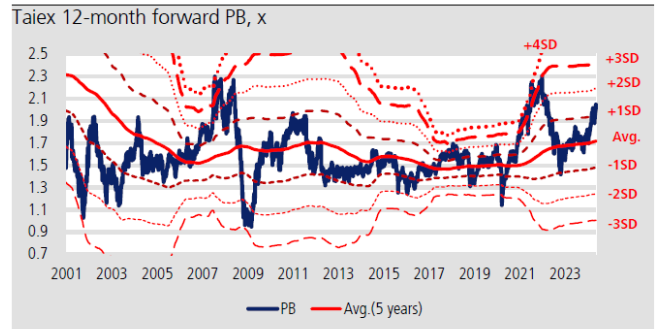
Source: TEJ; KGI Research

**Figure 10: Taixex valuations are above historic average by more than one standard deviation**



Source: TEJ; KGI Research

**Figure 11: Taixex valuations are above historic average by more than one standard deviation**



Source: TEJ; KGI Research

**Figure 12: Taixex – Valuations**

	Forward PB(X)									Forward PE(X)								
	Forward 1-year	2023	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward 1-year	2023	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom
Taixex	2.04	2.34	2.10	1.94	1.71	1.61	1.62	2.28	0.95	19.31	24.38	20.38	16.97	15.12	14.95	17.13	21.73	8.80
Taixex excl. TSMC	1.56	1.80	1.61	1.49	1.40	1.38	1.46	2.22	0.89	18.56	23.69	19.69	16.15	14.80	14.94	16.04	22.71	8.06

Source: KGI Research

**Figure 13: Our top picks**

Company	Code	Investment rating	Target price (NT\$)	Mkt cap (US\$m)	Share price (NT\$)	Change +/- (%)	EPS (NT\$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)		
							2024F	2025F	2024F	2025F	2024F	2025F	2024F	2025F	2023	2024F	2025F
Novatek	3034 TT	Neutral	620.0	11,203	591.0	4.9	37.84	39.80	15.6	14.8	5.1	4.7	33.4	33.1	5.4	5.3	5.6
SMP	6121 TT	Neutral	490.0	2,334	405.0	21.0	30.53	34.76	13.3	11.7	2.1	2.0	16.2	17.5	5.4	5.4	6.1
KTB	2809 TT	Outperform	51.0	2,077	60.0	(15.0)	5.62	N.A.	10.7	N.A.	1.2	N.A.	11.8	N.A.	5.0	5.0	N.A.
EVAAIR	2618 TT	Neutral	37.0	6,225	37.0	0.0	3.23	2.19	11.5	16.9	1.7	1.6	15.6	9.8	4.9	3.9	2.7
Alltop	3526 TT	Outperform	290.0	446	241.5	20.1	15.53	18.82	15.6	12.8	5.5	5.4	35.1	42.4	4.8	6.4	7.7
UMC	2303 TT	Outperform	56.0	20,335	52.1	7.5	4.39	4.99	11.9	10.4	1.7	1.6	14.6	15.4	4.8	4.7	4.7
Catcher	2474 TT	Neutral	255.0	4,928	232.5	9.7	20.22	13.77	11.5	16.9	1.0	1.1	8.9	6.3	4.3	4.3	4.3
Primax	4915 TT	Outperform	103.0	1,373	95.2	8.2	6.30	7.38	15.1	12.9	2.5	2.3	16.4	18.1	4.2	4.5	5.3
Chicony	2385 TT	Outperform	258.0	4,534	191.5	34.7	13.70	14.93	14.0	12.8	3.3	3.0	24.4	24.3	4.1	5.1	5.5
CTBC Holding	2891 TT	Outperform	34.0	22,923	37.5	(9.3)	3.24	N.A.	11.6	N.A.	1.5	N.A.	14.1	N.A.	3.5	3.7	N.A.

Source: KGI Research

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