

## Strategy

### Recent earnings downgrades could be the beginning of a downcycle

#### Key message

1. Market has been revising down 2025F Taixex earnings since March, marking the end of a 20-month upcycle.
2. AI was the only outperforming sector in 1Q25 earnings season, but this is the first time its outperformance was not enough to shore up the broader market.
3. We believe recent Taixex earnings downgrades could be the beginning of a downcycle, as end-market demand will be hurt by tariffs.

#### Event

We lower 2025F Taixex earnings growth to 17% YoY, down from 19% YoY previously, after the 1Q25 earnings season.

#### Analysis

**Consensus has been revising down 2025F Taixex earnings since March, marking the end of a 20-month upcycle.** After reviewing the latest 1Q25 results, we cut our 2025F Taixex earnings growth forecast to 17% YoY, down from 19% YoY. The recent earnings downgrades by the market mark the end of a 20-month upcycle for Taixex earnings, which started in 2H23. Notably, according to FactSet, consensus has also lowered 2025F earnings growth for the S&P 500 to 9% YoY, from a previous 12% YoY. Although US and Taiwanese firms have both delivered strong 1Q25 results on tariff-triggered pull-in demand, investors fret about market demand in the 2H25F peak season, given tariff uncertainties, and we thus downgrade our forecasts for 2025F Taixex earnings. The two most mentioned words in 1Q25 earnings calls were “tariff” and “uncertainty.” According to FactSet, 83% of S&P 500-listed firms spoke of tariffs, the highest ever in history, while 78% mentioned uncertainty, the highest since the COVID-19 pandemic, in their 1Q25 earnings announcements.

**AI was the only outperforming sector in 1Q25 earnings season, but this is the first time its outperformance was not enough to shore up the broader market.** Since last year, AI-related firms have been the only ones to deliver stellar results and provide upbeat guidance on earnings. However, this is the first time that their outperformance was not enough to make up for the earnings shortfalls of non-AI sectors. We think this could be another major reason for consensus downgrades to Taixex earnings, in addition to US tariffs.

**We compiled the latest Taixex and US corporate results and adjusted our earnings forecasts accordingly.** The majority of companies whose earnings have been raised substantially are AI-related, including thermal, networking, CCL and power supplier firms within the Taixex, while for the S&P 500, we only markedly revised up the earnings of a few leading US communication service firms, such as Alphabet, Netflix and Disney. At the same time, we lowered the 2025F earnings of non-AI firms in both Taiwan and the US.

We believe recent Taixex earnings downgrades could be the beginning of a downcycle, as end-market demand will be hurt by tariffs. Although global stock markets have fully recovered from the shock of US tariffs, following a de-escalation of trade wars, we note that investors may have overlooked the risk of actual implementation of blanket tariffs and their impact on the broader economy, in which case further corporate earnings downgrades will be warranted. According to the Peterson Institute for International Economics, a 10-20% blanket tariff levied by the US government will hurt US GDP growth by 0.4-0.9ppts, and the impact will double to 0.9-1.8ppts if trade partners of the US retaliate. In a nutshell, whatever tariffs the Trump administration opts for will undermine the economy. Before the current trade wars, the Federal Reserve had guided 2025-26F US GDP growth of 1.7% and 1.8%, respectively, during a regular meeting in March. While the impact of tariffs may not drag the US economy into recession, the writing is on the wall for a significant slowdown ahead. A US federal court ruled on May 28 that Trump’s tariff policy may be illegal, but the President could still appeal. We will keep an eye on developments in the lawsuit.

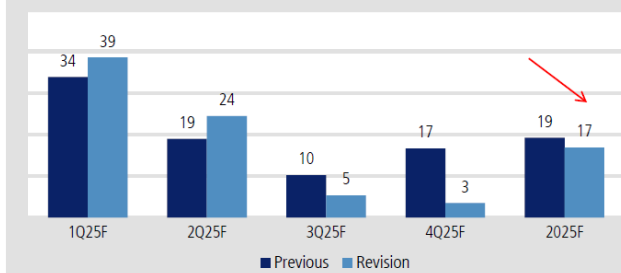
Taiwan's supply chain is highly correlated to the US economy. A substantial US economic slowdown will inevitably lead to earnings contractions for Taiex firms, and a deep economic recession will decimate Taiex earnings. Looking back at three periods of US economic slowdown over the past 20 years, earnings forecasts for Taiwan stocks were revised down by as much as 13% to 26%, with the duration of these revisions lasting between 8 to 20 months. This suggests that once the ripple effects of tariffs are transmitted to the economy, earnings forecasts for Taiwan stocks may once again face downward revisions.

### Conclusion & top picks

The market has been revising down earnings forecasts for Taiex constituents since March, ending a 20-month cycle of upward revisions. We are concerned that this may mark the beginning of an earnings downgrade cycle, as this is the first time that the strength of the AI sector cannot offset the weakness of non-AI sectors. Additionally, the economic impact of tariffs should not be underestimated. We believe the current rebound for the Taiex has reached its peak, and there is a risk of a pullback in 3Q25F. In response to the policy risks associated with Trump, we recommend maintaining a low equity exposure. Instead, focus on high yield stocks or undervalued AI-related stocks.

**Figure 1: Our 2025 Taiex earnings outlook has been revised down from 19% YoY to 17% YoY**

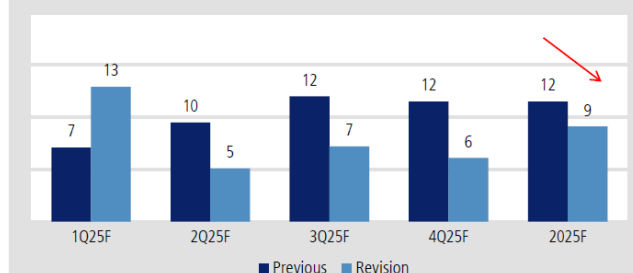
Taiex constituents forecast earnings YoY, percent



Source: TEJ; KGI Research and KGI estimates

**Figure 2: Our 2025 earnings outlook for US stocks has been revised down from 12% YoY to 9% YoY**

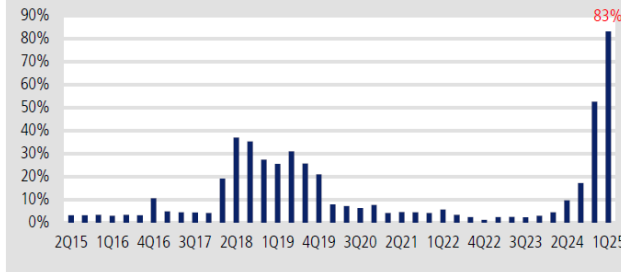
S&P 500 constituents consensus forecast earnings growth YoY, percent



Source: FactSet; KGI Research

**Figure 3: A striking 83% of companies cited "tariffs" in their earnings reports**

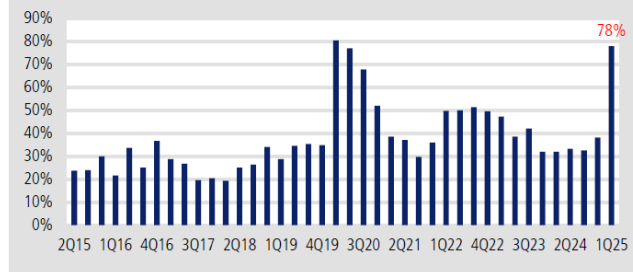
The proportion of S&P 500 companies that mentioned "tariffs", percent



Source: FactSet's; KGI Research

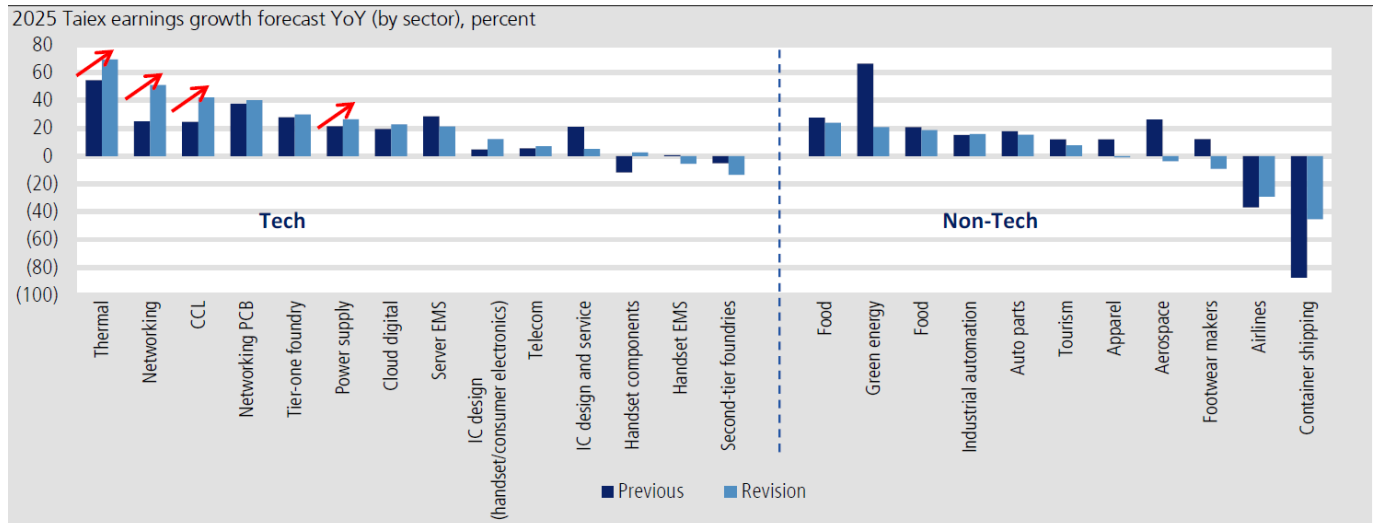
**Figure 4: A striking 78% of companies cited "uncertainty" in their earnings reports**

The proportion of S&P 500 companies that cited "uncertainty", percent



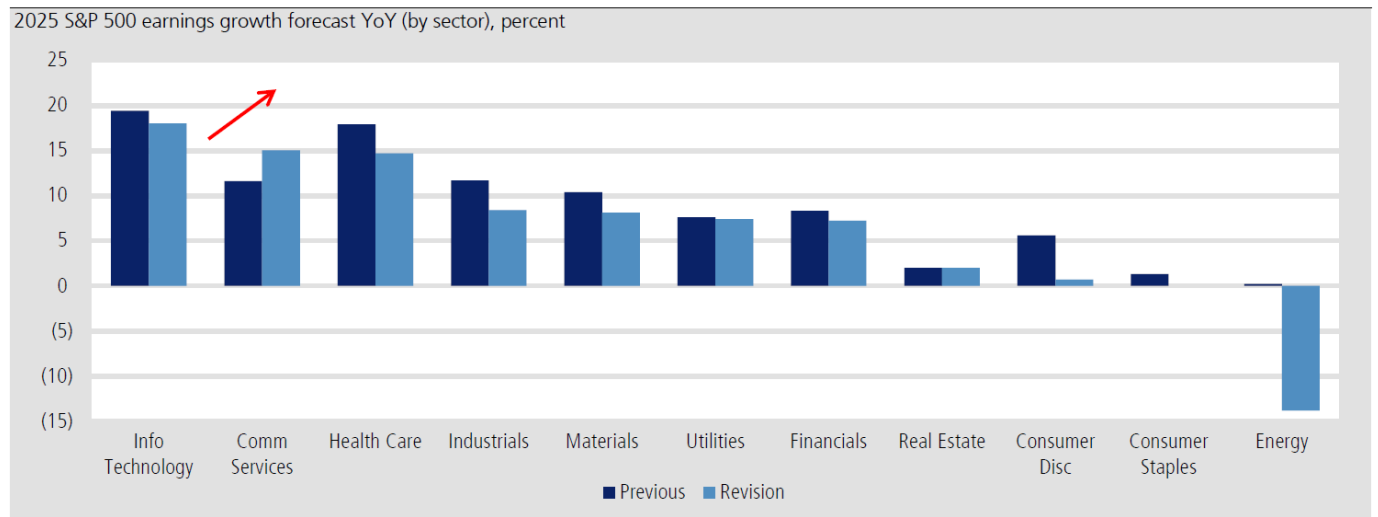
Source: FactSet's; KGI Research

**Figure 5: In 2025, earnings forecast upgrades in the Taiex have been largely confined to AI-related sectors, whereas most other industries have experienced downward revisions**



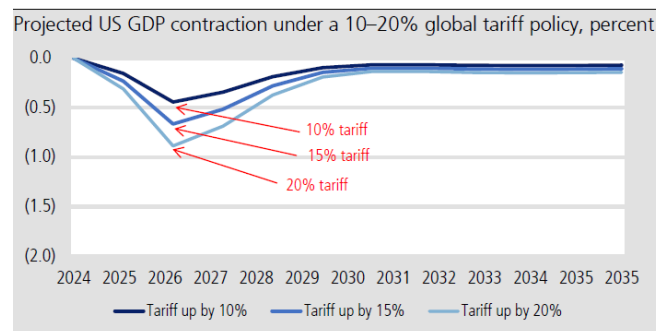
Source: TEJ; KGI Research and KGI estimates

**Figure 6: In 2025, communication services has stood out as the only S&P 500 sector with upgraded earnings expectations, whereas the majority of other sectors have faced downward revisions**



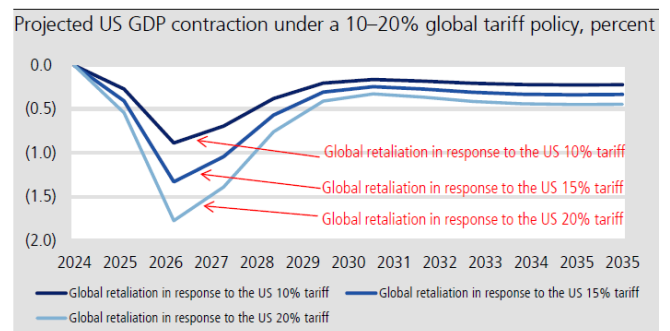
Source: FactSet; KGI Research

**Figure 7: The maximum impact on US GDP could reach 0.4-0.9 ppts if Trump imposes a 10–20% universal tariff on global imports**



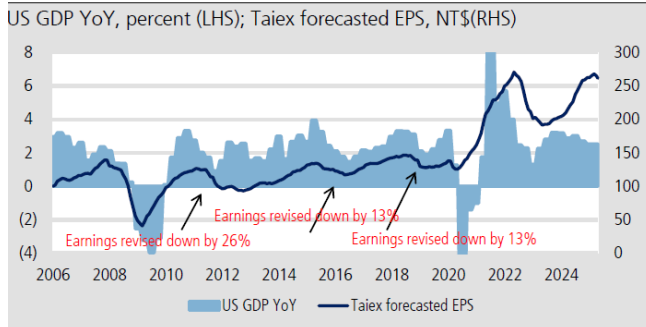
Source: Peterson Institute for International Economics (PIIE); KGI Research

**Figure 8: Maximum impact on US GDP could reach 0.9-1.8 ppts if Trump imposes a 10–20% universal tariff on global imports & retaliatory measures from other countries are implemented**



Source: Peterson Institute for International Economics (PIIE); KGI Research

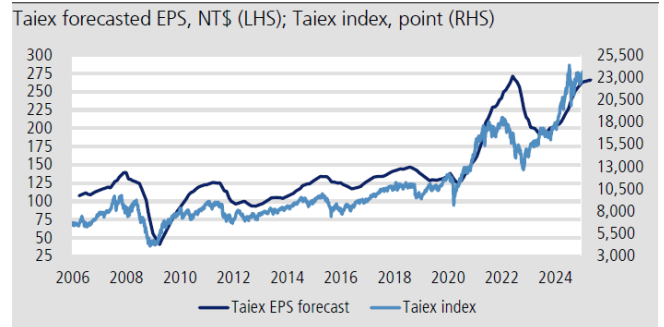
**Figure 9: Taiex is highly correlated with the US economy; a significant slowdown in the US would erode Taiex earnings, while a deep recession would prove even more detrimental**



Source: Bloomberg; KGI Research

Note: We use the EPS forecast in January 2006 as the base, at 100

**Figure 10: Taiex is highly sensitive to earnings expectations, and any further downward revision of these forecasts would negatively affect the index**



Source: Bloomberg; KGI Research

Note: We use the EPS forecast in January 2006 as the base, at 100

**Figure 11: Historical corporate earnings downgrade cycles: Revisions, index trends & duration**

Market	Earnings downgrade cycle	2008-2009 Financial crisis	2011-2012 US credit rating downgrade/ European debt crisis	2015-2016 RMB exchange rate reform	2018-2019 US-China trade war and interest rate hikes	2020 COVID-19 pandemic	2022 Stagflation
Taiex	Magnitude of earnings revisions (%)	-71	-26	-13	-13	-9	-29
	Change in index level (%)	-60	-28	-28	-17	-30	-30
	Duration of earnings downgrade (months)	15	20	12	8	3	12
S&P 500	Magnitude of earnings revisions (%)	-39	-2	-3	-2	-22	-5
	Change in index level (%)	-56	-18	-14	-20	-34	-34
	Duration of earnings downgrade (months)	18	2	6	4	4	8

Source: Bloomberg; KGI Research

**Figure 12: Earnings forecasts & valuations of Taiex constituents**

P/E (x)	2021	2022	2023	2024	2025F
Taiex	17.5	18.2	25.5	18.2	15.6
Taiex excl. TSMC	13.1	15.8	23.6	16.7	15.1
Tech	24.8	22.1	28.0	21.1	16.9
Tech excl. TSMC	17.0	19.8	26.1	20.8	17.3
TSMC	42.0	24.7	29.9	21.4	16.5
<b>EPS growth (%)</b>					
Taiex	78.1	(3.7)	(28.9)	40.5	16.8
Taiex excl. TSMC	97.4	(17.0)	(33.1)	40.8	10.9
Tech	51.7	12.2	(20.9)	32.4	25.3
Tech excl. TSMC	77.1	(14.2)	(23.9)	25.2	20.3
TSMC	15.2	70.4	(17.5)	39.9	30.0

Source: KGI Research and KGI estimates

Figure 13: Earnings forecasts &amp; valuations of Taix sectors

Tech	Earning YoY (%)					Forecast PE (x)		Non-tech	Earning YoY (%)					Forecast PE (x)	
	2022	2023	2024	2025F	2026F	2025F	2026F		2022	2023	2024	2025F	2026F	2025F	2026F
Server EMS	(1.7)	3.7	24.8	21.4	27.8	14.2	10.7	Cement	(50.7)	8.4	27.9	(6.7)	17.7	18.9	15.4
Thermal	34.5	20.5	54.0	69.5	28.7	17.0	12.6	Food	(13.6)	6.8	12.7	18.7	12.4	18.8	16.7
Power supply	15.1	2.4	(1.7)	26.5	17.3	18.7	16.0	Petrochemicals	(62.6)	(51.0)	(80.8)	20.6	74.0	52.9	24.7
ABF	102.5	(68.1)	(70.1)	140.2	75.5	23.0	12.6	Apparel	32.1	(11.0)	17.3	(0.9)	4.9	16.9	16.3
Optical communication	-	63.4	20.5	139.6	-	17.7	-	Footwear makers	100.0	(45.2)	18.0	(9.1)	5.4	22.3	21.2
IC design and service	94.8	5.3	29.9	5.1	51.1	35.9	24.9	Auto parts	113.5	25.1	44.3	15.3	9.6	13.0	11.6
Networking PCB	56.1	(22.8)	59.1	40.2	19.6	15.4	12.9	Industrial automation	5.2	(14.2)	6.6	15.9	15.7	25.3	21.4
Networking	77.3	15.2	15.3	51.1	-	15.6	-	Bicycle	(12.7)	(44.8)	(88.9)	813.6	20.6	15.9	13.2
CCL	(7.7)	8.2	74.5	42.1	8.3	18.4	17.0	Container shipping	19.7	(94.4)	631.6	(52.2)	(15.0)	9.9	13.4
Tier-one foundry	70.4	(17.5)	39.9	29.9	12.3	16.5	14.6	Steel	(75.4)	(89.0)	(41.0)	562.0	50.2	58.1	27.8
Second-tier foundries	56.3	(30.1)	(22.6)	(13.4)	9.5	14.5	13.2	Tourism	(46.5)	176.4	2.7	7.7	16.0	13.5	11.1
Handset components	11.4	(40.3)	44.0	8.1	8.0	11.6	10.2	Food	(40.3)	144.6	(11.9)	24.1	21.5	16.7	13.5
Telecom	2.6	13.7	13.6	7.1	2.7	26.4	25.7	Aerospace	127.3	26.8	(0.3)	(3.7)	23.1	23.0	18.3
IC design (handset/consumer electronics)	(2.9)	(32.6)	29.8	12.1	11.1	15.9	14.7	Airlines	(37.8)	185.5	52.7	(29.1)	(40.2)	11.7	20.9
Handset EMS	(26.5)	4.1	7.4	(5.4)	9.8	14.1	12.9	Heavy electrical	30.4	23.3	67.9	14.0	(4.0)	22.1	18.9
Cloud digital	16.3	17.1	13.1	22.8	16.7	19.4	16.5	Green energy	56.9	85.5	26.8	101.7	42.3	21.5	12.0

Source: KGI Research and KGI estimates

Figure 14: Forecast matrix for the Taixex

Taixex (points)		Target PE (x)								
		10	11	12	13	14	15	16	17	18
2025F earnings growth (%)	(20)	9,400	10,340	11,280	12,220	13,160	14,100	15,039	15,979	16,919
	(10)	10,575	11,632	12,690	13,747	14,804	15,862	16,919	17,977	19,034
	(5)	11,162	12,278	13,395	14,511	15,627	16,743	17,859	18,976	20,092
	0	11,750	12,925	14,100	15,274	16,449	17,624	18,799	19,974	21,149
	10	12,925	14,217	15,509	16,802	18,094	19,387	20,679	21,972	23,264
	15	13,512	14,863	16,214	17,566	18,917	20,268	21,619	22,970	24,322
	20	14,100	15,509	16,919	18,329	19,739	21,149	22,559	23,969	25,379

Source: KGI Research and KGI estimates

Figure 15: 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 (%)	
							2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F
QCI	2382 TT	Outperform	320.0	35,062	271.5	17.9	17.75	19.82	15.3	13.7	4.4	4.2	29.9	31.4	5.2	5.8
Wistron	3231 TT	Outperform	135.0	11,274	116.5	15.9	8.47	10.21	13.8	11.4	2.3	2.0	17.1	18.4	4.3	5.2
AVC	3017 TT	Outperform	725.0	8,046	620.0	16.9	36.26	45.78	17.1	13.5	6.6	5.3	43.2	43.4	2.8	3.5
GCE	2368 TT	Outperform	282.0	4,275	260.0	8.5	16.01	19.15	16.2	13.6	4.9	3.9	33.2	31.8	3.1	3.7
Gigabyte	2376 TT	Outperform	325.0	6,182	276.0	17.8	20.29	23.16	13.6	11.9	3.3	3.1	24.7	26.8	5.9	6.7
Chicony	2385 TT	Outperform	188.0	4,295	169.0	11.2	12.52	13.98	13.5	12.1	2.6	2.5	19.3	20.7	5.8	6.5
Asustek	2357 TT	Outperform	800.0	15,521	625.0	28.0	53.29	54.46	11.7	11.5	1.7	1.6	14.4	14.3	6.8	7.0
CTBC Holding	2891 TT	Outperform	45.0	26,838	40.9	10.2	3.32	3.95	12.3	10.4	1.6	1.3	13.5	13.8	5.1	5.9
E.S.F.H	2884 TT	Outperform	34.0	15,937	29.8	14.1	1.84	1.94	16.2	15.4	1.7	1.5	11.0	10.3	4.5	4.7
Uni-President	1216 TT	Outperform	92.0	15,122	79.6	15.6	4.32	4.86	18.4	16.4	3.2	3.0	17.7	18.7	3.8	4.0
EGAT	2645 TT	Outperform	155.0	1,415	113.0	37.2	5.15	7.24	21.9	15.6	3.2	3.1	14.5	20.1	4.1	5.8

Source: KGI Research and KGI estimates

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