Strategy

AI long-term outlook unchanged; Taiex to consolidate at elevated levels

Key message

1. We expect the Taiex to remain range-bound at elevated levels over the next month, as bullish and bearish factors largely offset each other.
2. Supported by TSMC (2330 TT) and robust AI-related demand, we raise our 2026F earnings growth forecast for Taiwan equities from 40% to 48%, while maintaining our 2027F earnings growth forecast at 23%.
3. Prioritize allocations to AI supply chain following recent valuation corrections, as well as low-base sectors with improving fundamentals.

Event

We expect Taiex to remain range-bound at elevated levels over the next month, as bullish and bearish factors are likely to offset each other. Investors may consider trimming positions as the index approaches its previous high of 47,000–48,000 points, while accumulating positions in tranches on pullbacks toward the previous low range of 40,000–43,000 points.

Analysis

A tug-of-war between EPS upgrades and PE multiple compression. Since the emergence of the AI boom in 2023, TSMC's (2330 TT) earnings calls have consistently served as a catalyst for upward revisions to earnings forecasts, supporting a more optimistic outlook on the Taiex. Looking ahead to the upcoming earnings season, we believe this positive cycle could play out once again. At its July 16 earnings call, TSMC raised both revenue and capex guidance, which is likely to drive earnings upgrades across its supply chain and support the Taiex's earnings uptrend which has held since 2023.

However, another force cannot be ignored - persistent uncertainty surrounding inflation which has led to volatile movements in US Treasury yields. As a result, the Taiex has increasingly been caught in a tug-of-war between earnings upgrades and valuation pressure. When investors focus on positive EPS revisions, equity prices tend to respond favorably. Conversely, when bond yields rise and concerns over higher funding costs resurface, PE multiples often come under pressure. The interaction of these opposing forces is likely to limit the potential for a sustained directional move in the near term, leaving the market more prone to range-bound trading at elevated levels.

Fund flows – Steady domestic inflows continue to offset foreign selling pressure. While persistent foreign net selling has increased the risk of market corrections, a steady stream of new domestic capital has flowed into the Taiex via recurring monthly ETF contributions, providing meaningful downside support.

More specifically, monthly contributions from Taiwanese investors through recurring investments in Taiex ETFs have risen from approximately NT$10bn a year ago to more than NT$20bn currently. When factoring in the capital amassed from lump-sum subscriptions, the amount of fresh capital entering the market is even more substantial. We estimate that ETF-related inflows reached NT$767bn in 1H26 alone, exceeding the NT$725bn recorded in all of 2025.

These domestic inflows have played a key role in absorbing approximately NT$1tn of foreign net selling year-to-date. In fact, since the outbreak of COVID-19 in 2020, foreign investors have been net sellers on the Taiex in every year except 2023, with cumulative net selling totaling approximately NT$3.7tn. Over the same period, capital inflows into ETFs have accumulated to roughly NT$2.8tn. This tug-of-war between domestic and foreign capital has been a major factor behind the resilience of the Taiex in recent years, and supports our view that investors need not be overly pessimistic during market pullbacks.

Industry cycle – Market focus has shifted from the scale of AI investment to monetization. Over the past three years, the market's primary focus has been whether AI-related capital spending would continue to expand. As long as the scale of investment kept rising, earnings expectations and share prices were well supported. However, investor attention is increasingly shifting from the scale of investment to the returns on those investments, with greater emphasis on whether AI spending can be translated into tangible earnings growth and sustainable commercial value.

From a fundamentals perspective, major cloud service providers (CSPs) continue to ramp up capital expenditures, supporting solid order visibility across TSMC, ASIC-related supply chains, high-speed connectivity, and thermal suppliers. As such, near-term fundamentals remain solid, with no meaningful signs of deterioration. However, investors are no longer focused solely on the pace of capex growth. Instead, key questions have shifted to whether AI agent commercialization is accelerating, whether CSPs can generate returns on their AI investments, and whether AI applications can translate into realized revenue streams.

This shift in market focus suggests that AI will be a key long-term driver of Taiex fundamentals, and should provide downside support to the market in the short-term. At the same time, the market currently lacks a sufficiently strong catalyst to drive earnings expectations materially above consensus. As a result, while fundamentals remain positive, the likelihood of the index breaking decisively above previous highs and entering a new leg of the bull market in the near term appears more limited.

Conclusion & top picks

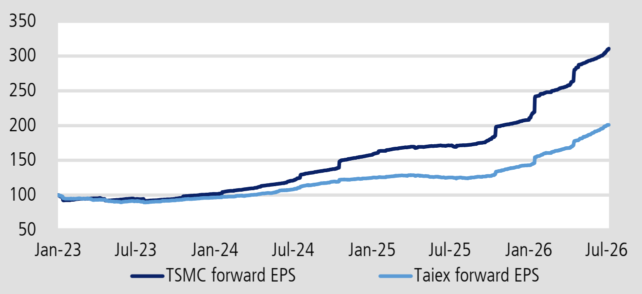
Synthesizing the three observations above — the tug-of-war between earnings upgrades and interest-rate volatility, the inflow of domestic capital offsetting foreign selling pressure, and the AI industry transitioning from an investment-driven phase to one focused on monetization, we believe the Taiex is more likely to be range-bound at elevated levels over the next month, rather than enter a sustained directional trend. Under this scenario, a "buy low, sell high" strategy remains the most pragmatic approach. Investors may consider taking profits and managing risk as the index approaches the previous high range of 47,000–48,000 points. On the other hand, should the market pull back to the 40,000–43,000 point range, we recommend accumulating positions in tranches, focusing on AI supply chain names with sustainable competitive advantages and growth sectors supported by solid fundamentals. This approach should help balance risk and return potential while awaiting the next major bullish catalyst.

From a medium- to long-term perspective, we maintain our view that the Taiex could reach 50,000 points by year-end, and 55,000 points over the next 12 months. Supported by TSMC's upward revision to guidance and continued strength in AI-related demand, we have raised our forecast for Taiex 2026F earnings growth from 40% to 48%, while slightly adjusting our 2027F earnings growth forecast from 25% to 23%. Within the technology sector, we now project 2026F earnings growth of 55%, up from 48% previously, while maintaining a robust 30% earnings growth forecast for 2027F.

In terms of positioning, we recommend prioritize allocation to AI supply chain whose valuations have corrected to more attractive levels, as well as low-base sectors with improving fundamentals and meaningful earnings recovery potential.

Figure 1: Since the AI boom in 2023, every upbeat outlook from TSMC has triggered upward earnings revisions, supporting the Taiex earnings outlook

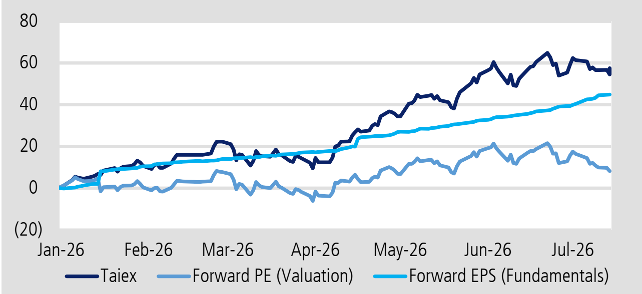
TSMC forward EPS vs. Taiex forward EPS (Jan. 1, 2023 = 100), points



Source: FactSet; compiled by KGI Research

Figure 2: Stock prices tend to strengthen when the market focuses on upward earnings revisions; however, rising yields often put pressure on valuation multiples, As these two forces clash, the Taiex will exhibit a high-level, range-bound pattern

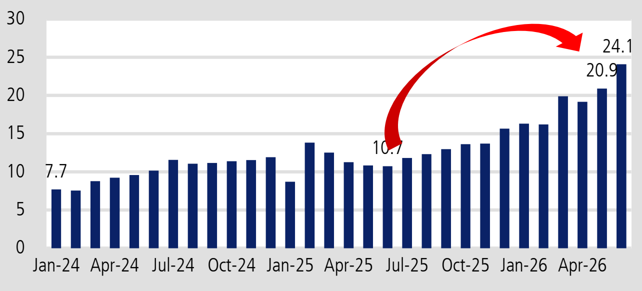
Taiex vs. forward PE vs. forward EPS (normalized, base = 0), points



Source: FactSet; compiled by KGI Research

Figure 3: Monthly recurring investments into Taiex ETFs have increased from NT$10bn to more than NT$20bn, providing a steady source of new capital & downside support

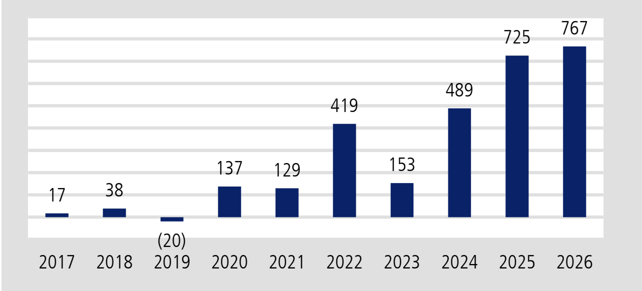
Monthly recurring investment inflows into Taiex ETFs, NT$bn



Source: SITCA; compiled by KGI Research

Figure 4: Taiex ETFs attracted NT$767bn of net inflows in 1H26, exceeding the total of NT$725bn in all of 2025 & setting a record

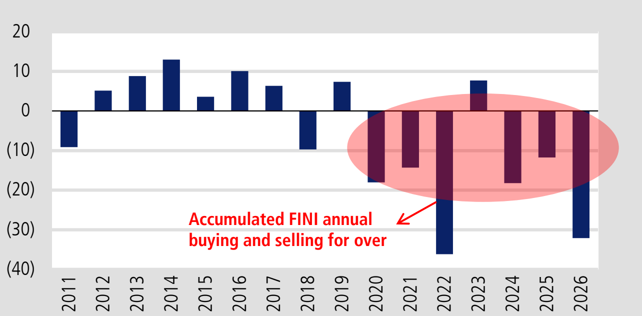
Annual net inflows into Taiex ETFs, NT$bn



Source: Bloomberg; compiled by KGI Research
Note: 2026 data are as of end-June 2026.

Figure 5: Since the COVID-19 outbreak in 2020, foreign investors have been net sellers of Taiwan equities in every year except 2023, with cumulative net selling reaching NT$3.7tn

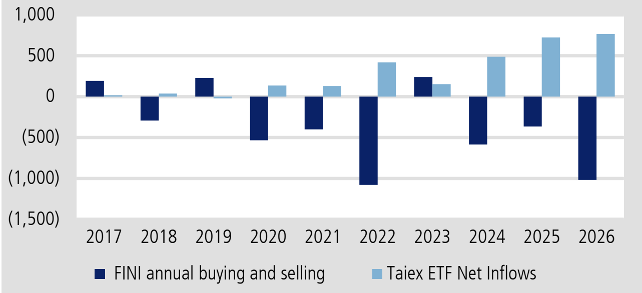
Annual net foreign buying/ selling of Taiwan equities, NT$bn



Source: TEJ; compiled by KGI Research
Note: 2026 data are as of end-June 2026.

Figure 6: Taiwanese investors have continued to channel funds into the market through Taiex ETFs, generating a steady stream of new capital that has effectively absorbed substantial foreign selling pressure since 2020

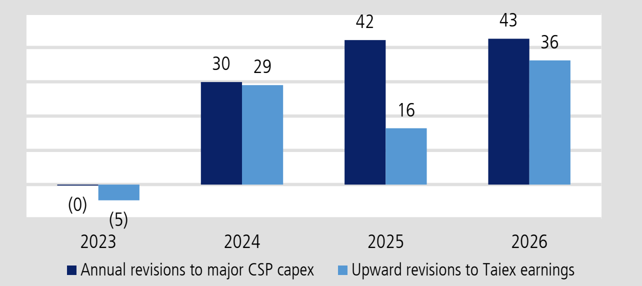
Net foreign buying/ selling of Taiwan equities vs. net inflows into Taiex ETFs, NT$bn



Source: TEJ; Bloomberg; compiled by KGI Research
Note: 2026 data are as of end-June 2026.

Figure 7: Over the past three years, capex increases by major CSPs have driven upgrades to Taiex earnings forecasts, forming the key pillar of the bull market

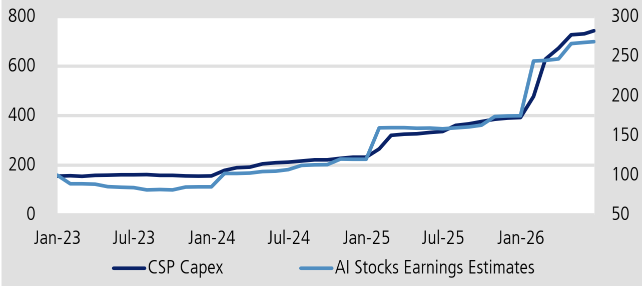
Annual revisions to major CSP capex forecasts vs. upgrades to Taiex earnings forecasts, percent



Source: Bloomberg; compiled by KGI Research

Figure 8: Rising capex by major CSPs has driven earnings upgrades across the AI supply chain, serving as the core engine of the Taiex's AI bull market since 2023

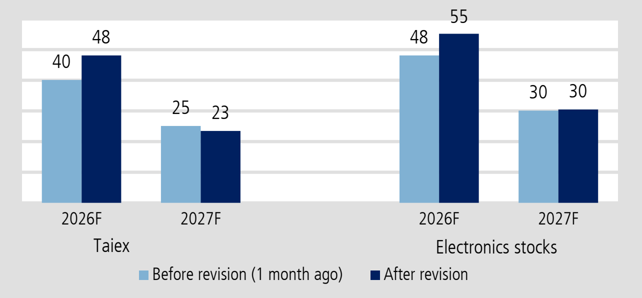
Major US CSP capex forecasts, US$bn (LHS); Taiex AI stocks earnings forecast, points (RHS)



Source: Bloomberg; compiled by KGI Research
Note: Earnings forecast index normalized to 100 at end-2022.

Figure 9: Following TSMC's positive analyst meeting and robust AI demand, our 2026F earnings growth forecast for the Taiex has been raised from 40% to 48%, while our forecast for technology stocks has been increased from 48% to 55%

Taiex and technology sector earnings YoY growth, percent



Source: TEJ; compiled and estimated by KGI Research

Figure 10: Taiex & corresponding valuations

2026F PE	Equivalent index level (points)	2027F PE	Equivalent index level (points)	26-27F Avg.PE	Equivalent index level (points)
15x	29,548	15x	36,475	15x	33,012
16X	31,518	16X	38,907	16X	35,213
18x	35,458	18x	43,770	18x	39,614
20X	39,397	20X	48,634	20X	44,016
21X	41,367	21X	51,066	21X	46,216
22X	43,337	22X	53,497	22X	48,417
23X	45,307	23X	55,929	23X	50,618

Source: TEJ; compiled and estimated by KGI Research

Figure 11: Our top picks

Company	Code	Investment rating	Target price (NT$)	Mkt cap (US$mn)	Share price (NT$)	Change +/- (%)	EPS (NT$)		EPS YoY (%)		PE (x)		PEG (x)		P/B (x)		ROE (%)		Cash yield (%)	
							2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F	2026F	2027F
DELTA	2308 TT	Outperform	2,910	139,670	1,740.0	67.2	41.54	72.01	79.5	73.4	41.9	24.2	0.5	0.3	12.7	9.2	34.5	44.2	1.2	2.1
EMC	2383 TT	Outperform	6,860	49,773	4,495.0	52.6	92.16	171.51	125.4	86.1	48.8	26.2	0.4	0.3	24.1	14.9	56.3	70.1	1.2	2.3
Unimicron	3037 TT	Outperform	1,000	40,263	794.0	25.9	14.31	27.77	240.7	94.1	55.5	28.6	0.2	0.3	10.0	7.8	20.4	31.8	0.8	1.6
ZDT	4958 TT	Outperform	695	17,853	521.0	33.4	16.92	26.71	166.7	57.9	30.8	19.5	0.2	0.3	4.0	3.5	13.8	19.3	1.6	2.6
Hon Hai	2317 TT	Outperform	315	101,767	234.0	34.6	17.94	21.46	32.3	19.6	13.0	10.9	0.4	0.6	1.7	1.6	13.7	15.3	4.1	4.9
MediaTek	2454 TT	Outperform	6,150	167,031	3,370.0	82.5	67.98	111.95	2.8	64.7	49.6	30.1	18.0	0.5	12.8	11.2	26.3	39.5	2.0	2.0
Chipbond	6147 TT	Outperform	280	4,107	178.5	56.9	5.30	7.45	41.6	40.8	33.7	23.9	0.8	0.6	2.5	2.4	8.2	11.2	2.2	3.1
HON	7769 TT	Outperform	8,800	68	6,070.0	45.0	122.62	221.68	78.4	80.8	49.5	27.4	0.6	0.3	16.0	11.8	34.9	49.5	1.4	2.6
AVC	3017 TT	Outperform	3,450	26,696	2,200.0	56.8	94.49	132.70	92.9	40.6	23.3	16.6	0.3	0.4	13.3	9.2	67.1	64.6	1.8	2.5
NTC	2408 TT	Outperform	720	42,168	395.5	82.0	75.16	130.67	3775.8	75.9	5.3	3.0	0.0	0.0	2.9	1.5	86.9	74.3	5.7	9.9
CTBC Holding	2891 TT	Outperform	63	37,761	62.1	1.4	4.38	4.68	7.0	6.7	14.2	13.3	2.0	2.0	1.9	1.6	15.3	13.1	4.3	4.5
SINOPACHOLDIN	2890 TT	Outperform	42	17,914	40.0	5.0	2.81	2.67	53.2	(5.1)	14.2	15.0	0.3	(3.0)	2.0	1.7	14.7	12.2	4.1	4.0
MIC	9914 TT	Outperform	95	2,434	84.0	13.1	5.11	6.79	27.4	32.9	16.4	12.4	0.6	0.4	1.3	1.2	7.8	10.0	4.2	4.5

Source: Estimated and compiled by 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 interet in the respectively covered stock, issuer and/or new listing applicant.