

Strategy

Bull market continues; temporary fluctuations inevitable

Key message

1. AI-driven earnings upcycle to continue into 2026F, keeping current bull market afloat.
2. AI stocks to consolidate near-term on stretched valuations and potential of rising inflationary pressure.
3. AI stocks remain our top picks, but investors may want to revisit after valuations correct. For non-AI stocks, we recommend defense/ aerospace, financials, construction, F&B, and convenience store names.

Event

Since end-2022, the Taiex has doubled, driven by the AI frenzy. We believe the long-term structural bull run will continue, but we recommend exercising caution due to the risk of short-term consolidation.

Analysis

Taiex has doubled since end-2022 due to AI frenzy, but cumulative gains remain below historic peak. As of September, the Taiex has risen from a low of approximately 13,000 in late 2022 to nearly 26,000, marking cumulative gains of 100%. The rally has largely been driven by the AI supply chain, particularly semiconductor and AI server firms that have benefited from increasing CSP capex.

Despite the impressive performance, the magnitude of the ongoing rally is moderate when compared to historical bull markets. Before the 2000 dot-com bubble, the Taiex surged more than 150% in just two years. In 2007, amid a housing boom and notebook replacement cycle in the tech sector, the index climbed from 4,000 to nearly 10,000 points, for a 150% gain. In 2021, pandemic-driven demand shored up tech names and stay-at-home stocks, prompting the index to surpass 18,000 at one point, up almost 120%. In contrast, the current AI-driven rally appears more moderate, suggesting that investors have remained rational.

AI-driven earnings upcycle to extend into 2026F, keeping current bull market afloat.

Looking ahead, we expect the AI-driven earnings upcycle to sustain the current bull market through at least 2026F. Historically, stock markets tend to peak six months before earnings. A key indicator to watch is the capex trajectory of major CSPs. As long as the “Big Four” continue to revise up capex, demand will remain strong for Taiwan’s AI supply chain.

Moreover, AI applications are expanding beyond cloud computing into edge computing and end devices, which we believe will generate a second wave of growth before 2026. This will further drive semiconductor demand and extend the earnings peak for related suppliers through end-2026. According to our estimate, Taiex-listed firms registered aggregate 2024 earnings growth of 41%, and their earnings will grow by more than 10% in both 2025F and 2026F. The Taiex is currently valued at 2026F PE of 18x. If the valuation multiple expands to 19-20x, the index could reach 27,000-28,500.

Short-term volatility risk should not be overlooked. While the medium- to long-term structural bull trend remains intact, short-term volatility risk warrants attention. This risk is primarily driven by two key factors:

- (1) **Elevated AI stock valuations make them vulnerable to unexpected negative news, which could trigger a sell-off.** AI-related sectors have been the primary driver of the current bull market, with valuations reaching historically high levels. Hence, any unexpected negative news could induce profit-taking pressure, intensifying short-term market fluctuations. As the recent rally has been focused on AI stocks, a healthy technical correction or capital rotation towards lower-valuation, early-cycle sectors, such as financials, traditional industries, and domestic demand, could help maintain the bullish structure of the Taiwan stock market, while reducing the risk of chasing overvalued stocks.

(2) If inflation accelerates, liquidity-driven rallies may face headwinds. Over the past month, market expectations for US Fed rate cuts over the next year have been significantly revised, from 3.65% down to 3.0%, reflecting an additional 50-75 bps of easing. This shift has pushed US Treasury yields lower and weakened the US dollar, fueling capital flows into emerging markets and tech stocks, and driven Taiwan equities higher. However, with inflationary pressure in the US likely to re-emerge between late 3Q25F and early 4Q25F, the market may reassess the Fed's rate-cut trajectory. If the Fed delays rate cuts due to inflationary concerns, liquidity-driven momentum may lose steam, potentially leading to increased short-term volatility in Taiwan's equity market.

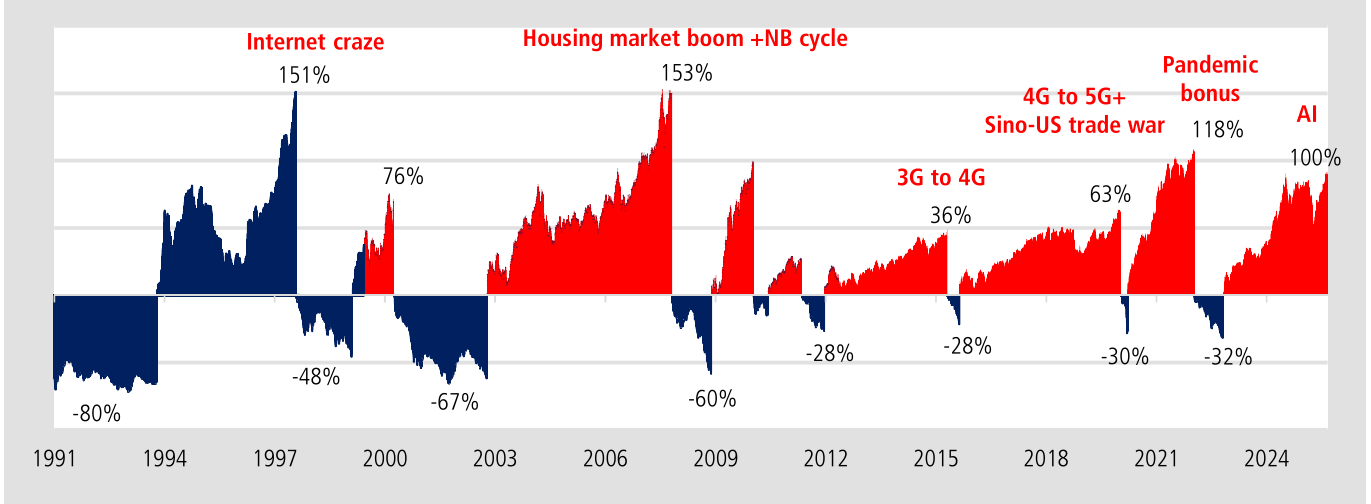
Conclusion & top picks

In summary, while Taiwan stocks have already recorded substantial gains during the current bull market, the AI-driven corporate earnings cycle continues to provide strong fundamental support, with momentum expected to carry into 2026F. Nonetheless, elevated short-term valuations and policy-related uncertainties may trigger volatility. Investors should remain vigilant, proactively adjust portfolio allocations, and closely monitor shifts in CSP capex and inflation trends.

We recommend investors focus on subsectors with notable spec upgrades, such as thermal management, networking PCB, power supply, and CCL, and consider a staggered entry during the correction phase. Additionally, given the relatively weak fundamentals of non-AI stocks, stock selection should be approached with caution. Sectors supported by policy or offering defensive characteristics, such as defense/ aerospace, financials, catering, and convenience stores, may present more resilient opportunities.

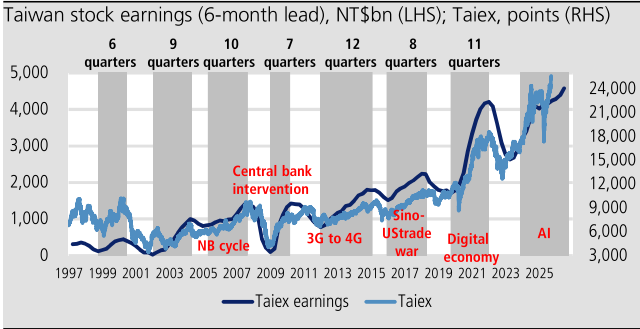
Figure 1: The AI frenzy has doubled Taiwan stocks since end-2022, but gains still trail historic bull markets

Cumulative gains during Taiwan stock market bull cycles & cumulative losses during bear cycles, percent



Source: TEJ; KGI Research compiled

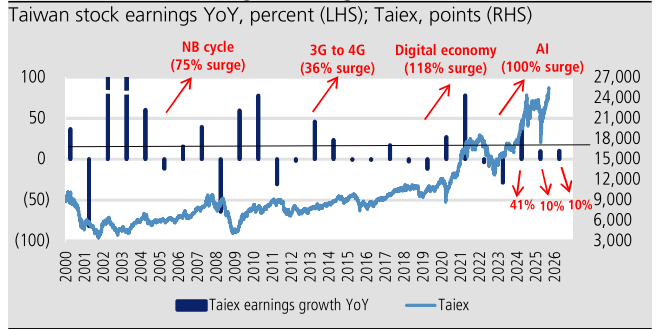
Figure 2: AI-driven corporate earnings growth cycle to extend through 2026F, providing solid foundation for TaieX bull market



Source: TEJ; compiled & forecasted by KGI Research

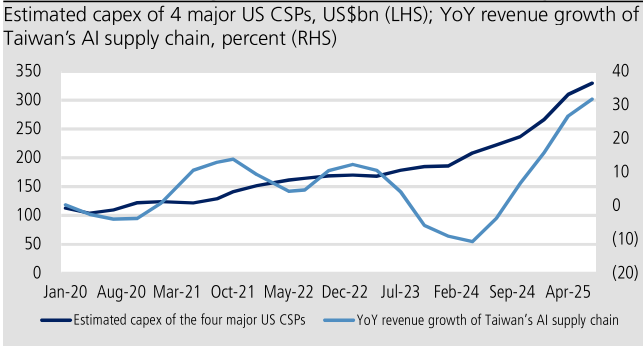
Note: Shaded area represents periods when corporate earnings are in upcycle.

Figure 3: During technological paradigm shifts, Taiwan stock profit growth has supported bullish momentum; market to maintain significant growth in 2024-26F



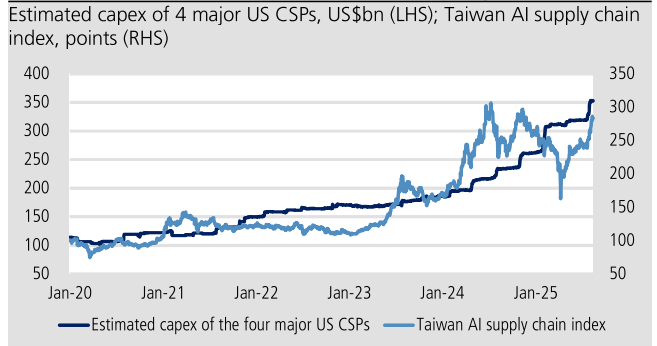
Source: TEJ; compiled & forecasted by KGI Research

Figure 4: Continued upward revisions to capex by 4 major CSPs to drive strong demand for Taiwan's AI supply chain



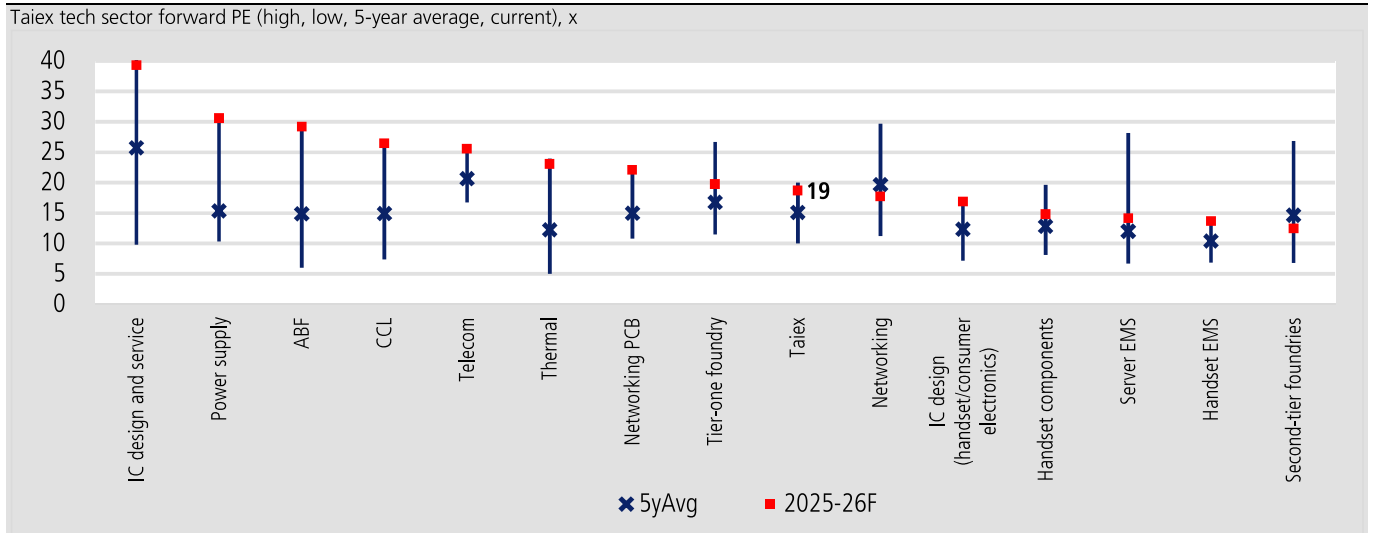
Source: Bloomberg; KGI Research compiled

Figure 5: Continued upward revisions to capex by 4 major CSPs to support bull run for Taiwan AI supply chain stocks



Source: Bloomberg; KGI Research compiled

Figure 6: Beyond foundries & server assemblers, AI subsectors like thermal management, power supply, CCL, & networking PCB hit five-year PE peaks



Source: TEJ; KGI Research compiled

Figure 7: In past month, the market expectation for Fed rate cuts has been revised down from 3.65% to 3.0%, dragging Treasury yields lower & weakening the US dollar, triggering a liquidity-driven rally

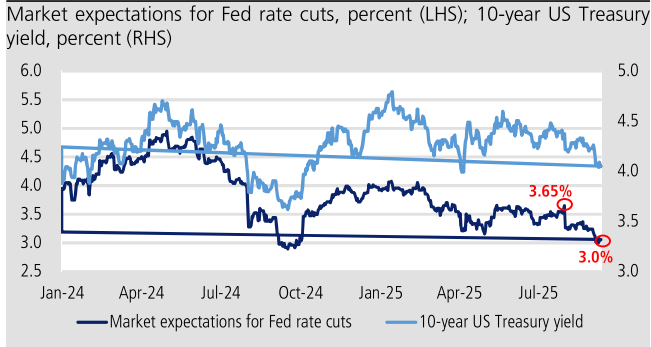


Figure 8: Emerging US inflationary pressure in late-3Q25F to early-4Q25F could prompt markets to reassess Fed's rate cut trajectory

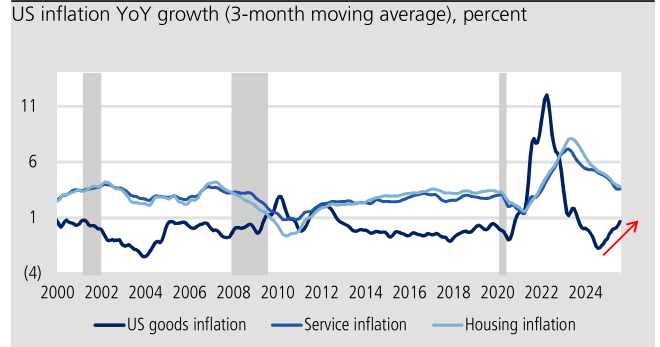


Figure 9: Taiwan stocks trading at 19x estimated forward 12-month earnings, with valuations approximately 1-2 standard deviations above historical average



Figure 10: Taiwan stocks trading around 19x estimated forward 12-month earnings, or 18x projected earnings for 2026

Taiwan stock valuation and index reference table

12M forward PE	Equivalent index level (points)	2026F PE (x)	Equivalent index level (points)
15x	20,027	15x	21,363
16x	21,362	16x	22,787
17x	22,697	17x	24,211
18x	24,032	18x	25,635
19x	25,367	19x	27,060
20x	26,702	20x	28,484
21x	28,037	21x	29,908

Source: TEJ; compiled & forecasted by KGI Research

Figure 11: Taiex projected earnings & valuations

Earning (NT\$bn)	2021	2022	2023	2024	2025F	2026F
Taiex	3,917	3,771	2,682	3,780	4,151	4,579
Taiex excl. TSMC	3,320	2,755	1,844	2,607	2,596	2,826
Tech	1,914	2,147	1,698	2,249	2,768	3,247
Tech excl. TSMC	1,317	1,130	860	1,075	1,213	1,494
TSMC	597	1,017	838	1,173	1,555	1,753
EPS growth (%)						
Taiex	78.1	(3.7)	(28.9)	40.9	9.8	10.3
Taiex excl. TSMC	97.4	(17.0)	(33.1)	41.4	(0.4)	8.8
Tech	51.7	12.2	(20.9)	32.4	23.1	17.3
Tech excl. TSMC	77.1	(14.2)	(23.9)	25.1	12.8	23.1
TSMC	15.2	70.4	(17.5)	39.9	32.5	12.8
P/E (x)						
Taiex	20.8	21.6	30.4	21.6	19.6	17.8
Taiex excl. TSMC	14.8	17.8	26.6	18.8	18.9	17.3
Tech	31.4	28.0	35.4	26.7	21.7	18.5
Tech excl. TSMC	20.9	24.4	32.1	25.7	22.7	18.5
TSMC	54.6	32.0	38.8	27.7	20.9	18.6

Source: Compiled & forecasted by KGI Research

Figure 12: Our top picks

Sector/ theme	Company	Code	Investment rating	Target	Mkt cap	Share	Change	EPS		PE		P/B		ROE		Cash yield	
				price	(US\$m)	price	+/-	(NT\$)		(x)		(x)		(%)		(%)	
				(NT\$)		(NT\$)	(%)	2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F
AI supply chain	DELTA	2308 TT	Outperform	686.0	72,216	836.0	(17.9)	20.43	24.51	40.9	34.1	9.0	7.8	22.5	24.6	1.3	1.5
	EMC	2383 TT	Outperform	1140.0	15,549	1315.0	(13.3)	45.28	58.33	29.0	22.5	10.3	8.2	39.5	40.4	2.1	2.7
	TSMC	2330 TT	Outperform	1350.0	1,090,946	1265.0	6.7	59.96	67.61	21.1	18.7	6.1	5.0	32.3	29.4	1.6	1.6
	Accton	2345 TT	Outperform	1180.0	19,873	1065.0	10.8	44.13	47.17	24.1	22.6	12.7	10.5	59.3	51.0	2.3	2.8
	AVC	3017 TT	Outperform	1350.0	13,048	1005.0	34.3	43.38	61.36	23.2	16.4	10.5	7.9	50.9	55.1	2.2	3.1
	Fositek	6805 TT	Outperform	1400.0	2,234	980.0	42.9	30.10	53.72	32.6	18.2	10.2	8.0	34.0	49.1	1.5	2.7
policy or offering defensive characteristics	GCE	2368 TT	Outperform	475.0	7,497	448.0	6.0	18.42	26.40	24.3	17.0	9.0	7.0	39.6	46.4	2.1	2.9
	Hon Hai	2317 TT	Outperform	245.0	97,940	212.0	15.6	13.24	15.32	16.0	13.8	1.7	1.6	10.9	11.9	3.3	3.8
	Alchip	3661 TT	Outperform	5280.0	10,128	3760.0	40.4	72.90	131.98	51.6	28.5	6.9	5.9	14.1	22.2	1.0	1.8
	ASEH	3711 TT	Neutral	155.0	24,896	169.0	(8.3)	7.59	11.92	22.3	14.2	2.2	2.1	10.0	14.9	3.2	4.1
	EGAT	2645 TT	Outperform	186.0	2,217	178.0	4.5	4.88	7.43	36.5	24.0	5.0	4.9	13.7	20.6	2.5	3.8
	CTBC Holding	2891 TT	Outperform	48.0	28,164	43.1	11.4	3.51	3.98	12.3	10.8	1.8	1.5	14.7	14.8	5.0	5.6
	E.S.F.H	2884 TT	Outperform	35.5	17,831	33.2	7.1	1.91	2.00	17.3	16.5	2.0	1.8	12.0	11.5	4.2	4.4
	CROWELL	2528 TT	Neutral	33.5	432	30.0	11.9	4.47	6.94	6.7	4.3	1.6	1.4	24.7	34.1	9.0	13.9
	PCSC	2912 TT	Outperform	303.0	8,643	250.0	21.2	11.88	13.36	21.0	18.7	5.7	5.2	28.2	29.2	3.6	3.6
	BAFANG	2753 TT	Outperform	234.0	444	200.5	16.7	11.96	13.02	16.8	15.4	3.5	3.3	21.7	22.4	4.5	4.9

Source: KGI Research estimates

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