Global Asset Management

Taiwan: third time's a charm?

Notes from the road

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I recently returned from a research trip to Taiwan where I met with our holding companies, as well as gathering some new ideas. It hasn't been a promising start to the year for the equity market, with the MSCI Taiwan Index losing approximately 14% of its market cap year-to-date. Taiwan was the standout performer in EM equities for the last two years, 2023 and 2024, but it's unknown yet whether 2025 could mark a third year.

Unsurprisingly, many of my meetings were in Hsinchu, the Silicon Valley of Taiwan. During my discussions with company management, I observed a notable shift in sentiment compared to my visit last year. In 2024, most tech companies were cautious, as AI-driven demand was growing but still represented a relatively small portion of revenues, and consumer electronics remained weak with no clear signs of recovery apart from modest re-stocking.

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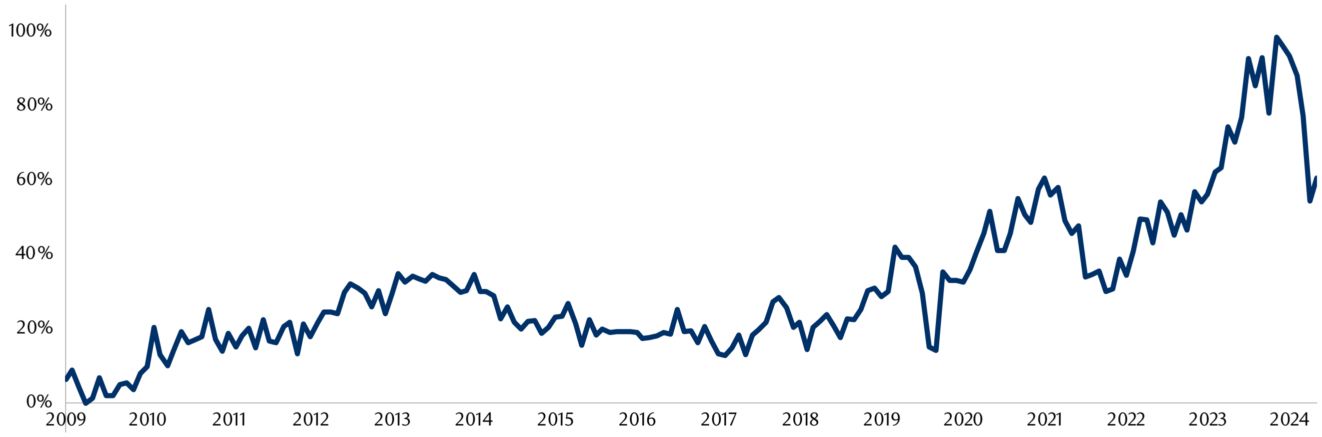
This year, however, the mood was far more optimistic. While Trump's 'Liberation Day' speech and the announcement of universal tariffs may have dampened sentiment recently, the executives I met with highlighted two key factors behind their confidence: firstly, the rapid expansion of AI markets, which have significantly increased revenue exposure for many companies, and secondly, early signs of a recovery in consumer electronics, particularly from Chinese smartphones and the beginning of a PC replacement cycle, the first since 2020.

Meeting with Voltronic CEO and founder.

Exhibit 1: MSCI Taiwan Index P/BV versus MSCI EM Index P/BV



Source: MSCI, Datastream, UBS, as at March 2025.

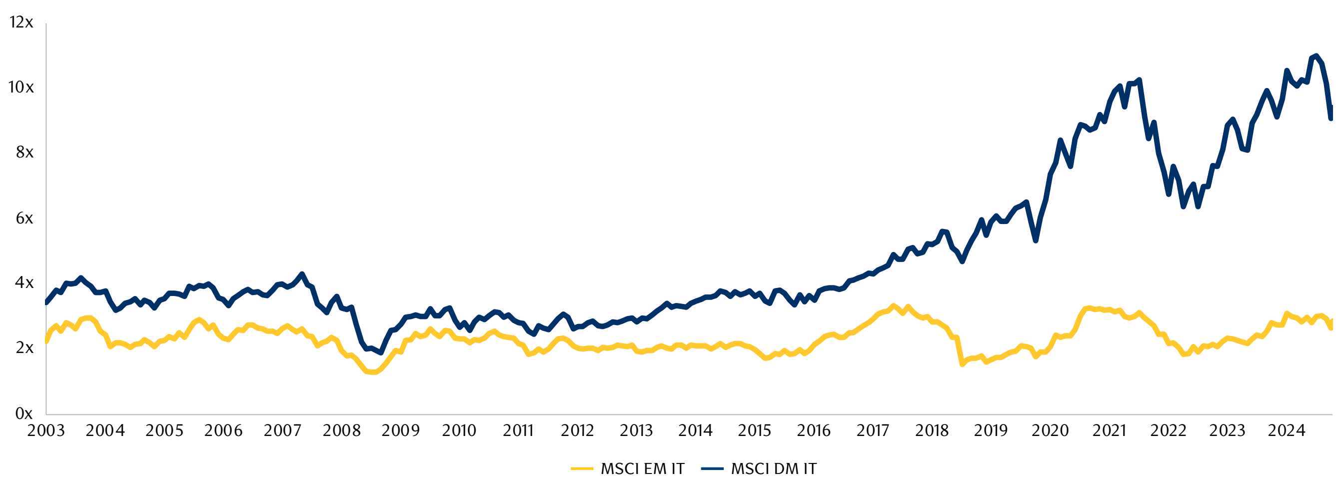
Despite this optimism, MSCI Taiwan Index's underperformance reflects broader market dynamics. At the beginning of 2025, Taiwan's price-to-book value (P/BV) ratio relative to the MSCI EM Index reached an all-time high, signalling that valuations had become stretched and disconnected from fundamentals (Exhibit 1). This was a trend we were observing across the IT sector globally, including in Taiwan, which houses the majority of the AI hardware supply chain and where the IT sector accounts for 85% of total market capitalisation[1]. Since then, we have seen a market correction, bringing valuations back to more reasonable levels. However, in the short term, we believe that challenges still remain.

One key headwind is continued weakness in U.S. technology stocks, which has global implications for IT markets, including Taiwan's. While IT companies in EM now trade at fairer valuations and remain at a significant discount to their U.S. counterparts (Exhibit 2), IT remains a global sector and therefore EM tech stocks are unlikely to be immune from any future deterioration in the U.S..

Another challenge stems from the natural progression of the AI hardware cycle. In the early stages of a new technology cycle, such as AI, the emphasis is on hardware, with new products being produced on a regular basis, usually every few months. This has been extremely profitable for Taiwan's IT industry, which mostly produces hardware. However, the rapid pace of invention eventually slows, and the focus shifts towards maximising the value of hardware investments. Therefore, as the cycle evolves, the focus shifts toward software, cloud services, and IT services, areas where Taiwan's dominance is less pronounced. Additionally, valuations remain high, and earnings expectations have yet to adjust downwards. Historically, the most attractive opportunities in tech emerge after earnings estimates are revised lower and valuations normalise, neither of which have occurred yet.

On a structural level, there are positive developments that support the sector in the long term. The AI infrastructure market has consolidated around fewer, more influential customers, primarily large-scale hyperscalers.

Exhibit 2: MSCI EM IT Index P/BV versus MSCI DM IT Index P/BV



Source: MSCI, Datastream, UBS, as at January 2025.

[1] MSCI, April 2025.

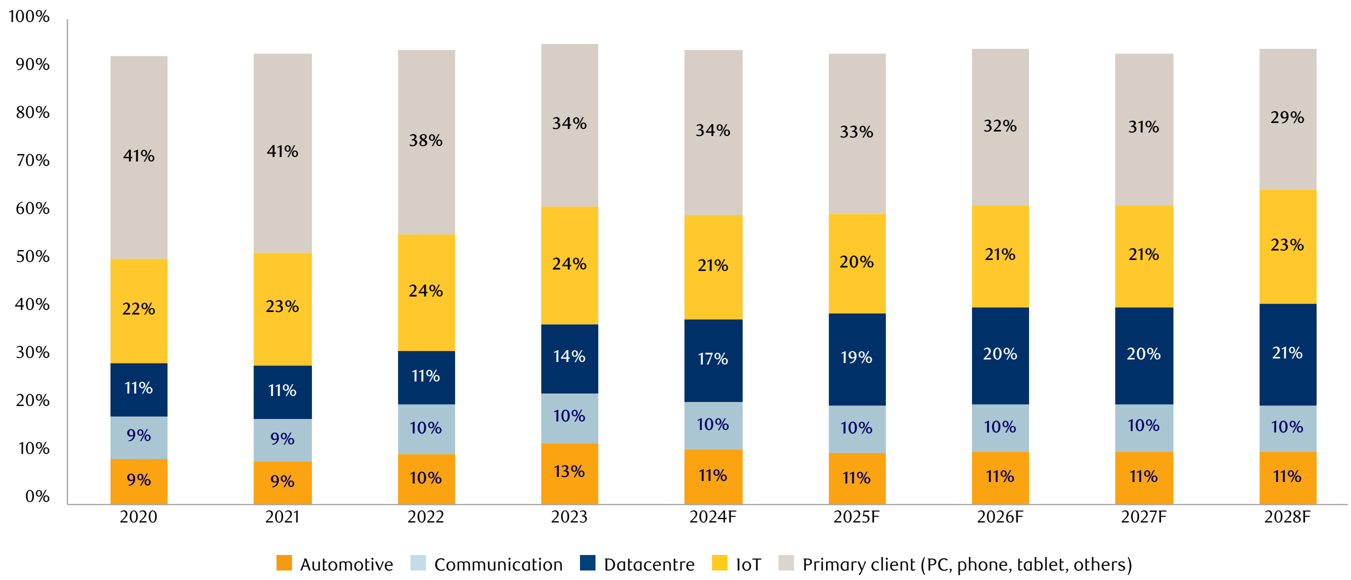
Datacentres have become the main driver of growth for hardware, and now account for one-fifth of global semiconductor demand (Exhibit 3). Unlike the highly fragmented consumer electronics market, characterised by short-term demand volatility across millions of customers, hyperscalers offer long-term visibility due to extensive, strategically planned investments. Significant consolidation across the technology supply chain has also occurred in the last decade, enhancing supply-side discipline. Additionally, because of the higher complexity of the products, supply chains are increasingly characterised by deeper integration and closer collaboration between hyperscalers and upstream suppliers, which increases visibility into product cycles and therefore lower inventory levels.

"Datacentre demand has become the main driver of growth for hardware, and now accounts for one-fifth of global expenditures in semiconductors."

Despite these favourable developments in demand and market structure, it is important to recognise that profitability in the global IT sector may have peaked in 2024. While the industry should continue to grow, we believe growth could be less profitable than in the past, due to several factors. Firstly, the amount of capital investments in hardware and the resulting speed of product innovation witnessed in the last two years are unlikely to be repeated. We also expect lower returns from EM corporates' overseas expansions, particularly in the U.S.. Finally, China's drive for semiconductor self-sufficiency is likely to have negative consequences for non-Chinese technology, by reducing the total addressable market and potentially increasing competition in the long run.

Taking all these factors into consideration, Taiwanese equities could face further consolidation in the near term. The combination of stretched valuations, global tech sector weakness, and the maturing AI hardware cycle warrants a cautious approach. While the jury is still out on whether this period of consolidation will be cyclical or more structural in nature, we have moved to an underweight position in Taiwan tech and the IT sector more broadly.

Exhibit 3: Global semiconductor demand by application



Source: IDC, as at May 2025.

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Guido is a portfolio manager and head of research for the RBC Emerging Markets Equity team at RBC GAM. Guido is currently responsible for research in Taiwan and Central and Eastern Europe. Prior to joining the organisation in 2010, Guido worked as an emerging markets portfolio manager and also as an equities analyst at a U.K.-based asset management firm, specialising in global emerging market strategies. He had previously worked at a global asset management firm as a securities analyst, where he progressed to become a junior portfolio manager. Guido began his career in the investment industry in 1998 as an equity and derivatives trader in Italy

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