

# Taiwan: “It’s More Than Just a Tech Stock”

## What Asset Owners May Be Missing in Taiwan

February 2021

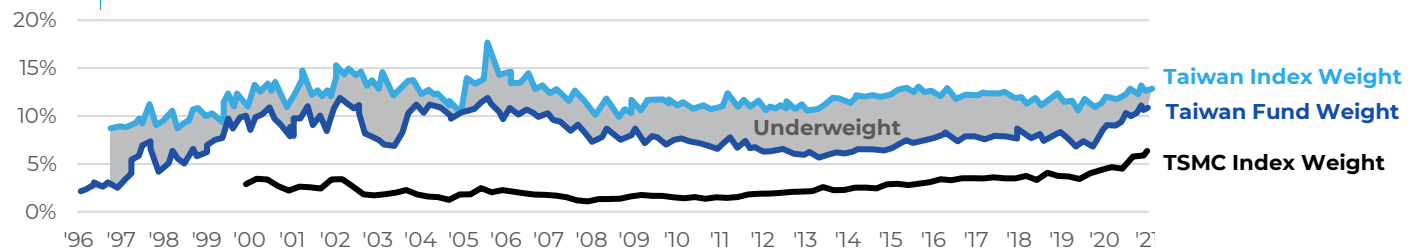
The best performing emerging market of the past decade gets no love from investors. Taiwan is a perennial underweight for active global emerging market (GEM) funds (see [Chart 1](#)), despite being the best performing market over the past decade (see [Chart 2](#)).

### Author



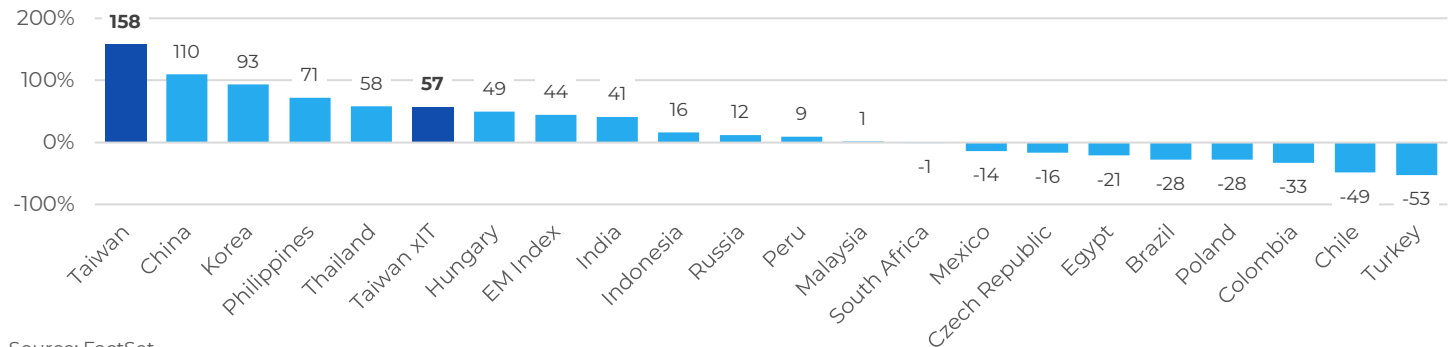
**Adam Choppin, CFA, APFI**  
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**Chart 1** Active GEM Funds Always Underweight Taiwan



Source: EPFR, RenCap, MSCI, FactSet

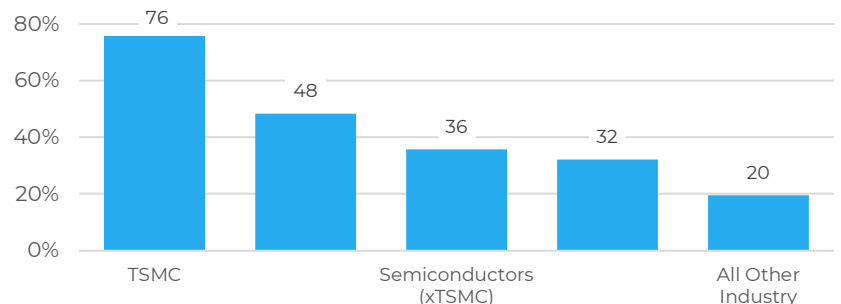
**Chart 2** Total Return 2011 to 2020



Source: FactSet

Moreover, the disregard from GEM managers is even more pronounced outside of the major market champion, Taiwan Semiconductor Manufacturing Co. (TSMC) and a handful of other tech and electronics companies (see [Chart 3](#)).

**Chart 3** Foreign Shareholding in Taiwan



Source: TWSE. As of 1/28/2021. Foreigners include mainland Chinese investors.

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Yet, the data indicates this is unjustified. While Taiwan’s huge IT sector (led overwhelmingly by TSMC) has represented the bulk of the market’s returns over the past decade (+241% cumulative), Taiwan xIT has also handily outperformed the MSCI EM Index over this time, with especially strong downside protection (see [Table 1](#)).

**Table 1** Taiwan xIT has also Handily Outperformed the MSCI EM Index

	2011- 2020	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
MSCI EM	43.90%	-18.41%	18.26%	-2.38%	-2.03%	-15.14%	11.17%	37.31%	-14.53%	19.06%	18.30%
Taiwan	<b>157.81%</b>	-20.82%	16.74%	<b>9.09%</b>	<b>9.37%</b>	<b>-11.72%</b>	<b>18.50%</b>	27.55%	<b>-8.93%</b>	<b>36.42%</b>	<b>41.03%</b>
Taiwan xIT	<b>57.01%</b>	-16.64%	12.12%	<b>13.57%</b>	-3.05%	<b>-11.3%</b>	<b>13.05%</b>	21.67%	<b>-0.58%</b>	16.48%	7.97%

Source: FactSet

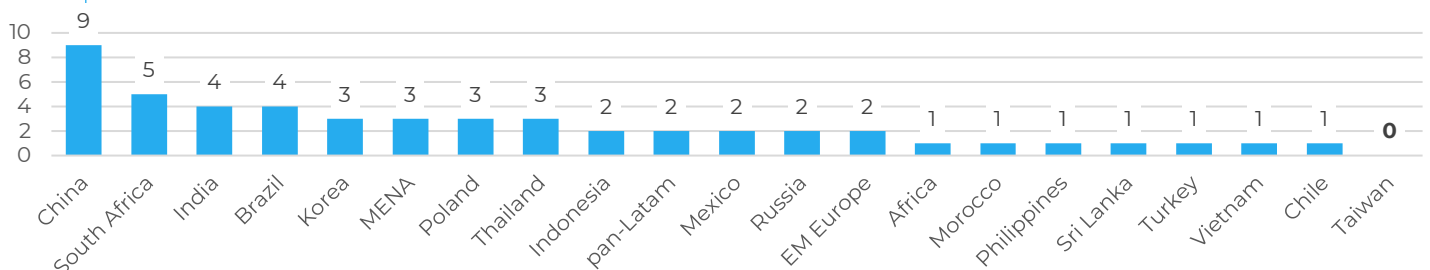
## Where is the Herd?

Defying the behavioral biases that seem to be plaguing other markets, Taiwan’s decade of outperformance has failed to attract the attention of independent fund managers both GEM and Asia specialists. Those who “disregard” Taiwan generally fall into two camps:

1. “Development diehards”, who ignore Taiwan because they deem it an already rich country, “emerging” in name only, without the potential of outsized market returns based on the tailwinds of demographics and concomitant economic growth.
2. The tech uninitiate, who see Taiwan as a glorified Apple supply-chain market and feel they can just buy TSMC at index weight and spend precious travel and research time on their “core areas of competence”.

Adding insult to injury, Taiwan gets no love at home or from its neighboring markets either. One of the largest local independent asset managers in Taiwan, with over \$2bn in AUM and a team of 76 people ( 63 of them in Taipei), offers a half dozen different strategies in Chinese equities, **but not a single one for Taiwan**. Taiwan’s largest asset management business (with over \$35bn in AUM and a 15% market share) told me recently that there is simply “no market for active Taiwanese equities” (most of their business is in ETFs and smart beta products). Even Norges Bank, famous for their use of local EM specialists, has not a single allocation to a dedicated Taiwan manager (see [Chart 4](#))! A former analyst for one of the world’s largest multi-managers with over \$300 billion in AUM, told me in a recent interview that the lack of specialized expertise in Taiwan was the main obstacle preventing them from launching their version of a global EM multi-manager product using country specialists.

**Chart 4** Norwegian SWF Number of Specialist EM Country/Regional Managers 2019 Annual Report



Source: Norges Bank Investment Management 2019 Annual Report. [www.nbim.no](http://www.nbim.no).

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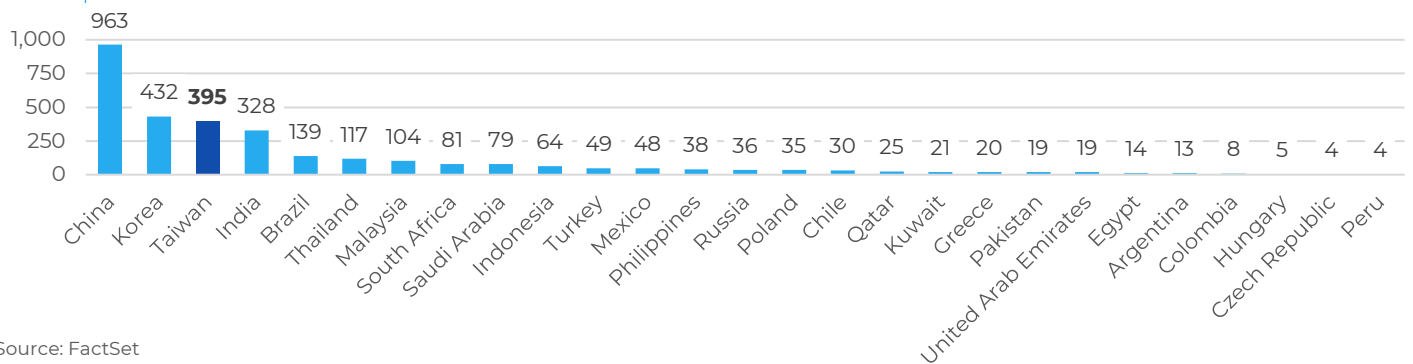
Part of the problem may be with Taiwan’s market champion, TSMC. The enormous weight of TSMC in the index (now over 30% of the local TAIEX index and 46% of the MSCI Taiwan), is a material barrier to local active managers given market regulations. Local Taiwanese regulations limit single stock weights to 10%, without any index relative weighting in active funds, whether for government pension funds or mutual funds. Given the exceptional returns of TSMC over the past decade, this makes it difficult for active managers to outperform. Many, including some of the firms mentioned above, have thus taken to closing their active funds and shifting to passive funds and ETFs. Local regulations do allow active funds to own ETFs at high portfolio weights, allowing managers to increase their weight in TSMC indirectly through local sector ETFs, but fees are a steep 50-70bps, serving as a drag on fund returns. Meanwhile, restrictive regulation has essentially eliminated the local market for independent hedge funds altogether.

There are talented specialists in the Taiwanese equity market; however, most of them can now be found (or are at least headquartered) in Hong Kong or Singapore. There, they have been increasingly drawn towards the booming market in Chinese e-commerce stocks, so most talented Taiwanese specialists are actually running tech or consumer/tech funds focused on “greater China.”

## The Taiwan Opportunity

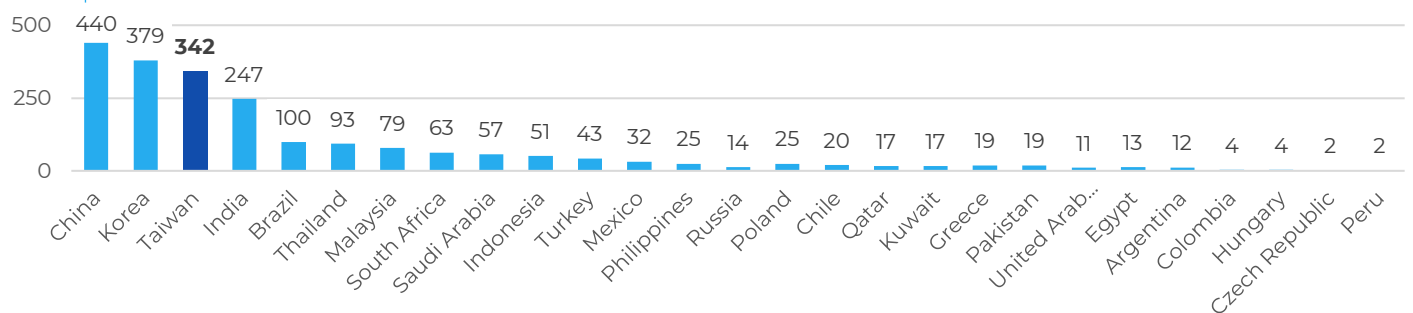
This phenomenon of relative “indifference” has created one of the world’s deepest markets in neglected (and attractive) small and mid-cap stocks. Of Taiwan’s 395 “investible” companies, (as classified by MSCI), 342 are under \$5bn and thus effectively cut off from most global EM funds (73% of the market is less than \$2bn market cap, see [Charts 5](#) and [6](#)). Meanwhile China has over half of its investible market in large cap stocks.

**Chart 5** Number of Names, MSCI EM IMI Indices



Source: FactSet

**Chart 6** Number of Names < \$5 Billion, MSCI EM IMI Indices



Source: FactSet

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Thus, investors are ignoring an abundance of potential alpha from high performing, liquid stocks beyond just TSMC. The Taiwanese market is well known for above average corporate governance and healthy dividends. Moreover, Taiwan increasingly appears to be a safe haven economy due to its fiscal prudence, monetary orthodoxy, and super effective public health management. In our opinion, GEM investors should give Taiwan a second look and more love in the 2020s!

**Table 2** | Taiwan Stockpicking Opportunity Set

	2015	2016	2017	2018	2019	2020
Top stock return	183.6%	118.0%	380.5%	104.8%	233.1%	332.8%
TSMC annual return	0.7%	34.3%	41.4%	-1.4%	57.9%	75.7%
# stocks outperforming TSMC	109	60	98	118	56	44
# stocks outperforming TSMC >\$2bn mc	14	9	19	37	20	23

Source: FactSet. Based only on MSCI Taiwan IMI constituents (year beginning).

To learn more about how Xponance employs local experts in Taiwan, please [click here](#).

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