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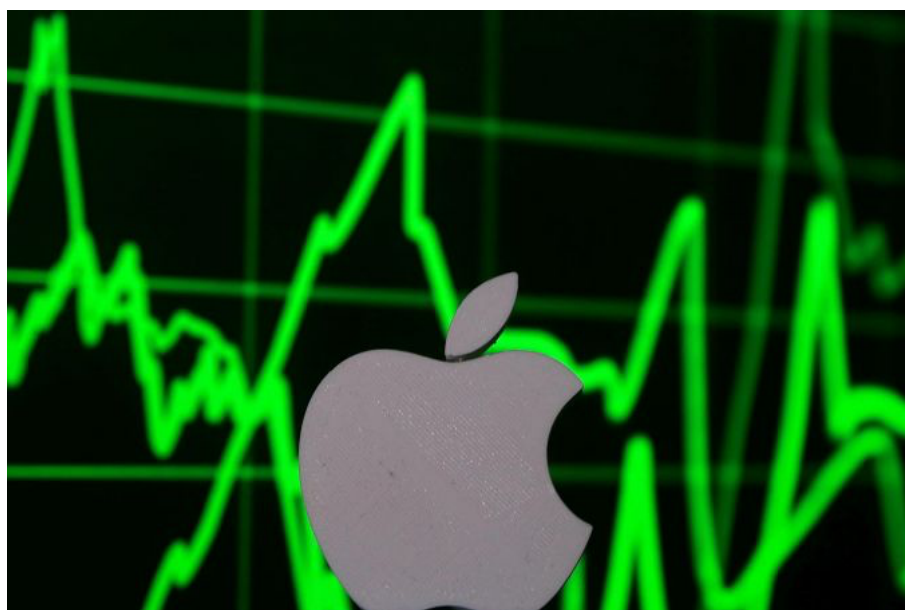
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Apple, not China, is JPMorgan's biggest risk for Taiwan stocks

THU, MAY 19, 2016 - 1:52 PM



For investors in Taiwan's US\$841 billion stock market, Tim Cook matters more than Tsai Ing-wen. PHOTO: REUTERS

[TAIPEI] For investors in Taiwan's US\$841 billion stock market, Tim Cook matters more than Tsai Ing-wen.

While the ascension of independence-leaning Ms Tsai to the presidency on Friday has sparked concern relations with China will deteriorate, JPMorgan Asset Management and BlackRock Inc say the bigger risk is the slowdown in the global smartphone business.

Apple reported its first quarterly sales decline in 13 years, with chief executive officer Mr Cook acknowledging on April 26 that - nine years after the iPhone's game-changing debut - the market had "stopped growing."

That's bad news for the island's largest companies, which help build the devices. Taiwan Semiconductor Manufacturing Co and Hon Hai Precision Industry Co both reported falling profit last quarter.

Investor confidence in Taiwan's stock market reflects "export demand, and by far the dominant export demand factor is electronics and Apple in particular," said Howard Wang, Hong Kong-based head of greater China for JPMorgan Asset Management, which managed US\$1.7 trillion as of March 31.

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"Any negative from Tsai can easily be washed out if the iPhone 7 does well."

Strait Ties

Exports account for about two-thirds of Taiwan's economy, with electrical equipment and machinery comprising half of all outbound shipments. Ms Tsai, who succeeds Ma Ying-jeou on Friday after winning elections in January, has shown no sign she will accept the principle that the island and China are both part of "one China" - a understanding that's underpinned eight years of improving ties across the Taiwan Strait.

Foreign investors pulled a net US\$2.2 billion from Taiwan's shares this quarter, the most among eight Asian markets tracked by Bloomberg, as signs of a deterioration in the smartphone market grew.

A gauge of technology companies on the MSCI All-Country World Index is the worst performer among 10 industry groups in the period, falling 4.5 per cent, while Apple has plunged 13 per cent.

The outflows are a reverse of March, when overseas funds pumped US\$5 billion into the island's stock market, the most since 2007. Stocks rallied as Apple's biggest monthly gain in almost three years lifted confidence in its suppliers and the victory by Ms Tsai, whose Democratic Progressive Party won its first legislative majority, failed to trigger a significantly negative reaction from China.

Forecast Cut

Falling profits at the island's technology companies are now weighing on the Taiex Index, with aggregate earnings dropping 24 per cent in the first quarter. Hon Hai's earnings slid 9.2 per cent. Pegatron Corp, which assembles iPhones, missed profit expectations and said April sales dived 16 per cent.

TSMC, one of the largest manufacturers of the application processors that are a mobile device's brains - cut its 2016 smartphone demand forecast in April. Its major customers include Apple, Qualcomm Inc and Huawei Technologies Co, according to data compiled by Bloomberg.

At the same time, Taiwanese firms such as Acer Inc and Compal Electronics Inc are still struggling to rebound from the downturn in personal computers, another key export for the island.

The technology industry's failure to develop new must-have products is darkening the outlook for Taiwan companies, says Andrew Swan, head of Asian equities at BlackRock, who is underweight on the island's shares.

Profitability Destroyed

"More and more tech spend has gone into software rather than hardware and Taiwan companies tend to be more hardware- driven," Mr Swan said at a press briefing in Hong Kong this week.

"Now that smartphones are fairly well saturated, technological breakthroughs haven't been keeping up to pace. That process has destroyed profitability for the sector."

The Taixex dropped 0.9 per cent to its lowest level since May 4 at 1 pm in Taipei. TSMC slid 0.3 per cent, while Hon Hai fell 0.4 per cent.

Still, investors will be watching China's reaction to Ms Tsai's inauguration speech closely for any signs of a change in approach toward the island. In March, Chinese President Xi Jinping vowed to "resolutely contain 'Taiwan independence' secessionist activities in any form," a warning to Ms Tsai's incoming government.

The Communist Party considers the island a province, even though it has been governed separately for more than 66 years, and reserves the right to use force to prevent it from moving toward formal independence.

Current President Ma improved economic relations with China, Taiwan's largest export buyer. The DPP's charter officially supports independence, although Ms Tsai and other leaders have sought to play down the provision.

For Stevie Chou, Taipei-based head of equities at Manulife Asset Management (Taiwan), Ms Tsai is unlikely to want to upset China. He favors companies linked to biotechnology and national defense, which are among the sectors her campaign highlighted.

"Taiwan having a government that's uninterested in unification with China is nothing new," Mr Chou said, referring to two former presidents who leaned toward independence.

"Tsai won't provoke China. She will focus on economic and social issues."

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