THE TAIWAN FUND, INC. (NYSE: TWN)

Manager's Commentary

Market Review

The Taiwan Stock Exchange closed the month of July 2021 down 2.35% in U.S. dollar terms, with the technology sector down 1.42%, non-technology down 8.21%, the financial sector up 0.61% and OTC stocks up 1.16%. The top three outperforming sectors were LED & optical components, software-others and integrated circuit-others. The bottom three underperforming sectors were freight transportation, paper and integrated circuit-DRAM (Dynamic Random Access Memory) manufacturing.

Fund Manager

Corrina Xiao
Lead Portfolio Manager

Allianz Global Investors

Fund Review (Attribution Reports)

The Taiwan Fund, Inc. (the "Fund") underperformed the Taiwan TAIEX Total Return Index (the "benchmark"). Sector allocation was negative, while stock selection was positive. On the sector level, the Fund's overweight positions in semiconductors and semi equipment, as well as underweight positions in capital goods, automobiles & components and materials helped the performance. The overweight position in healthcare equipment & services, along with the underweight positions in transportation, banks and insurance detracted from performance. At the stock level, the best active contributors were Kinsus Interconnect Technology Corp., Nuvoton Technology Corporation and Wan Hai Lines Ltd.; the worst active detractors were Evergreen Marine Corp., Pegavision Corporation and Fulgent Sun International Holding Co. Ltd.

Key Transactions

This month, we continued to adjust our allocations toward technology to capture the growth in this sector, as we exited many cyclical positions, including those in cement, petrochemicals, glass, marine transportation and machinery. The positions we exited included Taiwan Cement, Formosa Petrochemical Corp., Taiwan Glass Group, Evergreen Marine Corp. and AirTAC International Group. In financials, we also took profits in Fubon Financial Holdings.

Further, during its second quarter earnings call, the management of Taiwan Semiconductor Manufacturing Co., Ltd. (TSMC) emphasized that demand is intact across the high-performance computing (HPC), 5G SoC (systems-on-chip)/infrastructure, automotive and accelerating IoT (internet-of-things) themes. This lends support to the specification upgrade trend in ABF (Ajinmoto build-up film) substrate and HPC, as well as the electric vehicle supply chain, both of which are themes we have favored for some time. As a result, we added more to our holdings in Kinsus Interconnect Technology Corp. and Alchip Technologies, and initiated new positions in Via Labs and Parade Technologies Ltd., among others.

Finally, this month, Intel unveiled the roadmap for its process and packaging technologies through 2025 and beyond. Intel's product roadmap, including plans to expand in-house chip capacity, looks very aggressive and this could cause sentiment on TSMC to suffer in the second half of 2021. However, we think that this potential weakness may represent a point in time to revisit TSMC.

Outlook and Strategy

As we move forward into the third quarter of 2021, the outlook is shifting to 2022, which now favors a resurgence in the technology space. It might be too early to call the winners, as consumer demand is still subject to great uncertainty. Some tech names have suffered this year due to a combination of the chip shortage, cost hikes in materials, rising shipping costs and foreign exchange losses. This provides food for thought as to whether this is the time for bottom fishing. However, we always aim to invest in stocks that have the potential for multi-year growth. Following TSMC's positive outlook, as discussed above, several sectors may benefit from cyclical upswings.

Another major story this month has been based around speculation on where TSMC will build its new fabrication plants. Its enormous capital expenditure plan is known to total circa US$100bn, which is expected to be deployed between 2021 and 2023. Of course, most of this investment will be in Taiwan, however options for overseas locations include the United States, China and Japan.

There will certainly be at least one new plant in the United States, with around US$12bn earmarked for U.S. investment. We think there will be a five nanometer node, with U.S.-based design capacity initially totaling around 20,000 wafers per month. Mass production should be on-line by the end of 2023 or early 2024 at the latest.

Considering options for a new fabrication plant in Japan, newspaper reports speculate that TSMC could build a 40 nanometer or 28 nanometer fab there, with design capacity of around 40,000 wafers per month.

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Outlook and Strategy (continued)

Regarding the expansion of Chinese fabrication capacity, the capex plan has put aside around US$2.8bn, to be spent over 2021 and 2022. Due to the impact of U.S. trade restrictions on high tech equipment and patents, there is a significant degree of uncertainty surrounding any new foreign investment in the Chinese fab space. However, if the expansion takes place, it is likely to include a 28 nanometer facility with capacity of 40,000 wafers per month. A 28 nanometer node would be less controversial, since it is no longer cutting edge technology.

Lastly, this month has seen a series of developments in China that have deeply affected capital markets there and overseas. Markets are re-rating the regulatory risks of doing business in the Mainland as a result. Taiwan is well-positioned as a stable, business-friendly safe-haven during this period. However, there is also the risk that a more systemic domino effect will be triggered by the recent Chinese moves. Despite the uncertainty these policies have caused, it remains clear that China is prioritizing the real economy, and especially the domestic chip sector, for growth.