

THE TAIWAN FUND, INC. (NYSE: TWN)

Manager's Commentary

Market Review

The Taiwan Stock Exchange closed the month of December 2021 up 5.20% in US dollar terms, with the technology sector up 5.16%, non-technology up 5.13%, the financial sector up 4.91% and over-the-counter ("OTC") stocks up 5.49%. The top three outperforming sectors were digital camera, scanners, and LCD-TFT panel. The bottom three underperforming sectors were department stores, golf and software - other.

Fund Review (Attribution Reports)

The Taiwan Fund, Inc. (the "Fund") underperformed the Taiwan TAIEX Total Return Index (the "benchmark"). Both sector allocation and stock selection were negative. On the sector level, there were no overweight positions to help performance, but underweight positions in retailing, energy and real estate helped performance. In contrast, the Fund's overweight positions in health care equipment & services and semiconductors & semi equipment hurt performance. Underweight positions in transportation, capital goods and consumer durables & apparel also hurt performance. On the stock level, the best active contributors were Formosa Sumco Technology Corporation, Novatek Microelectronics Corp. and GlobalWafers Co., Ltd.; the worst active detractors were Mediatek Inc., Tatung Co. and Asmedia Technology Inc.

Key Transactions

We took some profits this month on one of our more successful stock picks of the year. ebike and server battery manufacturer Advanced Energy Solution Holding Co., Ltd. is experiencing what we view as a frothy valuation at the moment, trading at around 40 times FY 2022 earnings. We deemed it prudent to reduce our exposure somewhat, although we do still like the company.

Also in December, we exited United Microelectronics Corp., which continues to be out of favor with analysts as it expects the semiconductor cycle to peak by mid-2022. We believe we can find more efficient uses for funds in the interim. We sold out of panel-maker Innolux Corp. too, as news out of China suggests that new panel capacity coming online in the second half of 2022 may now target the information technology sector. This will hurt the company, which focuses on the notebook segment.

Lastly, we exited Tatung Co., as surprise resignations by both the new Chairman and the new CEO negated the investment thesis that drove our investment in the firm.

On the plus side of the ledger, we increased positions in the memory sector (Nanya Technology Corporation and Winbond Electronics Corp.) and added to marine shipping (Evergreen Marine Corp. (Taiwan) Ltd. and Wan Hai Lines Ltd.). We will comment extensively on the reasoning for these allocations in the Outlook and Strategy section.

Other purchases in December were opportunistic, based on inexpensive share prices. We see opportunity in LARGAN Precision Co., Ltd., Yageo Corporation and Win Semiconductors Corp., as their stocks have not reflected the value in their businesses adequately over 2021. These companies all represent good upside potential with limited downside risk, in our view.

Outlook and Strategy

2022 could be a year of significant change for the markets. Inflation has turned out to be less transitory and more persistent than initially imagined and the United States, in particular, is experiencing ongoing consumer price index prints that are among the highest in the world. A more inflationary environment will tend to benefit cyclical stocks and companies with good earnings growth, rather than the more speculative growth stocks which have dominated for so much of the last decade.

For Taiwan, cyclical sectors include the passive component manufacturers, memory manufacturers and shipping lines. These industries also currently benefit from relatively attractive valuations, since stock prices for many companies did not move significantly over 2021. Additionally, some very well-run companies in these sectors are offering yields over 5%. We scaled up our existing holdings in these three sectors in December and our exposure to cyclical stocks is now approaching our intended target level.

Apart from cyclical names, we also like companies with strong earnings profiles, especially in the semiconductor space. However, there is a need to be selective within integrated circuits ("IC") because many firms already experienced strong earnings growth over 2021, which may become increasingly difficult to maintain into 2022. Taiwan Semiconductor Manufacturing Co. ("TSMC") announced that it will raise prices in 1Q22 but was one of the last companies to do so. We expect that this should lead to continued improvement in gross margins at TSMC. Other firms will find this more challenging as capacity constraints become less severe in specific areas, such as display driver IC.

Fund Manager



Corrina Xiao
Lead Portfolio Manager



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Outlook and Strategy (continued)

Another of our preferred-related plays is Ajinomoto build-up film (ABF) substrate, which is predicated on the tech upgrade cycle. Demand for high-performance computing is still enjoying continuous growth, with the latest driver being the trendy metaverse story. Servers, PCs and laptops will all need to step up to match the demands of the next iteration of the internet as it takes shape over the next several years.

Uncertainty over investor response to the planned Fed tightening is a key consideration for us as we enter the new year. The market may suffer from large swings and the policy response to these will largely dictate equity performance for the year. We suspect some kind of "taper tantrum" would likely be met with easing by the Fed, given the ongoing pandemic and the recent failure to secure support for the Build Back Better bill. The only thing that is certain is that uncertainty will be higher in 2022.

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