

CEFA:

Welcome to CEF Insights, your source for closed-end fund information and education, brought to you by the Closed-End Fund Association. My name is Diane Merritt. Today we are joined by Corrina Xiao, Portfolio Manager with Allianz Global Investors. We're happy to have you with us today, Corrina.

Corrina:

Thank you Diane, it's great to be here.

CEFA:

Corrina, you specialize in Taiwanese equity investments. First, thinking from a macro point of view, we have had a very volatile period in global economies and investment markets. Can you update us on how the Taiwan economy has done over the first half of 2020, and how you see it positioned going forward?

Corrina:

Yes. Taiwan's economy is strongly export-oriented. Furthermore, the exports are mostly technology-related, such as integrated chip. This has put the island in the interesting position in which we are able to potentially benefit from the decoupling we are seeing between the U.S. and mainland China. Of course, we are also exposed to the downside risk with events in both of these major economies and in the global economy as a whole. However, the Taiwan tech industry is in general very robust, flexible and skilled at reducing production costs during times of crisis. And on the other hand, we also are home to one of the world's largest companies, Taiwan Semiconductor Manufacturing, which is a giant in terms of R and D and in the fabrication industry globally. This company can be said to be the backbone of Taiwan's economy, dominating the market with 22% of total market capitalization.

Regardless of who comes out on top in this confrontation between China and the USA if there can be any real winners in a trade war TSMC will remain the key link in the international supply chain for advanced IT, due to their massive lead in technology. Beyond technology exports, Taiwan also has robust domestic consumption, running at around 53% of GDP in 2019. Although underrepresented in the domestic equity space, domestic consumption has held up extremely well during the global pandemic, as Taiwan manages to minimize the impact of the first wave of COVID-19. So only roughly 450 cases in seven days -- this means there was no lockdown here, and GDP growth was up 1.69% year on year at the end of first quarter. Finally, the exchange rate between the new Taiwan dollar and the U.S. dollar is quite stable.

CEFA:

Corinna, you manage The Taiwan Fund symbol TWN, a closed-end fund for U.S. Investors. This fund is a bit unique among closed-end funds, with its focus on equities in a single country. What are the characteristics of the Taiwan equity market? And what is your approach in constructing the portfolio?

Corrina:

As I mentioned earlier, Taiwan has one major tech company that dominates the market. This means that foreign investors tend not to look very closely at the wider market here, with almost no analyst coverage, especially in the English language, outside of Taiwan. The result is that there is a whole range of very high-quality investment targets that remain virtually unknown to foreign investors. This of course is something we can take full advantage of with our local knowledge and detailed bottom-up analysis. In terms of market cap, technology accounts for around 60% of Taiwan's equity market as a whole; the market therefore is strongly impacted by the tech product cycle. I think it occupies such a key part of the supply

chain for so many major players, such as Apple. This tech product cycle in turn drives shorter cycles in supply and demand across a wide array of components.

Keeping up to date on new developments in the product cycle is vital. In terms of a technology advance, the cycle can be very short. Once more, often informed investors' days are short to generate alpha. Other general features of the market include the high-dividend yield, driven by a high A-R ratio and cash generated burn; very low gearing across the complete spectrum as a whole; and the fact that few companies in Taiwan use share buybacks, on top of the tech trade as the original goal for Asia in global perspectives, for example, compared to the markets that we see in the mainland China, or the U.S. tech trade.

Finally, Taiwan has an exceptional high standard of operating governance, especially considering it is placed in the "emerging market" bucket by many investors. In fact, the economy is as advanced as any in East Asia, with standards to match. To summarize, our approach attempts to combine the best of bottom-up stock picking and an informed top-down view of the cycle, given the local market, to construct a premier portfolio.

CEFA:

This year, we have seen significant volatility across markets, and many of the headline risks are still unsettled. What has the impact been on valuations of equities in your market?

Corrina:

Mm, again, since we are most heavily weighted to tech stocks in the global supply chain, the fortune of Taiwan's market, we will know... or maybe global market... We saw a very sharp sell-off earlier this year, followed by an equally rapid recovery. Then Asia in March became incredibly attractive during the worst days of the sell-off. Tech has led the liquidity driven recovery globally. And so in Asia, here in some sectors are at or even above levels we saw in January of this year. Nonetheless, Taiwan offers some very compelling opportunities from a valuation perspective.

CEFA:

Do you see differences in Taiwanese equity valuations compared to those of U.S. equity markets?

Corrina:

Taiwan equities typically trade at a lower multiple than their peers in the USA. This is due to several factors, including the size differential between the markets, the amount of analyst coverage, and the misinformation of Taiwan equities and market. As we already discussed, there are reasons to believe that Taiwan is a far more developed market than the EM label suggests. Hence, we think there is a strong case to be made for U.S. investors to buy some of Taiwan's equities.

CEFA:

Are there opportunities at these valuations going forward?

Corrina:

The highly cyclical nature of this market generates good opportunities naturally to enter and exit at an attractive valuation, regardless of the improvements in the average market wide multiples since March. There are always moments when good price points present themselves for us to invest in well-managed companies. Apart from the usual atmosphere of the short and mid-term component and product cycles, we see excellent opportunities on the long-term thematic basis. We all know that 5G is going to create an entirely new technological era for the global economy. And Taiwan is an integral part of the story.

Furthermore, the demand for cutting-edge chips will continue to grow. This is an area where Taiwan has undisputed dominance. Lastly, as the trade war seems to be evolving into a kind of Cold War fight, Taiwan will likely benefit as the West and regional alliance seeks a reliable partner. I believe any shifts of demand from Chinese firms in the tech supply chain may favor Taiwan.

Of course, as the direction becomes confirmed, we are exposed to the risk of heightened volatility in the global market, in these very uncertain political and macroeconomic environments. We do seek to mitigate this, however, using a partial hedge to insure the portfolio against real market downsizing, when we see issues in the demand side, policy initiatives that are not market friendly, or when innovation becomes very strained.

CEFA:

Corinna, passive investment strategies in various asset classes have gained a lot of traction in recent years. Allianz is an active investment manager. For a market like Taiwan, what advantages do you see for an active manager with respect to managing risk and adding to performance?

Corrina:

As I told earlier, we actively trade the various market cycles that assert themselves in Taiwan. In addition, we may hedge the market downside to protect the portfolio in more uncertain market environments. Furthermore, Taiwan is a complex market for overseas investors to analyze in the sense that there are very distinct and substantial barriers for foreign investors to gathering, monitor, or verify market information. This means there are many opportunities which go unnoticed which we are specialized in identifying.

Also, especially in Taiwan, professional traders tend to have a large cap bias. This is further compounded by the fact that many Asian markets are dominated by so-called "national champions," such as our own TSMC, or the Samsung Group in South Korea. This in turn means that an index, such as the MSCI, holds outsized investments in this company's stock. If a foreign investor wants to replicate the performance of the ETF trade team, the MSCI Taiwan, in many cases, they may as well, just by the ADR traded for TSMC in New York. We seek to do better than that for our investors.

CEFA:

As an investment manager, do you see benefits to managing the portfolio in a closed-end fund structure?

Corrina:

One of the key advantages for investment managers is that being a closed-end fund does not suffer as much from fund inflow or outflow and also during times of investor overconfidence or panicking activity. By definition, the capital is limited to the shares in issue and the sentiment of the investment community is reflected in the discount or premium to a NAV in which the shares trade. This can provide flexibility for an investment manager during times when market retract, allowing us to make purchases when others may be forced to exit positions at or near the bottom of the market sell-off.

CEFA:

U.S. investors are typically underweight in their allocations to non-U.S. investments. How do you see a financial advisor or investor best positioning an allocation to Asian markets, and particularly Taiwanese equities, within an investor's diversified portfolio?

Corrina:

When selecting investment overseas, investors are naturally less certain of markets with which they may be unfamiliar. In this period of heightened tension between mainland China and the USA, there may be even more uncertainty than usual. Nonetheless, we all know that return is the flip side of risk. And it is exactly in this circumstance that outsized returns are possible for investors. Taiwan has often been overlooked as just a part of the greater China story.

As the recent pull of events has shown, however, Taiwan offers distinct opportunities when compared to regional markets. With valuations stretched in U.S. markets, Taiwan is the growth story in an environment which offers rule of law, good governance. So U.S. investors who want an entry point into the global tech supply chain at valuations far more attractively priced than elsewhere would do well to consider an investment in Taiwan high-tech.

CEFA:

Corrina, thank you so much for taking the time to join us today.

Corrina:

Thank you.

CEFA:

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