



# What Was Behind Recent Market Correction

August 2024

Taiwan stock market was hit by AI worries amid stretched valuations, US recession concern and capital outflows. Looking ahead, though it may be premature, we remain our base case for a soft landing. With AI trend on track, fundamentals remaining sound and stock markets cooling off, rate cut effect, earnings results of major tech players and industry outlook are to watch when investors' shaky confidence will be restored.

By Cathay SITE

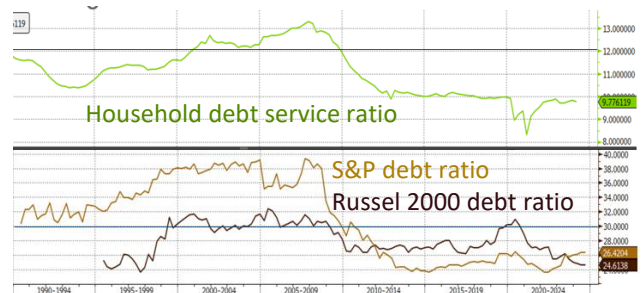
## Reasons behind market correction

Taiwan's benchmark plummeted 7.9% on 5 August, extending previous week's sell-off spurred by fears of a recession in the United States. The sudden turn looks to be driven by below factors.

- 1). Japanese yen has been strengthening against the US dollar since the Bank of Japan raised interest rates at the end of July. Stronger yen triggered carry trade unwind and altered the dynamics of capital flows.
- 2). The market rout began after weaker-than expected economic data in the US sparked concerns about the world's largest economy. Is the US heading for recession? Has the Fed waited too long to act?
- 3). On top of all these are technology companies and their share prices. Market rumors suggested that Nvidia may have to delay the release of its new AI chip due to a design flaw.

A range of signals in recent months pointed to a slowdown in growth and suggested monetary policy was restrictive in reining in demand and inflation. Investors now fret that the Fed may have waited too long to ease borrowing costs and the economy is losing speed, raising the risks of a recession. From mid-to long term perspective, we do not see recession within

view considering that household debt service ratio and corporate debt ratio are still below historical average levels. With Federal Reserve rate cuts incoming, there is still room to envision the economy avoiding a downturn.



Source: Bloomberg, compiled by Cathay SITE

## AI trend is here to stay

As for the reported chip delay, we do not expect it to change the mid- to long-term story for AI adoption. It remains clear that demand levels continue to rise, with all major CSPs continuing to grow their capex outlooks. As the AI arms race heats up, these CSPs will not stop or slow their AI infrastructure while working on capitalizing on AI applications. There has been a long-running rally in those technology shares. What markets were experiencing lately was an unwinding of that bullish positioning.

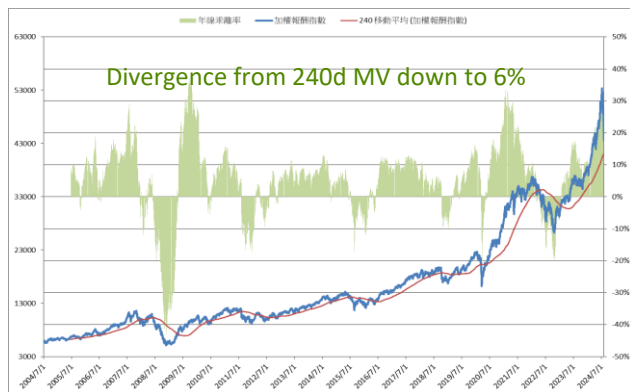
The U.S. and Taiwan stock market rally has been built on a handful of big technology companies that were fueled in part by optimism over AI. After such a strong rally since last fall, valuations, sentiment, and investor positioning



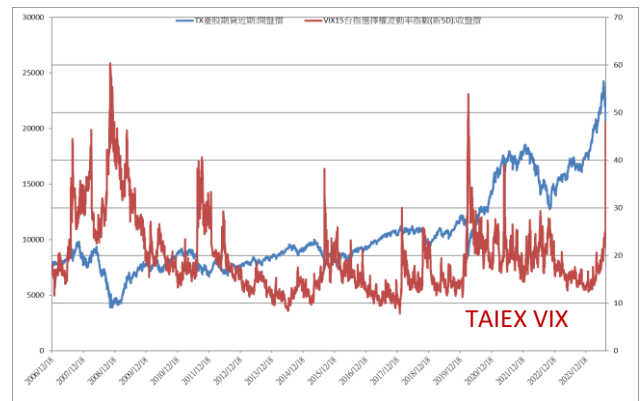
have become stretched. Having said that, most tech companies have been fine in terms of earnings results, meaning that the fundamental factors that lifted the indices to their peaks have not changed. Prior to last week, lofty expectations for the revenue and profit growth of those companies made it difficult for them to wow investors with solid earnings reports. Even if earnings came in as expected, the valuation multiples were so high that it was hard to sustain those prices.

**Indicators down from overheating**

After the market correction, some technical indicators that had shown signs of overheating have been brought down to more neutral levels. The rapid sentiment shift to extreme fear could be a sign that investors were too worried. We see the plunge more of panic or forced selling that was not supported by underlying fundamentals.



Source: Cmoney, compiled by Cathay SITE



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In a nutshell, Taiwan stock market was hit by AI worries amid stretched valuations, US recession concern and capital outflows. Looking ahead, though it may be premature, we remain our base case for a soft landing. With AI trend on track, fundamentals remaining sound and stock markets cooling off, rate cut effect, earnings results of major tech players and industry outlook are to watch when investors' shaky confidence will be restored.

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