

Taiwan Financials

The December Effect Revisited

■ Industry Overview

- **Pushing for a December rally** — We see catalysts coming together for a December rally, as risk appetite resumes, news flow on cross-strait reaccelerates, and FINIs too negative and underweight. We note the Taiwan financials index has consistently delivered positive absolute returns in December in ten times out of the past ten years, generating an average return of +5.9% in the month.
- **A precedent for outperformance** — We look at the past ten years data from 2002 to 2011 and financials index has consistently delivered positive returns in the month of December, ranging from a low +0.7% in 2005 to a high of +18.6% in 2010. Although we find that the Taiex also rises in December, financials outperform 60% of the time and on average by +2.5%. In fact, doing the same analysis but narrowing it to the past five years shows even stronger outperformance, with financials up +8.6% on average and beats the market 80% of the time by an average margin of +4%. Obviously the reasons for outperformance differ every year - ranging from cross-strait, M&A, to elections – but aside from plain old window dressing, we also note activity in the space also picks up a bit in Dec vs. the rest of the year with FINI volumes as a % of total volumes rising on average c50bps. Retail activity for the Taiex also increases slightly by an average 1.1ppt in Dec compared to the rest of the year.
- **Catalysts to watch out for** — [1] Shift from tech to non-tech; [2] News flow on cross-strait re-accelerating with onshore RMB business opening up and strategic stakes starting to materialize; [3] Positive revisions to consensus EPS estimates as earnings come in better-than-expected and banks manage impact of 1% GP implementation. Add to these a sizeable FINI underweight in the space, with FINI % ownership once again approaching lows at 8.3%.
- **Sector strategy** — We continue to bottom-fish the banks. Among large caps, we like Mega but as this is already consensus, we see an opportunity to revisit Chinatrust as a laggard with plenty of negatives likely priced in. We also push our non-consensus Buy on First, expecting property redevelopment theme to kick in. Among mid-caps, we push E. Sun and Taishin. We also like Yuanta as a high beta market proxy with excess capital likely to lead to more dividends and share buybacks as long as regional and domestic expansion plans stay on hold. We remain cautious insurers in the mid- to long-term on reinvestment risk and slower new business growth, but note valuations may have bottomed and could benefit from MTM in the ST. Among those we cover, Cathay provides higher beta, while Fubon is more defensive.

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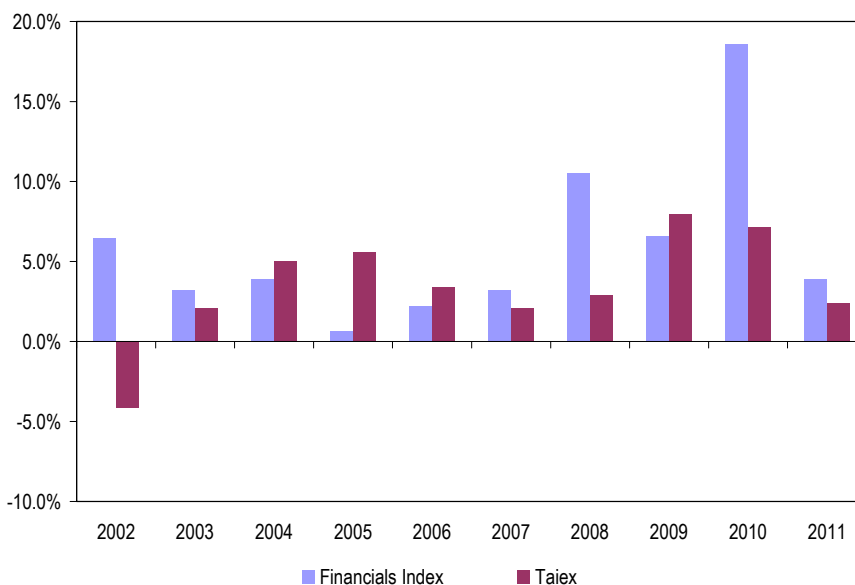
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Figure 1. Financials Index & Taiex – Absolute Returns in December, 2002 – 2011 (Percent)



Source: Citi Research

Figure 2. Financials Index Absolute Performance (Percent)

	Full Year	November	December
2002	-4.0%	-0.3%	+6.5%
2003	+26.5%	-6.2%	+3.2%
2004	+20.0%	-0.5%	+3.9%
2005	-15.0%	+3.1%	+0.7%
2006	+18.9%	+8.8%	+2.2%
2007	-11.5%	-9.7%	+3.2%
2008	-36.5%	+1.3%	+10.5%
2009	+52.7%	-1.7%	+6.6%
2010	+14.5%	-2.0%	+18.6%
2011	-24.6%	-14.6%	+3.9%
To date 2012	2.0%	4.7%	?
Average – 2007-2011	-1.1%	-5.4%	+8.6%
Average – 2002-2011	+4.1%	-2.2%	+5.9%

Source: Citi Research

Figure 3. Taiex Absolute Performance (Percent)

	Full Year	November	December
2002	-19.8%	+1.5%	-4.2%
2003	+32.3%	-4.5%	+2.1%
2004	+4.2%	+2.4%	+5.0%
2005	+6.7%	+7.6%	+5.6%
2006	+19.5%	+7.8%	+3.4%
2007	+8.7%	-11.6%	+2.1%
2008	-46.0%	-8.4%	+2.9%
2009	+78.3%	+3.3%	+8.0%
2010	+9.6%	+1.0%	+7.2%
2011	-21.2%	-9.0%	+2.4%
To date 2012	4.7%	3.4%	?
Average – 2007-2011	+5.9%	-4.9%	+4.5%
Average – 2002-2011	+7.2%	-1.0%	+3.4%

Source: Citi Research

Figure 4. Financials Index v Taiex Relative Performance (Percent)

	Full Year	November	December
2002	+15.8%	-1.8%	+10.7%
2003	-5.8%	-1.7%	+1.1%
2004	+15.8%	-3.0%	-1.1%
2005	-21.6%	-4.5%	-4.9%
2006	-0.6%	+1.1%	-1.1%
2007	-20.2%	+1.8%	+1.1%
2008	+9.6%	+9.7%	+7.6%
2009	-25.6%	-5.0%	-1.4%
2010	+4.9%	-3.0%	+11.4%
2011	-3.4%	-5.6%	+1.5%
To date 2012	-2.7%	1.3%	?
Average – 2007-2011	-7.0%	-0.4%	+4.0%
Average – 2002-2011	-3.1%	-1.2%	+2.5%

Source: Citi Research

Figure 5. Financials % Total Taiex Volumes (Percent)

	January to November	December	Difference
2002	9.0%	13.0%	+4.0%
2003	12.7%	16.0%	+3.3%
2004	16.5%	17.2%	+0.7%
2005	9.8%	6.8%	-3.0%
2006	7.4%	7.0%	-0.5%
2007	6.6%	6.4%	-0.2%
2008	11.4%	10.7%	-0.8%
2009	9.8%	5.9%	-3.9%
2010	7.3%	13.7%	+6.4%
2011	9.3%	9.6%	+0.4%
Average – 2007-2011	8.9%	9.3%	+0.4%
Average – 2002-2011	10.0%	10.6%	+0.6%

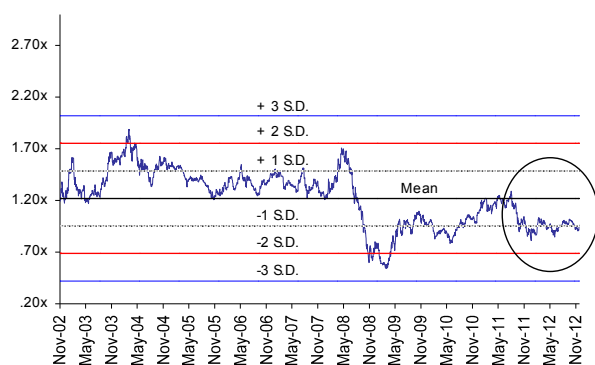
Source: Citi Research

Figure 6. Taiwan Financials – Ratings and Valuation, 26 November 2012 (NT\$, Times, Percent)

Name	RIC Code	Citi Rating	Price (NT\$)	Target (NT\$)	2012E (x, %)			2013E (x, %)			Dividend Yield (%)
					P/B	P/E	ROE	P/B	P/E	ROE	
Cathay FHC	2882.TW	Sell, 3	30.50	28.00	1.0	21.9	7.1	1.0	17.9	8.2	1.6
Chang Hwa Bank	2801.TW	Sell, 3	15.45	13.75	0.9	16.3	6.9	0.8	17.4	6.1	1.2
Chinatrust FHC	2891.TW	Buy, 1	16.30	20.00	1.2	10.6	12.3	1.1	10.5	11.6	2.3
E. Sun FHC	2884.TW	Buy, 1	15.55	19.00	1.0	11.7	9.1	0.9	11.2	9.1	1.2
First FHC	2892.TW	Buy, 1	17.40	22.50	0.8	14.9	7.9	0.8	15.4	7.3	2.2
Fubon FHC	2881.TW	Sell, 3	32.35	30.00	1.2	12.2	10.3	1.1	11.9	9.8	3.0
Mega FHC	2886.TW	Buy, 1	22.40	25.00	1.1	12.8	9.6	1.1	12.1	9.8	3.7
Shin Kong FHC	2888.TW	Sell, 3	7.88	7.50	0.6	5.9	10.2	0.5	6.4	8.5	0.0
SinoPac FHC	2890.TW	Sell, 3	12.00	10.25	0.9	12.8	7.5	0.8	14.0	6.5	1.1
Taishin FHC	2887.TW	Buy, 1	10.75	14.75	0.8	9.9	9.6	0.8	9.4	9.4	1.9
Yuanta FHC	2885.TW	Buy, 1	14.25	19.00	0.9	21.0	4.5	0.9	15.7	5.8	1.4

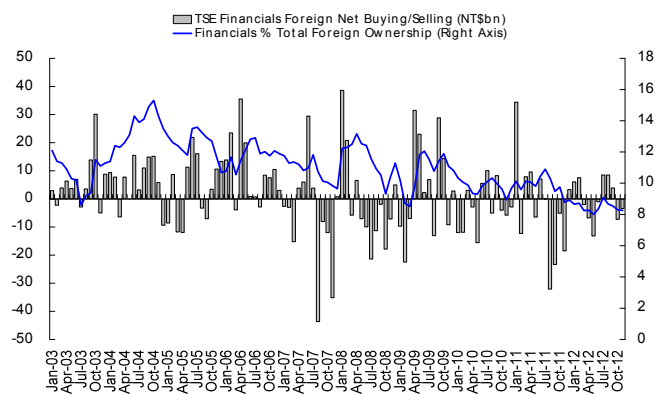
Source: Citi Research Estimates

Figure 7. Taiwan Financials – Sector Forward P/B vs. 10 Year Mean



Source: TEJ, Citi Research

Figure 8. Taiwan Financials – Monthly Net Foreign Buying and Selling Trends and FINI Ownership Levels, Jan 2003-Nov 2012



Source: TEJ, Citi Research

Appendix A-1

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