

Daily: Semis stumble. Time to reboot expectations?

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Thought of the day

Pressure has ratcheted up on global chip stocks in recent days, with the Philadelphia Semiconductor Index down around 8% over the last five sessions and South Korea's tech-heavy Kospi falling over 12% since the start of the month.

Investors have been grappling with concerns over the durability of AI spending, competitive risks from China's rising memory maker, higher-for-longer rates, and the debate surrounding OpenAI's reported revenue trajectory. Sentiment was further affected after Broadcom's CEO warned earlier this week that financing the AI infrastructure buildout could eventually become a greater constraint than component shortages, highlighting the demanding expectations embedded in AI-linked stocks.

But while volatility could persist as markets brace for third-quarter results and investors scrutinize the sustainability of AI-related investment, we maintain a constructive outlook on the structural opportunity. ASML earlier on Wednesday reported stronger-than-expected earnings and raised the low end of its 2026 revenue forecast for a third consecutive quarter.

Without taking a view on any individual companies, we see the chip-centered sell-off as more of a reset in expectations than a deterioration in the underlying AI investment cycle:

AI monetization trends remain strong. The market reaction was amplified by media reports suggesting OpenAI's revenue growth was falling short of expectations. Subsequent clarification indicated much of the discrepancy reflected differing accounting treatments rather than a meaningful change in demand. Looking beyond a single company, we continue to view cloud growth as one of the clearest real-time indicators of AI monetization. Expectations for further acceleration in hyperscaler cloud growth suggest AI investment is increasingly translating into commercial revenues rather than remaining solely a capital-spending story. Recent launches of agentic AI products also point to continued momentum in AI adoption and monetization.

Earnings expectations remain constructive. Positive EPS guidance among S&P 500 companies is tracking at a five-year high, while AI-related spending and cloud demand continue to support profit growth across the technology ecosystem. We expect another strong reporting season, with S&P 500 earnings growth of around 28%, supported by AI infrastructure spending, resilient consumer demand, and an improving cyclical backdrop. Semiconductors remain a key contributor to earnings growth, and the upcoming reporting season is likely to be a more important driver of sentiment than recent headlines around competition or financing constraints. Though earnings growth is moderating from exceptionally strong levels, we think the direction of markets will depend more on the outlook for profits and earnings revisions than on the pace of deceleration itself.

Valuations, rates look manageable. The current backdrop differs meaningfully from the technology correction of 2022. Our base case remains for only modest tightening by the Federal Reserve, well

below the scale of tightening experienced during that period. Technology earnings growth remains robust, while semiconductor valuations are still below long-term historical averages. We also believe that rising rates should have a more limited impact on corporate earnings than in prior cycles, given generally long debt maturities and continued economic resilience. We reflect this outlook in our AI thematic positioning, favoring diversified exposure across AI infrastructure beneficiaries, platform companies, and select defensive technology businesses.

So, while increased competition within AI, rising financing requirements, and higher rates may periodically add to volatility, we view this latest bout as more of a recalibration of expectations than a fundamental break in the AI investment story. We suggest investors focus on where AI spending is translating into sustainable earnings growth and broader enterprise and consumer adoption.

With valuations now more attractive and growth trends remaining resilient, investors may consider adding exposure to the "Magnificent 6." Within the AI supply chain, we continue to favor semi-cap and robotics equipment companies, followed by foundry/OSAT and compute beneficiaries. Memory remains lower in our pecking order despite optically attractive valuations, reflecting medium-term supply concerns and the risk of additional capacity coming to market over time. More broadly, we favor diversified and active exposure across the AI value chain, balancing semiconductor exposure with platform companies and defensive technology segments that can benefit from growing software, cloud, and productivity adoption.

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