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CIO believes AI should continue to drive growth in the years to come. (UBS)

Compelling risk-reward outlook for global tech

19 August 2024, 2:21 pm CEST, written by UBS Editorial Team

Global technology stocks have bounced back from their recent trough in early August as risk sentiment improves. The Nasdaq index has rallied more than 10% from its intra-session low on 5 August, recouping more than half of its losses from the benchmark's all-time high in July.

Volatility could rise again until investors are convinced that the US economy isn't slowing into a recession, and future gains could be more gradual amid risks around the US elections and geopolitical tensions. But we believe the recovery in tech shares has room to run, and we see tailwinds from both fundamental and technical perspectives.

AI spending has more room to grow. Strong investments into artificial intelligence have propelled the tech rally this year, and big tech companies are on track to increase their capital spending by 43% year over year in 2024. Contrary to general perception, however, the capex intensity—capex divided by sales—for big tech remains below their historical peaks. Our analysis shows that big tech's capex could potentially increase by as much as 25% in 2025—much higher than the consensus projections of a 10-15% increase. This strong capital spending outlook is especially positive for AI enablers in the semiconductors field.

Recent earnings reports point to strong AI demand and increased adoption. Taiwan Semiconductor Manufacturing Company (TSMC) recently reported 45% year-over-year sales growth for July, accelerating from June's 33% year-over-year growth. Separately, a Taiwanese chip-testing and packaging company raised its planned 2024 capex by 57% owing to rising AI demand, while another company that assembles AI servers for big tech issued a strong second half outlook on top of a record second quarter profit. Walmart's management in its recent earnings call talked about how the use of generative AI has led to productivity gains. Without taking a single-name view, we believe these examples show that AI demand remains strong amid rising adoption and monetization.

Investor positioning should become supportive. The recent correction in tech stocks was partly due to the unwinding of yen carry trades, where investors borrow the Japanese currency at near-zero interest rates and invest in higher-return markets including global tech stocks. But these positions have largely been liquidated, with data from the US Commodity Futures Trading Commission showing that leveraged funds' yen positions have shrunk to the smallest net short stance since February 2023. Other data showed that hedge funds and retail investors alike are re-entering the market, while corporate buybacks should soon increase as the earnings season concludes.

So, with some 15-20% earnings growth expected for the tech sector over the next six quarters, we see a compelling risk-reward outlook for global tech. We believe that AI should continue to drive growth in the years to come and that investors should ensure they have sufficient allocation to beneficiaries in the semiconductors and software industries. For those concerned about elevated volatility, structured strategies can be utilized for more defensive exposure.

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Original report: **Tech rally could have further to go, 19 August 2024.**

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