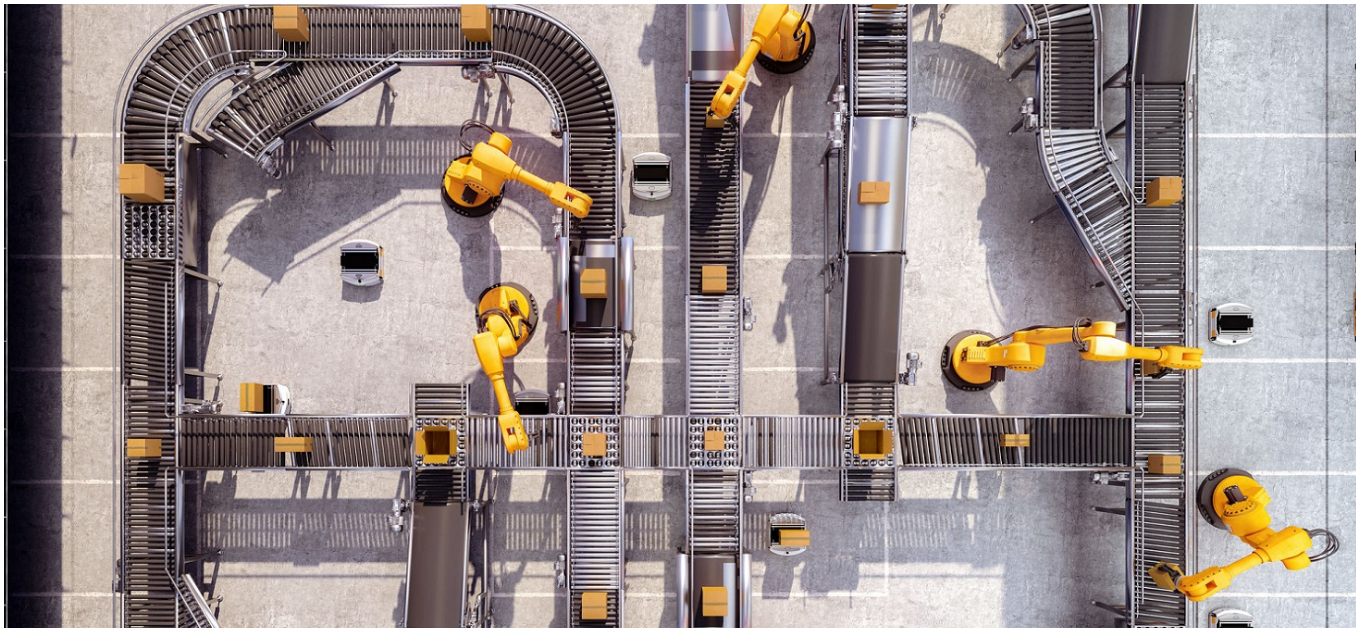

Within tech, CIO likes companies with strong balance sheets and a track record of earnings growth, as well as those that are exposed to structural growth drivers. (UBS)

Correction has uncovered structural opportunities across quality tech segments

08 August 2024, 3:27 pm CEST, written by UBS Editorial Team

While some degree of calm has returned to the market, sentiment around crowded long tech trades has clearly become more shaky, and many have reached out to us for guidance on managing global tech exposure.

We make several observations:

Tech fundamentals remain solid, in our view, while valuations have now reset lower. Second quarter tech earnings were somewhat mixed, suggesting a normalization in growth. But stepping back, the fundamentals overall remain solid, with global tech tracking to report earnings growth of around 20-25% year over year in the second quarter. This normalization, in our view, will still mean sustained 15-20% earnings growth over the next six quarters. AI spending, meanwhile, looks resilient, with 2024 capex guidance for big tech rising to USD 211bn after second quarter results, up from USD 202bn after first quarter results. Global tech valuations have settled back down to around 22x 2025 earnings per share (EPS).

The speed and breadth of the selloff suggest technical factors were part of the story this week. The rapid unwinding of crowded global consensus trades—whether short yen, short volatility, long Japan equities, or long mega-cap tech—were likely exacerbated by illiquid August market conditions. It is difficult to measure the scale and flow of the carry trade, but it’s clear that the yen’s rapid appreciation from the early July high of 162 USDJPY to an intraday low of 141.66 forced some investors to sell assets bought with borrowed yen. A near 170% intra-session surge in the VIX implied volatility index on Monday, a spike far outstripping any pandemic or global-financial-crisis-era moves, suggests not just a flight to safety but also a squeeze on systematic and volatility-selling strategies.

The new market setup is reminiscent of past periods of tech outperformance. Looking back through 2015, bouts of Nasdaq index volatility that resulted in 10% midcycle corrections were historically followed by big gains in the six months following the trough. The current situation surrounding the ongoing correction in tech looks similar to the near 15% correction for tech in the third quarter of 2011.

So, while the volatility in tech has been dramatic in recent days, we believethe global correction has uncovered structural opportunities across many quality tech segments. Investors may consider building balanced exposure in global tech, with a modest bias to internet and semiconductor names. Within tech, we like companies with strong balance sheets and a track record of earnings growth, as well as those that are exposed to structural growth drivers. Within the AI opportunity set, we continue to prefer the enabling layer of the AI value chain—which is benefiting from significant investment in AI capabilities—and vertically integrated mega-caps. Investors can also consider looking beyond the US for ways to capture AI growth, including in China's tech monoliths, which may also offer some defensive exposure in current conditions.

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