Without taking any single-stock views, CIO retain their positive view on AI and recommend investors to take advantage of near-term volatility to build up sufficient exposure to quality AI stocks. (UBS)

Big tech's AI spending should continue to support the AI trade

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Market reaction to the US third quarter tech reporting season has been mixed despite an overall beat in results.

Higher tech valuations, uncertainty over the US presidential election outcome, and still elevated geopolitical tensions in the Middle East all weighed on investor sentiment.

But a detailed look into the big tech earnings gives us confidence that the growth story of artificial intelligence (AI) remains robust. We have raised our 2024 global tech earnings growth forecast to 22% from 20%, and the 2025 growth forecast to 18% from 16%.

Big tech's AI spending should continue to support the AI trade. Microsoft, Alphabet, Amazon, and Meta account for almost half of all AI spending, and their strong balance sheets and willingness to invest will likely continue to support strong growth in AI spending. In fact, we have further raised our big tech capex forecasts following last week's quarterly results. We now expect their combined spending to grow 50% this year to USD 222bn, and another 20% to USD 267bn in 2025. Assuming peak capital intensity (capex divided by sales) for each company, the combined capex could potentially reach USD 280bn, highlighting further upside to our estimates.

AI adoption and monetization have picked up further. Cloud revenue growth across big tech accelerated for the fourth consecutive quarter during the July to September period, and margins remained strong. Amazon CEO Andy Jassy suggested he expects generative AI to drive enough operating income and free cash flow to make the investment worthwhile, while other management comments also showcased increasing AI adoption and efficiency gains. Alphabet CEO Sundar Pichai said more than a quarter of all new code at Google is generated by AI, which helps the firm's engineers "do more and move faster," and Microsoft CEO Satya Nadella highlighted increased adoption of copilots "from customers in every industry."

Tech earnings weakness mostly came from cyclical segments such as PCs and smartphones. We have highlighted the growing division within tech between strong structural AI trends and a sluggish recovery in consumer tech demand, with the latter evidenced by Apple and Samsung Electronics' results. In particular, Apple guided only low- to mid-single-digit revenue growth for the fourth quarter, a stark contrast to 20-25% growth expected for leading cloud platforms exposed to AI. As global handset shipments have exhibited high sensitivity and correlation to global real GDP growth, weaker-than-expected global economic growth next year could pose further downside risks to consumer tech demand, in our view.

So, without taking any single-stock views, we retain our positive view on AI and recommend investors to take advantage of near-term volatility to build up sufficient exposure to quality AI stocks. We continue to favor select semi names and big tech.

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