There are opportunities for investors to build exposure to the US IT sector. (Getty)

Buy the dips in tech amid market volatility

14 May 2024, 4:07 pm EDT, written by US Editorial Team

Equity valuations are elevated for the US IT sector, but the Chief Investment Office (CIO) believes improving end markets should help drive earnings upside.

CIO believes investors who are under-invested in the technology sector and the AI revolution can find potential opportunities amid sell-offs.

CIO rates the US information technology sector most preferred given its above-average tilt to quality and since it should benefit from the bottoming of demand within the smartphones, servers, and PC end markets as well as potential AI opportunities. Additionally, CIO advocates diverse strategic exposure to the sector and recommends investors pay close attention to concentration risk and the potential for pullbacks.

Sector highlights:

1. We expect improving end-market demand to drive earnings upside for semiconductor companies.
2. IT demand appears to be improving.
3. Surveys of chief information officers point to IT budget growth in 2024.
4. We prefer companies focused on sales to large enterprise rather than consumers.
5. Generative AI represents a significant secular trend, yet we believe investment in AI infrastructure will be cyclical, similar to the adoptions of the internet and cloud computing, with a potential digestion period for existing capacity over the next 12 to 24 months that may not be accounted for in current consensus estimates. We think software-as-a-service (SaaS) companies are particularly well-positioned to leverage AI without additional investments.

Industry group preferences:

- **Most preferred: Semiconductors and semiconductor capital equipment**
  - We expect semiconductors to experience a cyclical recovery off depressed levels since we believe PCs, servers, and smartphones are emerging from a cyclical trough. We forecast improving demand and potential upside benefits from inventory channel restocking.
- **Least preferred: Software and services**
  - We prefer broad-based enterprise software companies at reasonable valuations
- **Neutral: Technology hardware and equipment**
  - We focus on enterprise hardware companies which benefit from improving supply chains and reasonable valuations rather than PC or smartphone exposed names.

Recent industry intelligence:
Customers are replenishing inventory and memory chip pricing is improving.
From the Semiconductor Industry Association's (SIA) World Semiconductor Trade Statistics (WTSC):

- WTSC reported March global semiconductor industry sales rose 15.2% year-over-year (3-month rolling average), on track for double-digit growth in 2024.
- During the month, memory chip pricing improved while analog pricing declined and both analog and microcontroller chips posted strong unit growth in March (up 50% from February), as customers replenished inventory. DRAM sales grew 18.3% in a month helped by stronger pricing.
  - We believe semiconductors are well positioned to benefit from improving end-market demand in AI, PCs, servers, and smartphones.

PC shipment recovery may benefit semiconductors.
From the global intelligence provider for the IT market, International Data Corporation (IDC):

- IDC indicated the first quarter of 2024 showed global shipments of traditional PCs grew for the first time in two years. The 59.8 million PCs shipped represented a 1.5% growth rate from the prior year.
  - We remain constructive on the semiconductor companies whose fortunes are most closely tied to PCs, servers, and smartphone end-markets.

Forecasts for semiconductor manufacturing equipment spending seem aggressive.
From the industry trade association, SEMI:

- SEMI believes semiconductor manufacturing equipment spendingwill post +5% growth in 2024, followed by +18% growth in 2025.
  - We maintain a fairly neutral view on the Semiconductor manufacturing equipment group as we believe estimates reflect overly aggressive forecasts for wafer fab equipment (WFE) spending and valuation looks extended.

For additional information, please review our US Equities Information Technology: Equity Preferences and US Equities Communication Services: Equity Preferences reports.

Contributors: Kevin Dennean and Jennifer Stahmer