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# The investment case for AI is still intact

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**As markets react to earnings announcements, we continue to like the US tech sector, which aligns with our focus on quality. We believe the semiconductor and software industries are well positioned to ride the AI wave and benefit from improving demand within the PC, server, and smartphone end markets.**

Amid heightened expectations, tech giants Meta, and Amazon announced revenue and earnings beats for December quarter 2023 after markets closed Thursday. Amazon provided an improved forecast for its first quarter and spoke of cost reduction benefits and strong consumer spending despite increasing credit card debt and delinquencies. Meta announced its first dividend, plans to buy back shares, and stronger-than-expected guidance for the quarter ending in March. Apple reported inline results but services and disappointing sales in China are a concern. Earlier this week Microsoft and Alphabet both narrowly beat revenue and earnings estimates but Alphabet's search advertising businesses disappointed and Microsoft's revenue and earnings beats were not as strong as previous quarters. Chipmaker AMD forecast a disappointing revenue outlook for quarter ending March.

But while markets react to announcements, the 'Magnificent Seven' have fallen 1% over the last week through Thursday's close, and are up 4% year-to-date following a 76% rally in 2023. The latest results highlight that companies with clear AI roadmap are benefiting from secular tailwinds. We believe the investment case for tech, including AI, remains intact and recommend investors use any undue correction in quality AI leaders as a buying opportunity.

**Improving AI monetization and strong capex trends.** Without taking any single name views, Microsoft and Alphabet reported accelerating cloud growth compared to previous quarters, thanks to rising contributions from AI. Moreover, we are also witnessing a broad-based increase in AI-related capex.

Currently, we believe most of the AI-related spending is concentrated in the infrastructure layer given the need to build and train huge datasets. Microsoft and Alphabet's strong commitment to increasing AI capex, as well as comments from TSMC and Meta CEO Mark Zuckerberg on the demand for AI-related chips support our positive near-term view on AI infrastructure. During 2022-27, we expect 50% CAGR for infrastructure spending, driven by emerging trends like GPU cloud and AI edge-computing.

And with broadening AI demand and rising monetization trends, we expect the applications and models segment to emerge as the dominant force in the medium to long term. We see 152% CAGR growth during 2022-27 for AI applications & models. Overall, we forecast global AI revenues to grow 15x between 2022-27 from USD 28 billion to USD 420 billion.

**Fundamentals of global tech companies intact.** Strong volume growth and AI-related tailwinds have prompted us to raise our global tech (IT and internet) 2024 EPS growth forecast from 16% y/y growth to 18%. Global tech's valuation of around 25x P/E is not cheap, but we believe the premium is justified given our expectation of lower rates and stronger EPS growth for 2024.

**Software and semis key beneficiary of AI upcycle.** We turned positive on global semiconductor manufacturers in October 2023 given our view of robust and broadening AI demand, and we continue to believe that the semiconductor and software industries are well positioned to ride the AI wave. We expect both industries to post solid double-digit profit growth (50% profit growth for semiconductors and close to 20% for software) and expect operating margins of more than 30% in 2024.

The Semiconductor Industry Association's expectation of double-digit sales growth of semiconductor chips due to improving end-market demand in AI, PCs, and smartphones supports our view of improving demand.

So, with AI set to remain the key theme driving global tech stocks again this year and likely the rest of the decade, we maintain our preference for the semiconductor and software sectors and see opportunities in those involved in memory and AI edge-computing. Overall, we like the US tech sector, which aligns with our quality tilt and offers exposure to compelling disruptive trends. Specifically, we believe tech monopolies with superior pricing power and strong margins are relatively well positioned given their dominant market share, track record, and high return on invested capital.

For more information, please read our latest report: "TechGPT: 4Q23 results takeaways and tech monopolies."

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