

Global Equity Strategy

Semis: the new oil...reasons to be overweight in parts

Semis are now 12% of global market cap, up from around c2.7% in 2022. Semis have directly accounted for 51%, 55% and 40% of market returns YTD in US, EM and Japan, respectively. Semis have only been this overbought (77% above its lows two months ago) twice before (in October-December 1998 and in January-March 2000) - one was a sell signal, the other a buy signal.

What is supportive?

1. **Since late November, we have had all 7 preconditions in place for a bubble to form** (every major new technology from railways to radio and mainframe was associated with a bubble and a bust). **We think the market today is more similar to early 1999 not Q1 2000.** We have not yet seen the preconditions required to be close to the peak (credit spread rise for 10 months, earnings roll-over a year ahead and central banks tighten to raise rates to be in line with nominal GDP). In previous bubbles, the P/E of the bubble areas has risen to at least 45x to 72x 12 month trailing earnings (cf to MSCI Global semis today at 37x trailing earnings) with overvaluation being 4 fold at peak (i.e. when the bubble burst, prices fall c80%). Asia, in particular, has seen extremes in bubbles in the past (e.g. the P/E of Taiwan and Japan in 1989 peaked at 72x and 100x 12 month trailing earnings, respectively). Into bubbles, we will get volatility on even worse breadth. In 1999, the Nasdaq rose 84%, twice as many stocks fell than rose and there were 5 corrections of 10% or more in the Nasdaq. As we wrote in our both 2025 and [2026 outlook](#), if there is to be a bubble it is likely to be in the Gen AI enablers.
2. **Simple view is supportive for semis.** P/E relative to the market (using 12 month forward consensus numbers) is close to its norm (a 17% premium to the market vs norm of 10%), earnings revisions are dramatically better (10% EPS upgrades relative to market in past 3 months alone) as is the 3m earnings growth (12-month forward EPS growth of 40% versus MSCI AC world of 12%).
3. **Hyperscalers no longer have falling share prices.** Our big concern had been that if the share prices of the hyperscalers fall too much, they will cut capex which in turn hits semis. The good news is that since Q1 results, where all hyperscalers announced a sharp rise in capex, only one (Meta) saw a modest fall in its share price. Maybe scarce compute and evidence of the use cases of LLMs are now supportive for the hyperscalers. Using UBS numbers, the top 11 hyperscalers have capex in line with cash flow in 2026 at \$874bn and \$110bn below cash flow in 2027 (ie capex would in 2027 need to rise 33% from 2026 to be above 2027 cash flow). To justify the cost of datacentres by 2030, we calculate that that the revenue of LLM needs to be c1% of global GDP in 2030 - and that seems reasonable.
4. **This is a supply side constrained cycle**, in part because of long lead times (3 year to build a fab) and excellent capital discipline of TSMC (capex only up 80% since pre-Gen AI period) and memory capacity can only increase c30% in 26 and 27. The rise in capex by TSMC and memory has greatly lagged that of the hyperscalers. **Limited over investment cf to TMT period:** IP equipment and software spending as a share of GDP is up 17% since 2022, cf to 1994 to 2000 when their share of GDP rose by 42%.
5. **Risk that spending on sovereign AI has been underestimated.** UBS forecast it to be c0.07% of global GDP. France recently announced by 2031 a €75bn of sovereign AI.

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6. **TAM not yet unrealistic.** If semis and software are the new oil (but semis cannibalise software in part), then semis and software could rise to 4% of GDP by 2030 (oil averaged 3% of GDP but spent a lot of time in between 4% to 5% of global GDP, peaking at 10%). This would imply semis revenue in 2030 could easily rise to 2% of GDP. In turn, that implies a 2030 TAM of \$3trn which on 2025 margins results in a P/E of 16x. It is not outlandish to see semi revenues rising to 3% of GDP by 2030.
7. **Worries over other parts of tech help semis by default.** Obvious concerns over disruption to software, with software no longer being oversold. There are also potentially some concerns over online advertising.
8. **Size. Many funds find it hard to even be benchmark.** Many funds are limited to a 10% cap on the allocation to a single stock (TSMC and SEC are now 15.6% and 10.8% of EM market cap and Nvidia is 10.0% of ACWI growth mandates).
9. **Tech IPOs** needs to be seen in context of the bigger picture. There is \$2.3trn of money flowing into US equities from dividends, buybacks and cash financed bid activity and there exists a further \$7.8trn of money market funds.

What to buy?

- **Memory cycle:** UBS forecast 57% of hyperscalers capex in 2027 to be on memory (up from 7% in 2022). The cycle peak has been pushed back to Q2 28 (stocks normally peak 2 quarters before). The cumulative FCF yield of SEC, SK Hynix and Micron from 2026 to 2028 is 53%, 50% and 26%. UBS have a Buy on all 3. The memory and NAND names have the biggest default upside on HOLT.
- **Cheapest names on P/E relative (i.e. less than 1 std above their norm on P/E relative to the market), Buy rated with positive earnings revisions that are not very crowded:** Wiwynn, Renesas and Quanta.
- **The names that have de-rated more than 5% since 27/2 and are Buy rated:** SEC, ASML and Nvidia.
- **The cheapest of the ASIC/GPU agnostic natural monopolies:** TSMC.
- **The natural migration to semi-equipment:** The FCF has already migrated from hyperscalers to semis. Logically, the next step is to semi cap equipment. ASML looks abnormally cheap versus AMAT, is oversold versus semis and has lagged earnings revisions.
- **We show Michal Lerner's HOLT on comparative advantage periods:** again favouring memory.

What are the risks?

- **We list the risks [here](#).**
- **If semis correct, the following sectors are typically the best performing:** consumer staples and pharma (and we show names that are Buy rated that are abnormally cheap in these sectors with positive earnings revisions).

Elsewhere in tech:

- **Software:** we are only benchmark (earnings momentum much better than performance but no longer oversold and no longer abnormally cheap).
- **Amazon** has de-rated more than any other Mag 7 since Jan 1st, 2024, and has by far the highest 2028 FCF yield of the Mag 7. To us, it is an AI enabler, adopter and Agentic Agents likely increase the share of retail sales online.
- **China internet.** Abnormally cheap, earnings revisions getting less bad (and positive for JD.com).

One knock on impact:

The big terms of trade and wealth boost in Korea and Taiwan has not been offset by higher real rates or exchange rates and thus risks creating a domestic asset boom (helping domestic banks, property and retailing).

