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DOES THE RECENT VOLATILITY IN THE TECH SECTOR HERALD THE BURSTING OF THE AI BUBBLE?

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While equity indices appeared to be rather resilient, with a majority of sectors posting positive performances in October, a powerful sector rotation severely penalised technology stocks. Following a relatively optimistic post-election period, a wave of panic gripped the markets, against a backdrop of fears of a slowdown in technology investment. This sell-off spread across most cyclical sectors, indices and geographies with an unusual amplitude. On the macroeconomic side, still well-anchored US inflation subsequently revived expectations of rate hikes and concerns about their possible impact on growth.

October marked by a significant sector rotation

While the majority of MSCI World sectors rose in October, the decline in technology stocks weighed on the index. Despite stronger-than-expected growth, a risk-reduction move favoured discounted and defensive sectors and pushed sovereign yields lower after their highs in September. Since October 5, when the yield on 10-year US Treasuries peaked, the best-performing sectors in the S&P 500 have been traditional defensive sectors such as consumer staples, healthcare and utilities. The US equity market diverged sharply in October. The median stock of the S&P 500 gained 10.3%, while the index fell 0.9%, penalised by its six largest constituents, down an average of 7.1%. In total, 72% of the companies in the index rose and 75% outperformed it. This rotation resulted in a 4.9% rise in the equal-weighted S&P 500, while the semiconductor index (SOX) fell 15.4%, bringing its decline since the end of June to 25%.

This risk-reduction move was observed across all geographies. In Europe, the Euro Stoxx 50 outperformed thanks to its lower technology exposure, despite rising energy costs. Energy, healthcare and media supported the market, while banks fell 9.9% as bond yields rose rapidly. The Stoxx 600 rose 1.9%. The more defensive Swiss SPI, supported by pharmaceuticals, gained 6.3%. In Japan, the cyclical Nikkei 225 lost 5.2% (in JPY). Emerging markets posted mixed performances, generally lower than those of developed countries, especially in markets whose indices are highly exposed to the technology sector, such as the Korean Kospi, which fell 16.2%.

The Democrats' victory has revived fears about AI investments

By the end of October, AI-related stocks had already fallen sharply. While the semiconductor sector had a price-to-earnings ratio of 29x at its peak on June 15, it had fallen to just 14x by the beginning of November. The situation was similar for the major hyperscalers, which underperformed the S&P 500 by an average of 26% over the month. The technology sector, represented by the Nasdaq 100, was trading at nearly 23 times earnings at the end of September, before falling back to 18 times at the beginning of November.

After the Democrats took control of both houses of the US Congress, the markets initially reacted favourably, with equities rising and oil prices falling. However, the movement was abruptly reversed on 5 November, as investors feared a slowdown in the development of data centres in the United States. The correction, which was unusually severe, then affected the entire AI value chain, from

semiconductors to AI-exposed industrials, servers and neoclouds. It then spread to a lesser extent to the broader market.

The results of the midterm elections have therefore amplified a movement that was already underway, characterized by a valuation shock and an increased perception of risk. The speed and magnitude of the correction observed on 5 November suggest a significant build-up of leverage and forced liquidations by some hedge funds. The rise in correlations between technology stocks, the underperformance of momentum strategies and the unwinding of risk-factor exposures confirm a dynamic of broad-based reductions in short-term exposures.

The risk of a new correction phase in the short term remains significant

In the short term, the risk of further deleveraging by hedge funds remains substantial. The size of the residual leverage, which is difficult to measure, volatility pressures, funding constraints and political uncertainties call for a certain degree of caution. The stabilisation of funding markets, the normalisation of cash flows at large hyperscalers and the maintenance of key technical levels will be decisive. In the medium term, the fundamentals of AI players remain solid. Only about forty instances of daily declines in the Nasdaq of more than 5% have been observed over the last 25 years. The historical statistics following these movements are positive. After three months, the Nasdaq has risen by an average of 4%, with a hit ratio of 55%. This ratio has even stood at 100% since 2010 with an average return of 19%.

Another interesting indicator is the one-month performance gap between the equal-weighted S&P Index and the Magnificent Seven, currently close to its all-time high of nearly 12%.Historically this signals an upcoming reversal. Another positive factor is that spreads on low-quality credit remain low, at 340bps for the US market. Certainly, there is discrimination in the credit market, but we are not seeing a sell-off in the biggest names in technology, as evidenced by the record demand for bonds issued in recent weeks.

Is the correction in valuations excessive?

The Democrats' victory in the US midterm elections has heightened fears that tighter political and regulatory conditions in the United States could delay some data center projects, particularly in Texas (a state expected to account for between 25% and 30% of construction by 2030), and temporarily weigh on investments and revenues in the AI ecosystem. However, a simple slowdown would not call into question the structural dynamics. The protests remain mainly linked to the local deployment of infrastructure without safeguards rather than to opposition to AI in general. Moreover, a widespread blockade would be difficult to reconcile with growth and employment objectives, and is highly unlikely from a legislative perspective.

We therefore believe that the market is adopting an overly alarmist reading of events and already seems to be pricing in very unfavourable scenarios. According to our models, the valuations of first-tier AI players, such as chip and optics manufacturers, and hyperscalers, are already pricing in a 30% to 80% cut in capital expenditure by 2030. By contrast, second-tier players, such as equipment manufacturers and data center infrastructure providers, are only pricing in a 15% to 30% decline. This puts into perspective some of the multiple corrections observed across the technology sector since this summer, although selectivity within the sector remains essential.

Thus, from a strictly fundamental point of view, the valuations of certain leading AI stocks seem to us too pessimistic. The consensus is that the capital expenditure of the five major hyperscalers will increase from $379 billion in 2025 to $847 billion in 2026 and $1,345 billion in 2030. Admittedly, even if reduced by 30%, capital expenditure would still be 2.5 times higher than its 2025 level.

Many other factors contributed to the continued high volatility in the markets

First of all, the revelations about the extra-marital affairs of the Nvidia boss, which led to his resignation, caused the share price of the semiconductor giant to fall. In addition, the publication of consumer and producer prices, above analysts' forecasts, immediately caused a rise in rate expectations in the United States next month, which in turn weighed on the markets. However, the reassuring results of CoreWeave, one of the main neoclouds, which crystallized some of the fears related to the financing of these highly leveraged players, allowed the Nasdaq to erase almost all of the decline observed on November 5 in just a few days.

In this context, our central scenario remains that volatility is likely to remain high in equity markets, but which is driven more by technical than fundamental factors, with selectivity remaining essential. Higher-quality technology stocks, with strong balance sheets and superior visibility on their revenues, could offer attractive entry points. Conversely, players most dependent on abundant external financing and a continued acceleration in infrastructure spending have a higher risk profile. The ongoing publication of corporate earnings, which at this stage are generally above analysts' expectations, should bring more visibility to the market. Central banks will also take crucial decisions in the coming weeks and could be influenced by the outcome of the Iran-US peace talks and their effects on oil prices and inflation expectations, which remain at the heart of their concerns.

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