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Investment Research

Rich valuations, but richer growth—raising tech EPS

Blog

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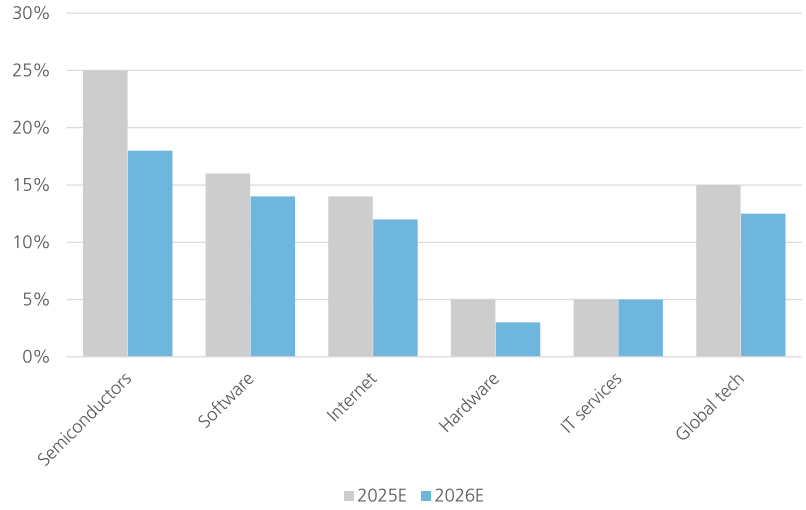
Driven by strong FX-related tailwinds and structural growth AI trends, we are revising up global tech's 2025 EPS growth forecast from 12% to 15% and introducing our 2026 EPS growth estimate of 12.5%. However, investors shouldn't be too complacent—given rich valuations and potential near-term cyclical risks around margin pressure for the 'Big 4' companies due to strong AI capex investments, and decelerating growth in supply chains due to high base effects. Hence, we continue to maintain a balanced exposure within our AI portfolio across semiconductors, software, and internet, and recommend adding exposure to AI laggards.

Fig. 1: Raising 2025 global tech EPS growth from 12% to 15% (driven by FX) and introducing 2026 EPS growth of 12.5%



Source: Company reports, UBS estimates as of July 2025

Big tech companies like Apple and Amazon are yet to report their earnings, but so far, the 2Q25 tech sector reporting season has seen more beats than misses. While it's true that the market reaction so far has been muted due to elevated expectations, the reality is that earnings estimates should be revised up as artificial intelligence (AI) momentum remains strong.

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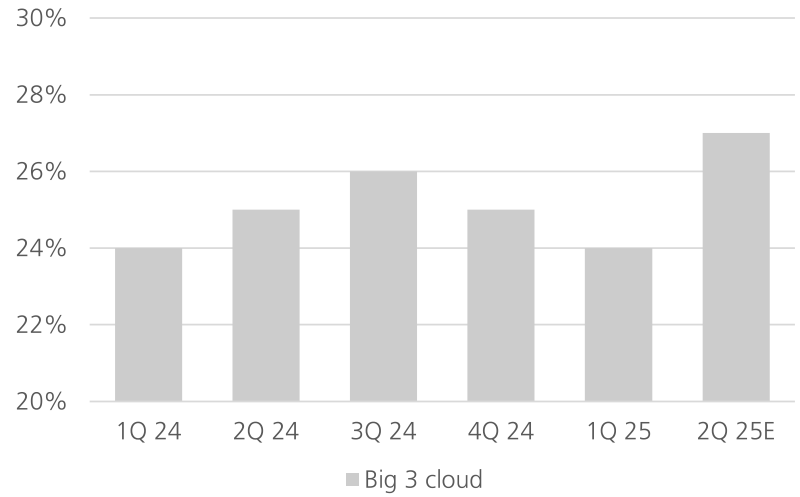
With the recent depreciation of the USD, we think FX-related tailwinds should play a bigger role in driving positive earnings revisions, while strong AI capex trends should support growth. As a result, we revise our 2025 global tech earnings-per-share (EPS) growth estimate from 12% to 15% and introduce our 2026 EPS growth forecast of 12.5% (see Fig. 1).

By industry, semiconductors should remain the fastest growing segment, though we expect the pace of growth to decelerate—from around 50% in 2024, to 25% in 2025, and 18% in 2026. The defensive software and internet industries should maintain their steady low-mid-teen earnings growth trends, while hardware and IT services should continue to weigh on overall tech growth rates with just mid-single-digit growth rates. Upside risks to our estimates include stronger-than-expected AI monetization, while downside risks include tariffs, margin pressure, and any potential sharp slowdowns in the global economy.

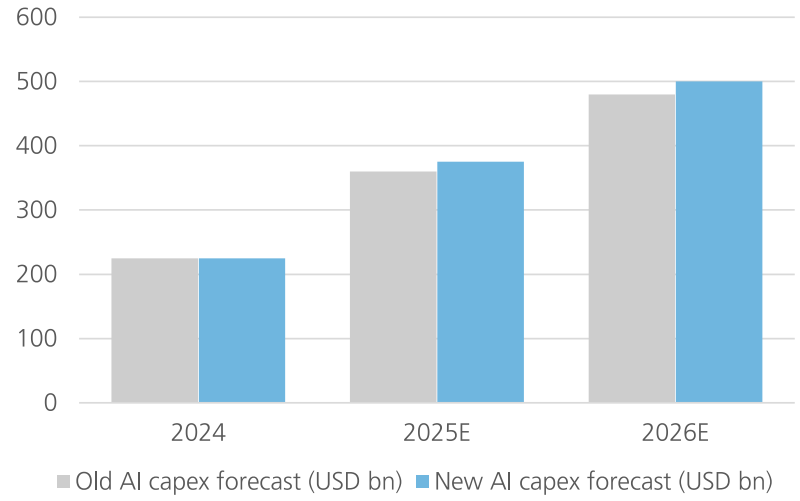
Fig. 2: AI monetization improving, supported by strong Big 3 cloud y/y revenue growth



Source: Company reports, UBS estimates as of July 2025

Meanwhile, on monetization, while revenues continue to lag the strong capex growth, the good news is that AI monetization is showing signs of improvement. Figure 2 shows cloud revenues from the three largest platforms —AWS, Azure, and GCP. In short, they continue to post strong growth of more than 25% y/y, with a solid overnight report from Azure. On the other hand, there are no signs of an AI capex slowdown, based on the results reported so far. Therefore, we raise both our 2025 and 2026 AI capex forecasts by around 4%. Our 2025 AI capex forecast is raised from USD 360bn to USD 375bn, and our 2026 forecast from USD 480bn to USD 500bn (see Fig. 3).

Fig. 3: Raising AI capex estimates by around 4% due to strong Big 4 spending



Source: Company reports, UBS estimates as of July 2025

With upward AI capex and EPS revisions, investors might question whether it's time to become incrementally more bullish on tech. While we maintain our structurally positive view on AI and the case for double-digit returns annually is intact, investors cannot afford to be too complacent. There are a few cyclical risks in the near term that should not be ignored, considering that tech valuations are also at multi-quarter highs with Nasdaq's forward P/E now exceeding 28x. Historically, in the past decade, when valuations reached this level, the index's forward 1-year returns averaged 5.6%, compared to the 10-year average of 16% (Fig. 4). Let's discuss some of these risks.

Fig. 4: 12-month forward returns of the Nasdaq Composite Index based on different starting valuations over the past decade

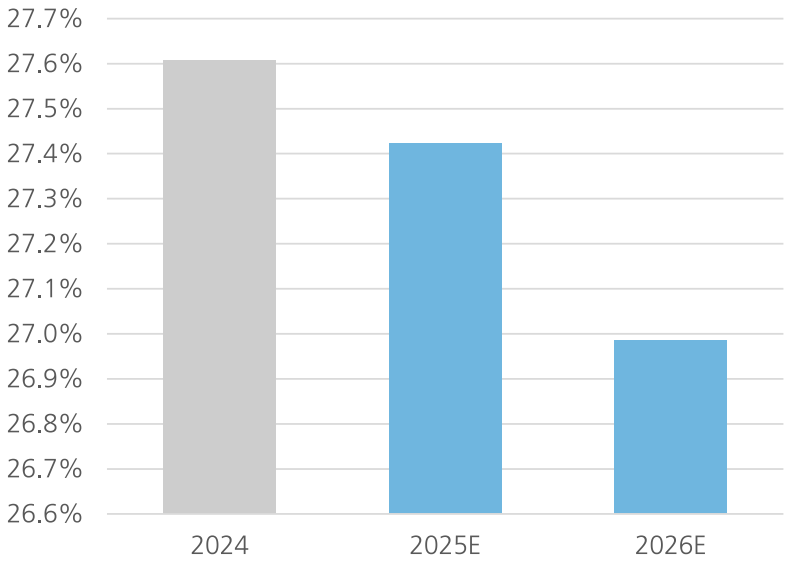
In %

P/E range	Percentile	12m forward returns
<21x P/E	0-25th	21.0%
21x to 22.9x P/E	25-50th	18.0%
22.9x to 27.4x P/E	50-75th	26.5%
>27.4x P/E	75-100th	5.6%
	Average	**16.0%**

Source: Company data, Factset, UBS as of July 2025

First, with elevated AI capex investments and AI monetization not playing catch-up so far, big tech's margins should be under pressure in the near term. Figure 5 shows our near-term margin assumptions for the 'Big 4' companies (Microsoft, Meta, Alphabet, and Amazon). In general, the heightened AI capex investments should be a near-term headwind for the overall sector due to rising depreciation expenses.

Fig. 5: Moderate near-term margin pressure for Big 4 due to heavy AI investments



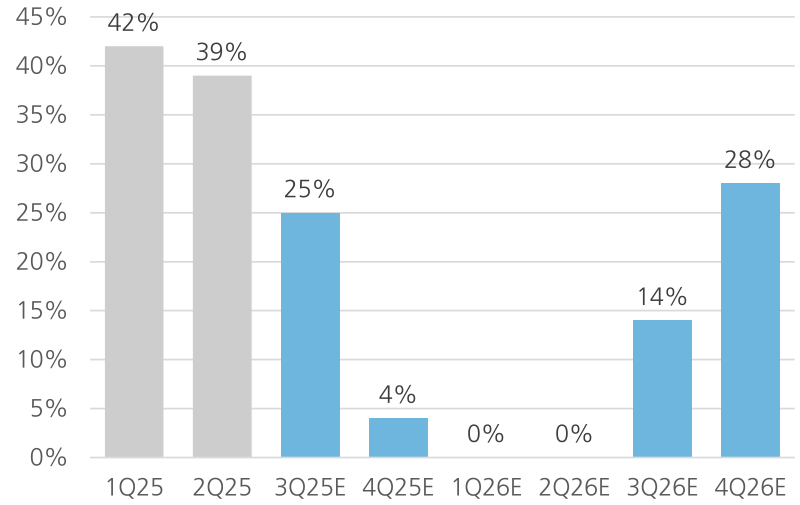
Source: Company reports, UBS estimates as of June 2025

Second, with strong growth in the tech supply chain over the past few quarters—thanks to AI-driven momentum, coupled with muted growth elsewhere like consumer products and traditional enterprise IT spending—we expect year-over-year growth trends to decelerate in the near term. While high base effects are partly to be blamed, the additional pressure comes from the front-loading we witnessed in 1H25 due to tariff-related uncertainties. The resulting digestion should thus weigh on near-term growth rates. Figure 6 shows the year-over-year growth rates for semiconductor foundry and contract manufacturing industry revenues, which support our near-term view of growth deceleration. The good news is that after the potential near-term digestion, we expect growth rates to eventually pick up sometime next year, so the adjustments are mostly cyclical in nature.

Against such a backdrop, we maintain a balanced exposure in our AI portfolio across semiconductors, software, and internet, with a preference toward laggards where we think the risk-reward remains attractive. Investors can also potentially take advantage of structured strategies during periods of heightened volatility, including capital preservation and put-writing strategies.

Fig. 6: Despite structural AI growth trends, be mindful of near-term cyclical risks

Semiconductor foundry y/y revenue growth (in local currency)



Source: Company reports, UBS estimates, as of July 2025

Appendix

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