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Investor tech enthusiasm running high into earnings season

18 July 2025, 10:36 UTC, written by UBS Editorial Team

Tech stocks have led the rebound in equities following the April sell-off on US President Trump's initial "Liberation Day" tariffs. But much of the recent rally has been based on multiple expansion. With the second quarter earnings season now underway, investors will be looking for news on profit growth to justify a further advance. While we remain positive on long-term fundamentals for the sector, we advise investors to seek diversified exposure across semiconductors, software, and internet platforms, rather than concentrating risk in any single segment or stock.

Between April and July of this year, allocations to the tech sector saw their largest three-month increase since March 2009, according to a Bank of America survey, while a net 14% of fund managers surveyed are now overweight tech versus a net 1% underweight last month. The tech-heavy Nasdaq has climbed more than 35% from its April lows, setting a fresh record on Thursday. NVIDIA, meanwhile, became the first company to reach a USD 4 trillion valuation, and has won US approval to sell once-banned chips into China.

This resurgence reflects growing optimism that the large-cap tech giants will continue delivering robust earnings growth despite lingering concerns over tariffs and regulatory risks. Among the early results, Taiwan-based semi foundry TSMC posted a record quarterly profit, surpassing market expectations for both earnings and on forward guidance. Shares in semi capital-equipment maker ASML fell 10% on Wednesday after disappointing 3Q25 guidance and new uncertainty over its 2026 growth outlook.

Ahead of a run of major second-quarter results, we make several observations:

Magnificent 7 results likely to show normalization. The Magnificent 7's rapid growth rates over the past two years have been a dominant driver of S&P 500 earnings per share growth. Profit growth for these mega-cap companies should remain strong at around 20% in the second quarter. But this would be a downshift from near 30% growth in each of the previous four quarters. On balance, we believe earnings for this cohort are likely to remain solid on the back of ongoing AI deployment and adoption. This outlook for industry growth rates was also supported by the latest guidance from TSMC, which also pointed toward a normalization.

After multiples expansion, solid earnings are needed for the next leg higher. The recent rally in large-cap tech and AI stocks has been fueled mainly by price-to-earnings (P/E) multiple expansion. While we remain structurally bullish on AI, we would prefer to see further gains underpinned by upward earnings per share (EPS) revisions rather than valuation expansion alone. Sustainable growth in the sector will ultimately depend on continued improvement in profitability and operational performance.

Semi-cap growth outlook is already diverging, driving dispersion. Generative AI-driven capacity investments should benefit the semiconductor capital equipment sector (semi-caps) across logic and memory, but we see these gains materializing over a longer horizon. In the near term, we remain defensive on the subsector given ongoing uncertainty around consumer semiconductor recovery, new capacity in China, and the broader economic outlook into 2026. Growth dispersion is already evident: AI semiconductor revenues are rising 60-70% at the chip level, and 25-30% at foundries, but only 5-10% at the equipment level. With limited visibility and heightened tariff risk, we recommend investors to focus on only the highest-quality semi-cap names.

So, we go into this earnings season anticipating healthy earnings growth and encouraging guidance from tech, with a structurally bullish view on AI and the opportunity set intact. However, earnings surprises in the coming weeks may also play a key role in shaping near-term sentiment, especially amid more demanding valuations. We believe strong AI capex trends and supportive currency dynamics will continue to underpin the longer-term opportunity, and we forecast 12% profit growth in global tech in 2025. We recommend investors to focus on these long-term fundamentals, and to seek diversified exposure across semiconductors, software, and internet platforms, rather than concentrating risk in any single segment or individual stock.

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