

MILL STREET RESEARCH

MACRO BRIEF

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Mid-terms and AI: initial thoughts on market and economic impacts

The "AI trade" in markets has been unwinding for several months now, and got a sharp kick after the mid-terms on worries about AI data centers along with likely leveraged position unwinding. Many Tech/AI stocks screen well on MAER, since many (not all) still have positive estimate trends, but valuation changes have been the main driver as investors seek to reduce risk on worries of a cyclical peak developing. We are growing more cautious on equities and will likely be looking for opportunities to tilt more defensive on market bounces. We also offer some updated stock screens for those that want Tech/AI exposure and those that do not.

As is often the case, big news events produce sharp market reactions, and we then see that the underlying trends already in place resume. The US mid-term elections were a surprise only in magnitude, not direction. The polls consistently showed the likelihood of Democrats taking control of Congress, but not quite the breadth of the shift. This includes the US Senate (South Carolina was a late-breaking surprise, and Mississippi is still yet to be called but would be an even bigger shock), but also state governors and many state legislatures and key state positions.

The main initial responses have been to assume that the new Congress (which is not in place until January 3rd) will do more to restrain Trump in trade policy and foreign policy, reject the more extreme appointees (possibly protecting the Fed), not vote for any more tax cuts (tax increases would be vetoed by Trump), try to reverse the cuts to Medicaid and SNAP benefits, and possibly act to limit the expansion of AI data centers.

The view on data centers is one of the key parts for the stock market, given that at least half of the S&P 500 by weight is somehow tied to the AI theme. However, much of the political pushback to data centers is at the state and local level, not the federal level, and was already tilting that direction before the mid-terms. There may be more "sand in the gears" of AI data center building now, but development will continue even if at a slower and more expensive pace.

The bigger issue for the equity markets is investor risk appetite, which is tied to the question of whether the AI boom is at, or possibly past, a cyclical peak. If so, then the US economy is also likely to slow down, given the direct and indirect impacts of the AI buildout on economic growth. Our Global Equity Risk Model has been deteriorating for several months now, and remains close to its bearish threshold. The Implied Growth Model has been showing high long-run growth expectations for a good while now, and so far those expectations have been met, but extrapolating the huge margin surge in the S&P 500 into the future looks riskier here. We see risk appetite following its traditional path of an initial surge (from the April 2025 lows) into the riskiest stocks, to progressively less risky stocks and less momentum. We look to be in the later stages of that process, though it can go on for a while. We have been neutral on equities, underweight bonds, and overweight cash in our asset allocation, and see the next likely move to reduce equity (beta) exposure and add to cash.

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Our indicators remain cautious on equities as risks of cyclical peak in earnings growth have risen

A key issue highlighted in our indicators right now is that relative stock returns have not aligned with the earnings indicators lately, mostly due to Tech/AI stocks being knocked down even as their earnings indicators mostly hold up.

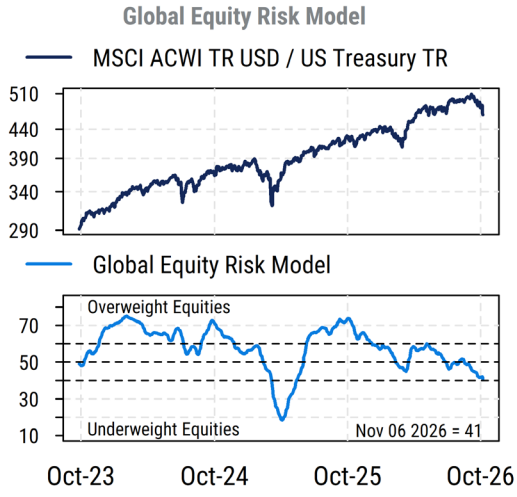
In some ways this is a parallel to the fact that stock prices have been weaker and bond yields have fallen lately despite strong GDP and labor market data in the US. Why sell stocks if growth is strong and/or improving, and why sell Tech stocks if earnings estimates are still rising?

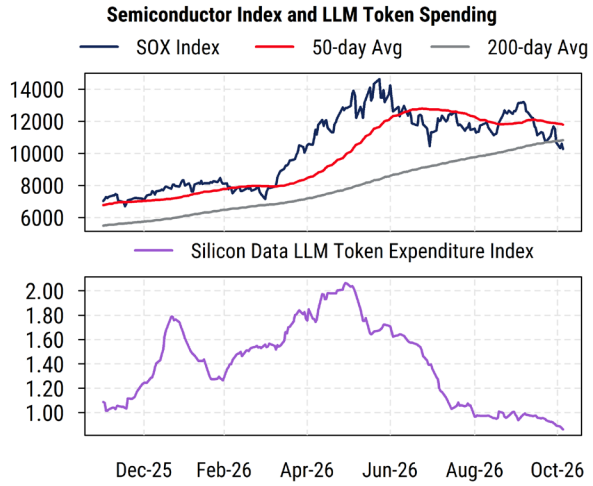
The key driver in these divergences is investor risk appetite, which is being affected by growing perceptions that we may be nearing a cyclical peak in earnings and the final stages of a late-1990s-style Tech boom, this time driven by AI instead of the internet.

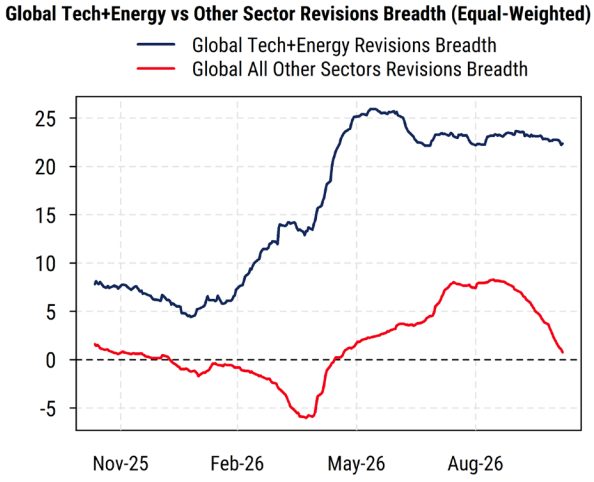
Our Equity Risk Model has been weakening for some time now, and so far the mid-term election results have not helped it. At 41%, it is sitting right near the threshold of outright bearish territory (40% on the model), reflecting rapidly weakening risk appetite, equity price momentum, and monetary policy backdrop (top chart).

One of the highest-profile reflections of the "AI trade" has been the semiconductors industry, captured by the widely-watched Philadelphia Semiconductor Index, or SOX. It peaked in June after a massive surge in Q2, and has just recently broken down below its 200-day average for the first time since early 2025. Perhaps not coincidentally, one measure of pricing for LLM models (dollars per million tokens used) also peaked around the same time and has plunged as competition among models has increased (middle chart).

With the two biggest LLM producers still yet to come public, the global Technology sector's revisions indicators are still holding up, as are Energy's (for now at least). Those two sectors stand out, as the aggregate revisions for all other sectors have decisively weakened globally and are close to turning net negative (bottom chart). So earnings estimates point to Technology and Energy but markets have favored other areas lately due to fading risk appetite (and volatile oil prices). We suspect there will be some tactical rebounds in Tech/AI, but given the risk that Tech earnings estimates weaken from current high levels, we will be likely be scaling back beta exposure in our asset allocation and sector allocations soon.







Source: Mill Street Research, Factset, Bloomberg

Stock ideas for Tech and non-Tech

Many Technology stocks still score well on MAER, as the pullbacks in stock prices combined with continued strong estimate revisions metrics have kept many (but certainly not all) Tech stocks near the top of the ranks. But our top-down views of equity risk argue for less beta in portfolios, which would limit high-beta Tech exposure. So here we offer two global large-cap stock screens for ideas from the MSCI ACWI universe: one for the Technology and Communication Services sectors (though no Communication Services stocks make the screen right now), and one for the sectors excluding Technology/ Communication Services and commodity sectors (Energy and Materials), as they are volatile (risky) and largely driven by underlying commodity prices right now. The screens aim to balance the earnings, price, and valuation components of MAER in this difficult environment.

Top-Ranked Large-Cap ACWI Technology + Comm. Services Stocks

Ticker	Name	Sector	Industry	Mkt. Cap. (USD)	Breadth Rank	Mag. Rank	Alpha Rank	1M Rev. Rank	Rel. EY Rank	Abs. EY Rank	MAER Rank
600183-CN	Shengyi Technology	Technology	Electronic Equipment	25,668	92.6	94.0	92.3	100.0	88.3	56.3	99.9
APH-US	Amphenol	Technology	Electronic Equipment	184,182	100.0	90.9	95.1	91.5	97.7	26.7	99.7
6669-TW	Wiwynn	Technology	Technology Hardware,	26,630	84.3	92.3	71.1	95.2	98.7	87.9	99.4
6981-JP	Murata Manufacturing	Technology	Electronic Equipment	60,557	96.6	96.8	88.9	100.0	54.4	38.5	99.3
2059-TW	King Slide Works	Technology	Technology Hardware,	22,038	90.4	79.9	99.3	95.2	77.6	48.3	99.0
DELL-US	Dell Technologies Cla	Technology	Technology Hardware,	103,629	93.6	56.5	97.5	97.2	58.5	72.3	98.1
ASM-NL	ASM Intl N.V.	Technology	Semiconductors & Sem	35,793	96.1	98.3	56.1	92.7	88.2	30.1	97.8
8035-JP	Tokyo Electron	Technology	Semiconductors & Sem	122,187	92.9	100.0	64.0	97.2	67.5	36.0	97.7
2383-TW	Elite Material	Technology	Electronic Equipment	41,844	95.0	92.3	65.7	95.2	59.4	50.1	97.6
LITE-US	Lumentum Holdings	Technology	Communications Equip	48,850	93.8	89.4	67.7	97.2	75.1	36.1	97.4
603986-CN	Giga Device Semiconduc	Technology	Semiconductors & Sem	25,343	78.3	82.0	64.9	90.5	100.0	81.0	97.2
300408-CN	Chaozhou Three-Circle	Technology	Electronic Equipment	21,129	76.8	100.0	83.4	95.2	70.5	29.1	96.9
MRVL-US	Marvell Technology	Technology	Semiconductors & Sem	123,818	91.1	65.0	87.1	97.2	78.3	25.9	96.2
CRDO-US	Credo Technology Group	Technology	Semiconductors & Sem	22,650	81.7	44.7	98.3	91.5	99.2	51.9	95.8
2330-TW	Taiwan Semiconductor M	Technology	Semiconductors & Sem	1,692,517	91.9	79.9	54.5	92.0	63.9	52.8	94.3
3017-TW	Asia Vital Components	Technology	Technology Hardware,	27,729	89.4	45.6	84.9	97.2	69.7	51.7	93.9
WDAY-US	Workday	Technology	Software	37,808	93.9	41.5	98.3	41.7	90.7	51.0	93.4
2327-TW	Yageo	Technology	Electronic Equipment	23,588	66.3	78.8	87.0	92.0	50.5	68.5	93.2
PTC-US	PTC	Technology	Software	21,191	80.1	75.9	95.7	54.4	74.8	25.9	93.0
NVDA-US	NVIDIA	Technology	Semiconductors & Sem	4,498,024	89.9	30.0	77.0	85.7	99.2	61.1	91.9

Top-Ranked ACWI Stocks: All Sectors Excluding Technology/Comm. Services/Commodities

Ticker	Name	Sector	Industry	Mkt. Cap. (USD)	Breadth Rank	Mag. Rank	Alpha Rank	1M Rev. Rank	Rel. EY Rank	Abs. EY Rank	MAER Rank
EXPE-US	Expedia Group	Cons. Disc.	Hotels, Restaurants	29,682	85.9	86.9	65.0	59.2	74.4	75.1	95.6
2887-TW	TS Financial Holding	Financials	Banks	29,520	100.0	84.2	97.9	83.3	59.3	67.8	99.6
PYPL-US	PayPal Holdings	Financials	Financial Services	49,208	87.9	94.0	91.5	34.5	86.4	77.7	98.6
SOFI-US	SoFi Technologies Inc	Financials	Consumer Finance	21,038	91.4	74.5	95.1	47.3	96.6	31.8	96.7
XYZ-US	Block	Financials	Financial Services	46,548	89.2	80.8	83.9	32.3	77.8	44.9	94.2
6178-JP	JAPAN POST HOLDINGS	Financials	Insurance	39,952	86.5	49.8	82.4	80.8	50.8	67.3	91.0
EQT-SE	EQT AB	Financials	Capital Markets	40,595	79.6	85.6	77.3	33.3	75.0	44.1	90.0
BPAC11-BR	Banco BTG Pactual SA U	Financials	Capital Markets	39,299	77.2	55.6	60.9	95.2	65.2	82.1	88.7
ADM-GB	Admiral Group plc	Financials	Insurance	16,037	77.8	80.8	80.6	27.8	61.8	53.8	87.8
1050-SA	Banque Saudi Fransi	Financials	Banks	13,481	72.7	69.0	67.3	50.7	67.1	85.0	86.8
1080-SA	Arab National Bank	Financials	Banks	11,200	81.4	42.6	57.6	81.3	69.7	87.5	85.0
2359-HK	WuXi AppTec Class H	Health Care	Life Sciences Tools	68,370	96.6	84.2	95.5	71.1	57.1	39.2	98.0
NOVO.B-DK	Novo Nordisk A/S	Health Care	Pharmaceuticals	136,206	72.2	92.3	54.5	41.7	86.9	67.0	88.6
7733-JP	Olympus	Health Care	Health Care Equipmen	12,275	77.7	61.0	71.0	82.2	63.5	45.4	86.1
KRX-IE	Kingspan Group Plc	Industrials	Building Products	19,399	83.2	82.0	91.7	67.0	56.3	39.8	94.9
BNZL-GB	Bunzl plc	Industrials	Trading Companies &	12,044	97.1	70.0	79.5	26.5	62.6	53.5	92.4
532155-IN	GAIL (India) Limited	Utilities	Gas Utilities	12,987	79.5	100.0	73.3	28.7	56.5	78.6	94.0
9503-JP	Kansai Electric Power	Utilities	Electric Utilities	17,997	94.2	67.3	57.0	72.2	54.2	88.2	93.5
EDP-PT	EDP S.A.	Utilities	Electric Utilities	23,318	79.8	98.9	76.5	42.2	50.4	50.2	92.3
NTGY-ES	Naturgy Energy Group S	Utilities	Gas Utilities	31,925	82.5	76.6	64.3	54.8	60.5	59.5	88.4

Source: Mill Street Research, Factset, Bloomberg

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