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PHILEQUITY CORNER

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More greed than fear

In our June 8 article, “Has the Tech Bubble Burst?”, we warned that when advances become parabolic, the corrections that follow can be just as sharp. Three weeks later, in “Irrational Exuberance,” we noted that the speed and magnitude of the AI run-up were comparable to the ascent of internet stocks during the dot-com era.

Two weeks ago, we wrote “Uncharted Territory” to describe the extraordinary speed and magnitude of the AI-led bull market. Semiconductor and memory stocks were making moves that even veteran investors had rarely seen.

That correction has now arrived. The declines have been just as fast as the gains.

Semiconductors lead the correction

The Philadelphia Semiconductor Index (SOX) has fallen 20 percent from its June 22 peak, putting it in bear-market territory. Last week alone was brutal: the SOX plunged 10 percent, dragging the Nasdaq down 4.2 percent.

The worst damage has been concentrated in the same memory and storage stocks that led the market higher during the first half of the year. As of Friday, Sandisk had fallen 42.4 percent from its all-time high. Western Digital was down 40.3 percent, Micron 32.4 percent, and Seagate 31.2 percent.

Good news is no longer enough

Micron recently reported record quarterly revenues and gave an even stronger outlook for the next quarter. Yet after initially surging on the results, the stock reversed and continued to fall. Samsung and Taiwan Semiconductor Manufacturing Co. also reported a massive increase in profits, but their shares fell as well.

When stocks go down despite excellent news, investors have concluded that much of the good news had already been priced in. Expectations have become so elevated that even record earnings are no longer enough.

DeepSeek 2.0?

In our February 3, 2025 article, “DeepSeek Sparks Global Tech Selloff,” we wrote about how the Chinese AI startup rattled markets by developing a powerful model using fewer advanced chips and at a fraction of the cost of its US rivals. Since then, investors have remained alert to the possibility of another DeepSeek-like breakthrough.

That concern resurfaced after China’s Moonshot AI unveiled Kimi K3, an open-weight model approaching the capabilities of leading US systems. Despite having less computing power than the largest Western AI laboratories, Moonshot narrowed the gap through smarter model design, synthetic data and improved training techniques.

What unsettled investors was that scaling is no longer the only game in town—and that ever-larger computing budgets may not be the only path to better AI.

Leverage works both ways

The sharpness of the decline has been amplified by leverage. Leveraged exchange-traded funds (ETFs), options and margin financing allowed investors to multiply their gains during the semiconductor rally. But leverage works both ways. When prices decline, these positions must be reduced, ETFs must rebalance and some investors are forced to sell regardless of fundamentals.

The Roundhill T-REX 2X Long DRAM ETF, which seeks to deliver twice the daily move of memory stocks, has lost about two-thirds of its value from the intraday peak last June 24.

In South Korea, the selloff reportedly triggered widespread margin calls, forcing some investors to liquidate their positions at a loss. Regulators responded by suspending new listings of leveraged single-stock ETFs following extreme swings in SK Hynix and Samsung.

Wild swings signal turning points

Wild and alternating swings often appear near important turning points. Near market bottoms, they can signal capitulation as frightened investors finally sell. Near market peaks, they can indicate distribution as astute investors take profits while latecomers continue buying aggressively. The violence of the swings tells us that the character of the market has changed.

A crowded trade

The timing of the reversal is telling. SK Hynix's heavily oversubscribed Nasdaq listing on July 10 reflected peak enthusiasm for memory and AI stocks. Its ADRs jumped on their debut, but the stock soon plunged in both New York and Seoul.

This exposed how crowded the AI-trade had become. Goldman Sachs CEO David Solomon recently described the mood on Wall Street as one where there was "more greed than fear." With investors still eager to buy every dip and only a few positioned for a decline, even a small change in sentiment was enough to trigger a rush for the exit.

Proceed with caution

Two weeks ago, we highlighted Jeremy Siegel's growing caution over the market's extreme moves. The author of Stocks for the Long Run is rarely bearish, which is why his warning deserves attention. Siegel described the swings in semiconductor stocks as unprecedented and advised investors to remain invested but avoid adding aggressively.

We agree. The AI revolution remains intact, and investors should continue to have exposure to it. But price, positioning, portfolio allocation, and stock picking still matter. Investors should reduce leverage and ensure their AI exposure is appropriate for their risk tolerance.

Be part of the AI transformation but proceed with caution.