

The Implications Of Semiconductors Dominating The Overall Market

The melt-up in semiconductor stocks has helped fuel the rebound in U.S. equities from their late-March lows, but the move is also exposing the market to growing risks.

The U.S. semiconductor industry is experiencing an unprecedented wave of growth, propelled by strong demand for A.I. infrastructure. Over the past month, chip stocks have enjoyed massive gains on the back of accelerating earnings, with the group adding over US\$2 trillion in market value in April, an increase of 28%. As a result, the semiconductor & semi equipment industry currently comprises 17% of the MSCI U.S.A. Index, up from less than 10% at the post-Liberation Day tariff low in April 2025 and only 4% at the beginning of the decade (**chart 1**).

For perspective, the current market cap weight of semiconductor stocks is more than double the weight of the group at the height of the dot-com bubble in the early-2000s. Semiconductors have become the largest industry group by market cap in the U.S. equity index and make up almost 50% of the tech sector's market value (**chart 2**). On a standalone basis, the market cap weight of semiconductor stocks exceeds that of each of the 10 non-tech GICS sectors, in most cases by a significant margin.

The growing influence of semiconductor stocks also extends to their share of total index earnings. The sub-group comprises 16% of total market 12-month forward earnings (**chart 3**). Semiconductor stocks have never accounted for such a large

Chart 1 **Semis' Share Of Total U.S. Market Cap Has Quadrupled In Recent Years**



share of overall forward earnings, including during the dot-com bubble. The earnings share of the industry was 10% as recently as mid-2025, and a mere 4% at the beginning of the decade. Only the financial sector makes up a larger share of the market's forward earnings. Within the technology sector, the earnings share of semiconductor stocks has surged to more than 50% from 17% at the end of the 2010s.

Market Impact

As the “picks and shovels” of A.I., semiconductor stocks are the equity market's most important leadership group, while at the same time representing one of its biggest vulnerabilities. This tension stems from two factors. The first is the extreme overbought condition of the sub-group, which leaves it vulnerable to a meaningful correction. The Philadelphia Semiconductor (SOX) Index is trading 25% and 45% above its 10- and 40-week moving averages, respectively (**chart 4**). The performance of the index has seldom been this stretched, signaling that sentiment towards the sub-group is historically frothy. One has to go back to the period around the dot-com bubble to find larger gaps between the share price of the SOX Index and its 10- and 40-week moving averages.

Parabolic moves, such as the one witnessed in chip stocks over the past month, are unsustainable, and typically do not end in a sideways consolidation. Rather, they tend to end with a violent reversal of a “blow-off” top where prices decline sharply, and retrace a significant portion of the prior gains. A sizeable mean reversion in the performance of the semiconductor sub-group would have significant negative ripple effects on the performance of the tech sector and broader equity market given the growing weight of chip stocks in both.

Chart 2 **Semis Comprise Nearly Half Of The Tech Sector's Market Cap**

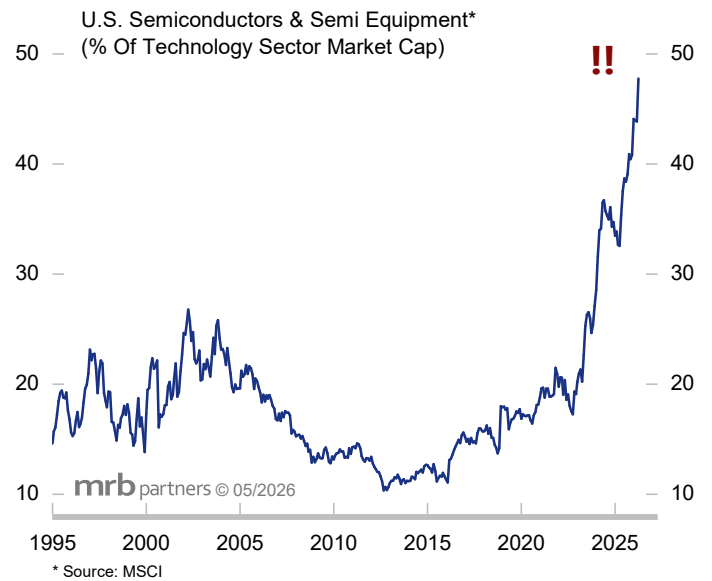
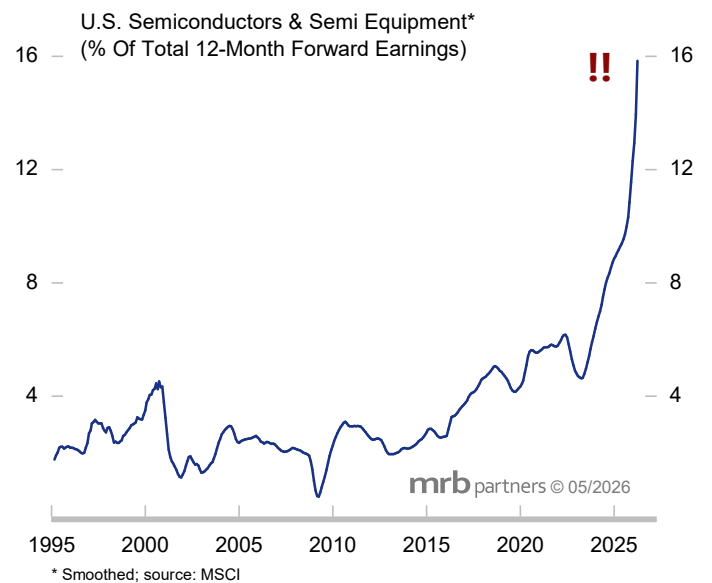


Chart 3 **The Contribution Of Semis To Total Forward EPS Has Become Significant**

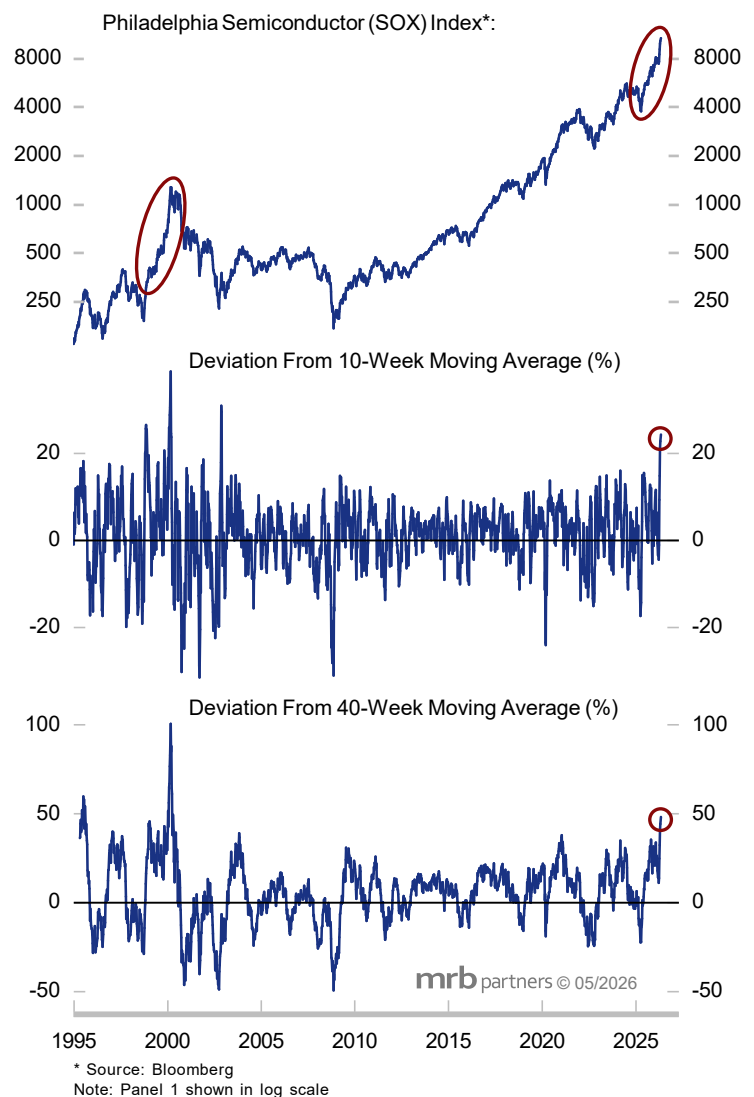


The second factor is that the dominance of semiconductor stocks exposes the earnings of the tech sector, and the equity market more generally, to greater volatility. Historically, semiconductors have been a highly cyclical industry, owing to the tendency of customers to double-order components during periods when demand exceeds supply, as is currently the case. This double-ordering inevitably leads to inventory gluts, resulting in sharp declines in customer orders that lower plant utilization rates and crunch the profit margins of semiconductor companies, thereby causing significant peak-to-trough swings in the industry's earnings and sales momentum (**chart 5**).

While there are no signs of an impending downturn in the semiconductor cycle, the industry's year-over-year growth in forward earnings is at the top of the historical range and will be difficult to sustain at the current level. The same is true for global semiconductor sales. Yet consensus earnings growth forecasts for the industry have continued to ratchet higher from very elevated levels, suggesting an extrapolation of the current strength (**charts 6 and 7**). Such extrapolations are typically a contrarian signal and warn that sentiment has reached a positive extreme.

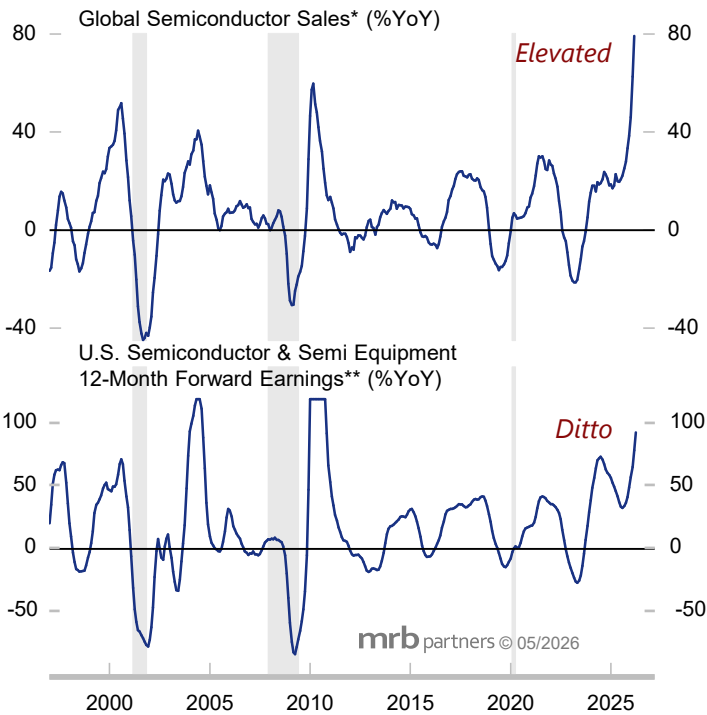
The optimism about the ability of semiconductor stocks to sustain robust earnings growth is rooted in the notion that the industry is in a "super-cycle" due to the insatiable demand for A.I. infrastructure and capacity constraints in the memory segment. This may be the case. However, it is also important to be mindful that downcycles in the chip sector typically occur with little warning due to the limited visibility into the sales channel, and develop rapidly once they start as small changes in customer demand often translate into large order swings that quickly flip the prevailing narrative of component shortages into one of gluts.

Chart 4 **The Rally In Chips Stocks Is Overheated And Reminiscent Of The Late-1990s**



A sizeable mean reversion in the performance of the semiconductor sub-group would have significant negative ripple effects on the performance of the tech sector and broader equity market

Chart 5 **Sales And Earnings Momentum Have Historically Been Highly Cyclical**



* Source: Semiconductor Industry Association
 ** Truncated above 120%; source: MSCI
 Note: Shaded for NBER-designated U.S. recessions

Chart 6 **EPS Growth For As Far As The Eye Can See!**

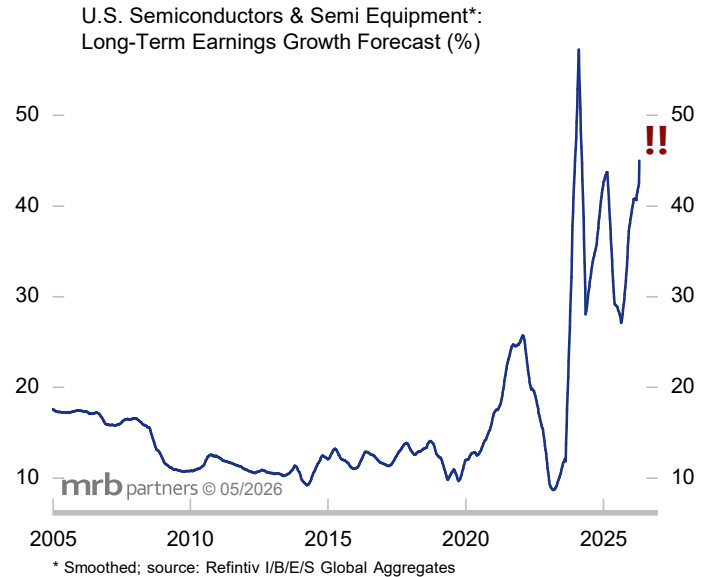
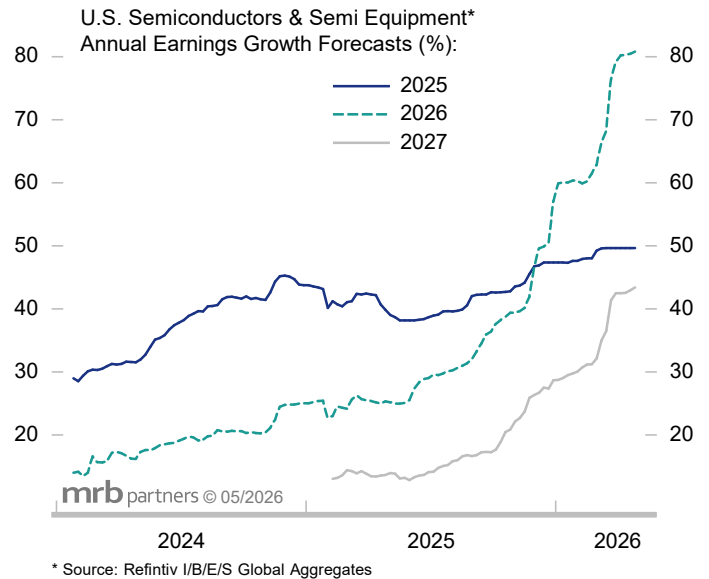


Chart 7 **EPS Growth Forecasts For 2026 And 2027 Continue To Be Revised Higher**



Although the timing is uncertain, the next semiconductor downturn, when it arrives, is likely to result in significant pain for the tech sector and the broader equity market given the increased representation of chip stocks in both. Even if the robust demand conditions in the chip industry prove durable over the long haul, semiconductor stocks remain a high-beta group. At a minimum, their growing share of total market cap is likely to make the tech sector and equity market prone to greater bouts of volatility for as long as the industry is a large component of the overall stock market.

Final Word: *Semiconductor stocks comprise an unprecedented 17% of U.S. market cap and 16% of total 12-month forward earnings. The chip industry's foundational role in driving*

the A.I. boom has transformed it into a dominant market force. However, the sub-group is very overbought following its recent parabolic rally. This leaves chip stocks vulnerable to a correction that would have negative ripple effects on the performance of the tech sector and the broad equity market. In addition, a downturn in the semiconductor industry, when it occurs, will create a significant drag on tech earnings and weigh on the profits of the overall equity market.

Dangerously overheated technical conditions and valuations that leave little room for error warrant an underweight stance on the semiconductor & semi equipment sub-group. We are also underweight on the broader tech sector, which is especially vulnerable to a correction in chip stocks.

Salvatore Ruscitti
Strategist, U.S. Equities

MRB U.S. Equity Sector And Industry Sub-Group Recommendations

Sector	Industry Ratings*			
	- N +	Underweight	Neutral	Overweight
Consumer Discretionary	<input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>	Automobiles Household Durables	Auto Components Consumer Discretionary Retail Textile, Apparel & Luxury Goods	Hotels, Restaurants & Leisure
Communication Services	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	Media & Entertainment Telecom Services		
Consumer Staples	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	Consumer Staples Retail Food Products Tobacco	Beverages Household & Personal Products	
Energy	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	Energy Equipment & Services Oil, Gas & Consumable Fuels		
Financials	<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>		Capital Markets Consumer Finance	Banks Financial Services Insurance
Health Care	<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>		Health Care Providers & Services	Biotechnology Health Care Equipment & Supplies Pharmaceuticals
Industrials	<input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/>	Machinery	Electrical Equipment	Aerospace & Defense Air Freight & Logistics Ground Transportation Industrial Conglomerates
Information Technology	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	IT Services Semiconductor & Semi Equipment Technology Hardware & Equipment	Software	
Materials	<input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		Chemicals Metals & Mining	
Real Estate	<input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	Real Estate		
Utilities	<input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		Utilities	

* 6-12 month horizon; relative to the U.S. equity benchmark
 Note: + = overweight, N = neutral, - = underweight



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