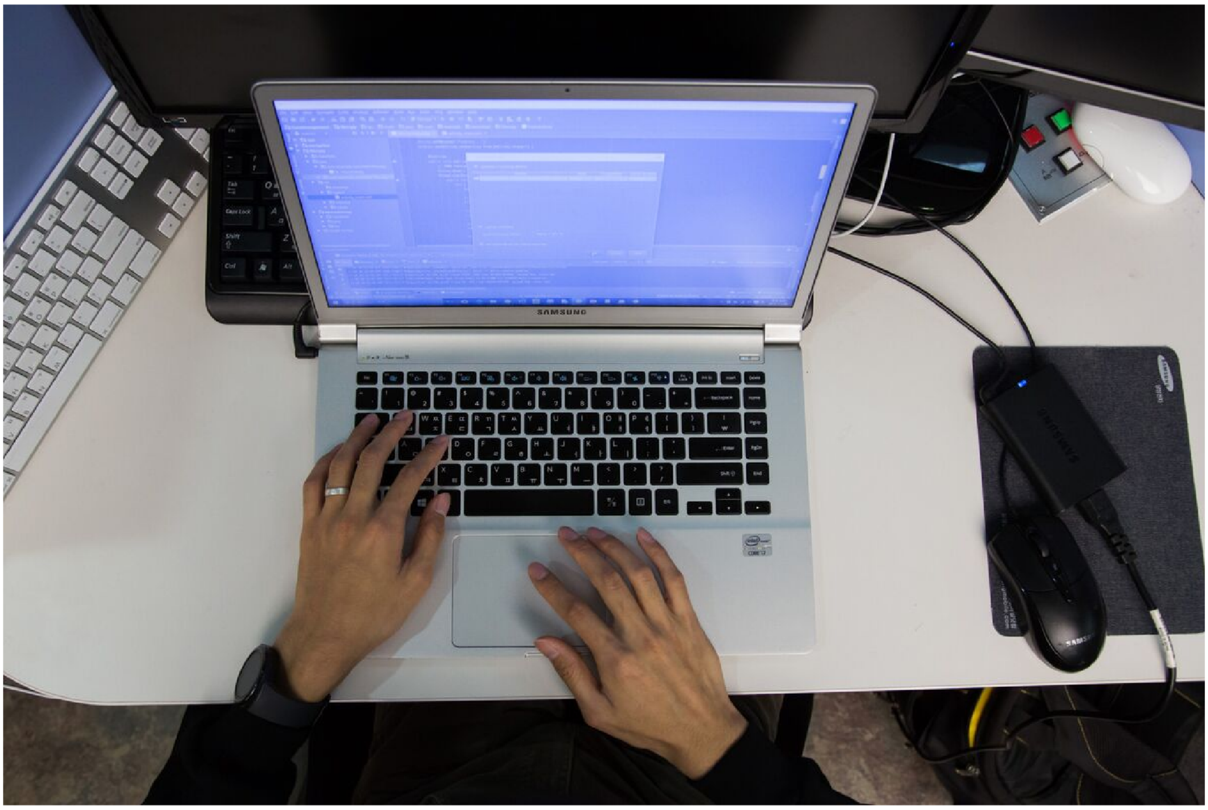
Technology

$1 Trillion Rout Hits Nasdaq 100 Over AI Jitters in Worst Day Since 2022

- Nvidia, Microsoft, Apple lead broader stock market declines
- Nasdaq 100 loses $1 trillion in market value in the selloff



Talk of a bubble in AI names was fanned by activity in derivatives markets that acted as rocket fuel during the rally. *Photographer: SeongJoon Cho/Bloomberg*

By Jeran Wittenstein
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Investors soured on the promise of artificial intelligence Wednesday, sparking a $1 trillion rout in the Nasdaq 100 Index as questions swirled over just how long it will take for the substantial investments in the technology to pay off.

The Nasdaq indexes tumbled more than 3% for the worst days since October 2022. The list of laggards was a who's-who of AI technology darlings, led by semiconductor companies such as Nvidia Corp., Broadcom Inc. and Arm Holdings Plc.

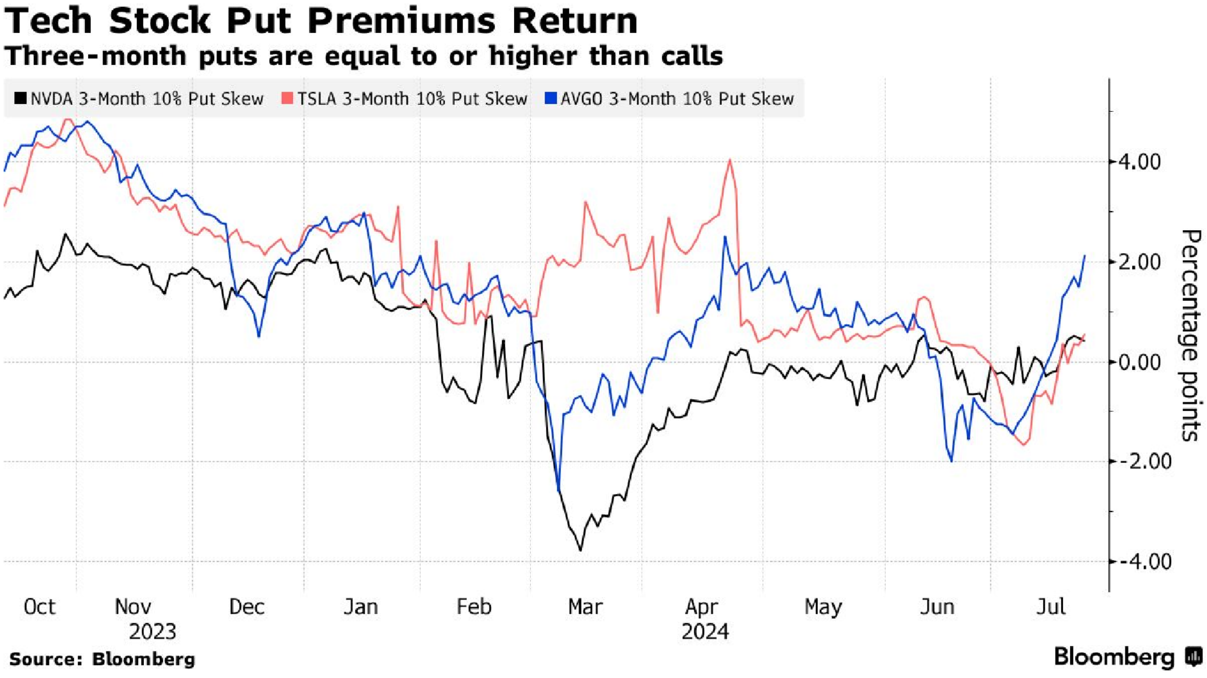
The selloff was triggered by a middle-of-the-road earnings report from Alphabet Inc. late Tuesday that featured a bloated capital expense. The company's stock sank more than 5% for its worst performance since

January. Tesla Inc. plunged more than 12% after Chief Executive Officer Elon Musk offered scant details about his company's self-driving vehicle initiative.

"The overarching concern is, where is the ROI on all the AI infrastructure spending?" said Alec Young, chief investment strategist at Mapsignals. "There's a pretty insane amount of money being spent. Maybe it'll pay off in a few years. But I think investors realize that the payoff is going to take time to materialize and the hyper scalers earnings are being hurt in the short term by how much they're spending on it."

As a result, traders are now paying more to protect against swings in tech. Options volatility on Nvidia rose to the highest level since mid-March, and the premium for puts on Broadcom Inc. is at a three-month high.

The rout comes two weeks after a cooler-than-expected inflation reading set off a massive rotation from tech winners into companies that would benefit most from Federal Reserve rate cuts, primarily small capitalization stocks. For a fourth straight session – and the 10th time in 11 days – small caps' performance exceeded that of their larger brethren on Wednesday. The Russell 2000 is up 0.5% this week compared with a loss of 1.5% in the S&P 500 and 2.6% in the Nasdaq 100.



Violent Selling

While the rotation from tech remains on display, the moves in tech were violent enough to suggest something else was at play. Specifically, investors appear to be listening to growing chatter in some Wall Street circles that the AI rally that fueled a bubble that added $9 trillion in value to the S&P 500 in the past year is bound to burst. While Wednesday may not mark the start of that, the magnitude of the drop raises alarms.

“In the short run, there may be a little AI fatigue, just because some of these investments that the Big Tech companies have made in AI may not be paying off in the time period that investors had in mind,” said Neville Javeri, portfolio manager at Allspring Global Investments.

The makers of hardware used in AI computing suffered some of the biggest drops on Wednesday after soaring this year. Super Micro Computer Inc. dropped 9.15%. Nvidia fell 6.8%, and Broadcom Inc. lost 7.6%. Megacaps also retreated, as Meta Platforms Inc. declined 5.6%, Microsoft Corp. slid 3.6%, and Apple Inc. dropped 2.9%.

Other traders, however, saw the moves as temporary.

“I don’t think you’re seeing anything other than some stocks that have done exceptionally well, have very solid year-to-date returns, seeing some profit taking in the face of not getting a giant beat and raise out of Google,” said Michael Sansoterra, chief investment officer at Silvant Capital Management.

The selloff sent a Bloomberg index of the so-called Magnificent Seven technology stocks down 5.9%, falling below its average price for the past 50 days for the first time since May. It remains up 33% since the start of the year.

AI Bubble Fears

Jim Covello, the head of equity research at Goldman Sachs Group Inc., is among a growing number of market professionals who are arguing that the commercial hopes for AI are overblown and questioning the vast expense required to build out infrastructure required for the computing to run and train large-language models.

Talk of a bubble in AI names was fanned by activity in derivatives markets, where investors piled into bullish options on indexes and individual stocks, especially Nvidia, that acted as rocket fuel during the rally. That sentiment shifted as the rotation from tech picked up speed, and potentially added to the downdraft Wednesday.

Last week, for example, demand for bearish puts in Nvidia outpaced calls by the most in five months. Tail-risk hedges that pay out in a stock crash - perhaps as much as a 30% downturn — were rising at the fastest pace since October. And the cost to protect against a retreat at around 10% or so was at the highest level since August 2023.

Tech stock valuations had moved into historically frothy territory. Two weeks ago, the S&P 500 information technology index's price-to-estimated earnings ratio hit the highest since 2002. Many in the Big Tech group are still priced at nose-bleed levels despite the selloff. Nvidia is priced at 36 times profits projected over the next 12 months, compared with an average of 21 in the S&P 500. Apple and Microsoft are both priced at more than 30 times. That's raised the stakes for earnings at an awkward time, with profit growth for the tech giants set to slow.

While Alphabet's results dimmed hopes that AI would be a bigger contributor to financial results for megacaps, investors have yet to hear from the rest of the cohort. Microsoft Corp. is scheduled to report on July 30, followed by Meta Platforms Inc., Apple Inc. and Amazon.com Inc. later in the week. Nvidia, the biggest beneficiary of AI spending, will be the last to report on Aug. 28.

"We are still holding onto our large-cap, quality, growth view," said Cayla Seder, macro multi-asset strategist at State Street. "Because even if there is trepidation around tech earnings, they are a more attractive option in terms of earnings growth and fundamental strength."

– With assistance from David Marino, Carmen Reinicke, and Alexandra Semenova