CIO Insights | Drive Into The Skid: Managing Idiosyncratic Risk

Expert drivers on slippery roads know that a skid is best navigated by turning into it rather than fighting it. The index dominating US tech sector, particularly semis and chips, are on a somewhat slippery path. Idiosyncratic risks ranging from trade restrictions, emerging threat from China and potential deceleration in growth are driving a rare under-performance.

Diversification is a proven way to mitigate industry specific risk – the question is what does one diversify into? Aside from a barbells positioning incorporating defensives, we see two other opportunities – broader AI ecosystem and China tech – when the roads are slippery, drive into what's causing the skid!

Mag 7 – Falling and Underperforming

Source: Tradingview

Idiosyncratic Risk – for Tech Hyper-scalers

Idiosyncratic risk, a.k.a.,unsystematic risk, is the risk specific to an individual company or industry that is not correlated with the overall market. Risks include product issues, competitive landscape, regulatory changes and operational challenges.

- **Competitive Landscape** – The "Deepseek Moment" raises the spectre of weakened demand for high end GPUs (impacts NVDA), reduction in data centre demand (also impacts NVDA aside from data centre majors such as AMZN, MSFT, GOOGL, META) as well as associated industries (advanced cooling –VRT). No surprise, these industry majors have seen sharp pullback in absolute and relative share price performance.

- **Regulatory & Geopolitical Challenges** – Trade friction, specifically involving the US and China is driving restrictions and retaliation on either side, potentially impacting demand as well as margins. An associated side effect of US restrictions has been to spur the development of the AI ecosystem in China.

- **Hype Cycles - Can The Investment Be Monetized?** While upstream demand has thus far remained robust, the big question is whether the committed capex can be monetized – often as much as a year's free cash flow, especially downstream. Over-investment and capital misallocation is the bane of every hyped-up trend.

Managing The Risk – Driving Into The Skid

Diversification, aside from hedging strategies, is a proven way to mitigate idiosyncratic risk. The key question is what to diversify into?

- **Cross-Sector Diversification - Defensive Sectors** – This is a classic approach and currently offers opportunities across the defensive spectrum (healthcare, staples and utilities), especially the healthcare sector, now reversing a substantial under-performance over the last two years.

Defensives – Performing After A Prolonged Decline

Source: Tradingview

- **Drive Into The Skid – AI Ecosystem** – While there may be doubts on how much will the demand curve for high end GPUs shift (and impact margins), this is balanced by a likely broader adoption through open source models),ultimately needing even greater compute power – all one has to do is look at the latest model releases by OpenAI and Anthropic. Associated with the increasing compute power needed, is the demand for energy. A sharp share price decline across the AI ecosystem, following Deepseek's announcements late Jan'25, opens up opportunities away from the hyper-scalers.

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Declines in Tech Stocks

Ticker	Mkt Cap (bn)	Price	52-Wk High	% chg
AMD	$ 161,821	$ 99.86	$ 227.30	-56%
PATH	$ 6,760	$ 12.30	$ 25.47	-52%
INTC	$ 102,751	$ 23.74	$ 46.63	-49%
AI	$ 3,027	$ 23.45	$ 45.08	-48%
DELL	$ 71,696	$ 102.76	$ 179.70	-43%
MU	$ 104,320	$ 93.63	$ 157.54	-41%
MDB	$ 19,916	$ 267.43	$ 449.12	-40%
TSLA	$ 942,375	$ 292.98	$ 488.54	-40%
VRT	$ 36,238	$ 95.17	$ 155.84	-39%
ASML	$ 277,862	$ 709.17	$ 1,110.09	-36%
PLTR	$ 199,082	$ 84.92	$ 125.41	-32%
QCOM	$ 173,830	$ 157.17	$ 230.63	-32%
ARM	$ 138,801	$ 131.69	$ 188.75	-30%
PWR	$ 38,477	$ 259.70	$ 365.88	-29%
ADBE	$ 190,909	$ 438.56	$ 587.75	-25%
NOW	$ 191,531	$ 928.78	$ 1,198.09	-22%
DLR	$ 52,624	$ 156.27	$ 198.00	-21%
KLAC	$ 94,195	$ 708.84	$ 896.32	-21%
AVGO	$ 934,799	$ 199.43	$ 251.88	-21%
ZM	$ 22,589	$ 73.70	$ 92.80	-21%
TSM	$ 819,036	$ 180.58	$ 226.40	-20%
CRM	$ 285,042	$ 297.85	$ 369.00	-19%
NVDA	$ 3,048,048	$ 124.92	$ 153.13	-18%
GOOGL	$ 2,089,477	$ 170.25	$ 207.05	-18%
ORCL	$ 464,463	$ 166.05	$ 198.31	-16%
MSFT	$ 2,951,217	$ 396.98	$ 468.35	-15%
AMZN	$ 2,249,686	$ 212.28	$ 242.52	-12%
META	$ 1,692,991	$ 668.20	$ 740.91	-10%
EQIX	$ 88,048	$ 904.62	$ 994.03	-9%
AAPL	$ 3,636,760	$ 241.84	$ 260.10	-7%
IBM	$ 234,079	$ 252.44	$ 265.72	-5%

Source: Lighthouse Canton

- **Drive Into The Skid – China Tech** – If China's tech majors area source of threat, well, diversify by buying into them. While the debate rages on whether Deepseek really did manage to develop their models on a shoestring budget, a greater adoption of their open-source models creates a competitive threat for US hyper-scalers and an opportunity for global investors. Besides, with trade restrictions, this is a complementary investment strategy to US Tech.

China Tech – Unlocking Performance

Source: Tradingview

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