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The Navigator

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Equity Views 3Q26: A positive case for 2027 AI build-out and the SaaS strikes back

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The MSCI AC World Equities (ACWI) declined modestly in July (-0.3%), rebounded in August (+2.7%), and retreated again in September (-1.2%), ending the quarter with a cumulative gain of approximately +1.2% (YTD: +12.9%). Nonetheless, the macro backdrop remained challenging, heavily influenced by elevated interest rates (with the 10-year treasury yield exceeding 5.3%), the Fed's first rate hike since 2023, and the ongoing US-Iran conflict, which continued to put upward pressure on energy prices and inflation.

In contrast, corporate earnings have remained remarkably resilient, with positive equity returns continuing to be underpinned by strong earnings momentum. During 3Q26, expectations for CY26 EPS growth for the S&P 500/MSCI AC World indices were revised upward to +32%/+34% yoy, respectively, from +23%/+26% in 2Q26. Despite these substantial earnings upgrades, valuations have become even more attractive, with forward P/E multiples declining to 19.0x/16.3x, respectively, from their 2Q26 levels (figure 1 & 2). This combination of accelerating earnings growth and valuation compression has further strengthened the market's fundamental risk-reward profile.

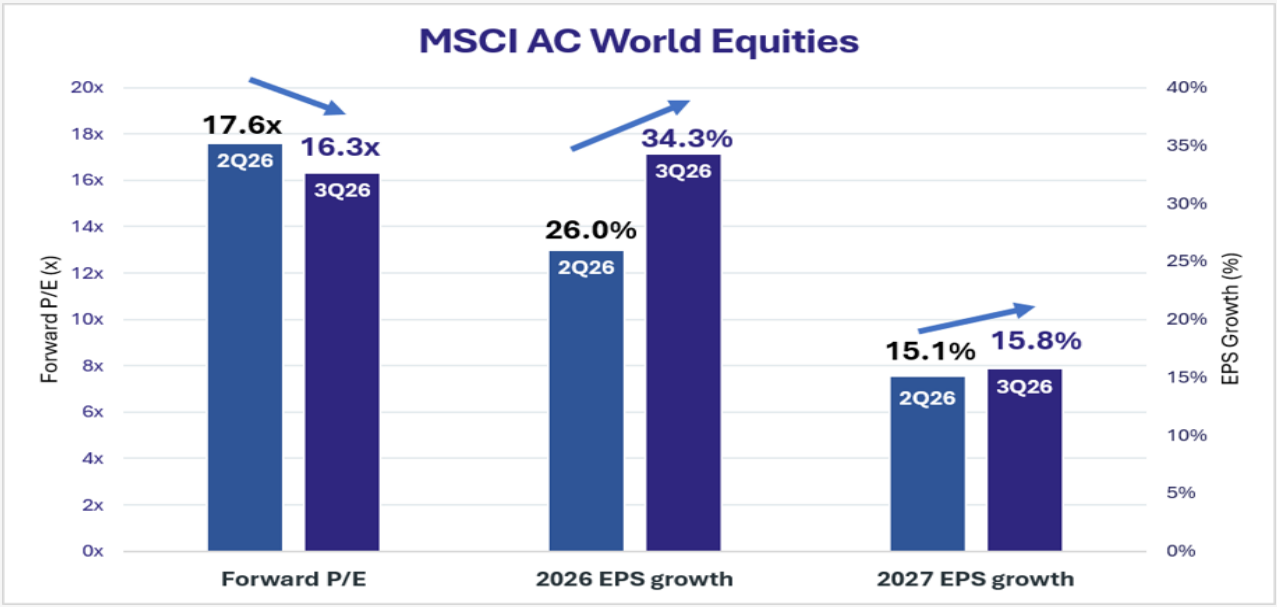


Figure 1. MSCI AC World Equities - lower valuations, higher earnings in 3Q26 vs 2Q26. Source: Bloomberg, FactSet.

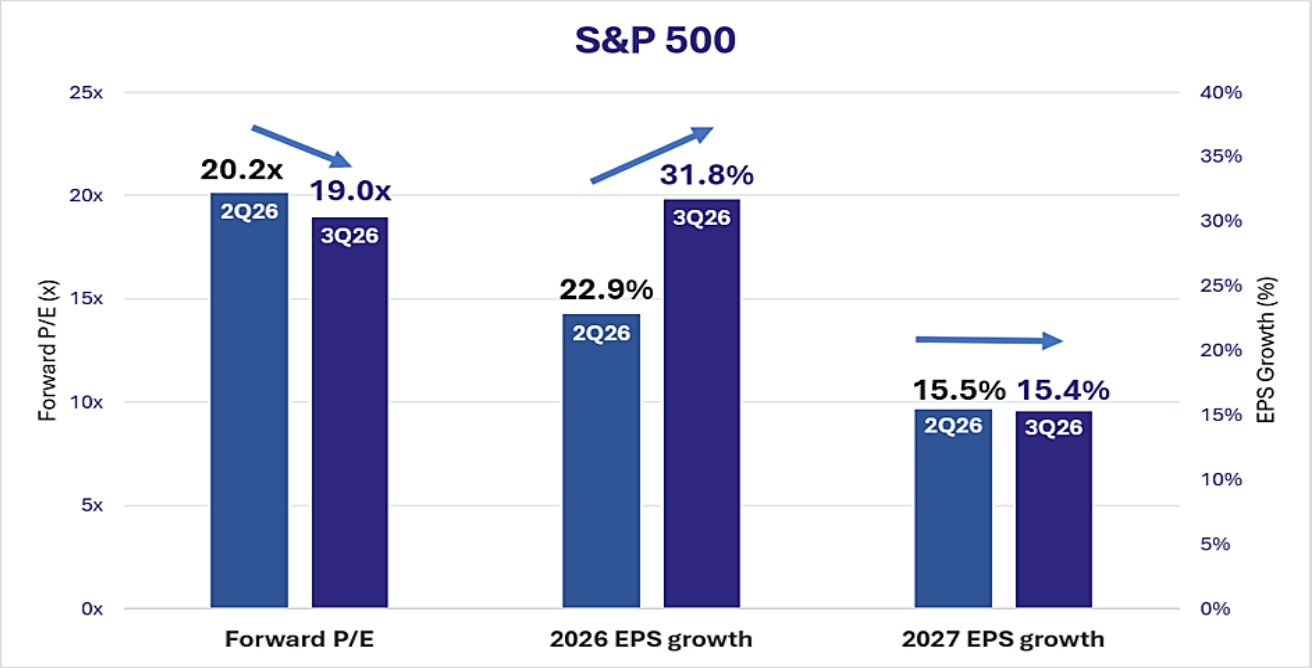


Figure 2. S&P 500 - lower valuations, higher earnings in 3Q26 vs 2Q26. Source: Bloomberg, FactSet.

In term of price action, the Nasdaq and the semiconductor sector (SOX) both experienced sharp drawdowns in July, with the SOX index falling by roughly -26% peak-to-trough, while the Nasdaq declined -6.6%. Beyond macro concerns, several events contributed to the selloff, beginning with the unwinding of leveraged ETFs linked to memory stocks and disappointing post-IPO performance from SpaceX. These events subsequently snowballed into the liquidation of Situational Awareness fund and broader de-grossing across the tech exposure.

Nevertheless, as discussed in the next section, we stick to our view that AI adoption and CapEx will continue to be strong going forwards. This should underpin revenue and free cash flow growth for our AI pick-and-shovel companies, some of which are also well positioned to increase shareholder returns. Against this backdrop, we view the recent correction in semiconductor stocks as an attractive opportunity to selectively add to our high conviction positions.

AI build-out continues in 2027

AI adoption showed no signs of slowdown, with Anthropic's annualized revenue run-rate (ARR) reaching $67bn this quarter. In addition, Nvidia also reported that nearly 20 companies had surpassed $1bn in ARR, up from 13 in 4Q25, underscoring the broadening AI ecosystem. Some of these points have been highlighted in our previous quarter's commentary.

Among the mega-cap hyperscalers, Microsoft, Alphabet, and Amazon have demonstrated their ability to re-accelerate the cloud business' growth and backlog: Google Cloud +82% yoy, Microsoft Azure +43% yoy, and Amazon AWS +37% yoy. Remarkably, Microsoft has managed to bring online 3 GW new data center capacity in the last 3 quarters.

At the current expectations, more than half of the S&P 500's EPS growth exclusive of "other incomes" in CY26 and CY27 is to come from "AI infrastructure" companies. As a result, it necessitates a close watch on the most crucial driver of the "AI infrastructure" layer: the AI CapEx cycle.

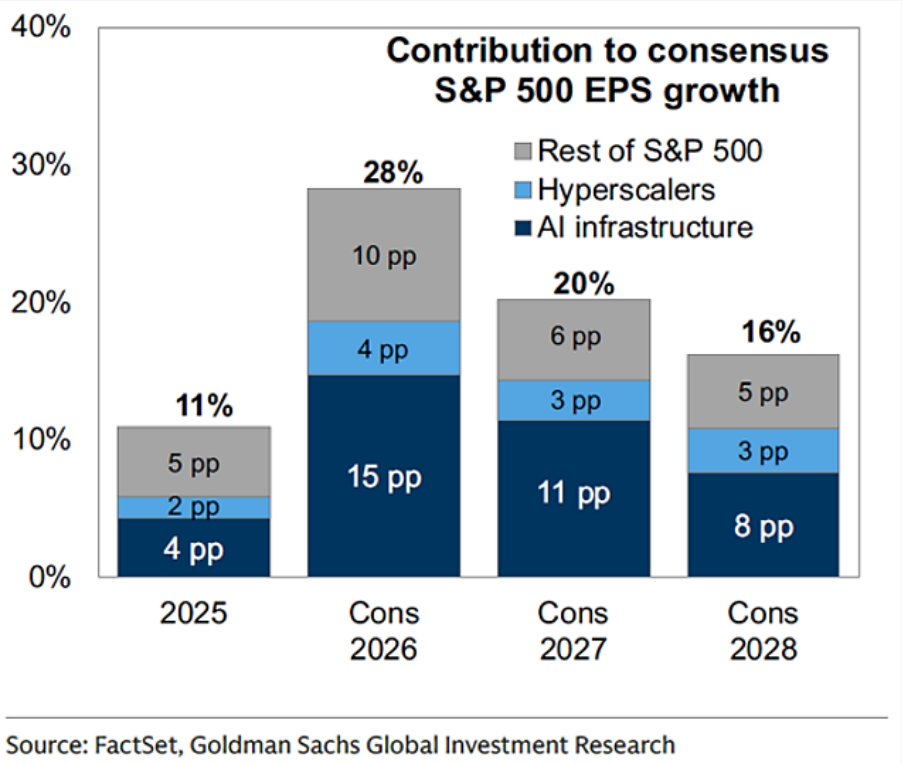


Figure 3. "AI Infrastructure" contributes to half of S&P 500's "ex-other incomes" EPS growth, according to Goldman Sachs.

In our base case, we believe that AI CapEx will remain on a strong growth trajectory in CY27, further supported by 3 potential upside drivers: higher-than-consensus CapEx by hyperscalers, continuous expansion of global neoclouds, and a longer-term ramp in regional neoclouds/sovereign AI deployments.

First, the hyperscalers (Amazon, Microsoft, Alphabet, Meta, and Oracle) are currently expected to increase CapEx to ~$1.1tn in CY27 (+37% yoy), a strong starting point in itself (figure 4).

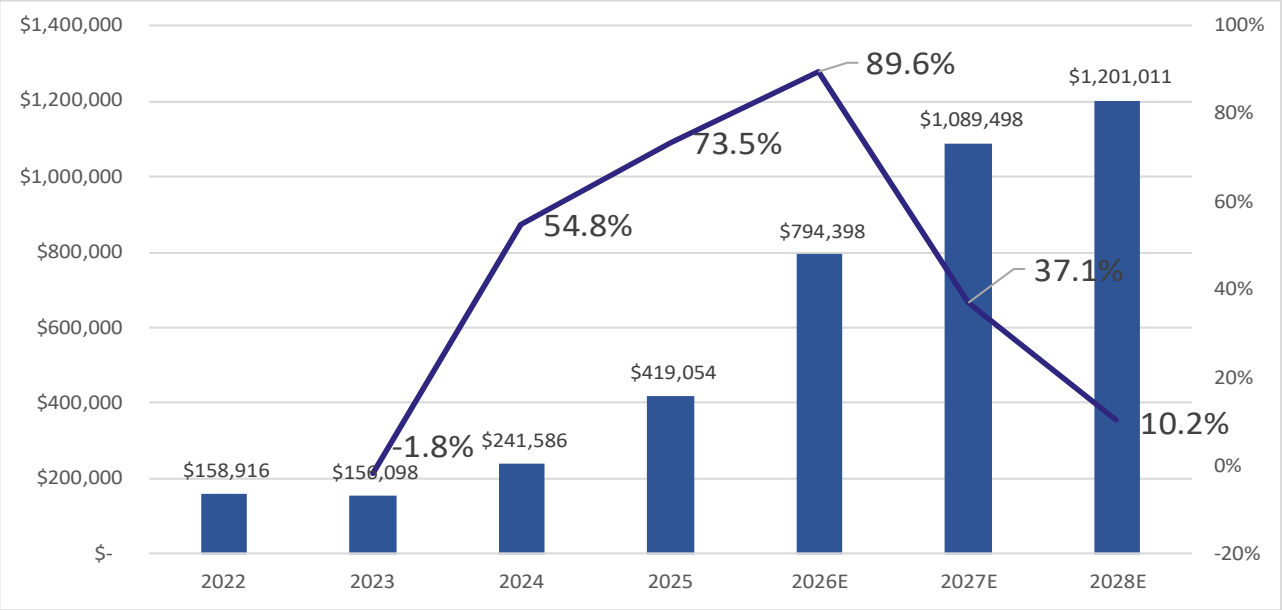


Figure 4. Hyperscalers' CapEx estimates (in $mn) and yoy growth. Source: Visible Alpha.

Moreover, hyperscaler CapEx has exceeded consensus estimates significantly for 3 consecutive years with yoy growth rate tracking +54%/+73%/+96% in 2024A/2025A/2026E, respectively, compared with beginning-of-year forecasts of +19%/+22%/+36% (figure 5). Given this track record, it would not be surprising to see CapEx growth once again exceed the currently forecast of +37% yoy in 2027.

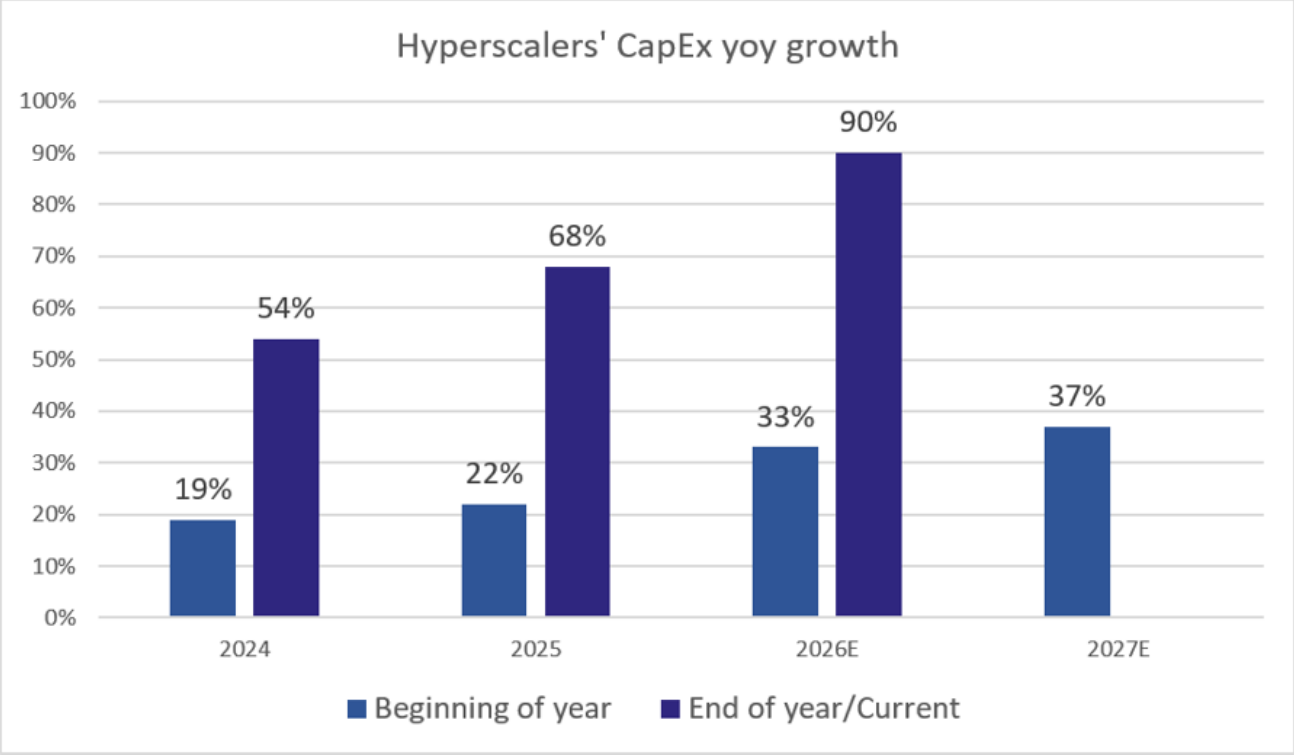


Figure 5. Hyperscalers' CapEx growth surprise - end of year/current vs beginning of year estimates. Source: Visible Alpha.

In addition, reverse-engineered estimates based on hyperscaler CapEx imply datacentre capacity net additions of ~22GW in 2027 and ~24GW in 2028 (We assume $50bn/GW total build costs for 2027 & 2028). Put differently, current market expectations already incorporate roughly a 30% delay relative to planned capacity additions due to power and chip shortages. These conservative assumptions continue to leave room for further upside surprises from hyperscaler investment.

Second, listed neoclouds (Coreweave, Nebius, and SpaceX) will expand datacenter capacity and CapEx in 2027 as well. Their management teams have consistently highlighted attractive economics, including short payback periods (2-3 years) and compelling ROIC on their new deployments. Incorporating both these global neoclouds and hyperscalers, we forecast AI CapEx growth of ~+45% yoy 2027 (figure 6).

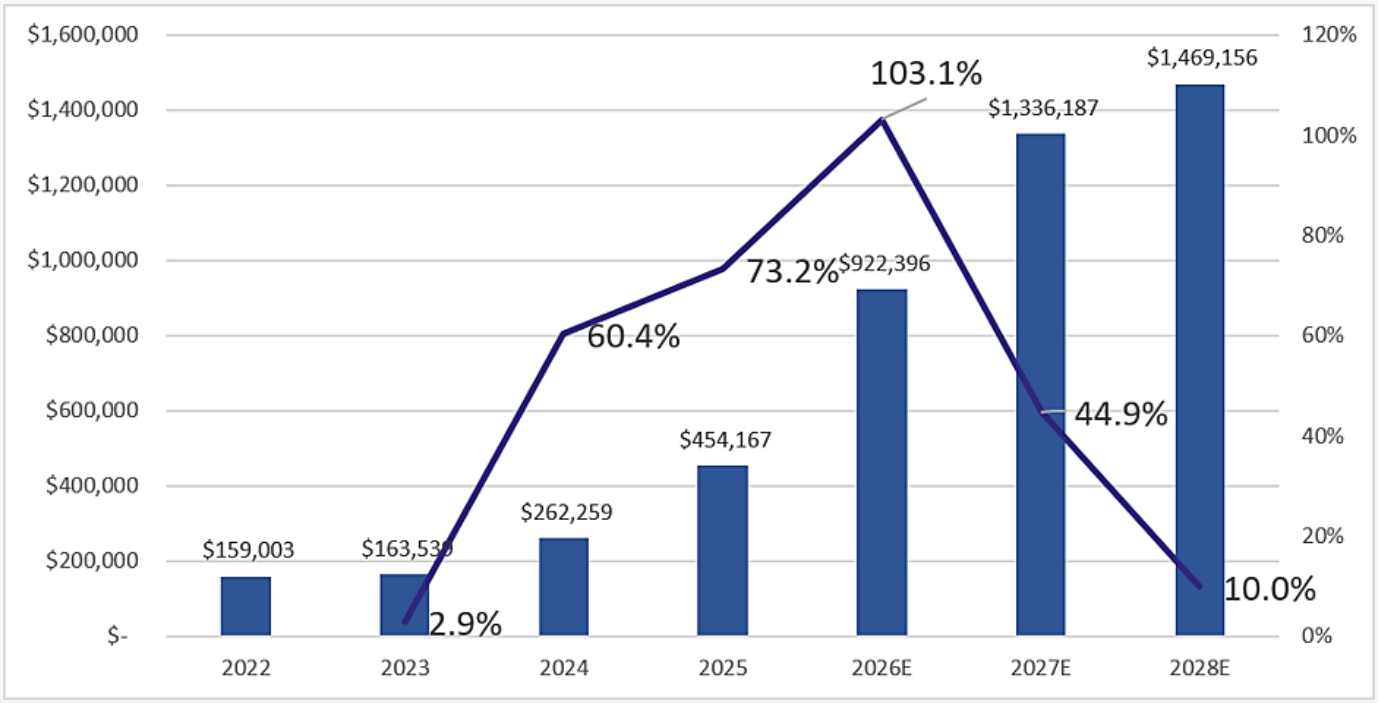


Figure 6. Hyperscalers + Neoclouds' CapEx estimates (in $mn) and yoy growth. Source: Visible Alpha.

Finally, sovereign AI initiatives continue to gain momentum across multiple regions, with governments committing substantial resources to develop domestic AI capabilities: South Korea's $900bn national AI plan, Japan's $2.3tn growth strategy, the EU's AI factories, UAE's G42/Stargate project, and Saudi Arabia's project HUMAIN. These nations' AI programs, together with the emergence of regional neocloud champions such as Australia's Firmus, Taiwan's GMI Cloud, India's Yotta and Neysa … are laying the foundation for a new wave of AI infrastructure investment in the future.

Taken together, we believe that AI infrastructure spending is unlikely to peak in the near term. This should support another year of robust earnings growth across our AI shovel-makers and the overall market in 2027. Nonetheless, from an investment perspective, we favour selective hyperscaler names over neoclouds, given the latter's greater reliance on leverage and weaker operating cash flow generation.

The SaaS strikes back

In 3Q26, as hyperscalers and semiconductor stocks came under pressure, the baton was passed to software companies. The software sector rallied +17.5% during this period, sharply outperforming the Semiconductor Index (SOX), which declined -11.2% (figure 7). As a result, the majority of the GEP's gains this quarter came from the software sector.



Figure 7. Performance divergence between Software (orange) and Semiconductors (white) in 3Q26. Source: Bloomberg.

Solid earnings from software companies have debunked "SaaS-pocalypse" concerns, driving the recent re-rating. MongoDB reported robust +30% yoy growth in its Atlas revenue, while Snowflake accelerated revenue growth from 34% to 37% yoy, supported by rising AI-related demand.

Snowflake dispelled concerns that AI would cannibalize data platform spend. Instead, AI acted as a structural multiplier. As enterprises deployed internal coding and data agents (such as CoCo and CoWork) to automate complex data tasks, underlying data query and storage consumption accelerated sharply.

Cloudflare highlighted a major milestone in digital infrastructure: over half of all global traffic flowing across its network is now non-human machine traffic generated by AI agents. This shift positions lightweight, edge runtime platforms as the essential execution environment for the agentic web.

Datadog showed that AI adoption is re-accelerating core non-AI cloud modernization alongside AI natives. As autonomous agents interact with databases and external APIs through tools like the Model Context Protocol (MCP), tracking model health, tool calls, and infrastructure bottlenecks has become mission critical.

Several of our lagging positions, including Microsoft and ServiceNow, also rebounded strongly during the month. In our view, both remain high-quality businesses whose share prices had been weighed down by overly pessimistic sentiment surrounding the “SaaS-pocalypse”.

The narrative has now shifted from proving relevance to executing the transition from seat-based revenue models toward consumption-based monetization. We therefore remain focused on businesses with durable moats, particularly mission-critical, infrastructure, and enterprise software providers. By contrast, companies that function primarily as “AI wrappers” or “systems of engagement” face a greater risk of commoditization.

Lastly, the AI “harness” has become increasingly key as agentic AI trend progresses. An AI harness of the infrastructure built around the large language model (LLM) to turn reasoning into reliable action, including APIs and tool calls, memory management, code sandbox, guardrails, and loop control. In an agentic AI system, the LLM acts as the brain, while the harness functions as the limbs. Hyperscalers, in partnership with software companies, are central to building and monetizing this AI harness.



Figure 8. Illustration of AI Harness

In summary, despite heightened macro uncertainty, we remain constructive on the equity market, underpinned by strong fundamental momentum, including resilient corporate earnings, accelerating AI adoption and improving return on investment (ROI). As highlighted in our 2Q review distinguishing between price momentum - often driven by shifting investor sentiment and market greed & fear - and fundamental momentum is critical to generating sustainable long-term returns. More importantly, we believe the AI investment cycle remains firmly intact through 2027, with sustained infrastructure spending supporting robust growth opportunities for our hardware and software infrastructure enablers. Against this backdrop, we view market volatility not merely as a risk, but also as an opportunity to selectively add to our highest-conviction positions at attractive valuations.

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