AUGUST 2026

Did the SOX Index Experience a Bubble in Q2 2026?

The returns generated by semiconductor stocks during the second quarter of 2026 were parabolic. The Philadelphia Semiconductor Index, commonly known as the SOX, gained approximately 88% during the quarter, its strongest quarterly return on record and one that dwarfed the advances experienced during the dot-com era. At one point, the SOX index was up over 100% in less than two months' time. Fundamentals were certainly strong, but the price action was unlike anything investors had seen in some time. Things have settled down, and the stocks have now corrected over 20%, wiping out trillions of dollars in value in the process. The question we pose is whether the recent action was more symptomatic of an investment cycle or a bubble. First, some definitions.

We rely on Morgan Housel, author of *The Psychology of Money*, to help identify the core drivers of bubbles. Because bubbles are as much psychological phenomena as financial ones, his framework is particularly useful. First, investors with different objectives and time horizons begin influencing the same area of the market, even though they are effectively playing different games. As prices rise, time horizons will shorten, and momentum attracts additional buyers. Fear of missing out then draws longer-term investors into the trade, often causing them to abandon their original discipline and take cues from short-term participants. At that point, recent price performance can become more influential than underlying business fundamentals, allowing the move to accelerate further.

An investment cycle, by contrast, is driven primarily by economic growth and corporate earnings. Share prices may become elevated, but they remain tied to the earning power and value of the underlying businesses, and capital flows are generally less extreme. The cycle eventually turns as demand, earnings, or other fundamentals weaken. The result is typically a market correction rather than the sharper crash associated with a bubble.

Based on Housel's criteria, the above bubble drivers were in place in the semiconductor and related component industries during the second quarter. Daily options activity increased, long-term investors chased price momentum, and leveraged investment vehicles magnified already extraordinary market moves. The exception to the bubble narrative is that the Semiconductor index has not crashed but instead has declined over 20% from its high. This means that there were likely symptoms of a bubble, but also some fundamental rationale for the move. What makes the semiconductor experience more difficult to characterize as a traditional bubble is the magnitude of the fundamental improvement occurring underneath the price appreciation.

In this case, the AI buildout led to extreme demand in a supply-constrained area of the market. Companies realized that they could raise prices without destroying short-term demand. Earnings gains, while still well behind the extraordinary rise in share prices, have themselves been remarkable. For example, Korean memory-chip manufacturer SK Hynix recently reported roughly $65 billion in quarterly profit, a 13-fold increase from the prior year and nearly as much profit as the company had generated in the previous 29 years since its IPO. Its shares nevertheless fell 8.7% following the results.

The issue is not whether AI-related demand and earnings growth are real. Rather, investors must consider how much of that improvement has already been reflected in share prices and what level of future growth those prices require. A company can produce extraordinary earnings growth and still disappoint investors when expectations have risen even faster. In this case, prices may have moved well ahead of fundamentals, but they did not become completely disconnected from them, and we have not experienced a crash.

Just the other week, prominent investors Jeremy Grantham and Ray Dalio warned that the broader AI-driven market advance bears the characteristics of a bubble. Viewed through that lens, the semiconductor rally may have represented a concentrated bubble-like episode within a broader AI-related bubble. Dalio has also identified rising interest rates and surging stock issuance as forces that can eventually bring a bubble to pop. Higher rates increase the cost of financing, while elevated valuations encourage companies to issue additional shares and take advantage of abundant investor demand. Both can alter the supply-and-demand dynamics that previously supported rising prices.

BCA Research's Peter Berezin offers another useful way to interpret the recent experience. He has described the AI trade as "primarily an earnings bubble rather than a valuation bubble," distinguishing it from speculative episodes built almost entirely on distant promises. Recent market reactions suggest that investors are becoming more discerning. Even among companies reporting strong earnings, investors appear increasingly focused on whether enormous capital expenditures can be credibly justified.

So, was the semiconductor rally a bubble and are we in a broader AI bubble? The answer is not a simple yes or no. There were certainly signs of a bubble, including shrinking time horizons, momentum-driven buying, leverage, and share prices that advanced far more rapidly than even exceptional earnings. At the same time, the fundamentals have been extraordinarily strong. The result remains to be seen, and in the meantime, we will continue to invest according to our long-held philosophy. We are focused on evaluating businesses where AI may enhance productivity, expand margins, improve customer value, or create meaningful competitive advantages. We continue to believe that quality, valuation, and long-term fundamental sustainability are especially important when enthusiasm is high.
