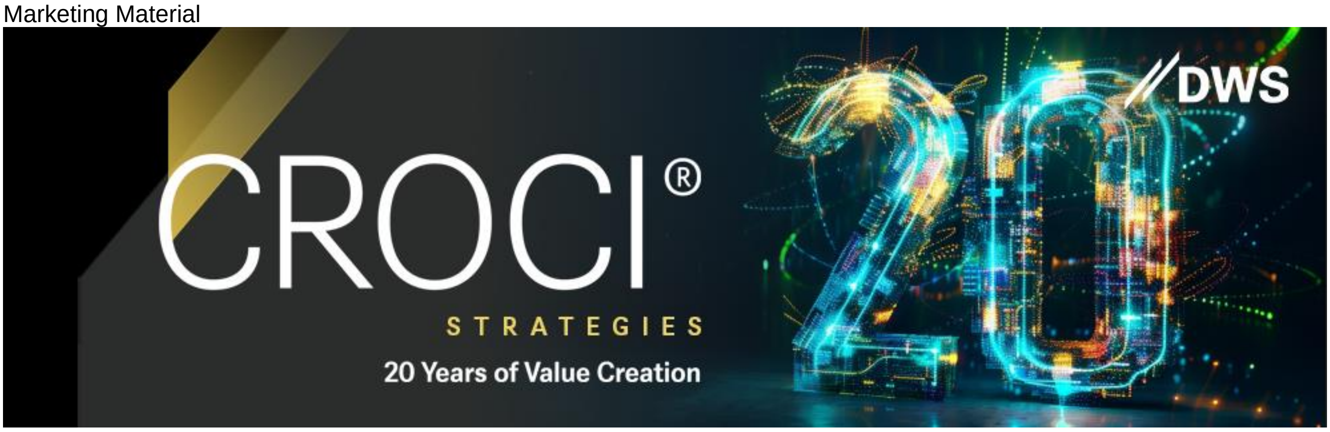
Marketing Material



Technology and the Magnificent Seven

MAG7 still have a growth premium but narrower than a year ago

Our analysis on the Technology sector in the 2025 CROCI Outlook focused on the Magnificent Seven (MAG7)[1], as well as analysing the cheapest companies in the global IT sector. Its key conclusions below still hold, based on our updated analysis:

1) About half of MAG7's current valuation is attributable to implied future growth, compared to about a third for our broader US coverage (up from around a quarter),

2) the market implied cash return for MAG7 remains significantly ahead of what MAG7 has delivered over the past five years and

3) the cheapest quartile of the broader IT sector continues to offer attractive valuation measured by Economic PE.

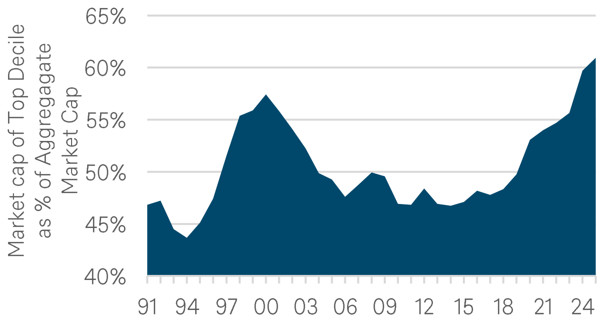
The impact of President Trump's tariff policies and other geopolitics led to a volatile first half of 2025, but ultimately did not affect the valuation of the Magnificent Seven. What has changed is that the valuation of MAG7 stocks is at a much lower premium (around 5%) to the rest of CROCI's US coverage universe, compared to more than 20% at the beginning of the year.

Concentrating on the concentration

High market concentration is still a hallmark of the US stock market, a phenomenon which in large part reflects the impact and size of the MAG7 companies.

The strong outperformance of mega-caps, especially in the US, has been one of the most dominant equity phenomena over the past few years. Figure 1 provides an updated analysis of market concentration based on CROCI's entire global coverage universe (excluding financials). The share of the top decile by market cap of CROCI's coverage universe is at its three-decade peak, even higher than during the TMT bubble in the late 1990s. There is a similar story for cash returns. Global aggregate cash returns are currently around 7%, but for the top decile the number is close to 12%, with the remaining coverage universe's returns only at 4.7%.

Figure 1: Large caps punching above their weight



Source: DWS, CROCI. Aggregate data of companies in CROCI's global non-financial coverage. The top decile is arrived at using the market cap of the entire CROCI non-financial coverage universe. Data as available on 16 June 2025.

Large cap bubble?

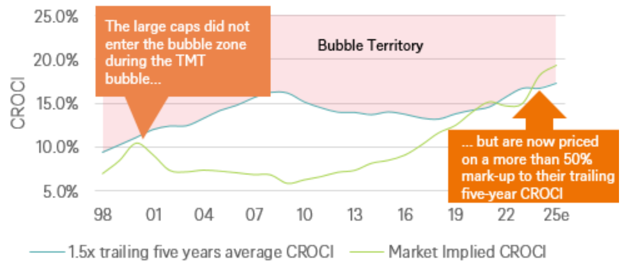
We also examine how far the market's pricing of large caps has become decoupled from economic reality. For the past twenty years, we have defined companies as being in bubble territory if the market is pricing more than 1.5x a company's medium-term (preceding five years) profitability. We do not explicitly take growth assumptions into account here.

The market-implied cash return of mega-caps is significantly ahead of their average profitability over the past five years. At an aggregate level, the market implied CROCI cash return of

[1] Magnificent Seven (MAG7) and Technology are often used synonymously but it's worth remembering that only three of the MAG7 are from the IT sector. Having said that, the driver of the core businesses and their supply chain will likely find most overlap with the IT sector and hence for the purpose of this section, we will continue to imply that the seven companies as part of the IT sector.

the large caps is nearly 70% higher than the average of the past five years, as Figure 2 below shows.

Figure 2: Largest 10% by market cap in bubble territory

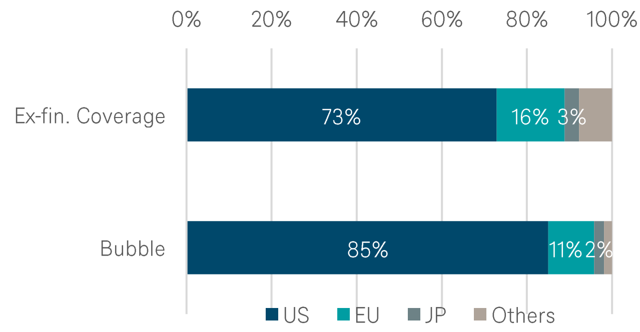


Source: DWS, CROCI. Data as available on 16 June 2025. Implied CROCI is equal to EV/NCI times cost of capital. No assurance can be given that any forecast, target or opinion will materialize.

Figure 3 provides regional breakdown of the total ex-financial coverage compared to the companies in bubble territory in terms of their market capitalisation. Unsurprisingly, our US coverage accounts for nearly three-quarters of our ex-financial coverage universe. However, that proportion jumps significantly when we narrow down to the companies in bubble territory.

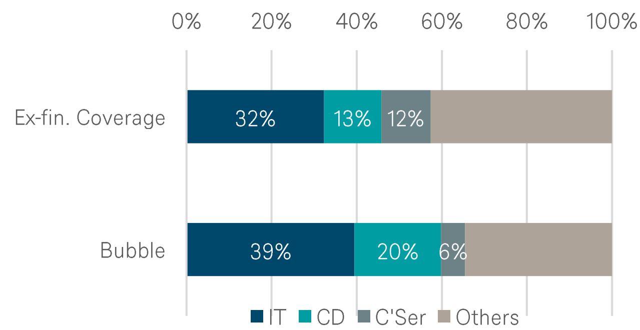
The aggregate market cap of companies in bubble territory accounts for more than half of the total market cap of the companies in our ex-financial coverage universe.

Figure 3: Regional split of companies (based on market cap)



Source: DWS, CROCI. Data as available on 31 May 2025. Bubble represents the proportion of coverage in bubble territory (determined as EV/NCI of 1.5x 5yr average CROCI).

Figure 4: Sectoral split of companies (based on market cap)



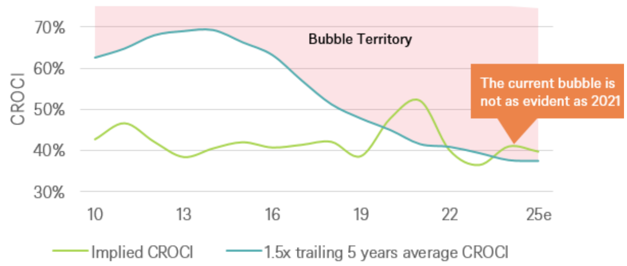
Source: DWS, CROCI. Data as available on 31 May 2025. Bubble represents the proportion of coverage in bubble territory (determined as EV/NCI of 1.5x 5yr average CROCI).

The three sectors that make up the MAG7 together account for nearly two-thirds of the aggregate market cap of companies in bubble territory. The share of IT and Consumer Discretionary goes up in the bubble zone, while that of Communication Services becomes half. For this reason, we show the extent to which the MAG7 are in bubble territory in Figure 5.

MAG7 in bubble yes, but with less fizz

Even though the MAG7 are in bubble territory by our definition, the accompanying exuberance is not as acute as we measured it to be in 2021. To put this into context, at the end of 2021, the implied CROCI cash return was 90% higher than the trailing five-year average CROCI cash return, and this ratio now stands at less than 60%.

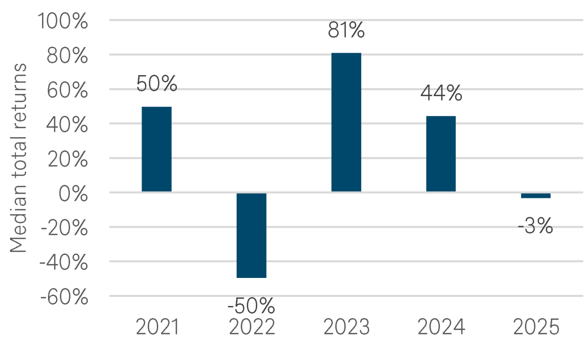
Figure 5: MAG7 in the bubble territory



Source: DWS, CROCI. Data as available on 16 June 2025. Implied CROCI is equal to EV/NCI times cost of capital. MAG7 or Magnificent Seven includes seven largest companies by market capitalisation in the CROCI US coverage universe. No assurance can be given that any forecast, target or opinion will materialize.

In short, whilst there is still some exuberance in the valuation, the correction in 2022 and the subsequent higher expected growth-led recovery in 2023/24 resulted in reining in of the bubble in the aggregate of the seven stocks.

Figure 6: Median MAG7 Total Returns (in share prices)



Source: FactSet. Data as available on 16 June 2025. 2025 representation year to date total returns in 2025. MAG7 or Magnificent Seven includes seven largest companies by market capitalisation in the CROCI US coverage universe.

The muted year-to-date performance of the MAG7, on the back of significant outperformance over the past two years, leaves their aggregate valuation at a lower premium of around 5% to the rest of CROCI's US coverage universe, a far cry from more than 20% at the beginning of the year.

This underlines the material relative improvement in earnings expectations for the MAG7 (evident in Figure 7), which (in spite of the outperformance in the preceding two years) has made the seven stocks at an aggregate level only slightly more expensive than our US non-financial coverage universe.

On a median basis, the MAG7 trades on an 2025e economic PE of 41.7x vs the rest of CROCI's US coverage on 33.7x. This higher PE multiple of MAG7 can be explained at least in part by their higher potential growth rate.

Figure 7: MAG7 versus US ex MAG7 – current valuation versus LT average

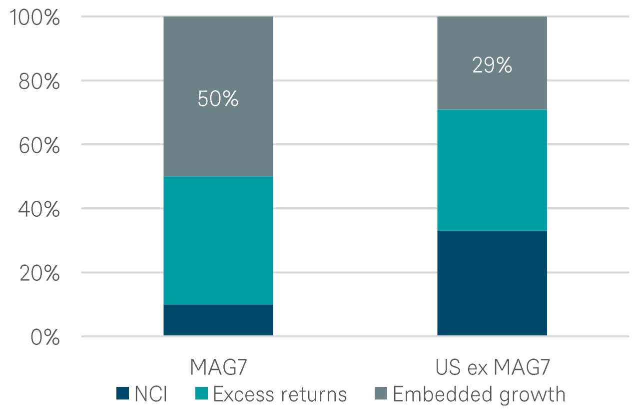
Valuation Summary	MAG7		US Ex MAG7		US IT Ex MAG7	
	FY1 (2025)	10Y Avg	FY1 (2025)	10Y Avg	FY1 (2025)	10Y Avg
EV./NCI (x)	8.95x	8.99x	2.98x	2.74x	6.75x	5.00x
CROCI	23.4%	27.4%	8.2%	8.8%	14.3%	16.7%
Eco.PE	38.2	33.4	36.2	31.4	47.3	30.6
Acc. PE	31.5	28.1	22.8	20.1	32.3	21.4
Sales / GCI	0.75x	1.07x	0.61x	0.66x	0.75x	0.86x
CROCI CF Margin	40.9%	34.0%	20.9%	19.9%	32.3%	30.4%
Leverage	0%	-3%	19%	22%	11%	15%
FCF yield (after SO)	1.9%	2.7%	3.3%	3.4%	2.6%	4.1%
Dividend yield	0.3%	0.6%	1.7%	2.1%	1.1%	1.6%
Cycl. Adj. growth (real)	11.9%	12.5%	2.0%	2.8%	2.7%	3.5%

Source: DWS, CROCI. Data as available on 20 June 2025. No assurance can be given that any forecast, target or opinion will materialize.

Growth priced in for MAG7 vis-à-vis that of US ex MAG7

Pivoting to the MAG7, we ask instead what growth they need to deliver to justify their current valuations. The following chart breaks down their current enterprise value into three components: economic assets (our measure of their total assets, including intangibles such as R&D); their profitability, and finally an implied growth expectation component.

Figure 8: Decomposition of 2025e valuation



Source: DWS, CROCI. Data as available on 16 June 2025. Aggregate data of MAG7 or Magnificent Seven includes seven largest companies by market capitalisation in the CROCI US coverage universe. US ex MAG7 represents US non-financial CROCI coverage universe excluding MAG7. No assurance can be given that any forecast, target or opinion will materialize.

We estimate that about half of the current valuation of MAG7 is attributable to implied future growth, whereas less than one-third of the current valuation of our non-financial US coverage is based on growth expectations.

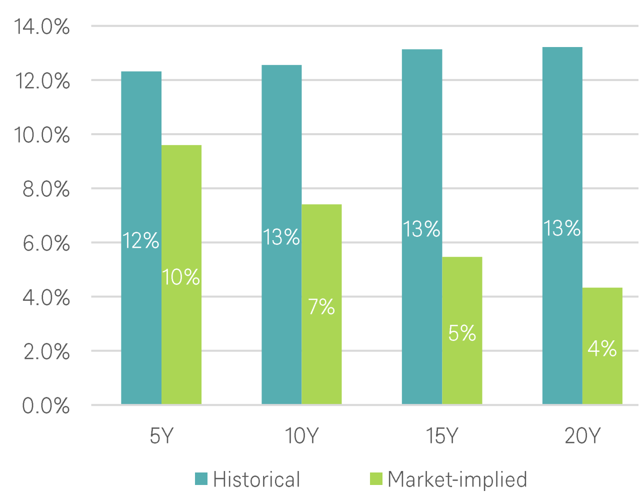
In short, ballooning growth expectations have been the key driver behind the MAG7's sustained outperformance and market premium (even though the number has decreased somewhat for MAG7 and increased for US ex MAG7 since we published our Outlook 2025 at the start of the year).

So how fast do they need to grow to justify the embedded growth component of their current valuation? Given the fast fades associated with high returning tech business, we have modelled our embedded growth using a fixed five-year starting point with the initial growth rate, and then assuming a standard fade period down to a low steady state to perpetuity. We solve for the initial growth rate.

Current valuations of MAG7 imply an initial earnings growth (in real terms) of around 9.5% per annum over the first five years of growth. Once five years of the fade are incorporated then that number falls to 7.5% per annum annualized over 10 years.

The chart below shows the average annualized historical growth for each period, compared to the market implied number for the same period going forward, based on the outputs of our growth model. In summary, the required growth rates are challenging – but nevertheless they are not as high as what they have delivered in the past 5-10Y.

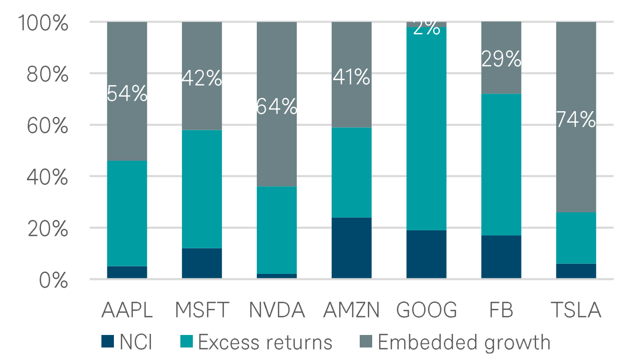
Figure 9: MAG7 – Historical versus market-implied economic earnings growth (CAGR, real) across different time frames



Source: DWS, CROCI. Data as available on 20 June 2025. No assurance can be given that any forecast, target or opinion will materialize.

We have also broken out the decomposition for each of the seven stocks. A wide dispersion of the embedded growth becomes apparent, ranging from as low as 2% to as high as 74%. One stock is essentially priced with no growth at all, while another is exactly in line with the US ex MAG7 equities in terms of the growth component of its valuation. At the other end of the scale, for one of the MAG7, a full three-quarters of its current enterprise value cannot be justified without future growth.

Figure 10: Decomposition of 2025e valuation for each of the MAG7 stocks

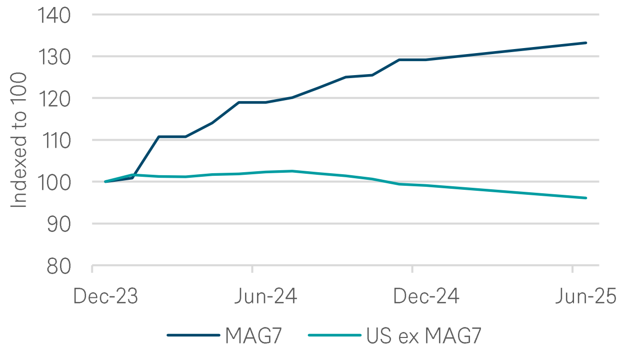


Source: DWS, CROCI. Data as available on 16 June 2025. No assurance can be given that any forecast, target or opinion will materialize.

Material upgrades to 2025 economic earnings expectations

Both 2024e and 2025e consensus earnings saw material upgrades over the course of the 2024. 2025e economic earnings estimates for MAG7 have jumped 25% year to date, while CROCI's US coverage ex-MAG7 saw a 3% contraction (Figure 11).

Figure 11: 2025e Eco. earnings evolution since Dec-23



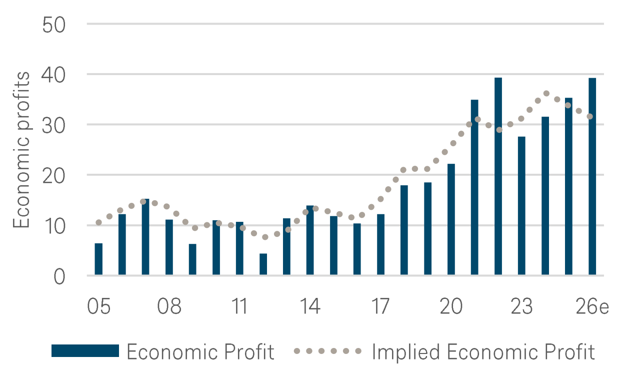
Source: DWS, CROCI. Data as available on 16 June 2025. Aggregate data of MAG7 or Magnificent Seven includes seven largest companies by market capitalisation in the US. US ex MAG7 represents US non-financial CROCI coverage universe excluding MAG7. No assurance can be given that any forecast, target or opinion will materialize.

Looking beyond MAG7 to the cheapest IT quartile

MAG7 has certainly continued to steal the limelight in the sector, but the broader IT sector in developed markets has also been an important beneficiary of growing themes such as cloud computing, smart mobility, generative AI, the internet of things and 5G.

This has kept the CROCI cash returns high and has contributed to stable growth prospects. For value investors, a CROCI strategy driven by fundamental value investing does offer an attractive value proposition–a basket of overlooked stocks from the IT sector which offer genuinely attractive economic value.

Figure 12: Economic Profit & Implied EP – Cheapest Quartile (in DM IT Sector)



Source: DWS, CROCI. Data as available on 16 June 2025. Aggregate data of the cheapest quartile (based on 2025e economic PE) of the CROCI's Developed Market IT sector. No assurance can be given that any forecast, target or opinion will materialize.

This basket is made up of the cheapest quartile in the sector and trades at 24.9x its 2025e Economic PE, nearly three-fifths the DM IT sector multiple of 42.2x. It generates cash returns of 15.7%, below the sector returns of 21.0% but nevertheless solid and explained by higher capital investments on high-growth themes.

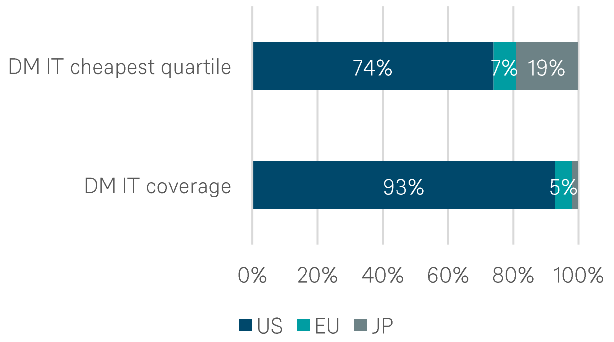
Current market valuations imply significantly lower growth relative to that of the IT sector. Consequently, the basket offers an attractive FCF yield of 5.3%, considerably higher than the 2.6% offered by the broader sector.

Figure 13: Putting DM IT sector's cheapest quartile into perspective

	EV/NCI	CROCI cash return	Ec. PE	FCF Yield	Div. Yield
Cheapest quartile in DM IT	3.9x	15.7%	24.9x	5.3%	1.7%
Total CROCI coverage (DM non-financials)	2.7x	7.4%	36.7x	3.0%	1.6%
DM IT sector	8.9x	21.0%	42.2x	2.6%	0.7%
MAG7	9.0x	23.4%	38.5x	1.9%	0.3%

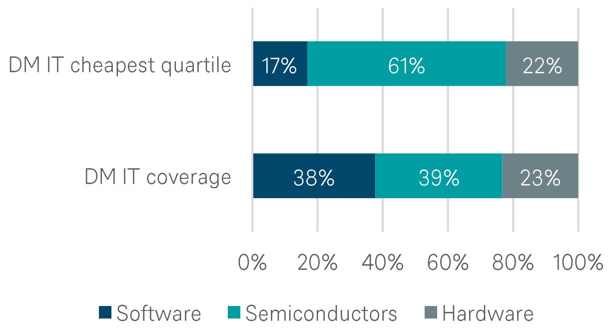
Source: DWS, CROCI. Data as available on 16 June 2025. Cheapest quartile represents data of the cheapest quartile (based on 2025E economic PE) of the CROCI's Developed Market IT sector. No assurance can be given that any forecast, target or opinion will materialize.

Figure 14: Regional split of companies (based on market cap)



Source: DWS, CROCI. Data as available on 16 June 2025. DM IT coverage refers to our Information Technology coverage within the Developed Markets. The aggregate market cap of the 21 companies in the cheapest quartile is 6.2% of the aggregate market cap of the entire IT sector coverage within the DM region (83 companies).

Figure 15: Sectoral split of companies (based on market cap)



Source: DWS, CROCI. Data as available on 16 June 2025. DM IT coverage refers to our Information Technology coverage within the Developed Markets.

Figure 14 provides the regional breakdown of the CROCI DM IT sector coverage compared to the companies in the cheapest IT quartile in terms of their market capitalisation.

US companies account for more than 90% of our IT sector coverage universe within DM. However, that proportion drops to about three-quarters when we narrow down the focus to the cheapest quartile within the sector, as some of the mega-caps are removed from consideration. The market cap share of companies from Japan increases to take its place amongst the cheapest IT companies.

There is also a high proportion of semiconductors in the cheapest quartile, and a sharp reduction in the proportion of software companies relative to the broader IT sector.

The Japanese companies (especially the two within the Software subsector) and the majority of the Semiconductors in the basket managed to generate strong performance year-to-date. The Tech Hardware space has been the weakest of the three so far.

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