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THE GREAT TECH BUBBLE: 10 YEARS LATER

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In December of 1999, a Gallup survey showed that investors expected to earn, on average, a 19 percent annual return on stocks over the next 10 years. So far, stock investors have not done quite as well as expected. From December 1, 1999 to May 1, 2009, the S&P 500, assuming reinvestment of dividends, has actually given investors an annualized return of negative 3 percent.

Putting that disparity of expectations and achievement into dollar terms, for $100,000 invested, instead of an expected value of $570,000, an investor would have $74,000 – only about one-eighth of what they expected.

The epitome of the high investor expectations of late 1999, was the Great Tech Bubble. While the general market had an incredible run with the S&P 500 increasing by a factor of four in the '90s, the tech-laden NASDAQ composite index increased 16-fold from 1991 until the time of its peak in March of 2000.

Taking a moment to look back at those heady times is a great way to remind ourselves of the madness of which financial markets are capable. As much as we like to think we're getting smarter about finance, these bubbles and busts just keep happening.

PREPARING THE LAUNCH PAD

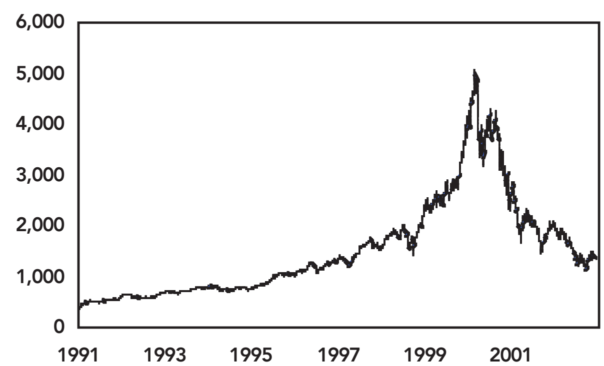
The right context to understand the tech bubble of the '90s is to see that it was the final dramatic peak of a broader stock market rise from the early '80s.

The bull market that started in 1982 was very unexpected at that time. The previous decade and a half had not been a great time for stock market investors. The Dow Jones Average hit 1,000 in 1966. In mid-1982, some 16 years later, the index was around the 800 level – a 20 percent decline … before inflation. After accounting for inflation, investors lost a large percentage of their wealth holding stocks. This was not a time that people made money selling books about "stocks for the long run." For typical stock market investors back then, a long-term hold was considered nine months!

In August of 1982, the stock market started one the greatest advances of all time with the Dow Jones quickly advancing by 350 percent over the next five years. Then, on October 19, 1987, the Dow Jones collapsed 23 percent in a single day. Many people saw this crash as a harbinger of further massive declines similar to the Great Crash of 1929.

However, a funny thing then happened. Instead of the market going down, it gradually went up. By the early '90s, the markets were making new highs. The great "lesson" of the '87 crash was whatever decline in the stock market happens, no matter how mysterious, it's a great buying opportunity–no need to fear declines, just buy!

Nasdaq Composite Index 1991-2002



By the mid-90s, a few tech companies like Microsoft, Cisco, and Dell had made their early investors multi-millionaires, which started to create the possibility in the public's mind of great wealth through technology investments. The launch pad for the tech bubble was now ready.

THE TECH BUBBLE TAKES OFF

The touch point of the bubble was the emergence and phenomenal growth of the Internet. My first sight of the Internet was visiting the only non-IT person in my company who had Internet access. As the software finished loading, a number of co-workers gathered around in amazement, perhaps not unlike those people who gathered around their first radio in the '20s or their first TV in the '50s.

The Internet was certainly not immediately embraced by everyone. I also distinctly remember some high school-aged siblings of a friend making fun of a classmate who had their own home-page. The Internet was very uncool initially. Popular sites such as MySpace or facebook were unimaginable back then. Nonetheless, the excitement was building.

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"THIS WAS NOT A MOMENTARY BLIP OF MADNESS. …"

Liftoff of the tech bubble can likely be dated to August of 1995 when the Web browser company Netscape went public. Its stock price, already doubled at the last minute prior to the IPO, increased almost 200 percent on its first day of trading. Over the next five years, the words "Tech IPO" became to be synonymous with massive riches.

What follows is just a small sampling of the bubble's great 'achievements':

- Dellionaires: With an almost 1000-fold increase in its stock price, most early employees (from secretaries to the shipping docks workers) had become millionaires due to their stock purchases and options. They came to be called Dellionaires.

- Irrational Exuberance: In December of 1996, more than three years before the peak of the bubble, Federal Reserve Chairman Alan Greenspan questioned if stock prices were being affected by irrational exuberance. However, within six months, Greenspan had changed his tune and suggested the boom was due to the productivity improvements from technology.

- e-Commerce: A small local mail order company, K-tel, saw it's stock price increase 10-fold in early 1998 when it announced it was going to–get this–sell records over the internet. The company ultimately went bankrupt.

- Price-to-earnings ratios were considered old-school and were often replaced with Price-to-revenues ratios–which often reached into the multiple 100s for some dotcom companies. (By the way, the NASDAQ composite's PE ratio hit 190 at its peak.)

- CNBC: Tech mutual fund managers paraded on CNBC regularly touting their one-year 300 percent returns. I recall watching CNBC almost right at the peak with one mutual fund manager exhorting loudly that Internet stocks "were not overvalued because people just could not realize how big the Internet was going to be."

- Yahoo! purchased Mark Cuban's Broadcast.com for $5.7 billion. Broadcast.com provided–wait for it–radio over the Internet. Broadcast.com now no longer exists.

- The New Economy: many economists talked about how technology improvement had eliminated economic fluctuations and ushered in a new era of economic prosperity.

- Accounting Chicanery: Because market share growth was viewed as critical to a company's future prospects, many companies accounted for their massive marketing expenses as an investment and deferred and amortized them over several years–often many years longer than the company had even been in existence.

- Stock analysts would often put a high rating on companies with good "deal flow." The more acquisitions a company made, the more likely there would be a catalyst for a higher stock price. The quantity of deals done was much more important than the quality of the deals.

- StockGeneration.com: From 1998 to 2000, StockGeneration.com was a Web site that allowed participants to trade real money in "virtual companies"–that is, companies that did not exist. It was really a ponzi scheme, but the euphoria of the tech bubble carried over to this virtual stock market. The "market" ultimately collapsed right around the same time the NASDAQ index started to fall.

- Nortel Networks, a manufacturer of telecom equipment based in Canada, became at its peak, over 30 percent of the market capitalization of the Toronto Stock Exchange 300 composite index–an index of the 300 largest companies in Canada. Nortel recently filed for bankruptcy protection.

- Mega-market caps: In early 2000, Microsoft and technology equipment maker Cisco were battling it out as the companies with the largest market capitalizations with each approaching the half-trillion dollar mark. The day Cisco took over the lead from Microsoft, the news sound bite 'explanation' provided by an investment manager was simply "Hardware will always beat out software in the long run." Microsoft, while no longer the overall leader, now has a 70 percent higher market-cap than Cisco.

- Convergence: A hot topic in the last few months of the tech bubble was how media and technology companies were converging into new powerhouses. In January of 2000, new economy company America Online (AOL) acquired old media company Time Warner. An investment analyst at the time noted that "today's announcement really does change the tectonic plates of the world." Recently, Time Warner announced it was looking to spin-off it's now very small AOL subsidiary.

• Pixelon, a "streaming-media" company, held a $16 million Las Vegas party to celebrate its IPO, which actually used up 80 percent of the company's latest round of financing. The company had been set up by a fugitive con artist who three years later would be serving a jail sentence.

While these examples give a glimpse of what the tech bubble was like, it does not really do justice to the era. This was not a momentary blip of madness, but rather something that got bigger and bigger day after day for several years. The gradual incremental changes that occurred over the '90s meant that many of the above examples we're seen as "normal" at the time.

Even those who saw the madness for what it was lost fortunes trying to short many of the tech stocks. It was a great example of Keynes famous comment: "the market can remain irrational longer than you can remain solvent."

Companies such as Amazon.com and eBay did fulfill some of their early promise, but the vast majority of the star companies from that time have either gone bankrupt or are a shadow of their former selves.

The NASDAQ composite index ultimately fell by 80 percent from March 2000 to July 2002. As much as "tech" was loved at the peak, two years later it was universally hated.

TEN STOCKS TO LAST THE DECADE

One last example of the mentality of the tech bubble was an article written in Fortune magazine in August of 2000, several months after the peak. Trying to figure out how to find the next Microsoft or Cisco, Fortune talked to a number of leading investment managers and analysts to find the stocks that would lead over the next decade. The 10 stocks and their subsequent performance are in the graph on the right.

Fortune called these stocks a "buy-and forget" portfolio. I imagine investors in many of these companies do truly want to forget them now!

ANOTHER REMINDER?

The Great Tech Bubble is one of the great bubbles and collapses in financial market history. It's an excellent reminder of the madness that humans in financial markets are capable of. That's just in case we need another reminder right now.

Company	Return
Genentech	127%
Univision	-24%
Charles Shwab	-50%
Oracle	-53%
Nokia	-58%
Morgan Stanley	-65%
Viacom/CBS	-86%
Broadcom	-86%
Nortel Networks	-99.98%
Enron	Oops!
Average Return	-50%
S&P 500 Total Return	-25%

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