

The Rise and Fall of Tech

OVER THE NEAR-TERM I REMAIN BULLISH on technology stocks, including those of semiconductor companies. However, my longer-term view is not so optimistic. Many experts believe we are in for a decade of sub-par returns for stocks, while others think concern over a secular bear market is overdone. I believe both views are wrong. Indeed, I suspect the NASDAQ is already in a secular bear market and over the long-term will produce disappointing returns. Yet I also think the broad stock market, as measured by the S&P 500, will do just fine throughout the rest of the decade, thanks to other sectors like financials and health care.

HISTORY'S LESSON

In light of that assessment, you might wonder why I've recommended owning tech stocks since late 2002 if I believe they are in a secular bear market. When you look at how bubble and post-bubble sectors have behaved historically, including the Dow Jones Industrial Average in the Great Crash and the Japanese Nikkei at the end of the 20th century, you find that these stocks tend to enjoy a very strong bounce after the long decline, a theme I touched on in my August 2002 column ("Go Long in the Second Half"). While I still think tech's post-bear-market bounce has further to go, a good analogy for what may follow is the behavior of energy stocks coming out of the 1970s.

Fueled by fears of a long-term energy crisis, tiny alternative energy companies enjoyed meteoric performance in the late '70s, while larger companies like Chevron became the Ciscos of their day – thanks to investors assigning them rich, high-growth multiples. Then in 1980, the energy-stock bubble popped. Although Chevron (for instance) had a very strong bounce off the bottom and outperformed the general market for more than a year, the energy sector subsequently underperformed the rest of the stock market throughout the powerful 1980s bull market. This is exactly the type of scenario I envision for technology stocks in the coming years – the broad market as measured by the S&P 500 should do very well, but tech will likely suffer from a secular bear market as valuations contract on a relative basis to reflect declining relative growth potential.

BECOMING VALUE STOCKS

To see the future of tech, one doesn't have to go all the way back to energy stocks in the 1980s; just look at Microsoft today. It's gone nowhere for the last two years, even as many "lower quality" tech stocks have racked up triple-digit returns. Microsoft continues to generate

immense cash and is even paying a dividend, signs that the ultimate growth stock has become a value stock. Whatever the claims of management, the company's massive cash reserves are indicative of diminishing growth opportunities. In semiconductors, for example, Applied Materials is sitting on well over \$1 billion

in cash and over \$4 billion in short-term investments simply because there aren't that many promising opportunities from new market segments, revolutionary products or growth-enhancing acquisitions.

Although in the semi equipment space I expect China, 300 mm, new materials and tighter design rules to all dovetail for one more good growth cycle, I'm not expecting a similar confluence to occur again. In other parts of the technology sector, corporate under-investment during the past few years in networking, software and hardware should help tech stocks make at least one more run higher later this year or in early 2005. But in these areas as well there are clear signs of increasing maturity; companies like Dell and Cisco generate and sit on ever-increasing amounts of cash, because the hyper-growth opportunities that existed a decade ago have vanished.

Once upon a time, automobile manufacturing was a growth industry, but over the years cars and trucks become evolutionary rather than revolutionary, acquisitions created consolidation and all the viable market segments were exploited. Like autos, tech isn't going away, but I think after one more uptrend, a good part of this decade will be spent letting the air out of everyone's expectations. In addition, recent regulatory and policy initiatives – like Sarbanes Oxley and options expensing – will help stifle innovation. The multi-billion dollar IPO of Google likely represents the final gasp for Silicon Valley's Golden Age, rather than the start of a new one. ☞

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