Today’s technology market: Not a replay of the ‘90s dotcom bubble

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Article Highlights

- Technology stocks have outperformed the broad stock market recently, but worries about a new “bubble” are overblown.

- Today’s tech sector is fundamentally different from the dotcom boom of the 1990s.

- Some large tech companies have reached “middle age,” offering investors dividends and value opportunities.

- Cloud computing and mobile devices are changing market dynamics, blurring the lines between traditional hardware and software companies, and offering investors growth opportunities.

- Investors can benefit from investment strategies that use fundamental research to choose the best growth and value opportunities in the tech sector.

A surge in technology stocks over the last year has pushed the sector to new heights. The tech-focused Nasdaq Composite Index, for example, surpassed an all-time high that was last set 15-years ago when dotcom mania peaked and then popped (see Figure 1). Soaring prices and recent volatility, however, have caused some investors to wonder whether tech stocks are poised for another crash.

We don’t see a resemblance between today’s tech market and that of the late 1990s, however. Unlike the late ’90s, today’s tech sector is profitable with plenty of cash and stock values that are driven by financial performance, not hype. After years of solid growth, some large tech companies are paying dividends that exceed the 10-year U.S. Treasury yield, which would have been unthinkable during the dotcom era.

We believe there are many important differences between “then” and “now,” and that tech stocks are anything but monolithic. There are newcomers and legacy companies, and some from each camp offer compelling investment opportunities. Today’s tech sector offers both value and growth opportunities, making it an important part of any U.S. equity strategy.
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Tech companies are split between smaller, high-growth companies and larger, legacy ones. In the large camp, we see opportunities for value-minded investors, meaning there are companies with stock prices that are cheap relative to their overall quality. Some of these are well-known “middle-aged” companies that have steady but not spectacular growth, and have plenty of cash in reserve. Cash provides opportunities to launch new products, make acquisitions, and pay attractive dividends. While the high-flying growth days might be gone for these middle-aged companies, some of them continue to offer solid investment opportunities, especially for investors seeking income and lower volatility.

Smaller growth companies, by contrast, are trading on values that are higher than their overall financial results would indicate. This is because many are growing rapidly and have not generated significant earnings yet. But that doesn’t mean they are imitating their 1990s counterparts. Most are cash-flow positive, generating significant revenue—a billion dollars or more—and in many cases, their customers are Fortune 500 companies, not individuals.

A shifting landscape in tech hardware

We’ve seen the tech market evolve rapidly over the last decade. Prior to the introduction of tablets and mobile computing, the technology market was largely driven by hardware demand, and personal computer (PC) sales were watched by analysts closely. The rise of tablets and smartphones, however, eroded demand for PCs, and current PC growth is essentially flat. Much of the PC market demand shifted to tablets, but now, even that growth is slowing. Tablet makers sell about 200 million units a year, but it’s not clear that those sales will increase.

Similarly, as recently as a few years ago, the market for mobile phones had a compound annual growth rate of 30% to 40%. Today, the smartphone market is growing at about a 10% annual rate. This has hardware makers looking for new
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ways to help customers stay connected, including wearable devices such as the Apple Watch. These devices, however, are unlikely to replicate the growth from tablets and smartphones. Because of these trends, maturing tech giants are returning some of their growing cash stockpiles to investors through dividends, largely unthinkable 15-years ago.

Technology migrating to the cloud

A shift from hardware to software is now being followed by a more subtle migration from traditional software to companies that specialize in cloud computing and mobile apps. Once high-flying software companies such as Oracle, Microsoft, and SAP are losing market shares to newcomers focused on cloud-based software.

Cloud computing represents a fundamental shift from hardware to software over the long-term. As more services move to the cloud, business customers are shifting their computing budgets from buying hardware they keep in-house—such as PCs, servers and storage equipment—to buying a package of software services delivered by the cloud provider. At many companies, even the workplace PC—once an office fixture—is being replaced by workers’ own laptops or mobile devices, all connected to the office via the cloud.

While newcomer cloud-based software companies are far smaller than the old-guard software giants, they are growing and gaining market share at a much faster rate—providing investors with some growth opportunities.

Conclusion: Today’s tech market offers compelling opportunities

Some tech stocks were badly bruised during the summer market swoon which underscores the volatile nature of the sector. But this is not a replay of the dotcom implosion experienced 15-years ago. Five of the ten largest U.S. public companies are in the tech sector—and these companies have largely led the stock market rally in October.

Tech stocks are not without risk, of course, but share prices are better supported today than they were during the high-flying and short-lived glory days of the 1990s Internet startup companies. At TIAA-CREF, we believe a stock selection approach grounded in fundamental research can best identify the value and growth companies most likely to outperform over the long term. We also believe that long-term thinking is essential in a market that increasingly is short-term-focused and trading-oriented.

To learn more about how technology stocks fit into your equity strategy, talk to your TIAA-CREF advisor for more information.