

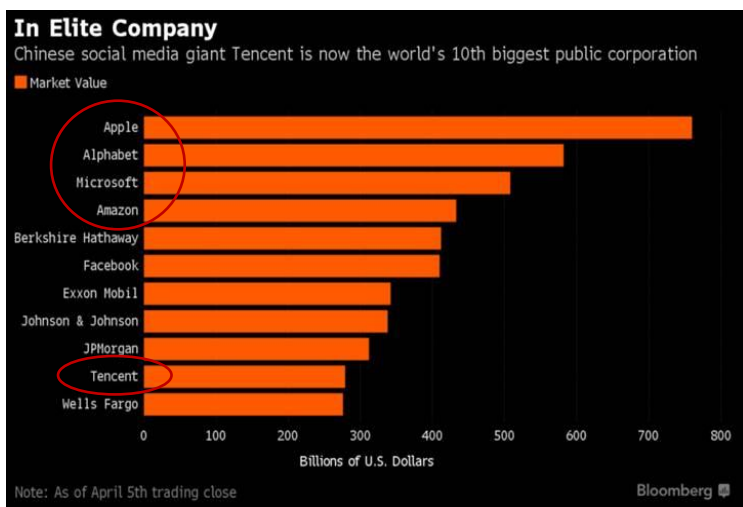
Market Musings

Party Like It's 1999

One of the more enduring debates in investment circles is the active versus passive strategy. Passive investors have enjoyed a renaissance with technology and automation driving an explosion in exchange traded funds (ETF's), and of course the attraction of lower fee structures.

Meanwhile, the active investors have largely disappointed, with political events creating confusion and traditional metrics seemingly less relevant.

This arm-wrestle, leads to an even more interesting debate surrounding the old world industries versus the new world. As can be seen below, technology companies are top of the pops at present with four tech companies leading the list of the largest publicly listed companies in the world. Furthermore, China's Tencent Holdings has just pipped banking behemoth Wells Fargo for the number ten spot.



Such a backdrop is somewhat typical in that every decade, or so, one industry or sector tends to dominate the leader board. In the mid noughties, financials were the big movers and shakers, followed by the mining and energy companies.

The current standings take us back to the late nineties when technology stocks were all the rage, and the NASDAQ struck a record intraday high of 5,132.5.

Fast forward to 2017, and the technology stocks are the market darlings once again, and the NASDAQ struck a fresh intraday peak of 5,936.4 a few days ago.

Let's compare a couple of old fashioned stocks with their newly crowned counterparts of a similar size (i.e. market capitalisation):

Company	Mkt Cap	Sales	Net Income	P/E Ratio
Amazon	\$429	\$136	\$2.4	183%
Johnson&Johnson	\$339	\$72	\$17.4	20%
Tesla	\$48.7	\$7	-\$0.73	N/A
Ford	\$44.9	\$152	\$6.9	6%

*Amounts in USD billions (Bloomberg)

Admittedly, it's difficult to compare companies at different stages of their lifecycles, especially when these tech stocks are investing huge sums into their businesses (and that investment has yet to generate income). For instance, Amazon spent a gargantuan **\$16.1 billion** in research and development last financial year.

There is, however, an important similarity that existed back in 1999 compared to today, and that is interest rates. Back in 1999, official cash rates in the US reached a cyclical low of 4.75%, before climbing to a (hard to fathom in this day and age) peak of 6.50% in year 2000.

Low interest rates allow technology companies to value their substantial investments, or future earnings, at much higher multiples. This is because lower discount rates increase the present value of future amounts.

And today's historically low interest rates value these future (expected) cash flows at yet higher valuations. However, just like 1999, interest rates are rising again (albeit slowly). Hence, equity valuations are up for review.

"The future belongs to those who prepare for it today." ~ Malcolm X