Equity Valuation

US tech sector surges past its dotcom era peak

Ninth consecutive day of gains pushes S&P 500 IT index into virgin territory

YESTERDAY by: Eric Platt in New York

The US technology sector on Wednesday surged past its dotcom bubble peak for the first time, as investor demand sent shares of companies including Facebook, Microsoft and Oracle into virgin territory.

The S&P 500 information technology index, which measures the largest companies in the industry, rose for the ninth consecutive day, closing up 0.6 per cent at 992.29.

That compares with the previous record of 988.49 on March 27 2000.

The crash of tech stocks after dotcom mania and the long, subsequent crawl back by the sector has been accompanied by radical change — and the latest leg-up has been fuelled by investor enthusiasm for an industry that has grown its profits rapidly despite the tepid performance of the wider US economy.

“The business models of leading technology companies are some of the best we’ve ever seen,” said Rahul Narang, a portfolio manager with Columbia Threadneedle. “These platforms are asset light, grow fast from network effects and are durable as they scale.”

The S&P 500 technology index tumbled more than 80 per cent from its March 2000 peak as a wave of young Silicon Valley companies failed. Seventeen years ago, Cisco, Microsoft, Intel, Oracle and IBM were the largest US technology behemoths.

While Microsoft remains, it has been usurped by Apple and Alphabet, and joined by Facebook and Visa.

“It’s not your father’s market. This is not what it was in Y2K,” said Howard Silverblatt, senior index analyst with S&P Dow Jones Indices. “The make-up and characteristics are different. Earnings are a lot more solid now. There are price-to-earnings ratios now, compared to ‘I wasn’t making any money back in 2000’.”

The S&P 500 IT index is the purest measure of the large-cap US tech sector. The Nasdaq Composite, which measures all the stocks on the tech-heavy Nasdaq market, passed its dotcom high in 2015.

Information technology — a sector that does not include Amazon, under S&P classifications — has outpaced all other sectors in the S&P 500 so far this year. It has gained nearly 23 per cent, compared with the broader market's 10 per cent advance.

Technology shares have benefited from discord in Washington. With investors sceptical that meaningful tax reform and infrastructure spending can be accomplished this year, they have purchased the shares of companies that have a record of growing sales and profits.

More than $9bn has been pumped into US technology stock funds this year, according to EPFR, while strategists with AllianceBernstein characterise it as "the most crowded group in the US market".

"We want to remain in tech because it's one of the sectors you are seeing such good earnings growth," said Jim Tierney, chief investment officer of AllianceBernstein's US concentrated growth fund. "Ultimately stock prices follow earnings. Growth is accelerating not decelerating so you need to be there."

The transformation of the industry over the past 17 years has been significant. Technology companies are expected to generate more than 25 per cent of the S&P 500's overall earnings in the fourth quarter of this year, compared with 15 per cent at the index's peak in 2000. At that time, tech stocks accounted for more than a third of the benchmark S&P 500. Today that figure has fallen closer to 23 per cent.

On the verge of quarterly results, sellside analysts project technology sector earnings will climb 10.9 per cent from a year prior, faster than any industry except energy, according to FactSet.

Messrs Silverblatt and Narang both pointed to a maturation of the industry, which now pays dividends and trades on real revenues and earnings. Mr Silverblatt noted that companies within the S&P 500 technology index have more cash than any other sector. Rating agency Moody's estimates that the industry holds more than $870bn of cash — or 47 per cent of the total cash on non-bank US company balance sheets.

Valuations are also close to the general market today, in sharp contrast to the extreme valuation gap seen in 2000. Tech stocks trade at 19.4 times 2017 full-year earnings, while the S&P 500 is at 19 times. In the first quarter of 2000, S&P 500 technology groups traded at 73 times earnings, Bloomberg data showed.

"If valuations got to where they were back in 2000, would I get nervous? Yes, absolutely," Mr Tierney added. "But we're far from those valuations. Yes there are a few companies like Netflix and Amazon with nosebleed valuations — but most are not."

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