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Long after the party, Nasdaq still hung over
Index hit its peak 5 years and 3,000 points ago

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Five years ago today, the party was at its peak. Confetti swirled everywhere, and the punch bowl seemed bottomless. It was the day when the Nasdaq Composite Index hit a record high.

But when the music stopped, it ushered in one of the longest and most painful declines in stock market history, wiping out billions of dollars from the value of technology shares.

The rest of the stock market also topped out within weeks, but other measures such as the Dow Jones industrial average and Standard & Poor's 500 index didn't fall as much and recovered faster. Still, the market's overall slump exacerbated the recession that followed, contributed to a spate of Wall Street scandals and taught millions of Americans some lessons in the school of hard knocks.

The question is why, in a technology-focused economy, has the tech-laden Nasdaq failed to bounce back with as much panache?

The index has nearly doubled since it bottomed in late 2002 but still stands 59 percent below the peak. By comparison, the S&P 500 is down 21 percent from its record high and the Dow is off just 8 percent.

The answer lies in a number of factors, from the tech bust's continuing aftershocks to businesses' reluctance to go on another tech-spending spree. On one hand, things are looking up, as businesses are hiring and spending more, boosting the economy. On the other hand, the painful memories of the bust are fresh, and caution still reigns.

The worst damage of the bear market was focused in Nasdaq stocks, and in the aftermath of this great speculative bubble, tech companies pared their payrolls as revenue slumped and profits dried up. Many firms disappeared altogether.

Stock market investors learned the wisdom of diversification and the need to think for oneself.

"When everyone gets the feeling something will be fabulous forever, that's a danger sign," said Barbara Walchli, portfolio manager of the Aquila Rocky Mountain Equity Fund in Phoenix.

The Nasdaq Composite Index - a grouping of more than 3,000 stocks tilted heavily to technology and telecommunications - typified the supercharged 1990s.

From a modest base of 100 points when it began life in February 1971, Nasdaq closed at a record 5,048.62 on March 10, 2000. Over the five or so years preceding that date, the index rose sixfold, fueled by a wide belief that technology innovations, especially the Internet, had ushered in a new era in which old business models and stock-valuation rules no longer applied.

"The optimism wasn't just on Wall Street - it was felt by tech companies, too," said Rose Papp, a portfolio manager of the Pioneer Papp Funds in Phoenix. "They all had very rosy forecasts and capital-spending plans."

During the watershed year of 1999, shortly before the index peaked, Nasdaq led a full-fledged bull stampede, vaulting 86 percent. A few stocks gained more than 1,000 percent that year, and nearly 190 mutual funds doubled.

No Arizona company typified the frenzy more than QuePasa.com, an Internet site geared to Hispanics. Its stock price doubled within weeks of a June 1999 initial public offering, despite a lack of proven business prospects.

Reality eventually set in for other tech firms, too, and once prices started to decline, the downward momentum snowballed. By October 2002, the Nasdaq Composite had shed 78 percent of its value.

While the Nasdaq has not bounced back as much as the broader market, some experts see a healthy aspect to its lagging. Papp points to much lower price-earnings ratios for tech bellwethers such as Microsoft Corp., Cisco Systems Inc. and Intel Corp. as a sign that a lot of the hype has been squeezed out of the market by investors.

Meanwhile, companies have become more circumspect in projecting growth.

"More attention is being paid to details like what should be sold and who will buy it," said Tony Massimini, chief of technology for semiconductor analyst Semico Research Corp. in Phoenix.

And while some tech firms disappeared and many jobs were lost, the survivors have become more adept, said Don Wehbey, senior economist at the Arizona Department of Economic Security.

"The managements and employees of these firms have had to become more efficient and better target their operations just to stay alive," he said. "They've had to make sure they're financially sound and delivering a good product."

All this doesn't necessarily point to heady days for the tech sector anytime soon.

"The extreme psychology and valuations that were created will take a while to work off, and I'm not convinced the process is finished," Walchli said.

As positives for tech firms, she points to an uptick in capital spending, especially since much of corporate America hasn't upgraded computer systems since before the Y2K deadline of Jan. 1, 2000.

But as a negative, public companies will have to start expensing options later this year - something that will affect tech firms especially because of their heavy reliance on options as a form of pay.

"A lot of companies will take a hit to earnings," Walchli said.

Investors presumably have learned a few lessons, such as the need to keep an eye on valuations and practice some type of sell discipline.

Also critical is having a good understanding of the investments one holds.

Before the peak, hundreds of mutual funds held 40 percent or more of their assets in tech stocks, providing less diversification than many people expected.

Above all, bursting of the Nasdaq bubble underscored the need to diversify one's portfolio by holding not just more stocks but different types of companies and assets.

"Hopefully, people will learn from this and not repeat their mistakes," Walchli said. "Because there's a likelihood we'll see another variation of this sometime in our lifetimes."

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