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Sharp Investing

Will Lightning Strike Twice in Technology Stocks?

By Daniel R. Sharp

In the late 1960's investors became very interested in a group of companies that they felt were destined to take over the world – known as the "Nifty Fifty". The Nifty Fifty were a group of large diverse companies that had one thing in common – sky high valuations created by the intense interest from investors. At their peak, Nifty Fifty stocks traded at over 50 times earnings while the rest of the market traded below 15 times earnings.

Nifty Fifty stocks were "must-haves" in every portfolio, right up until the moment that the bubble burst. In 1972 a slowing economy plunged the country into a deep recession that was accompanied by the worst bear market since the Great Depression 40 years earlier. All of a sudden, stocks that were trading at over 50 times earnings but only growing at 1% didn't look quite so nifty. While the Dow was down 40% during the last great bear market, it doesn't even begin to do justice to what occurred to the Nifty Fifty. The Fifty was pounded into oblivion as it became obvious that the party was over.

Many investors that bought into the Fifty at their peak were devastated, but vowed to hold onto their "must-have" companies until they bounced back.

It took over 20 years until the Fifty as a group was worth as much as it had been prior to the bear market.

So why the history lesson?

Notice any similarities between what went on 30 years ago and what is going on today? How about 70 years ago? Does human nature change?

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Socking it Away Roth's and IRA's

(Part one of a two part series – next issue we discuss SEP's, SIMPLE's and 401k's)

With tax season just behind us, interest is high for ways to reduce the annual sting of taxes. The government provides various incentives to funding retirement plans, from tax deferral, to tax deduction, to out and out tax-free plans. The ability to take advantage of these

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The New Nifty Fifty was actually a group of several hundred technology stocks, ranging from big blue chip technology stocks to wet-behind-the-ears internet start-ups. In 1999 investors poured and poured and poured money into this one small area of the market until the average tech stock traded at over 100 times earnings (for those that had earnings), more than twice the level of the original Nifty Fifty. Of course, history has repeated itself in spectacular fashion as the whole "New Economy" house of cards came tumbling down.

You know all this, of course, so what is the point? Just as history has repeated itself time and time again in the first two stages of a bubble (Stage One – Overvaluation, Stage Two – Re-evaluation), it is also destined to follow the last stage of the bubble – Stagnation. It took the Nifty Fifty 20 years to get back to even. Tech stocks were considerably higher in valuation. You do the math.

Cisco traded at 220 times earnings at one point. If you paid $80 for Cisco (I love to pick on Cisco), you will be waiting a long, long time to see that $80 per share again. I'm not saying that Cisco isn't a very good company, and I'm not saying that Cisco can't grow earnings at a 15%+ clip once the technology slowdown is over – but even assuming those things to be true, it is going to be decades before earnings justify that $80 pricetag again – unless you believe Cisco will trade at 200 times earnings again someday.

Even with Cisco trading in the teens, it is still nearly 50 times earnings. The average premium granted by investors for the stock of the best companies in America is right around 30 times earnings. By this measure, Cisco could still be considered *overvalued.* I pick on Cisco, but many technology stocks are in the same boat, way down from their highs of a year ago – but still no great bargain.

1) Overvaluation 2) Re-evaluation 3) Stagnation. Over 400 years the cycle of a bubble has always contained these three elements. The technology bubble has seen two of the first three, and investors unwilling to let go of some of their technology stocks at less than they paid

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The Dow is down over 20% in the past 12 months
The NASDAQ is down over 60% in the past 12 months
Value based investing is UP over 20% the past 12 months!

Wed May 9 7 pm
Finding higher income yield in the low interest rate environment

Tues May 22 7 pm
Tech stocks and Value investing; An odd couple that works!

Wed June 13 7 pm
8 Point Portfolio Management Strategy

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Investing styles run in three to five year cycles. We are only in year one of a strong value cycle. Over long periods of time no strategy has produced better returns than investing in undervalued companies. Learn why and what it can mean for you!

Presented by
Daniel R. Sharp
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are destined to endure the third leg of the cycle and miss the opportunities available in the broad market.

Did you know that small stocks have actually moved up over the last 12 months? Did you know that value stocks are up more than 20% over the past 12 months? Are you aware that many blue chip Old Economy companies have more than doubled in the past 12 months? *If you are sitting on depressed technology shares waiting for a complete comeback, you are missing these broad market opportunities.*

Lightning strikes a particular spot once in a blue moon. The safest way to not be struck by lightning again is to go stand right on the scorched earth, as the rare odds that caused the original strike go up exponentially against it happening in that spot again. The tech bubble was as rare as a lightning strike. Someone sitting on a portfolio of tech wipeouts will only result in fulfillment of the third leg of the bubble – stagnation. The last big bubble took 20 years to recover, this recent bubble was bigger and more bloated – which to me implies an even longer recovery time.

My best advice to investors in this situation, which many are, is to use market rallies to prudently move out of certain tech stocks at fair prices rather than spend 20 or 30 years waiting for the Cisco's of the world to get back to $80 per share. **$**

Socking it Away.. continued from page 1

plans depends on a person's income level and whether they are covered by a plan at their workplace, or whether they are self-employed.

Let's start with the basics: You are allowed to contribute to retirement plans as both an individual and as an employee. As an individual, your choices are limited to a traditional or Roth IRA, both of which can be funded with $2,000 under current tax law. A traditional IRA is tax-deferred, meaning you eventually will pay taxes on distributions taken in retirement. A Roth IRA is tax-free, meaning that the distributions will never be taxed. Obviously, the Roth IRA is the better deal in retirement, and if an individual has the option of funding either a Roth or a traditional IRA, the Roth should usually get priority, assuming the individual qualifies under the income limits (currently $110,000). The traditional IRA has no income limits for the annual $2,000 contribution, but besides being tax-deferred, can also be a tax-deduction for individuals with an AGI less than $32,000, and joint filers with AGI less than $52,000. Also, if an individual is not eligible for a retirement plan through work (either they don't work or work for an employer without a retirement plan), their IRA contribution is always tax deductible, regardless of income level. The Roth is never tax-deductible.

So why is a Roth preferable in most cases? Even in the best

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Is Your Portfolio or Fund full of Busted Technology Stocks?

We can help you determine whether you should sit on a down portfolio waiting for your tech stocks to rebound or whether you are better off diversifying away from technology stocks during a market rally. Analysis of the companies, the levels at which they were purchased, and their future prospects and reasonable expectations can all be beneficial in getting you back on a steady path to creating wealth. A complimentary investment consultation can be arranged at your convenience in person or over the phone. Fax or mail us your current account statement and our Portfolio Managers will discuss your goals & risk tolerances, and analyze your portfolio.

For a free consultation, please call 503-520-5000 or 888-760-9046
or fill in the information below and fax to 503-520-0530

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Please contact me for an appointment…

- ❑ **…this month**
- ❑ **…in 3 months**
- ❑ **…in 6 months**

Name: ____________________

Phone: ___________________

Email: ____________________

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case, an IRA will reduce your taxable income by $2,000 when fully deductible. For someone in the 28% tax bracket, that would put an extra $560 in your pocket at tax time, but you will have to pay taxes on the distributions in retirement. But a Roth contribution of $2,000, compounding for 20 years at 10%, would reduce your taxable income by $13,500 down the road in retirement, which would put an extra $2,500 in your pocket, even after adjusting for inflation. Of course, most people will not just sell off their Roth assets and take distributions; they will convert stocks, etc., to bonds and other income-producing vehicles for retirement. The income coming out of the Roth is tax-free, so the benefits of the tax-free income can run indefinitely, as the Roth can be passed on to heirs such as spouses or children and still retain its tax-free status. *A rule of thumb is that if the money will compound for more than five years, you are better off with a Roth than a traditional IRA.*

The government also allows individuals to convert IRA's to Roth's by paying the taxes on the IRA in full at conversion (but no penalties). Again, there are income limits ($100K AGI) but this can be a very attractive option for younger people with the cash flow to pay for the extra taxes, or in certain cases for older people looking to pass on wealth to heirs as a part of their estate planning. To convert or not to convert is something that is very unique to the individual and so needs appropriate analysis before making the decision.

There is current legislation to raise the annual contribution limits to $5,000 from $2,000, but even at today's limits investors not using either the traditional IRA or the Roth are passing up a government "freebie" that can lower your taxes now and make your life more comfortable in the future. $

Value Investing: The purchase of companies, through the stock market, for less than their economic value due to temporary unpopularity (lack of investor demand). This is the opposite of growth investing, which is buying companies at a premium in the hope that other investors continue to push their prices higher and higher regardless of what the business is actually worth.

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