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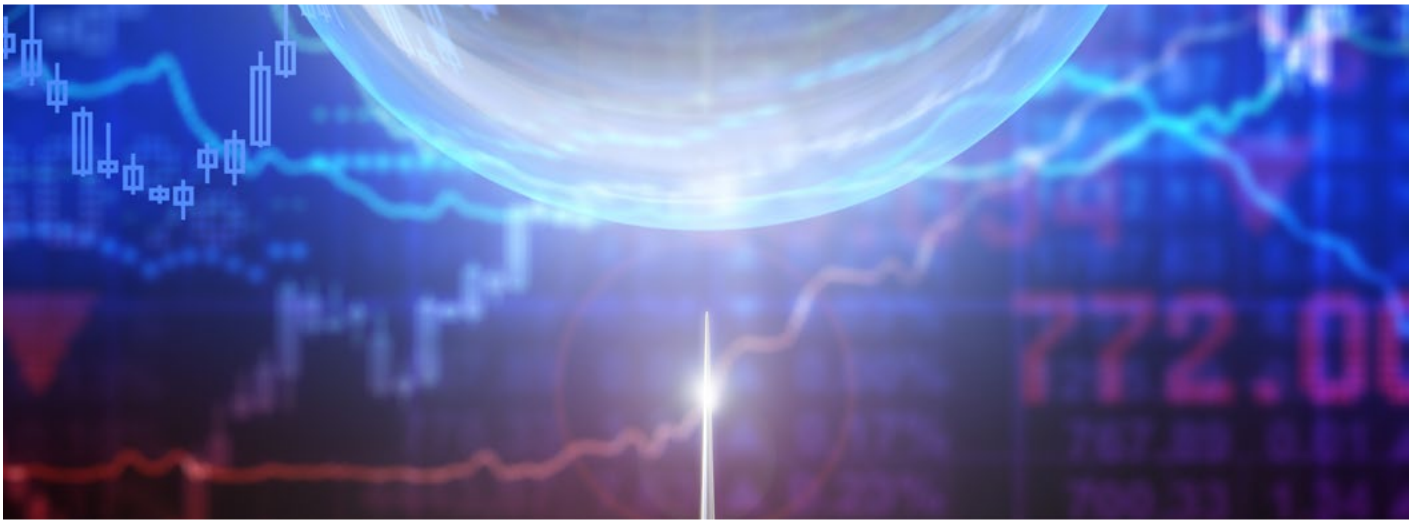

Remembering the dotcom bubble and bust

20 years on, we consider what lessons have been learned

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Can you describe the sense of exuberance in the period leading up to 10 March 2000?

- The phrase 'irrational exuberance' was coined to describe the market environment during the late 1990's/early 2000. It is certainly my prevailing memory of the period as technology and tech-related stock prices surged ever-higher, confounding expectations – just before it all came crashing down.
- Investor enthusiasm for technology stocks rapidly gained momentum in the late 1990s. Fueled by speculation about the 'unlimited potential' offered by the internet, and the prospect of significant share price gains, investors were captivated. It didn't seem to matter that many of these companies had never made a profit, nor had a credible plan to ever become profitable. Many were also run by young entrepreneurs with little managerial experience. Yet, each new tech-oriented IPO seemed to have little trouble raising capital.
- The media also played a big part. Even as valuations became detached from any rational financial underpinning, or historical norms, the media hype continued. Commentators suggested that these companies were re-writing the rules of business.
- With money flowing into tech-focused passive strategies, stock valuations became significantly inflated. Many growth-oriented funds in our peer group also became increasingly concentrated as they responded with greater allocations to the expanding tech sector weightings in most growth indexes.

What was your thinking during this period, did you share in the dotcom optimism, or were you more pessimistic?

- We were generally underweight technology sector companies during this period. Even early on, many companies in the universe simply lacked the kind of fundamental support we look for. Our negative view became more resolute as investor optimism became increasingly extreme and valuations ballooned to irrational levels.
- That is not to say that we didn't question our positioning throughout the period. Our contrarian stance, amid an almost universal tide of opposing sentiment was difficult, particularly when the result was to increasingly underperform the market. The longer the boom progressed, and the higher stock prices rose, the more we doubled down on our research, revisiting our investment theses to ensure we weren't missing something.
- Had we found technology companies that met our quality and growth criteria, we would have certainly considered investing. However, whichever way we looked at it, the valuations that many of these companies were commanding, particularly new, untested businesses, seemed unjustifiable.
- We aim to invest in high-quality growth companies that can sustainably compound earnings over time, generate durable free cashflow growth, and have strong management teams that know how to allocate capital. The technology companies of the dotcom period typically fell well short of these key characteristics.

Instead, we were often faced with untested business models, inexperienced management and a lack of profits or cashflows. Not only did they seem poor investments, they appeared to be among the riskiest and most over-priced companies in the market.

- The media compounded the pressure we felt at the time, with periodic reports criticizing our investment approach, our 'misplaced' conviction, and, of course, our underperformance. This headline appeared in the national press on March 6, 2000, just days before the dot com bubble burst. Ultimately, it paid to have the courage of our convictions!

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Marriott is starting to furlough what it expects to be tens of thousands of employees without pay as hotels close, but most still will get health benefits

T. Rowe Pays High Price For Avoiding Tech Craze

Tradition-Bound Firm Stays on Road Less Traveled, and Runs Low on Gas

By Pui-Wing Tam and Aaron LucchettiStaff Reporters of The Wall Street Journal

Updated March 6, 2000 1:07 am ET

What lessons did you learn from the dotcom boom and subsequent bust?

- Throughout history, bubbles have followed a pattern of progression from cheap capital to price appreciation amid speculation, a euphoric peak, and then a crash as prices succumb to financial reality. However, this pattern is often more recognizable in retrospect.
- The dotcom period was particularly unsettling because our conviction belief was contrary to the general sentiment of the market for an extended period. Many tech company investments we avoided saw substantial increases in their share prices on the back of extreme, and indiscriminate, investor optimism. The period confirmed the importance of backing our process, research team and, ultimately, trusting our judgement.
- Instead of changing our strategy or second-guessing our understanding of company quality, we doubled-down our analysis, checking and then re-checking every assumption made about each company. This included those we owned and the names we avoided. The longer the dotcom boom went on, the deeper we went. We re-examined every decision, talked to companies again, and considered the implications for customers, suppliers, and competitors, to ensure that every assumption held up to scrutiny.
- Being contrarian can be a lonely and unpopular place when things are going against you, but it can also lead to significant investment gains over the longer term. We didn't waver from our insistence on company quality, reasonable valuations and portfolio diversity. In the end, our disciplined approach was vindicated, and our investors rewarded, once the tech bubble burst in 2000.

Can you draw any parallels with the investment landscape of today?

- There's always a risk that certain areas of the market can become fully or even over-valued, particularly during the latter stages of an investment cycle. And at such times, we could experience a pause, or even a correction, in the market. However, we see few parallels today with the irrational sentiment and blind optimism characteristic of the dotcom boom.
- We are finding many reasonably valued companies, across a broad range of market sectors. We currently own some growth-oriented stocks that might initially appear to be richly valued. However, deeper analysis of the anticipated earnings growth profile of these businesses shows that the valuations look reasonable.
- As investors question the durability of the current growth cycle, US growth company valuations may periodically appear extended. However, we see few signs that the structural tailwinds that have driven the US growth rally are fading. Innovative companies are driving disruption in retail, media, enterprise technology, even energy. In the process they are taking market share from incumbents.
- We believe that solid fundamentals—including improvements in cash flow, revenues, earnings, and profit margins—continue to underpin the market.

Is the current rise of tech/disruption sustainable, or is there likely to be disappointment ahead?

- Industry innovation and disruption are ongoing and sustainable trends. What's more, these are trends that are well suited to active investing. Quality, active managers with the resources to identify these kinds of disruptive businesses early, can potentially add significant value for investors.
- The global corporate landscape continues to be reshaped by a revolutionary combination of technological innovation and changing consumer preferences, which is upending established business models. Correctly identifying the winners and losers in this competitive struggle will be the key to portfolio outperformance.
- Innovation, technological change, and automation—particularly the use of artificial intelligence (AI) applications, continue to disrupt a growing number of global industries and this dynamic shows no sign of abating any time soon.
- In contrast, companies and industries caught on the wrong side of technological change and disruption continue to be negatively impacted. Whether it is cable television networks, newspapers, retail, legacy technology, or legacy oil, all are under pressure from rapid, disruptive changes.
- Interestingly, disruption is also improving the growth characteristics of some more traditional sectors. Utilities, for example, have typically been viewed as a classic defensive yield-play. However, the sector has evolved in recent years, and the emergence of low-cost renewable energy sources, fracking technology, as well as regulatory reform, has led to new-found growth potential that may not yet be fully recognized by the market.

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