# Facebook is an unfriendly reminder of IPO risk

May 27 2013, by William L. Watts

Facebook's flubbed initial public offering a year ago Saturday laid bare some important truths worth remembering even as major U.S. stock indexes score a string of all-time highs.

The debut offered a timely reminder to retail investors "that the playing field is not a level one," said Mercer Bullard, a securities law professor at the University of Mississippi School of Law.

"Some investors got more information than others. Those that didn't, ended up perhaps buying more Facebook stock that better-informed investors left on the table," he said.

One could argue that the May 18, 2012, IPO marked a botched opportunity for a securities industry that had seen retail investors pack up and stay away from equities, discouraged by the market carnage that accompanied the 2007-2008 financial crisis.

But it's not why small investors have yet to fully embrace a stock rally that has taken major U.S. stock indexes to a string of all-time highs in recent months, strategists said.

"You have to look at it in the context of what the market has done in the past year, which is go straight up," said Nicholas Colas, chief market strategist at ConvergEx.

The Standard & Poor's 500-stock index is up almost 28 percent in the past 12 months, while the Dow Jones industrial average is up 23 percent in the same period.

While that's likely been a source of comfort, it doesn't appear small investors are yet participating in the rally in a big way.

Data on mutual fund flows from the Investment Company Institute, an industry trade group, show that after an eyebrow-raising $18.4 billion surge into domestic equity mutual funds in January, investors pulled money back out in February. Since then, inflows have been tepid at best.

Flows into U.S. equities via exchange-traded funds, or ETFs, are more robust at $52.7 billion year-to-date, according to data firm XTF.com.

But Colas said the impression he gets from talking with clients is that small investors are still sticking to the sidelines.

The retail investor "is still very reluctant to believe in this rally right now. There is still a fear response from the volatility of 2007-2008," he said, noting that even institutional investors appear cautious. That, after all, is a reason why hedge funds have struggled to beat the broad market.

As for Facebook, the company's debut was hyped to individual investors to a degree that surprised even some veterans of the dot-com boom and its string of high-flying IPOs.

"Facebook was and probably always will be a bit of an anomaly. I've not seen an IPO as hyped as that was," said Kevin O'Connell, a partner at law firm Posternak Blankstein & Lund in Boston.

Shares of the social network debuted on May 18 of last year at $38 each, quickly rising as high as $45, but then dropping below their offering price. Technological glitches at Nasdaq prevented many investors from canceling orders. Later it was revealed that revised analysts' estimates were provided privately to institutional investors days ahead of the IPO.

Hearings and lawsuits, which continue to work their way through the legal system, ensued.

Facebook closed Friday at $26.23, down 31 percent from its IPO price.

More broadly speaking, Bullard at the University of Mississippi contends that the Facebook IPO exemplifies a sea change in how companies approach IPOs. Firms such as Facebook and Zynga Inc. debuted in an attempt to extract maximum value from the IPO, in contrast with an earlier approach that saw firms offer small slivers in an effort to prime the market for future rounds of stock issuance at higher prices.

But it also comes as many of the companies debuting are of lower quality than in the past, thanks in part to new laws, such as the Jumpstart Our Business Startups Act, which have watered down the criteria for companies to go public, Bullard said.

So were retail investors all that discouraged by the Facebook IPO?

"People say they are skeptical of everything," said Dan Greenshields, president of Capital One Sharebuilder, an online brokerage firm. That extends to IPOs, individual stocks and even managed mutual funds.

But when it comes down to whether they're willing to invest in stocks, it's often more a matter of age, Greenshields said, noting that his firm's customer base tends to skew toward younger investors who may have avoided getting burned when the financial crisis turned 401(k)s into "201(k)s," as the joke went.

"The younger you are, probably the more likely you are to be in equities," he said.

Meanwhile, the IPO market is showing signs of life. As reported by The Wall Street Journal, 64 U.S.-listed public offerings have raised $16.8 billion so far this year, on track for the biggest year since 2007.

Yet the markets' new highs places investors who have been late to reenter the stock market in a bind: worried about missing out on future gains but fearful of buying at a top.

ConvergEx's Colas says a disciplined approach is key. For each investor, it comes down to their goals and risk tolerance.

As an example, an individual with $10,000 and 30 years to go before retirement must realize the need to be in the market, he said. But that doesn't mean they should chuck it into stocks all at once out of fear of missing the rally. That would be a mistake equivalent to selling at the bottom, as many investors did in the midst of the financial crisis.

Instead, look to put the money to work on a regular basis in the next five years, Colas said.

"The bottom line," he added, "is that fear and greed are equally bad motives for investing - or disinvesting."