Tech sector slips into surprising slump

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In a surprising turn, the tech industry is in a slump even as the U.S. economy picks up steam. The announcement last week that Silicon Valley giant Cisco Systems, which sells networking and telecommunications equipment, plans to cut 4,000 jobs is the latest sign of a slowdown that has sucker-punched high-tech firms.

After a remarkable six-year boom set off by the introduction of the first iPhone in 2007, tech companies of all shapes and sizes are finding growth slowing, and even contracting in some cases.

Though there are still bright spots among companies that help manage data or provide cybersecurity, many of the industry's biggest companies - Microsoft, Google, IBM and Dell - are struggling to figure out the changes in the way businesses and consumers are buying and using technology.

There even have been signs that tech's dysfunction was having a wider effect. When Wal-Mart reported disappointing earnings last week, the company's executives pointed the finger at consumer electronics for a lack of exciting new products.

"Our performance was pressured by soft results in both electronics and media and gaming," said William Simon, a Wal-Mart president and executive vice president, on the company's earnings call with analysts.

It's not a bust - not yet at least. And it isn't as serious as the 2000 dot-com crash, when tech's fortunes quickly deteriorated. Indeed, on the ground in Silicon Valley, there is a bit of a disconnect because competition for hiring remains intense.

But in recent months, tech earnings have plummeted as tech companies have reported slower growth or declines. Venture capital has fallen almost 7 percent this year. Tech mergers and acquisitions have tumbled. And tech stocks have lagged the broader stock market this year. As of early August, the S&P 500 was up 19.7 percent, but tech stocks in the index were up only 11.1 percent, one of the lowest-performing categories.

While observers fumble for explanations and many remain optimistic about tech's long-term outlook, the industry is wondering whether this slump is simply a pause or the new normal.

"What I've seen is that a lot of the tech heavyweights are having challenges," said Patrick Moorhead, principal analyst at Moor Insights and Strategy. "There's a fundamental shift in the marketplace that many people are grappling with. What we're seeing is a transitional period."

And tech finds itself in the unusual position of being a laggard in the economy's recovery.

"Technology remains a big drag on earnings growth," Zacks Investment Research analyst Sheraz Mian wrote in a recent report. "The sector's earnings picture is very poor."

Being labeled a "drag" is the ultimate insult for an industry that likes its growth fast and furious. But why has tech lost its mojo?

There doesn't seem to be a single villain.

Mian chalks it up to the lackluster global economy. Tech firms are increasingly dependent on sales and profits abroad, where corporate spending remains weak. In the U.S., others have pointed to the faster-than-expected collapse of PC sales.

"That's having a ripple effect through a lot of sectors of technology," said Greg Harrison, a corporate earnings research analyst at Thomson Reuters.

Companies continue to shift from buying their own hardware and software to renting computing power through cloud-based services in which files are kept at massive data centers in far-flung locations. These save money for buyers but generate less revenue for sellers.

Consumers, meanwhile, appear to be showing signs of fatigue after embracing so many new gadgets in recent years.

PC sales have been devastated by tablets. But now tablets are losing steam, with even Apple reporting a decline in iPad sales in the most recent quarter.

Worldwide tablet shipments fell nearly 10 percent in the second quarter compared with the first quarter, according to an August study from IDC.

Whatever the reasons for the slowdown, the recent cycle of earnings reports this summer shows how widely the infection is spreading.

Some big tech companies, of course, have had years of trouble, such as BlackBerry, Nokia, Yahoo and Hewlett-Packard. And then there is the buyout saga of Dell, which seems stuck in the PC slow lane in a world speeding by with mobile devices.

But many others who faltered were surprising. In recent weeks, Oracle, Intel, Nvidia and IBM reported poor earnings, with the latter reportedly cutting up to 8,000 jobs.

This summer, earnings disappointed on the same day for Google and Microsoft, which took an ugly write-down of $900 million because of poor sales of its Surface tablet. Apple's growth slowed, though its earnings sent its stock soaring in part because they were not as bad as many had feared.

These earnings blues are not isolated. According to Zacks, profits in the tech sector in the first and second quarters declined 4.5 percent and 10.6 percent, respectively, from a year earlier.

It's a sobering moment for an industry that has just had six remarkable years.

The launch of the first iPhone in 2007 accelerated the tech boom and had the kind of effect on consumers and businesses that the dot-com bubble once promised but failed to deliver.

Cloud. Mobile. Social. These three trends combined to make for heady times in Silicon Valley and beyond.

The tech industry's earnings grew from $99.6 billion in 2008 to $182.2 billion last year, according to Zacks. And as the calendar turned, 2013 promised more of the same. Estimates compiled by Thomson Reuters in January projected that tech earnings would grow 7.5 percent in the second quarter.

Instead, it appears they fell 3.6 percent, according to Thomson's latest data.

The pinch isn't confined to tech giants. The startup world is also being squeezed.

In the first half of 2013, venture capitalists invested $12.7 billion, down from $13.6 billion for the same period last year, according to the National Venture Capital Association and Thomson Reuters.

Meanwhile, tech companies going public remain rare, and even mergers and acquisitions are struggling. Though there were a handful of large deals in July, the number of tech deals overall fell sharply from the same month a year earlier, from 341 to 240.

After quietly losing momentum for several months, tech's troubles came into wider view last week.

Most alarming was Cisco's announcement that its outlook was much weaker than expected and that it was turning to layoffs.

"This recovery is more mixed and inconsistent than the others I have seen," Cisco Chief Executive John Chambers said in a conference call with analysts. "The environment in terms of our business is improving slightly but nowhere near the pace that we want."

Amid the gathering gloom, tech companies also face a paradox.

While tech's finances suffer, many firms believe that they can't afford to scrimp on research, product development and hiring. Oracle, for instance, is navigating the shift driven by customers from its traditional business of selling hardware, database software and business applications to renting these services through cloud-based services, a sector in which competition is tougher.

"We've been adding a lot of salespeople in the cloud," Oracle CEO Larry Ellison said on a June conference call during which the company reported that revenue for the last year had been essentially flat.

Indeed, competition among rivals such as Google, Apple, Facebook and Samsung is too intense to throttle back on investing in innovation.

"You're not seeing any cutbacks in sales teams or research and development," said Grady Burkett, an analyst at Morningstar. "The competition is too fierce. They have to invest in product development and engineering."

As this technology shift becomes more evolution than revolution, everyone is looking for a catalyst. Something amazing that will ignite the industry's next boom. Wearable gadgets? Internet TV? Robot cars? Google Glass smart eyewear?

In the meantime, some folks in the tech industry wonder how long these companies will maintain their pace of hiring and investment if revenue and profits continue to stumble.