Once-soaring tech stocks sink in sobering comedown

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The stock market's laws of gravity are ravaging its highest fliers. Just look at the list of technology trailblazers whose values have plummeted from record highs during the past few weeks. Investors have re-focused on safer sectors such as utilities, health care and consumer staples instead of companies that promise potential growth from online services that are building huge audiences.

Stung by the abrupt change in sentiment, the stocks of recent stars such as Netflix, Facebook, Twitter and LinkedIn are 20 percent to 45 percent below their recent peaks. The steep downfall is raising questions about whether this is just a fleeting fit of fickleness or the foreshadowing of another market bubble about to burst.

Stocks across all sectors dropped Friday. The tech-driven Nasdaq composite index fell 54.37 points, or 1.3 percent to 3,999.73 to punctuate a punishing week, and is down 8 percent since early March, when it hit a 14-year closing high of 4,358. Last year, the Nasdaq soared 38 percent.

The Standard & Poor's 500 index fell 17.39 points, or 0.95 percent, to 1,815.69 Friday. The S&P 500 is 4 percent off its recent high on April 2.

Optimists expect a rebound. They point out that technology remains a bright spot in an otherwise dreary economy as software, computers, mobile devices and the Internet fill increasingly instrumental roles in work, entertainment and communications.

"Tech is where the action is," says longtime industry analyst Roger Kay.

Pessimists view the tech sector as Ground Zero for a long-overdue reckoning. They say the stock market has been pumped up by the flood of money that the Federal Reserve has funneled into the long-term bond market since the financial meltdown of 2008 decimated the economy. Now that those government-backed bond purchases are tapering off, people are starting to realize "the only thing holding this balloon up is the Fed blowing air in it," said Fred Hickey, editor of The High-Tech Strategist newsletter.

That's why he believes investors are parachuting from stocks that had soared to dizzying heights in a short period of time.

Internet video subscription service Netflix Inc., for instance, nearly quadrupled in value last year to top the charts of the bellwether Standard & Poor's 500 index. The company was worth $27 billion by the time its stock peaked at $458 early last month. At that price, investors were paying the equivalent of $117 for every $1 of Netflix's projected earnings. Investors were betting Netflix will become increasingly prosperous as the number of U.S. subscribers to its $8-per-month video steaming services swells from 33 million at the end of last year to management's long-term hopes for 90 million.

Even Netflix CEO Reed Hastings cited the "euphoria" surrounding the stock as he discussed the company's quarterly earnings last October. "We have a sense of momentum, investors driving the stock price more than we might normally," Hastings said in a video presentation. "There's not a lot we can do about it."

Netflix's stock closed Friday at $326.71, nearly 30 percent below its peak.

Another mind-boggling run-up occurred after short messaging service Twitter Inc. priced its initial public offering at $26 per share in November. By late last year, Twitter's stock had more than doubled to a peak of $74.73. At that level, Twitter boasted a market value of roughly $50 billion, even though the San Francisco company has never turned a profit in its eight-year history. The stock lost nearly half its value as it tumbled down to about $40. That still leaves Twitter with a market value of about $28 billion.

"It's the most insane pricing I have seen since 2000," Hickey says of technology stock prices.

Invoking the year 2000 is touchy subject in technology circles because it harkens back to the end of the dot-com boom. The Nasdaq composite index closed at an all-time high of 5,047 in March 2000 and then plunged 78 percent before bottoming out at 1,108 in October 2002.

By one key measure, tech stocks aren't nearly as overvalued as they were in 2000 when the accelerating adoption of personal computers and the early days of the World Wide Web drove an investment fervor that lasted through most of the 1990s.

By March 2000, investors were paying $68.72 for every $1 in earnings generated by companies in the S&P 500 information technology index, according to S&P Capital IQ. Last month, the ratio stood at $18.26 for every $1 in earnings in the same index.

"This is like a little bubble that kind of popped up in the past year or so," said Daniel Morgan, a portfolio manager at Synovus Trust Company, who focuses mostly on technology. He noted that most tech stocks besides iPhone maker Apple Inc. have lagged other sectors since the current bull market began in March 2009.

While more speculative stocks such as Netflix and Twitter have seen big increases in the past year or so, Morgan noted that long-established tech companies are still holding up relatively well. Many companies in this older crop, including Yahoo Inc., Microsoft, Cisco Systems Inc., Hewlett-Packard Co. and Intel Corp., still haven't surpassed their record highs from the 1990s and 2000.

"Investors are rotating out of the risky or high-momentum stocks into safety, but they always do that," Hickey concedes. He thinks an even safer choice is to sell all stocks now and save the cash until the current turmoil settles down.

There are other signs that the market may be overheating. One is the stampede of startups trying to go public. Last year, 222 initial public offerings were priced in the U.S., the most since 2000, according to the research firm Renaissance Capital. The IPO pace so far this year has more than doubled from 2013. In a sign that investors are becoming less receptive to the market newcomers, the average return on this year's batch of IPOs has been 13 percent, down from last year's average gain of 41 percent, according to Renaissance Capital.

The bubble worries also escalated during the past two months after Facebook Inc. agreed to pay $19 billion for mobile messaging service WhatsApp and then $2 billion for virtual reality device maker Oculus. WhatsApp has about 450 million users, but little revenue while Oculus hasn't even released its first product.

Facebook financed most of those deals with its own stock, which had more than tripled in value since last summer. The stock has retreated by nearly 20 percent in the past month.

"That's one of the reasons people are casting a questioning eye on the tech sector," Kay says. "I think there is a lot of value being generated, but also a lot of crazy stuff going on. We trust the market to sort it out for us."

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