

Silicon Valley heading toward another tech bubble, some investors say

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Venture capital rising to levels not seen since 2001. Companies with no profits going public. Billions of dollars being paid for start-ups. These and other signs that the tech boom may be taking an irrational turn are leading some notable investors to utter the dreaded word "bubble," waking up the ghosts of an era many in Silicon Valley would prefer to keep buried.

Has Silicon Valley once again lost its collective mind?

Hedge fund manager David Einhorn thinks so. "There is a clear consensus that we are witnessing our second tech bubble in 15 years," he warned in a note to his clients in late April. "What is uncertain is how much further the bubble can expand, and what might pop it."

Venture capitalists and entrepreneurs insist that the Silicon Valley tech economy is not in bubble territory. Yes, they misjudged just how fast the Internet would change the world a decade ago and let things get a little bit out of hand.

But this time, they say, the revolution of mobile and cloud services justifies big, bold bets. And most of the companies going public are profitable, with real businesses that are transforming the way we live.

To some tech insiders, the region's economy is in a "Goldilocks" moment. Not too hot. Not too cold. Enough of a boom to be just right.

Greg Becker, president and chief executive of Silicon Valley Bank, isn't so sure. "There's absolutely a frothiness out there in certain sectors," he said. "With some of these companies, we've never seen growth rates like this before. How much is that growth worth? What's the value? That's what people are trying to get their arms around."

During the dot-com bubble of 1999 and 2000, Silicon Valley believed the Internet was causing such a rapid revolution that there was ample justification for pumping billions of dollars into half-baked startups that went public by the hundreds.

Tech executives insisted there was no bubble - that it was a "new economy" - right up to the moment when their hubris drove the region into an economic abyss.

The tech-heavy Nasdaq composite index fell from 5,046.86 to 1,114.11. Silicon Valley saw 200,000 jobs evaporate overnight. But the bubble grew so large that its bursting also dragged the national economy into recession. Silicon Valley was chastened and saw its credibility shredded.

It's taken almost a decade for the region to regain the trust it squandered, particularly with Wall Street and investors. And the valley is eager to show that it has learned all the right lessons.

But the valley is the valley. And what often makes it an object of fascination - an appetite for risk and a love of big visions - is also what has made it vulnerable to excess at times. Outsiders are now beginning to wonder whether the region is once again setting aside caution in favor of recklessness.

Some of that fear is being stoked by headline-grabbing deals: Facebook buying mobile messaging service WhatsApp for \$19 billion. Google buying Internet-connected thermostat maker Nest for \$3.2 billion. Those

valuations seem indefensible by any traditional financial metrics used to assess a company's worth.

If those examples were isolated, the current attitude toward the valley might not have shifted. But the broader numbers seem to indicate that what had been a boom seems to be accelerating.

The Nasdaq composite climbed to 4,357.97 in early March, up from 3,320.76 in June. Its dot-com peak seemed within reach. Stocks like Netflix and Facebook more than doubled in value.

The surge opened wide the window for tech IPOs. So far, there have been 23 tech IPOs in 2014, putting the industry on a pace for 70 or more. That would be the most since 2000 - right before the bust.

"Investors have been attracted to the strong returns of the IPO market, with most interest focused on the fast-growing technology and health care sectors," said Kathleen Smith, co-founder of investment research firm Renaissance Capital.

And that, in turn, is making [venture capitalists](#) giddy. According to the latest MoneyTree report, venture capitalists invested \$9.5 billion in 951 U.S. companies during the first three months of 2014.

According to the report - which is published by PricewaterhouseCoopers, the National Venture Capital Association and Thomson Reuters - that's the biggest sum since the second quarter of 2001, when the dot-com boom was gasping its final, dying breaths.

This increasing frenzy is being felt beyond the cubicles of these companies. Wealth is rolling through the Bay Area. Open houses are drawing mobs of potential buyers and sparking bidding wars. Competition for talent is causing salaries for software engineers and

developers to skyrocket.

Unemployment across Silicon Valley is down to 5.5 percent, compared with 6.3 percent nationwide. Average home prices in some parts of the Bay Area soared as much as 30 percent in the past year, according to DataQuick.

"There are very few markets where we consider housing to be overpriced," said Steve Cochrane, managing director of Moody's Analytics. "But this is one of them."

Few in Silicon Valley will concede that all this evidence points to a bubble. But those willing to entertain the argument are eager to point out that if there is a bubble - with additional emphasis on "if" - then it is tiny compared with 1999-2000.

The potential 70 tech IPOs this year is relatively small compared with 369 in 1999 and 261 in 2000.

Even if [venture capital](#) keeps its current pace, it would pale in the face of the \$100 billion invested by venture capitalists in 2000. The Nasdaq has still not reached its dot-com peak. And even with the recent flurry of hiring, Silicon Valley has still not recovered all the jobs it lost after the dot-com bust.

And unlike the dot-com bubble days, bigger companies like Microsoft, Cisco System, Oracle and Intel have not seen their stocks become wildly inflated. Indeed, many of these larger players are struggling to find ways to grow, getting no lift from whatever startup craze may or may not exist.

If this all goes downhill again, Silicon Valley executives say the stakes are not as high as before.

"If you look at the amount of venture capital coming in, it is nowhere near what it was during the bubble," said Jon Haveman of Marin Economic Consulting. "To the extent that there is a bubble, it's likely smaller than it was, and it's likely to be much less disruptive."

When it comes to some of the eye-popping deals, Silicon Valley would have you know that what might seem crazy to outsiders is really the result of sober, reasoned analysis. There are certain areas, such as mobile, cloud and data, that are getting so big so fast that they are worthy of daring, outsized bets. If WhatsApp, one of the fastest products to reach 500 million users, does become the mobile social network of the future and ensures Facebook's dominance for decades, it seems worth paying any price.

"Growth is hard to find," said Kevin Landis, chief investment officer of Firsthand Capital Management of San Jose, Calif. "Where you can find it, the price goes way up."

Still, just in case, Wall Street has fired a warning shot. In addition to Einhorn's warning of unjustifiable stock valuations, investors have pulled back a bit on tech stocks, and that has cooled off tech IPOs a bit.

During the second week of April, for instance, only 10 of 16 startups with scheduled IPOs went through with them, and seven immediately fell below their IPO price.

"The correction over the last few weeks I think was a healthy thing," Becker said. "It slowed things down a little bit. I think that's good for the long term."

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