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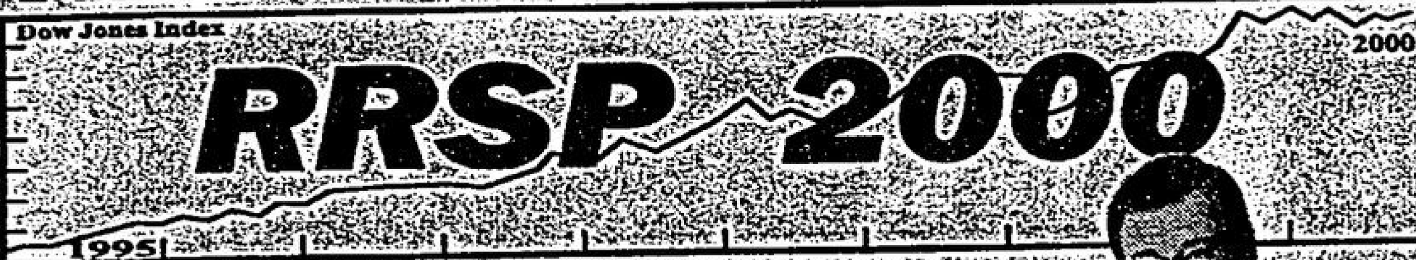

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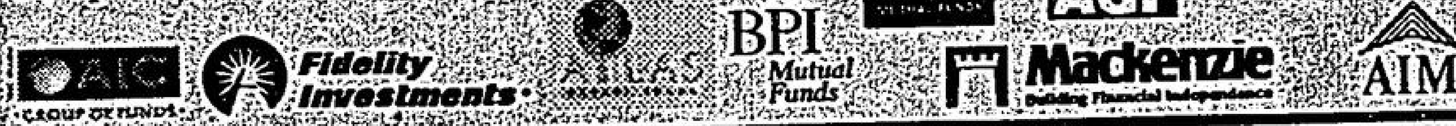

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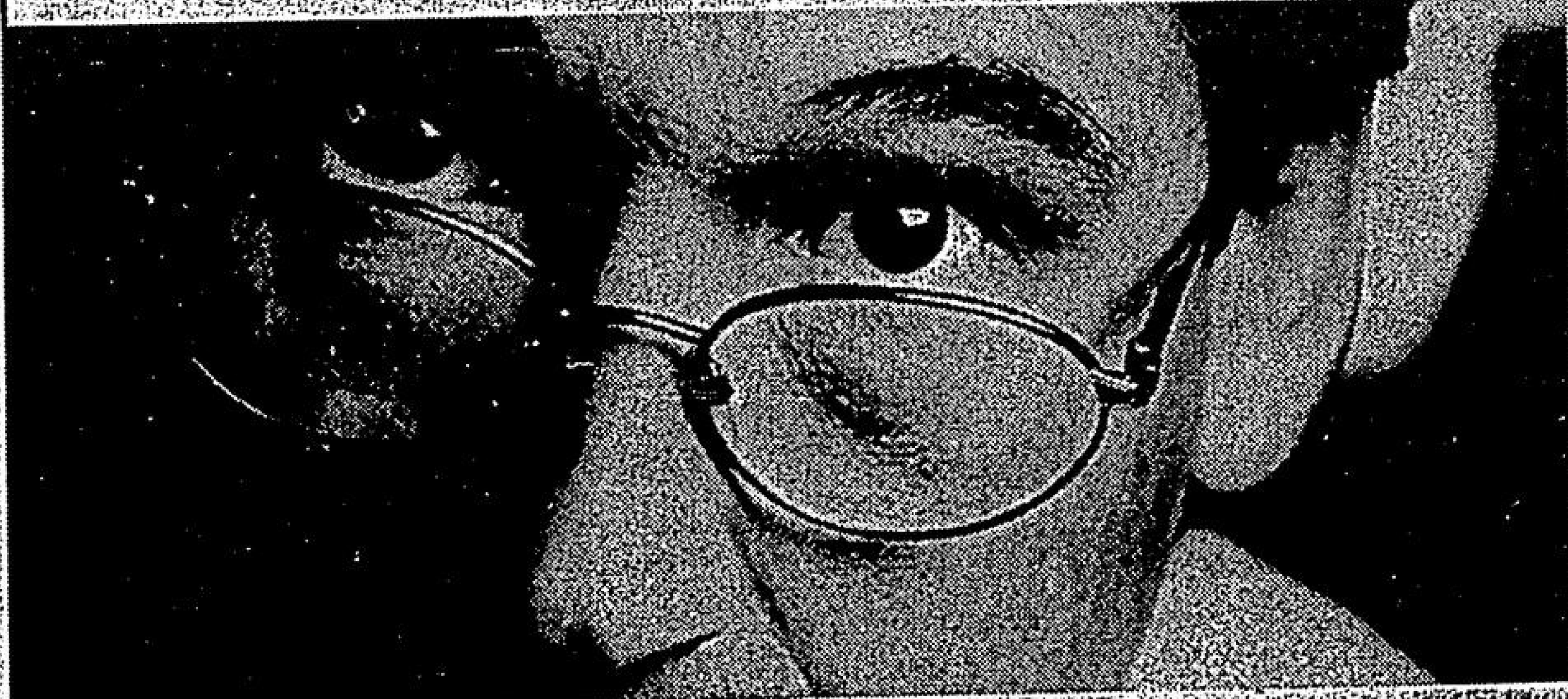

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Advertising feature

Technology boom end in sight

With 2000 now upon us, we can confidently say 1999 will be remembered as the year of technology.

For the most part, the stocks of technology companies powered broader market averages such as the TSE 300 and the S & P 500. Value investing, an investment style that focuses on the intrinsic value of a company utilizing traditional valuation measures such as price earnings multiples or price to book ratios, has been out of favour for years. Even the world's best-known value investor, Warren Buffett, seems to have stumbled a bit. The Financial Post in December 1999 ran a story on Mr. Buffett headlined "Is Warren Buffet yesterday's man?" The article was promoted by the fact that an investment in Mr. Buffett's Beckshire Hathaway Class A shares on Dec. 10, was off 34 per cent from its 52 week high. Granted you can never accuse the financial press of being guilty of having a longer term perspective, but even hinting at Mr. Buffett's demise does seem just a little premature.

Let's face it, we are all guilty of making assumptions about the future by overweighing the significance of events we can see in the present.

Technology has been on a roll but the tech stocks one way ride won't keep going up forever and value investing won't always be out of favour. While timing such events isn't easy, I can't help but think the economic outlook now evolving is one that will be more conductive to such a possibility.

This time last year, the global economic outlook was, well, pretty dire. The global economy was skirting with the first global recession since the early 1980's, the emerging markets were in a shambles, commodity prices had plunged and monetary policy had been aggressively eased globally. By late last year, the International Monetary Fund had coughed up roughly $180 billion U.S. to bail out various emerging market economies. The recovery of the global economy was expected to be slow and protracted. A year later the recovery has been surprisingly robust proving once again it's always a mistake to underestimate the resiliency of pent-up demand that emerges from a period of recession. While Japan's economy is still something of a wild card in terms of global outlook, Asia minus Japan looks poised to return to the robust rates of economic growth we were familiar with before things began to unravel in Thailand in 1997. Throw in Europe growing at 3 per cent this year and the world economy is heading back to its longer-term growth trend rate of 3.7 per cent. Maybe even a bit stronger. What does this mean for the average investor?

Well, for one I think it means some of the better investment opportunities will be outside the United States. To a large degree the U.S. economy and the U.S. stock market has been the only game in town for a number of years. If you think of all the stocks that trade around the world, their total market capitalization is now roughly $25 million U.S. of which the U.S. stock market accounts for about half up from 30 per cent in 1990. Now contrast those numbers with these. The Japanese stock market now accounts for only 10 per cent of the global market capitalization down from 40 per cent in 1990. Similarly the emerging markets have fallen to 8 per cent of world market cap from 14 per cent prior to the onset of the Asian flu in 1997.

I have got a simple way of looking at things. Compared to valuations in the U.S. market, these markets look relatively cheap. Relative to the U.S., I also like Europe partly because I think the Euro will appreciate against the U.S. and Canadian dollars this year and partly because Europe is now experiencing some of the best growth rates and lowest inflation rates in thirty years. Like the U.S. market, equity valuations are stretched but monetary policy should be a little more market-friendly than policy in North America.

What bothers me the most about North America is that years of disinflationary growth has spawned a sense that the business cycle has been tamed. Inflation is a non-issue and the economy can grow robustly because strong productivity gains emanating from investments in new technologies such as the Internet. I don't entirely disagree with the subdued inflation outlook nor am I discounting the role technology is playing in keeping it subdued, but I do think it will drift a little higher in both the U.S. and Canada next year. For this reason I think short term rates are headed 25-50 bp higher during the first half of next year or as high as it takes to cool down the U.S. economy which I expect to continue on a strong growth path into next year. As long as both economies remain strong it will keep some upward pressure on bond yields. But I'm not that negative on bonds. 1999 was one of the worst years ever for bonds, and I do think economic growth will begin to slow by the middle of next year, which will set the stage for a meaningful rally.

Overall I expect the year 2000 will be a year of transition in many respects. Economically, the primary transition will be away from the American economy, which has been the primary engine of global growth for a number of years, towards a better balance of growth within the global economy. If this transition can take place smoothly I also think it will enable a transition within North American equity markets that enables more stocks other than primarily technology stocks to participate in the advance of the overall market. In 1999 the S & P 500 was up roughly 15 per cent but the median stock return (the 250th best returning stock on the S & P 500) was down 3.9 per cent. That's right, down 3.9 per cent. In Canada the performance of the TSE 300 has been dominated by one stock, Nortel Networks. Take Nortel and its parent Bell Canada Enterprises out of the index and the returns are less impressive.

The tide of the technology boom has been in for a long time. A lot of money and manpower has been thrown at the industry and its impact on the economy has not been small. Between 1995 and 1998 technology while accounting for 8 per cent of the U.S. economy accounted for 35 per cent of its economic growth. But booms come to an end and the after effects can be difficult.

Tim Whelan, C.F.P.
Region Manager, Investors Group