TECHNOLOGY | COVER

Yes, It's a Stock Market Bubble. That Doesn't Mean Trouble for Investors Just Yet.

By Ben Levisohn Updated Sept. 12, 2020 10:42 am ET / Original Sept. 11, 2020 6:12 pm ET

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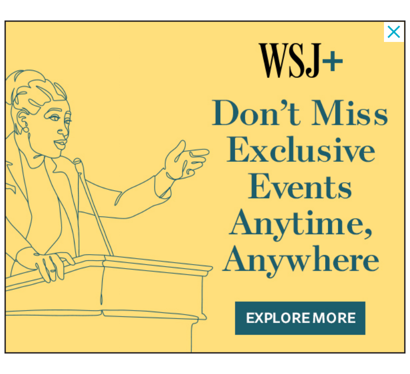

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Every stock market bubble begins with a story, and make no mistake—this is a stock market bubble.

The story began easily enough, if not with "once upon a time." A virus forced the country to shut down and accelerated the gains in a select few technology stocks that are uniquely capable of thriving with everyone stuck at home. A central bank took quick action to prevent financial markets from seizing up, pushing interest rates about as low as they could go. That helped lift the stocks of companies that are growing, including chiefly the aforementioned tech stocks, even if some have no profits. These stocks were among the first to rally once the stock market bottomed in March.

Now, get ready for the plot twist: Good investment ideas can stop being good ideas if the story goes on for too long. The tech trade—including tech companies that aren't officially labeled as such—went too far before correcting suddenly in the past two weeks.

After gaining 75.7% from its March 23 low through Sept. 2, the tech-led Nasdaq Composite fell 10%, to 10,847.69, over three trading days, its swiftest correction on record.

But one correction doesn't mean that the story is over, or that the bubble is ready to burst. To the contrary, the forces that drove stocks such as Apple (ticker: AAPL) and Amazon.com (AMZN) to astonishing heights remain firmly in place. They include the companies' continued growth, the Federal Reserve's determination to do whatever it takes to keep the economy afloat, retail investors' newfound interest in trading, and maybe even a bit of fiscal largess. Stocks will remain volatile, but the tech bubble will continue to inflate.

TRADING LIKE IT'S 1999

With Covid killing the sports-betting market, more retail investors have been speculating on stocks.

44%
The percentage of total stock trading attributed to retail investors, up from 25% in 2009

For an investment bubble to occur, there has to be a widespread belief that a new paradigm has taken hold requiring an adjustment in valuations far beyond what previous fundamentals would imply. This belief needs to engage the imagination of investors beyond Wall Street, and there must be plenty of capital available to chase stock prices higher. The Covid-19 crisis has unlocked all three prerequisites.

Stairway to Heaven

The dot-com bubble was the dress rehearsal for the Nasdaq's remarkable rally.

Nasdaq 100 / S&P 500 ratio

Source: FactSet

Consider how the world has changed in the past six months. Social distancing is now the rule, and working from home is encouraged, when possible. Movie theaters are half-empty, and attending school now means opening a laptop at home for many students.

Companies that bring us a taste of our previous lives—such as Zoom Video Communications (ZM) and Peloton Interactive (PTON)—have seen their share prices soar. Shares of tech titans Apple, Microsoft (MSFT), Amazon, Alphabet (GOOGL), and Facebook (FB) have risen because the businesses are growing far more than most, and investors know that bigger is better in today's world.

At the same time, near-zero interest rates have encouraged investors to pay up for growth, while some retail investors, starved for something to bet on in the absence of professional sports, have turned their attention to stocks, trading through online brokers like it's 1999.

As a result, Apple, Amazon, Microsoft, Alphabet, and Facebook now account for nearly a quarter of the value of the S&P 500 index, a level of concentration rarely seen in the benchmark. And that might understate the influence of Big Tech. Add Amazon and the S&P Information Technology and Communication Services sectors constitute 45% of the benchmark index, according to J.P. Morgan data, compared with 40% during the dot-com bubble.

Even as the biggest tech names have seen market caps swell, some formerly small companies have graduated to the big leagues. Zoom, for one, jumped 41% in a single day after reporting sales that more than quadrupled the previous year's, a consequence of the video service's widespread adoption beyond a business audience. Zoom stock, having zoomed 465% in 2020, is now worth more than $100 billion. Peloton has a market cap of $25 billion after gaining 209% this year, as its stationary bikes replaced gym memberships.

Over the Moon

No amount seems too much to pay for these stock-market darlings.

Company / Ticker	Recent Price	Market Value (bil)	YTD Change	2021E P/E	2021E Price/Sales
Tesla / TSLA	$371.34	$346.0	344%	131.1	8.3
Zoom Video Communications / ZM	384.48	109.4	465	147.3	35.5
Peloton Interactive / PTON	87.75	24.9	209	NA	7.6
Etsy / ETSY	110.57	13.2	150	50.5	7.7
Fastly / FSLY	82.60	8.7	312	1,272.4	21.7

E=Estimate. NA=Not applicable.
Sources: Bloomberg; FactSet

Zoom trades for 50 times 2020 sales, and Peloton, 9.3 times. Both are priced as if future growth is unlimited—a risky bet, especially if the postvirus world looks not all that different from the previrus world. "New-era thinking is everywhere," says Rosenberg Research's David Rosenberg. "But there are no 'new eras.' "

That may be, but it still doesn't mean the bubble is in danger of popping soon—not so long as retail investors keep piling into the market. Retail trading now accounts for 44% of the total, says Jefferies strategist Steven DeSanctis, up from 25% in 2009. Retail investors have been particularly enamored of companies that aren't covered by Wall Street and have little or no earnings, including Eastman Kodak (KODK), Workhorse Group (WKHS), and Overstock.com (OSTK).

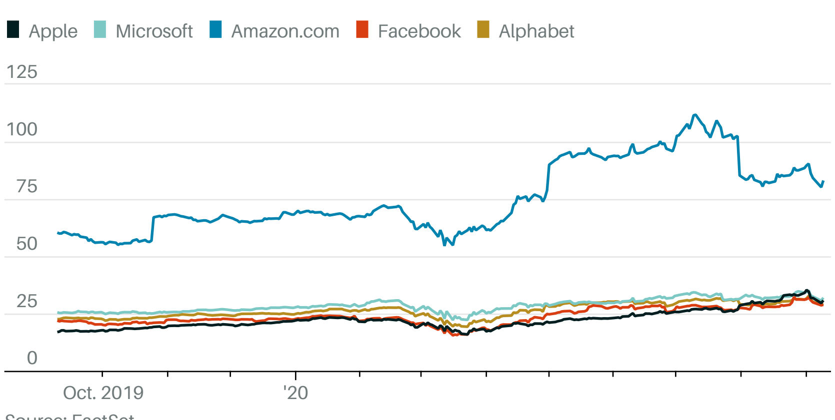
That points to another strange aspect of the current market—the existence of multiple bubbles. The one defined by the Nasdaq 100 gets the most attention, but the run-up in shares of companies that have sought bankruptcy protection, such as Hertz Global Holdings (HTZ) and J.C. Penney (JCPNQ), and electric-vehicle stocks like Nikola (NKLA) and Tesla (TSLA), also merits the bubble label.

Behind the scenes, meanwhile, the Fed is operating the bubble-making machinery. It has pumped trillions of dollars into the economy, expanding its own balance sheet to more than $7 trillion from $4.1 trillion at the start of 2020. This time around, its asset purchases have included not only Treasuries and mortgage-backed securities but also investment-grade and high-yield bonds. All of this demand has served to lower interest rates to near zero.

Getting Rich

Low interest rates have encouraged investors to pay more for fast-growing tech companies.

Forward price/earnings multiples



Source: FactSet

The Fed typically has burst past bubbles, including the dot-com bubble of the late 1990s and the housing bubble of the mid-2000s, by raising interest rates. Don't count on that now, or at least not yet. Fed Chairman Jerome Powell has effectively promised to keep rates low for years, which means there should be plenty of cash sloshing around to keep the bubble growing.

Perhaps the biggest reason to keep betting on tech—and the stock market—is that things aren't nearly as frothy now as they were during, say, the dot-com bubble. Even in August, the market never reached the sustained frenzy that characterized the late 1990s, when the major indexes went parabolic and stayed that way for months, says Katie Stockton, managing partner of Fairlead Strategies. Stockton thinks the market's recent pullback will create another buying opportunity, "A bubble would be characterized by prolonged upside momentum," she says. "The market doesn't have that."

There are risks, however. Wolfe Research strategist Chris Senyek cites a possible deterioration in the economy, an increase in Covid-19 cases, and Congress' failure to pass another fiscal-relief package. The November election, too, could derail stocks. On the other hand, if the economy grows faster than expected, investors could bail on tech to buy more-cyclical issues.

How to handle a bubblicious market depends in part on one's time frame. A money manager judged quarterly has little choice but to hang on and try to time the top. That could mean buying Apple, habitually underweighted in large-cap growth and core funds, notes Wells Fargo strategist Chris Harvey.

Finding a middle ground between growth and value is another option, says Credit Suisse strategist Jonathan Golub. He highlights companies with growth rates a touch lower—and stocks much cheaper—than Zoom. Aspen Technology (AZPN) is growing sales by nearly 20% a year, but trades for 24.6 times earnings after gaining just 2.2% this year. Qualcomm (QCOM) is growing by nearly 30% a year, but trades for 16.9 times earnings.

Economically sensitive stocks could be a good bet for investors with a longer time horizon, says MKM Partners strategist Michael Darda, who expects them to outperform over one to three years. He predicts that a strong economic recovery will follow the Covid-19 crisis. "If you assume that we beat this virus, and have a multiyear holding timeline, how could you not prefer reopening trades over the lockdown stocks that have led so far this year?" he asks.

But that's a whole different story.

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Roku Stock Has Rallied This Year. Here's Why Its Run Could Continue.

By Teresa Rivas Sept. 8, 2020 11:01 am ET

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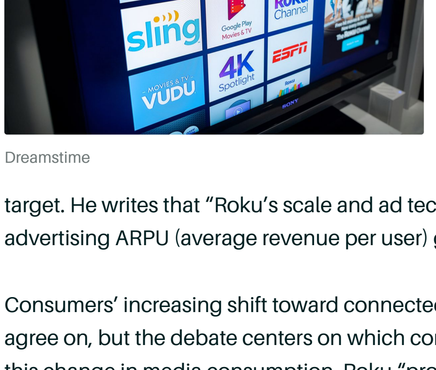

Dreamstime

Roku stock is climbing more than 4% on Tuesday, following a bullish plug from Wells Fargo, which says the streaming platform's shares can keep rising as advertisers shift more of their traditional TV budget to this medium.

Analyst Steven Cahall initiated coverage on the shares with an Overweight rating and $215 price target. He writes that "Roku's scale and ad tech will drive above-expectation advertising ARPU (average revenue per user) growth, creating a future heavyweight."

Consumers' increasing shift toward connected TV, or CTV, is a trend that everyone can agree on, but the debate centers on which companies will be the ultimate winners of this change in media consumption. Roku "provides one of the better CTV platforms," Cahall writes, although advertisers are still primarily allotting dollars to Roku from their digital programming budgets, rather than their broader-based, brand-building budgets...

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