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THE THRILL RIDE ISN'T OVER

Uncertainty on Wall Street has given rise to the most volatile market in 20 years

By DANIEL KADLEC

A $1 TRILLION PLUNGE

The combined value of all NASDAQ stocks fell about $1 trillion over the past month, taking down scores of high-flying dotcoms. The volatile market spells disaster for investors who trade on margin, even though blue-chip tech stocks have stabilized for now.

Market capitalization of every NASDAQ stock, daily closes

Source: NASDAQ

FOR A FEW PRECIOUS HOURS LAST Tuesday, you could actually tell truth from fiction. All those fish stories you'd heard in recent months, the ones about friends and office pals with multiple thousands invested in the likes of Qualcomm and JDS Uniphase—were they true? Were real people actually soaring with the highflyers the way you'd dreamed of doing yourself?

Here's your answer: if you saw those folks anywhere near lunchtime and they weren't sweating bullets, forget everything they've ever said. They're not players.

It's that simple. On a day that the dot bombs and other tech dears descended into a panicky free fall, no one with a sizable stake could help fretting that the bubble had burst. At the lows, the decline was in some ways worse than the 1987 crash. Yes. The Crash. Doesn't register? Think. Mom or Dad may have mentioned it. On that dark day 13 years ago, the NASDAQ, then just a funny series of letters to most people, fell all of 11.4%. But on Tuesday the NASDAQ, now our most closely watched market gauge, was down 13.6% on extraordinary volume and with hours yet to trade. And that was on top of a chilling drop the day before, on top of a steady erosion over the previous few weeks that in all took the index down a stunning 28.9% from the March 10 high to the April 4 low—wiping out an incredible $1.1 trillion of value.

Then everything changed. Or should I say nothing changed? Investors flooded into the market to buy the dip, and the NASDAQ roared back to end the day with only modest losses, then skipped through the rest of the week with little grief. Indeed, tech bellwethers, including Oracle and Intel, finished the week with gains.

Yet something was different. Even if just for a short while, the element of risk, as inseparable from the market as it was invisible during a long run-up, had reimposed itself on investor psychology in a cathartic half a day of pain. "All those people who somehow figure that Wall Street owes them money found out that it doesn't," says Laszlo Birinyi, chief executive of market-research firm Birinyi Associates in Westport, Conn. "The market doesn't work like that."

So just how *does* it work? Well, news matters. When Alan Greenspan raises interest rates, as he has been doing for nearly a year, interest-paying investments like bonds and even scorned bank certificates of deposit siphon dollars from the stock market—and stocks become less attractive. When the government wins big in a court case that could bust up one of the most valuable companies in the most valuable industry in the world, as happened in the Microsoft trial last week, it breeds uncertainty—and stocks become less attractive. When the market's most credible bull sours on the market, no matter how faintly, as Abby Joseph Cohen at Goldman Sachs did recently, some people are bound to sell.

So let's not pretend the market swoon came out of nowhere. And now that stocks seem somewhat stable, let's not pretend that we're simply back to the races. This is the most volatile stock market in 20 years. The Dow has moved up or down more than 1% on nearly half of all trading days this year—more than double the normal rate, Birinyi reports. In the long run, wide price swings don't hurt a thing, and can actually pad returns for those who dollar-cost average, buying every month or quarter no matter what. But in the short run, volatility spells risk and scares off buyers—some of whom should be plenty scared.

Caught in last week's roller coaster were a fast-growing number of speculators buying stocks with borrowed money. Since late last year, margin debt has been rising rapidly, and it hit a record $265.2 billion in February. The tally ignores those who are buying stocks while allowing their credit cards and home-equity lines to go unpaid—in essence charging their investments.

At least in margin accounts you have to put up some dough, usually half, to buy stocks. You also have to pony up whenever the value of your collateral (that's the stock you just bought) falls below a certain threshold. When that happens, as was the case for many last week, you get a margin call. Your broker demands that you write a check to cover your losses—this minute, please—or your stocks will get sold regardless of price. Margin calls played a big role in last Tuesday's debacle. "There was a lot of liquidation," says Ron Shear, president of Carlin Financial Group. "Some very scared people found themselves on ships that weren't coming back."

Shear and others estimate that margin calls were running two to four times as high as normal. When that happens, the impact isn't just on highflyers. A lot of brokers have stringent debt limits, and some even restrict borrowing against volatile tech stocks. To beat the system, investors borrow against their blue chips—AT&T, Disney, GE—to speculate in the likes of drkoop.com and Fogdog. When the margin calls come and the client has no money, blue chips get sold too. That pattern was evident Tuesday, when the Dow dived in delayed synch with the NASDAQ.

But margin calls were only part of the problem. With a run of negative news and long-standing valuation concerns as the backdrop, a lot of pros already had their finger on the panic, er, sell button. Some who had loaded up with the right tech

Photo-Illustration by Ed Gabel

stocks were ahead of the S&P 500 by as much as 20 percentage points. "My God, their year was made in three months," notes John Manley, senior equity strategist at Salomon Smith Barney. "All it took was the least little nudge, and those guys rushed to lock in that outperformance [by selling winners and going to an index weighting]."

This year's astonishing volatility points up the shifting nature of the economy and investors' uncertainty about how things will shake out. Most recognize both the promise of the Internet and the inherent value of old-economy blue-chip companies. They just can't figure out how the two will come together—even though they know that somehow they must. As the betting on Wall Street goes back and forth, the NASDAQ and the Dow act like a pair of magnets turned the wrong way. When the NASDAQ is up, the Dow is down, and vice versa.

For the past month, the old-economy Dow has been on top, surging 9% while the new-economy NASDAQ has fallen 9%. But things were going the other way in January and February. Where this all leads is anyone's guess. Volatility says nothing about where prices are headed—only that confusion reigns. A lot of market watchers believe that the NASDAQ's low point last week will prove to be a bottom. They cite the quick rebound and the broad strength in blue chips and the general economy, as well as the robust profit reports that are expected in the coming days and weeks.

But even if they're right, the ride will remain bumpy. So close your eyes. Or if you're really squeamish, leave the park for a while.

—With reporting by William Dowell/New York

AT THE MARGIN

In a volatile market, margin trading gets even riskier. Here's an example:

March 31: You buy a share of eBay for $200

You pay **$100**

You can borrow up to **$100** from a broker

If stock goes up, you reap all profits (minus interest charges)

April 4: The stock dips below $133

Because of the drop, your own stake falls below a **25%** required minimum ...

... so you must deposit additional funds, or you'll have to sell the stock

During market drops, buyers may not meet margins, and so must sell off their portfolios.

Sources: New York Stock Exchange, Financial Markets Center

DOOM STALKS THE DOTCOMS

A market recovery won't help a passel of sinking e-tailers and other once hot sites

By JOHN GREENWALD

WHEN THE STOCK MARKET careened out of control last Tuesday, Rick Neely could only hold on tight. Neely, the interim chief executive officer of Beyond.com, a struggling software seller, had 200,000 options priced at $7 a share riding on every lurch. Last April, when Beyond.com stock hit $37, such options would have been worth $6 million—small by dotcom standards but far better than last week's figure. With Beyond.com down to $3.75, his options were "under water"—worthless. "The drop this week was so dramatic, you can't even comprehend it," says Neely, who took over in January after the previous CEO quit. "Everyone is dealing with the same problem."

Indeed, everyone is. The violent swings of the NASDAQ over the past month have overshadowed the virtual collapse of many battered online companies—e-tailers such as grocer Peapod and music seller CDNow and information-and-advice sites like drkoop.com—that a year ago were among Wall Street's highflyers but now may be down for the count. Stock prices of these hemorrhaging havenot.coms have plunged 50% to 75% below their 12-month highs, and many trade below their initial offering price. Case in point: shares of TheStreet.com, a financial-news-and-advice site, peaked at $71.25 on the day it went public last May but closed at $7.63 last week.

It's not that Americans don't love surfing the Internet and shopping online. Consultant Forrester Research predicts that Web spending will soar from $20 billion in 1999 to $184 billion by 2004. But superheated competition in everything from apparel to videos—e-shoppers can choose from 100 look-alike pet-supply sites and more than 200 toy stores, for example—virtually guarantees mass extinction. "The reality is that many of these companies are simply running out of cash," says Tom Wyman, who watches online shopping for J.P. Morgan. "They are losing anywhere from $10 million to $30 million a quarter." By year's end, Wyman says, "a majority of the owners will be forced to turn out their lights and go home."

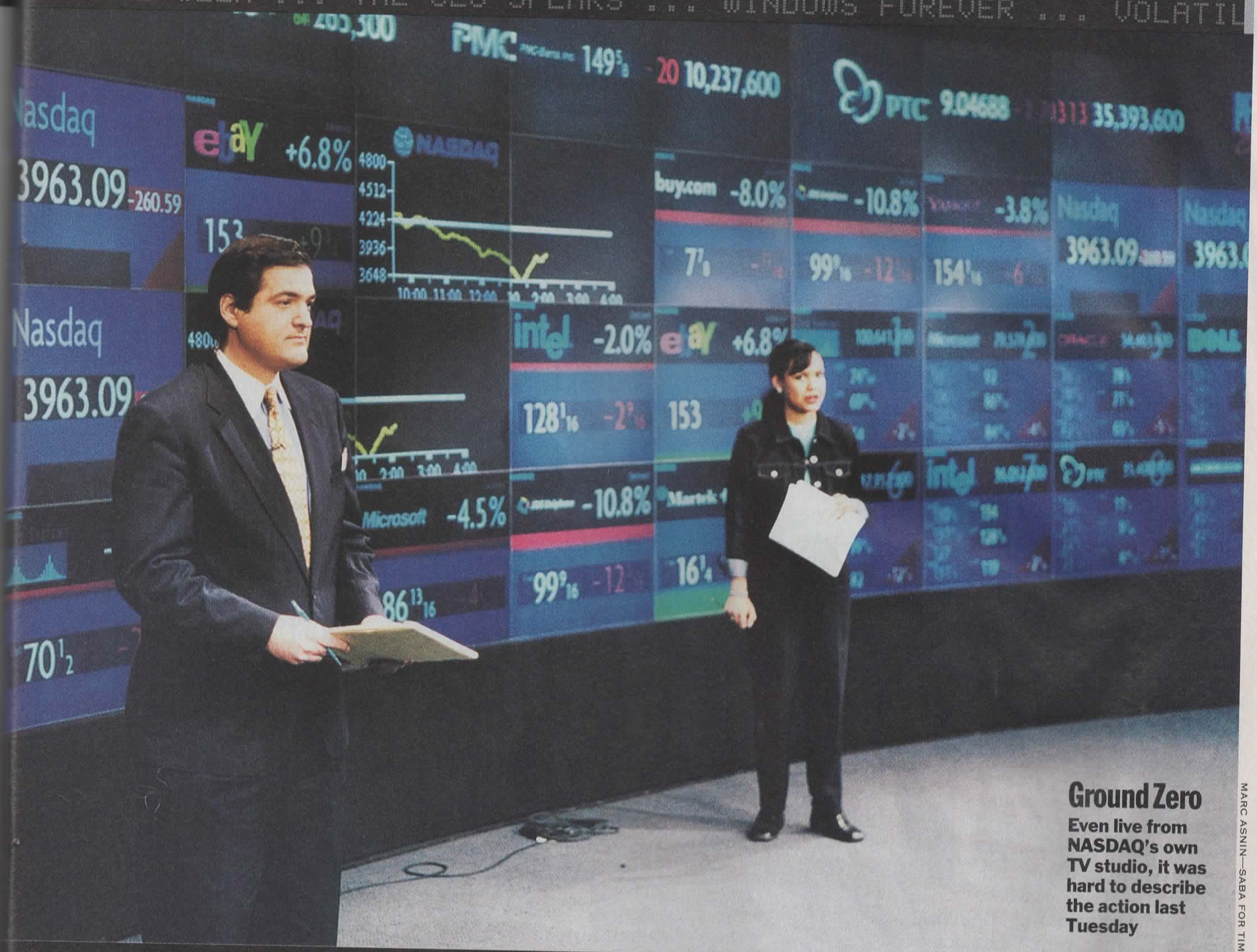
The collapse of these new-economy stocks is both a predictable and rational phase of economic development—though it may not feel so rational if you've been burned by them. Launching a dotcom company in recent years has been a bit like getting a license to collect money. Venture capitalists showered you with cash, and Wall Street snapped up your stock at five or 10 times the offering price—sometimes all in the same day—in the hope that you would soon become the next Intel or Microsoft. That money was a magnet for executives of boring old-economy companies, who joined dotcom start-ups for the thrill of working 20-hour days in return for wheelbarrowfuls of options. And certainly, lots of people got filthy rich.

But with many dotcoms declining, neither venture capitalists nor Wall Street is eager to give them a dime, prompting a flurry of initial public offering postponements. "You'd be a fool to invest in an e-tailer that sells books today or wants to go into any other well-recognized market," says Michael Moritz, a general partner at Sequoia Capital in Silicon Valley, which launched the popular Internet portal Yahoo. "The large waterfront properties have not only been purchased but developed."

The plight of the e-tailers and information providers sharply separates them from their more resilient Internet and technology brethren that have been able to show actual profits. Companies like Cisco, whose routers switch bits and bytes around the Internet, and Yahoo have seen their stocks rebound after each recent tumble. Shares of Cisco, a company with $12 billion in 1999 revenues, fell to $64 during the worst of Tuesday's carnage but at week's end rallied to $74.94, about 10% off their peak of $82 for the past 12 months.

But the failure of most e-tailers to generate anything resembling income has ex-

ES' BAD WEEK ... THE CEO SPEAKS ... WINDOWS FOREVER ... VOLATIL

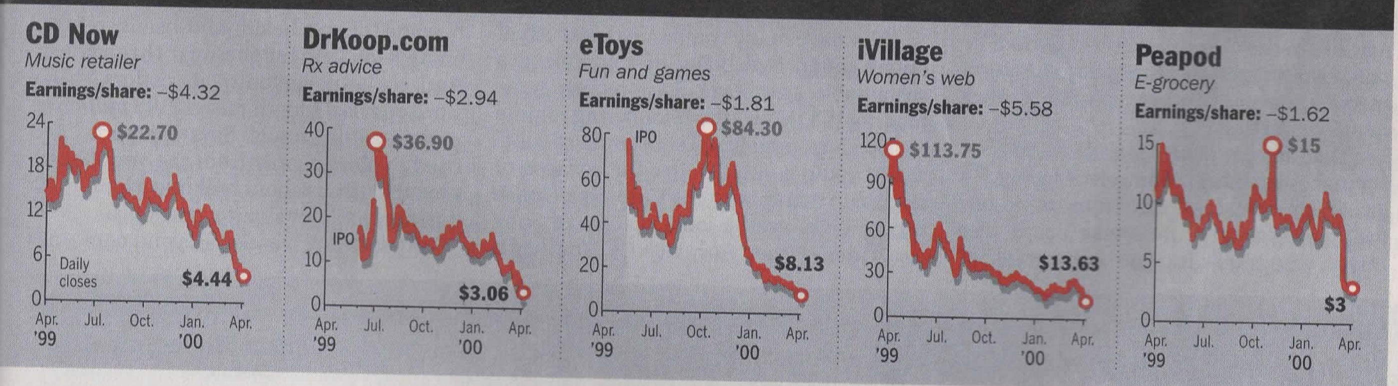


Ground Zero

Even live from NASDAQ's own TV studio, it was hard to describe the action last Tuesday

MARC ASNIN—SABA FOR TIME

THE DOTCOM DUDS



posed their strategy as essentially hollow. That's because their game plan has called for spending whatever it takes to attract the millions of eyeballs—and open wallets—that any site must have to turn a profit. And "whatever it takes" has too often meant shelling out more for marketing ploys like Super Bowl TV spots than typical customers spend on online products. Wyman estimates that it costs a company like music retailer CDNow more than $70 to win a customer who may spend less than half that amount before departing forever.

Many companies are only now wising up. "We've had the opportunity to learn the lessons of the Internet," says Glenda Dorchak, CEO of Value America, a discounter that once sold everything from crackers to computers but has narrowed its selection to electronic equipment for home and office. Lesson No. 1, Dorchak says, is that "spending tens of millions of dollars on ads on national TV" doesn't make any sense. In fact, Value America is still trying to recover from its overzealousness. The company laid off nearly half its work force in January and has been scrambling for funds. Its share price has fallen from a high of $74.25 a year ago to just $3.13 last week.

Worse yet, many e-tailers depend solely on cheap prices to lure and hold fickle customers. That just deepens red ink without preventing shoppers from hopping to


NIGEL PARRY—CPI

In Search of Pain Relief

Drugstore.com's Neupert stresses long-term remedies


STEVE LISS—CORBIS SYGMA

Shelled

Peapod CEO Andrew Parkinson must halt the company's slide


DAVID GRAHAM

Facing the Music

Dimmer prospects for Jason and Matthew Olim's CDNow


MARIO RUIZ

No Laughing Matter

EToys CEO Toby Lenk has seen rivals slice his company's lead

other sites with deeper discounts—to say nothing of auction venues like eBay. Online retailing "is not about the lowest price anymore," says Josh Goldman, the CEO of mySimon, a comparison-shopping site that describes more than 2,000 e-stores. What customers prize more, he says, are bells and whistles such as instant messaging, access to product specialists, and e-mail alerts of upcoming deals.

It was Amazon.com CEO Jeff Bezos who preached the gospel of getting big at all costs in order to dominate an online sector. And he may emerge as the biggest beneficiary, even though Amazon, which attracts more than 17 million customers a month, has yet to earn a penny of profit (one reason its shares closed at $67.56 last week, down from their peak of $113 in December).

All those eyeballs, however, have enabled Bezos to turn Amazon into an online bazaar full of links to myriad other e-tailers, who each pay a fee to be listed. "If you really want to be the place where people can find anything," Bezos says, "you have to partner with other companies." Meanwhile, he fondly compares the profusion of e-tailers today with the explosion of new life in the Cambrian era—a period, he says, that witnessed "the greatest rate of speciation ever seen but also the greatest rate of extinction."

That fate is what countless Amazon wannabes now find themselves facing. "A lot of companies looked at Amazon and saw the market forgive its losses," says Lise Buyer, who tracks Internet companies for Credit Suisse First Boston. "The difference is that Amazon has transformed its traffic into revenue while some of the others have not been as successful."

Nor have many companies that rushed online found that being first conferred a sustainable advantage. Last month auditors for CDNow, the pioneering online music shop, reported "substantial doubt" that it could continue after the collapse of its deal to merge with the Columbia House record club, itself a joint venture of Sony and Time Warner. Although CDNow had a head start, it was quickly challenged by rivals, from Amazon.com to websites that let users download virtually any song.

One company that seemed to have it all was drugstore.com, which last July became the first online pharmacy to go public. Along with high-profile backers that included Amazon.com and venture capitalist John Doerr of Silicon Valley, the start-up boasted partnerships that enabled customers to pick up orders at Rite Aid pharmacies and buy GNC nutritional products online. Drugstore.com even lured its CEO, Peter Neupert, from Microsoft, where he had been running the MSNBC cable channel and website. Small wonder that drugstore.com commenced trading at $65 a share. But the stock closed at $10.88 last week, with Neupert having lost some $75 million on paper.

What happened? "We've been moving as fast as we possibly can at every stage to be ahead of our competition," Neupert explains. "We are spending a lot of money, so our losses are large." The outlays included $30 million in equipment to set up the company's own distribution center in Bridgeport, N.J., and a $105 million deal to become the sole health-and-beauty retailer on Amazon.com for the next three years. And to help replenish its coffers, drugstore.com last month raised $108 million in private-equity funds. Says Neupert: "I've tried to alert people from the very beginning that this is about building a long-term business and not about a quick hit."

At software vendor Beyond.com, CEO

THE BLUE CHIPS

Cisco
Routermaker
Earnings/share: 37¢

Intel
Chipmaker
Earnings/share: $2.11

Oracle
Software
Earnings/share: 47¢

Qualcomm
Cell phones
Earnings/share: 46¢

Sun Microsystems
Workstations
Earnings/share: 77¢

MICHAEL KRANTZ

The Day the World Ended

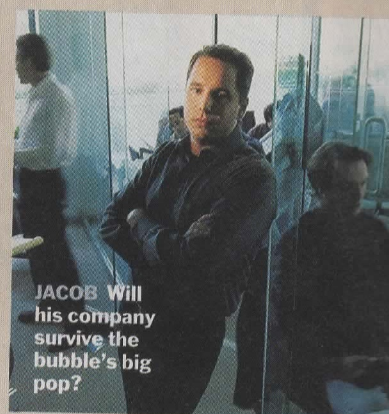
I'm hypnotized at my computer, watching the NASDAQ collapse, when e-mail reminds me of our biweekly company meeting. Eighty or so Keen.com employees gather around our chief executive, Karl Jacob. "Well," he says, "we all know what happened in the market today."

Yeah. The world ended. The fact that the NASDAQ may have hit a new high by the time you read these words doesn't erase the vague sense in dotcomland that the party, if not quite over, is definitely winding down. It's behemoths like Cisco and Intel that are keeping the NASDAQ afloat. The Web bubble is bursting. Has burst. Which means that some of us now roaring toward online glory may instead face that Wile E. Coyote moment when you look down and realize you just sprinted off a cliff.

At my firm, of course, we're fine. Those jerks down the block may obsess about initial public offering millions, but here at Keen.com we care only about building a great business by continually improving our products and better serving our customers' needs ... O.K., the truth: if you just bet your career on a Web play (as I did, leaving TIME recently), the last thing you want to deal with is reality. "Please let the market hold," said a colleague last week with a shaky laugh.

But does the market really matter? Karl has one message—Suck it up—and two themes. Theme No. 1: Everything Is Different. The NASDAQ's woes don't affect us directly—we don't have a steady supply of paper clips yet, let alone public stock—but our industry's free ride is clearly over. The men are about to be separated from the boys, the wheat from the chaff, the Yahoos from the yahoos. And—oh, my, Greenspan—we can't go public at the drop of a business plan anymore. "It's going to be much harder under these conditions," Karl warns. "The model has to be that much more ironclad."

And we're the lucky ones. In January, Keen.com scored a startling $60 million in venture capital, easy money that's getting scarcer. We gleefully imagine our rivals going broke while we ride out the Web's long, hard winter and emerge the big winner. After all, we aren't just me-too e-commerce hacks; we have a novel business model. We're running trippy TV ads. Hey, we even have revenue!



WILLIAM MERCER MCLEOD FOR TIME

JACOB Will his company survive the bubble's big pop?

We just have to work hard, Karl insists, and we'll win.

Which brings us to Theme No. 2: Nothing Is Different. We were frantic and exhausted two weeks ago, and still are today. We still have to create a brand-new business out of thin air under crushing deadlines and immense competitive pressure for stakes higher than most of us care to consider—i.e., sudden wealth vs. abject humiliation only partly mitigated by the likelihood of landing a new and even more lucrative gig if this one tanks.

So we take solace in, of all things, the long view. Forget the NASDAQ and going public, Karl says. Last year's IPO darling is this year's sinkhole. What matters is our 2003 bottom line, and that means—sing along, kids—building a great business by continually improving our products and better serving our customers' needs.

Sigh. Back to our cramped cubicles. New economy, my ass. ■

Michael Krantz is editorial director of Keen.com

Neely has taken the opposite tack and shifted the company from consumer retailing to business-to-business selling. The move to B2B involved more than $11 million in special charges to cover the layoff of a fifth of the company's workers plus the removal of Beyond.com buttons from such sites as America Online and Yahoo. Neely hopes the resulting savings will help his company turn a profit by the end of 2002.

That could make it one of the few survivors of a massive shakeout whose onset drew closer with the events of last week. "This is the start of a serious consolidation," says Joe Sawyer, an analyst at Forrester Research, who predicts that a handful of companies will dominate each major e-tail sector. The likely winners, he says, are the very same brick-and-mortar retailers, such as Wal-Mart and K Mart, that the Internet was supposed to make obsolete. But instead of this happening, such behemoths are rapidly bringing their deep pockets, brand recognition and nationwide customer bases online. "It's really their game to lose," Sawyer says. If that forecast proves accurate, the Brave New World of retailing could soon look a lot like the old one. For many investors, it's one shopping trip they could have done without. *—With reporting by Julie Rawe and Anamaria Wilson/New York*

WILL THEY THRIVE?