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Forget Waldo -- Where's That Tech Boom? It Was Here Just A Minute Ago.

Forty years ago, offices were using carbon paper to make copies and hand-crank adding machines to make calculations. There was no fax, no overnight delivery, no air conditioning, and no desktop computers. All this has changed. Copy machines replicate documents, packages are shipped across the country or overseas at great speed, and there is less need for either copies or packages to be created at all thanks to the Internet and e-mail. These advances have been imprinted in the minds of a new generation of investors focused on technology, bidding up the prices of big tech stocks to the point that they dominate the stock market indexes.

*"Can you tell me where all the money went? We might not be broke, but we're badly bent"
-- The Tractors*

Having lived through this wonderful period of technology and growth stock dominance, we were surprised to find out that we had misplaced it recently while doing research on total returns for various market indexes. We compared trailing returns through May 2001 for the growth and value components of the Russell 1000 index (the 1,000 largest U.S. stocks) developed by Frank Russell Company, with data starting in 1979. With two exceptions, the Russell 1000 Value index had higher returns than the Russell 1000 Growth index over every annualized trailing period (1 year, 2 year, 3 year, 4 years and so on). The exceptions are the last 12 and 13 year periods, in which growth beat value by less than one-fifth percent annualized. Value stocks also had lower volatility than growth stocks in every trailing period back to 1979.

"Now wait a minute," we hear you saying, "while I was alive in 1979, I certainly wasn't paying attention to this stuff. But I was paying attention over the past few years, and I know the big tech stocks that dominate the growth index were having a field day. I saw it! I was there! Are you telling me it didn't happen?"

No, but we are telling you that the period of big tech dominance has been overcome by events. If you look at individual calendar years, growth stocks did 23 percent better than value stocks in 1998 and almost 25 percent better in 1999, by far the biggest disparities between the value and growth indexes since they were created by Russell in 1979. An even bigger disparity came in 2000, however, when the value stocks beat growth stocks by more than 29 percent, with another 13 percent advantage for value in the first five months of this year.

We do not mean this to be an unqualified endorsement of value investing. Each style has its own cycles, and we don't have to go back all that far to find it. Like archeologists digging down another layer at Pompei, we compared trailing

returns for the value and growth indexes from 1979 through March 31, 2000, the approximate peak of the technology boom. The view could hardly be more different than today's -- growth beat value in every trailing period. Just as it is now difficult to find evidence of the tech boom in return numbers, a few months back, it was hard to locate the long term advantage of value investing. Wise media pundits suggest looking at long term performance as well as what's happened recently, but it is easy to forget that recent performance can dominate the long-term numbers as well.

***"Practice random acts of logic
and senseless rationality."
bumper sticker suggested
by ContraryInvestor.com***

The conclusion is not that either growth or value investing is always superior, it's that you should believe the fine print that says "past performance is no guarantee of future results." Unfortunately, chasing past performance is exactly what many investors do, despite evidence that they would do better to buy what has performed the worst lately, not the best. The performance-chasing bug is particularly virulent with technology stocks, because people become emotionally attached to their glamour. It takes more bad performance to shake confidence in technology stocks after their "superiority" has been fixed in investor brains.

How this emotion can border on madness is exemplified by the "analysis" of earnings announcements on consecutive market days for a couple of the leading horsemen of the tech boom, Oracle and Nortel. Oracle announced quarterly earnings that were more than 80 percent below the comparable quarter a year ago. This met company estimates (recently revised downward), but was a penny above the consensus expectations of the Wall Street analysts (also recently revised downward). Happy investors perceived that Oracle "beat" estimates. The previous trading day, Nortel Networks shocked analysts by announcing a loss of over \$19 billion, wiping out several previous *years* worth of earnings and more than half the total market value of the company after the announcement.

On one hand, analysts delight in a penny's difference relative to sharply reduced expectations in quarterly earnings that can be played like a guitar by the company. On the other hand, a company vaporizes many quarters of total combined earnings in a manner reminiscent of tagline for the character Emily Litella on Saturday Night Live -- "Never Mind."

The pretense of "analysis" often masks a less rational influence of glamour or other emotional factors. If you would like a rational diversified investment approach that doesn't risk being "misplaced" by changing market events, contact us.