

## Party Like It's 1999?

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Few active managers remember 1999 fondly. Many lost accounts for not owning plays like Nokia, Ericsson, France Telecom, Sonera, JDS Uniphase, Sun Microsystems, Cisco Systems, Hikari Tsushin, Softbank or PCCW.

Reflecting on the period, Scott McNealy, the Sun Microsystems boss, said in 2002: “Two years ago we were selling at 10 times revenues when we were at US\$64. At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends. That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate. Now, having done that, would any of you like to buy my stock at US\$64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?”

In the late 1990s the market mood was that anyone not investing in the internet was set up to be roadkill

Needless to say, what people were thinking was that the growth rate of the late 1990s would be projected for many years into the future. The view was that thanks to the rollout of the internet, tech capital spending was no longer cyclical, but structural. Companies had no choice but to spend whatever dollars they made from developing their online presence. Those that did not risked being left as roadkill on the “information superhighway”. The mantra ran that firms should spend every thing they made investing in tech, but they should also either borrow or dilute existing shareholders in order to get access to capital and make the investments needed to stay relevant.

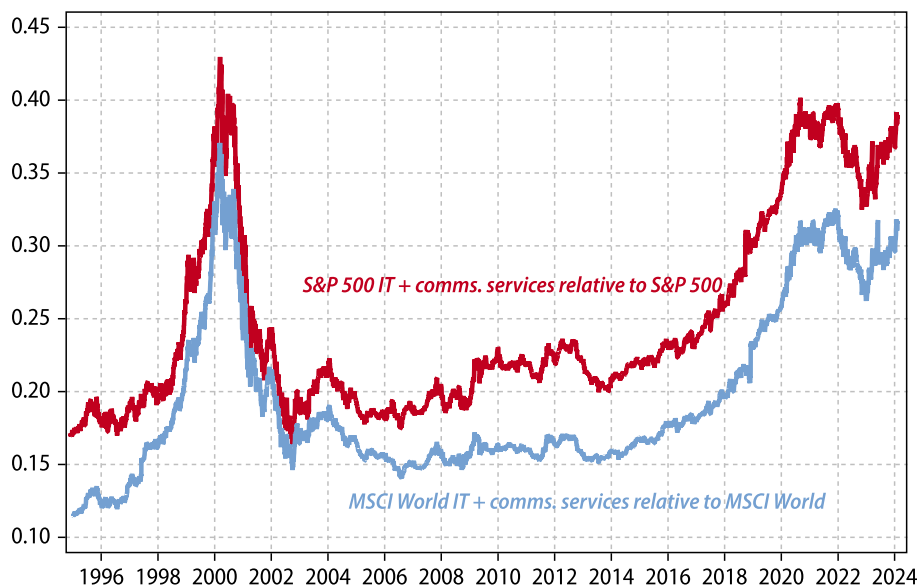
Today, a similar aura surrounds the artificial intelligence investing theme

Fast forward a few decades and today's narrative is similar. Artificial intelligence has replaced the internet as the destination for capital expenditures. Still, “*comparaison n'est pas raison*” and no two situations are ever the same. In the following piece, I will look at what makes 2024 somewhat similar to 2000, and what makes it different—in both good ways and bad ways.

### 1) How 2024 feels like 2000

**Market concentration.** In the US and globally, the late 1990s/early 2000s were all about TMT (tech, media and telecom). The valuations were as ridiculous internationally as they were in the US—as was the media hype. By early 2000, technology and communications services accounted for more than 40% of the S&P 500 and a third of the MSCI World index, which are broad levels that we are approaching today, as shown in the first chart overleaf.

**IT and comms are approaching a record share of global equity**

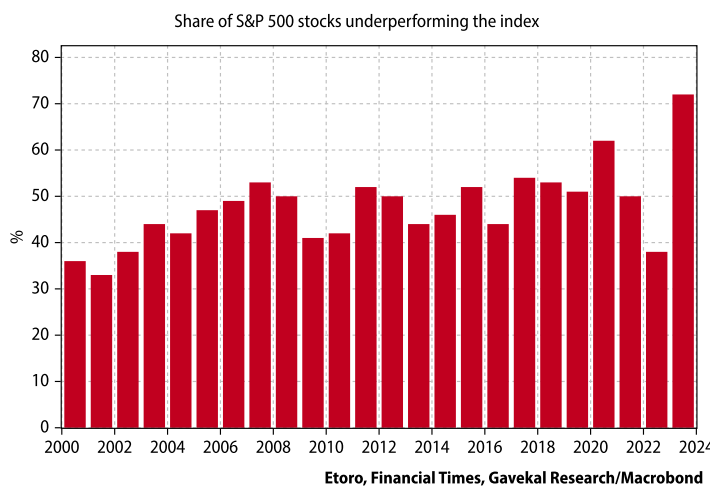


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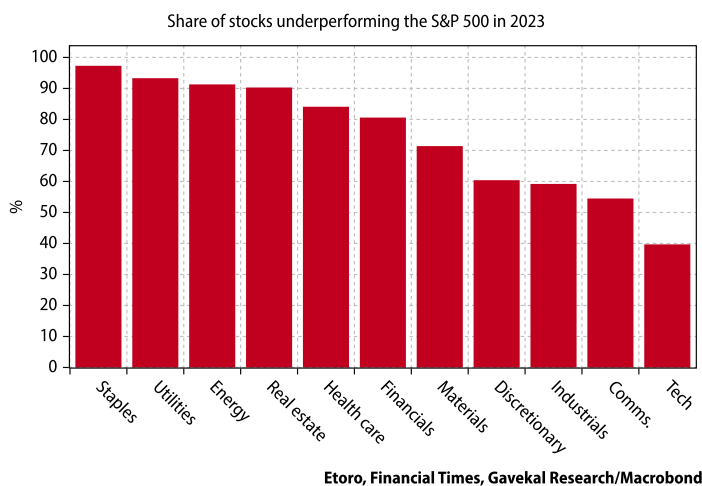
And just as in 1999, almost all of the market’s performance in 2023 came from a handful of stocks, which all happened to be in the same sector (see [New Highs Or A Double Top?](#)). In 2023, almost three quarters of stocks underperformed the market, as shown in the left-hand chart below. However in only one sector did a majority of stocks do better than the S&P 500, as shown in the right-hand chart below.

**In 2023 an unprecedented number of stocks underperformed the market**

**Most stocks underperformed the S&P 500 because of the tech distortion**



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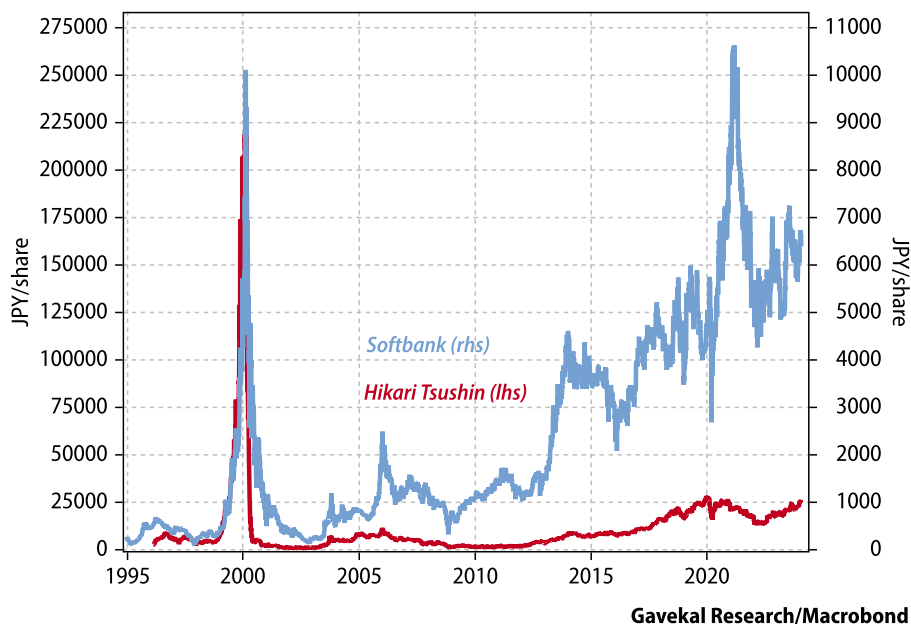
I could go on, but the reader probably gets the point that the concentration of market performance gives off strong vibes seen around the turn of the millennium.

## 2) The dot-com and EV parallel

Perhaps surprisingly the first rumble of the 2000 tech bust was heard in Japan

The boom and bust of the late 1990s/early 2000s unfolded in several waves. Few people noticed at the time, but the first sign of a market souring showed up in Japan. Having posted disappointing earnings and sales numbers, in February 2000, cell phone retailers Hikari Tsushin and Softbank (yes, that Softbank!) traded limit-down every day for a month.

### Canaries in the coal mine: Softbank and Hikari Tsushin



For a while it seemed like network infrastructure providers would be unscathed in 2000, but they too were dragged into the bust that followed

By late March 2000, capital-burning “B2C” and “B2B” dot-coms were imploding all over the world. However, companies involved in rolling out the internet’s infrastructure like Lucent, Cisco, Nokia, Ericsson, and JDS Uniphase hung in there and by August 2000 were mostly making new highs. Yet as the fall rolled around, it became clear that such infrastructure firms’ growth had occurred thanks to a surge in spending by cash-burning dot-coms that had bought gear using vendor financing and could no longer pay their bills. In time, the bankruptcies (Global Crossing) and accounting scandals (MCI WorldCom) appeared and the sector went into freefall.

Could the same scenario unfold today?

As the likes of semiconductor, software and social media stocks make new highs, it is notable that Chinese equity markets, and especially Chinese small-cap stocks, are in free-fall. If misery loves company, then holders of Russell 2000 positions may take solace in the fact that China’s small-cap index, the CSI 1000, is already down -30% year to date, as shown on the chart overleaf. And unlike Hikari Tsushin, they haven’t even reported disappointing sales!

### Chinese equity markets are in free-fall

Indexes in local currency



Gavekal Research/Macrobond

China's markets are now in free-fall, even while a boom gathers pace in the US

The unwinding of structured products (the “snowball effect”) seems to be the main driver of this sudden waterfall movement in Chinese equity markets. Interestingly, however, spreads on junk bonds, hibor rates and the like do not seem to be indicating undue financial stress. This does lead me to ponder the old market adage of whether the flap of a butterfly’s wing in Shanghai might unleash a hurricane on Wall Street?

Western policymakers may feel they have no choice but to move against the Chinese EV supply chain

Perhaps that is a stretch. What is less of a stretch is the fact that China has taken the electric vehicle industry by storm and Chinese EV manufacturers are now in a position to massively undercut other producers. This leaves non-Chinese policymakers in a bind. If they choose, for environmental reasons, to continue pushing their constituents into buying EVs, then it almost seems certain that China will end up controlling the global auto supply chain. Needless to say, unless one is a German Green, this is a most unappetizing prospect. It thus seems more likely that Western policymakers will follow Rishi Sunak’s lead in Britain and quietly start walking back climate change commitments and the promotion of EVs (see [The EV Implosion](#)).

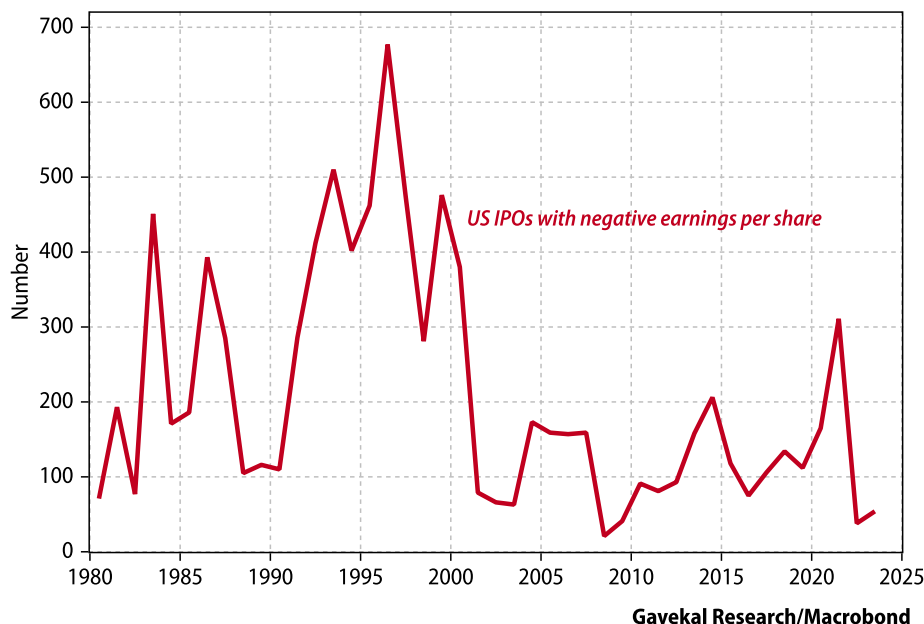
Such a move could hit the richly-valued semiconductor sector

The reason this matters for investors is that a typical EV includes roughly twice as many semiconductors as a car running on an internal combustion engine. So could the unfolding EV bust start to hurt the richly valued (yet still deeply cyclical) semiconductor industry—an impact similar to what the 2000 dot-com bust ended up having on the broader tech hardware sector?

### 3) What is different, and positive, in 2024

**Initial public offering activity and positive cash flows.** In the late 1990s, if one did not work in tech, the next best thing was to be an investment banker. For a few years, it seemed that every day would see the public listing of some loss-making firm (these were the pre-Enron, pre-Sarbanes-Oxley Act days before running a public company in the US became more onerous, and risky for its directors). The number of loss-making companies raising capital from the general public soared, as shown in the chart overleaf.

### Loss-making companies making IPOs shot up in the 1990s



This proved to be unsustainable. The obvious problem was that each IPO saw a draining of savings that were lost in negative cash-flow businesses. At a certain point, the excess liquidity needed to fuel the next IPO was not there.

Now, in fairness, 2021 did see a return of silly IPOs and, to borrow a phrase, “irrational exuberance”, but nothing on the scale of the late 1990s—and sure enough, working at investment banks in recent years has been nowhere near as much fun! Hence in the last couple of years, it would be fair to say that IPO activity has not been a drain of excess liquidity. This has been a key difference between today’s cycle and the one that prevailed in the late 1990s.

Instead of issuing paper, tech behemoths like Microsoft and Apple have busily bought back their existing shares in recent years and so shrank their share counts. Rather than draining excess liquidity from the market, the broader tech sector has been pushing liquidity back in! To put it differently, in 1999-2000, a large share of tech companies were posting negative cash flows so when liquidity dried up, they often went under. Fast forward 25 years and the situation is quite different. Most firms can fund their “AI investments” from their own cash flows and have no need for public markets.

#### 4) What is different, and bad, in 2024

**A crowding-out effect?** In 2024, new IPOs will (most likely) not be draining excess liquidity from the broader market. Hence, in a world where one has to decide whether there are “more money than fools” or “more fools than money” this is clearly a strong tailwind for markets, and thus a marked difference from 1999-2000. Alas, another key difference is that, unlike in 2000, the US government will be the one draining serious cash from global markets. Indeed, between debt roll-over and budget deficits, it will need to issue roughly US\$10trn of new bonds in 2024. That is almost twice the total amount of US government debt in 2000. So even if companies themselves will not be a drag on excess liquidity, the US government most definitely will.

The IPO market today is very different from that of the late 1990s

Rather than issuing paper, tech firms in the US continue to buy back shares

US banks were in a strong position in 2000...

...but that is less the case today

The US real estate market today is not booming like it was starting to do in 2000

It is strange that big tech firms are now laying off staff apparently in order to fund new AI capital spending

**A tougher backdrop?** Another key difference between today and 1999-2000 is the state of the real estate market and the slow-motion capital write-offs that US regional banks likely still have to confront. Few people realize this, but amid the 2000 market meltdown, US banks actually delivered positive returns for investors. In 2001, returns were slightly negative, which was mostly the result of everything selling off in the aftermath of the 9/11 attacks. Finally, in 2002, banks led a strong rally that would last until late 2006, when the first troubled mortgages started to surface.

Fast forward to today and the picture for US banks is less clear cut. JP Morgan's share price may be close to record a high, but look closer and US regional banks are far more frail. This weakness in smaller lenders seems to be down to their exposure to a slowly imploding commercial and retail real estate market (see [Size Matters](#)).

Indeed, the situation with US real estate is another key difference between today and the early 2000s. Back in 2000, the real estate boom was just gathering momentum. Today, it mostly seems to be stalling, with segments like commercial, retail and industrial looking decidedly problematic.

## 5) A parting thought

A key evolution in the broader tech industry in recent months has been the sudden sharp rise in lay-offs. Few companies have been spared and with the job cuts often comes the need to release excess real estate. For example, Google just took a US\$1.2bn charge in order to send the keys back to landlords for space it would no longer be needing.

Interestingly, the explanation often being given by tech companies for laying off staff is not that their growth prospects have suddenly dimmed, but rather that they need to increase AI-related capital spending. This seems like an important change in narrative.

A couple of years ago, the investment case for tech stocks rested on the fact that they were asset-light, cash-flow-generating firms making so much money that the only thing they could do was to buy back stock. Against such a backdrop, stock prices would most likely continue to be pushed higher. But fast forward to today and the narrative has changed. Suddenly, tech companies need to fire workers in order to fund upcoming AI-related capex.

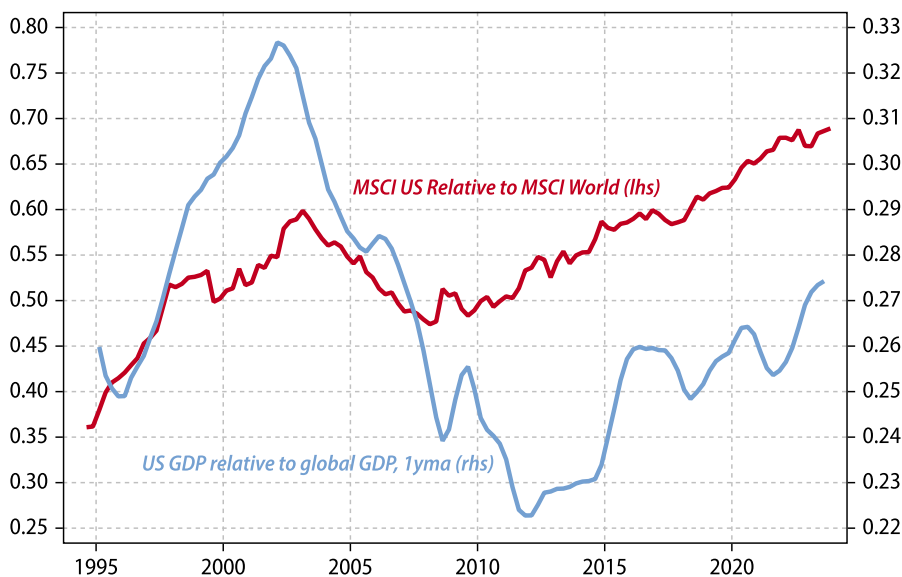
This could simply be a PR-related narrative. After all, few executives will readily admit to having badly overstaffed, or want to sound as ruthless as Jack Welch who prided himself on culling the bottom 10% of performers out of General Electric every few years. But if there is truth to the explanation that staff are being pruned to help pay for AI investments (and Nvidia's share price would seem to indicate that a lot of capex must happen in the not-so-distant future), then the tech boom's narrative will have shifted, with many firms no longer being an asset-light, limited capex business proposition.

### Conclusion: the genuine quandary

As reviewed in the first chart, tech and communication services now account for about 40% of the broader US equity market. Over the long term, can one sector really account for 40% of US profits? It may be possible if one thinks of large-cap US tech stocks not as US hegemony but global powerhouses. Yet this raises another quandary: the fact that the US now accounts for 70% of global equity market value (up from 45% in late 2007 and 35% in 1994).

Can US tech firms really grow from such a position of global dominance?

US equity markets and GDP are rising as a share of the global total



Gavekal Research/Macrobond

This level of market concentration has developed despite the US having only around 4.3% of the global population and 17.8% of global GDP. This situation only makes sense if one assumes a relative profitability for US corporates that is far higher than that in the rest of the world—the kind of profitability that can only really be achieved by monopolies—and a continued impressive growth rate for US corporate profits.

Such firms are priced to earn monopoly profits almost in perpetuity

This raises the prospect that big tech stocks are being valued as monopolies—which some undeniably seem to be—and will remain unthreatened for years to come. Unthreatened not just domestically, but internationally as well.

Is this likely? Historically speaking, the combination of capitalism and democracy has seldom been a happy one for monopolies. Indeed, either new companies chip away at corporate monopolies' market position, or failing that, elected officials come in and cut them down to size.

In turn, this brings us to a major question for 2024: will US voters revolt against the regulatory capture that so many Americans have had to endure, whether from big pharma, big food or big tech? In this regard, perhaps the greatest threat to the US bull market today is not disappointing earnings or higher long-term interest rates, but threats from both the right (Donald Trump) and the left (Robert F. Kennedy Jr.) to break open cozy arrangements between big business and governments.

Political opposition on the left and the right suggests that a US monopolist cannot be secure in its position

Would a returning President Donald Trump be supportive of big US tech firms?

If nothing else, a newly reelected President Trump may want to inquire why he was kicked off Facebook, Instagram and YouTube following January 6? Why Parler was removed from the Apple and Android app stores? Why Amazon refused cloud space for Parler's app? With this in mind, stocks priced for perfection typically struggle to take in bad news. And given today's poll numbers, perhaps investors should ponder whether a reinstated Trump will prove to be a vindictive, or forgiving, kind of person.