Should I Invest in Technology Stocks?

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They're back!!

It may be hard to believe but unfettered excitement over investing in technology stocks has returned with a vengeance. It feels like a lifetime ago – actually, barely five months – when fear swept through the financial markets as the Covid-19 global pandemic sent the world economy into an abyss. Entire economies were effectively shut down with ramifications as uncertain as predicting the weather. Panic ensued, causing some investors to sell everything and wait out what they believed would be the worst financial crisis in more than a century. Fast forward to today and fear has been replaced with unbridled optimism over revolutionary changes to various industries that will benefit technology companies for years to come. Given this near-certainty surrounding the new direction the global economy is headed, loading up on technology stocks seems like a "no brainer" investment strategy to many. While we would agree the opportunities are vast, selecting investments within the sector is a bit more complicated.

The meteoric rise of many technology stocks has some financial market prognosticators suggesting the current stock market is in a bubble like the one we last saw in the late 90s. The similarities are eerily familiar as the current rally is being led by technology stocks, with a select few contributing to the lion's share of the gains. Stocks such as Tesla, Square, Roku, Teledoc, and Zoom have become household names to those participating in the current tech stock trading frenzy. While almost no one would argue the potential these companies have is tremendous, investors should be cautioned by the realization that technological innovation is nothing new.

Forecasts of how these industries will change the world remind us of how the internet would revolutionize our lives 20 years ago. While the predictions of the internet were undoubtedly proven correct, using this narrative to justify unimaginable valuations of companies was fraught with peril. Although their share prices may have skyrocketed in their early years making the founders and early investors tremendously wealthy, late stage investors paid the ultimate price. Names such as WorldCom, Enron, Lucent, JDS Uniphase, Ciena, Juniper Networks and everyone's favorite…Pets.com, may strike a chord with those of you who remember those days. At the time these were "can't miss stocks" with unlimited growth potential. Needless to say, things turned out a bit differently than most expected.

So, is the coronavirus rally – as some have labeled it – just another version of the dot-com bubble we experienced nearly two decades ago? Only time will tell. Regardless of the eventual outcome a prudent way to ensure that you are participating in the rally without going overboard would be to compare your holdings to a broad market benchmark such as the S&P 500. This index currently allocates 25% of its assets to the technology sector, but stocks such as Amazon, Google, and Facebook are not categorized as technology stocks by S&P. When you adjust for this you can make an argument that technology could be as high as 35% of the S&P 500. Accordingly, we would caution investors against allocating a significantly higher portion of their stock portfolio in technology related stocks.

With that said, we must raise a flag of caution for those heavily invested in technology stocks to be prepared for the possibility of a completely unpredictable turn of events should sentiment change. Most investors have long since forgotten (or were too young to have experienced) how the dot-com bubble burst because it definitely was not overnight. The story is told best through perfect hindsight with the technology laden NASDAQ composite closing at an all time high in March of 2000 and then losing 40% of its value in less than two months. Despite the dramatic fall, optimism remained high as the index rallied nearly 40% over the next couple of months, but it eventually closed the year over 50% off its all-time high. Ultimately the index lost nearly 80% over the next two and a half years. To this day not a single market event can be pointed to that caused the index to peak and turn lower. Investor sentiment merely shifted.

As we previously mentioned, technological innovation has been a consistent event throughout the history of this country. The world we live in today is evidence of this by comparing the lives of modern Americans to those who lived more than a century before us. As great as these advancements have been, it must be pointed out that these changes have often times led to speculative investment frenzies that make early investors unimaginably wealthy at the expense of the ones last to the party…thus, caveat emptor.

Two decades ago the internet did revolutionize the world and forever change the way we live. There were a couple of huge winners that have seen their stock prices catapult astronomically higher from those days. Apple and Amazon are two we are all very familiar with. However, even some of the winners such as Microsoft and Oracle saw their share prices mired in the red for more than a decade, with both taking over 16 years to reclaim their 2000 share price peaks. Cisco and Intel, two companies that remain dominant players within their respective industries have still not seen their share prices eclipse their 2000 highs. Others such as the companies previously mentioned and countless more no longer exist, suggesting stocks such as Apple and Amazon are more the exception, than the rule. At some point even great companies can have stock prices that make absolutely no sense.

To wrap up our comments on technology stocks we want to make it very clear that we are not suggesting one should avoid them. Quite the contrary as we firmly believe timing the market is impossible. Our advice is to maintain a similar weighting in your portfolio to that of the S&P 500. The safest way to invest in the technology stock boom is through a diversified portfolio of multiple names within the industry. While this guarantees you won't become financially independent based solely on selecting the next Apple or Amazon, it does allow you to participate in the sector by riding the wave to wherever it takes us. A well-known disclosure when it comes to investing is past performance is no guarantee of future results. This reminds us there is no guarantee history repeats itself, but as Mark Twain famously once said, "it often rhymes". Invest accordingly by balancing the risk versus reward of investing in technology stocks prudently.

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