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Nasdaq's 5,000 is not a repeat of the year 2000

Lukas Daalder
Chief Investment Officer,
Robeco Investment Solutions

- **Underlying macroeconomic factors are different this time**
- **Index composition has moved to more mature companies**
- **Factoring in dividends or inflation gives different readings**

The Nasdaq's rise towards 5,000 does not mean a repeat of year 2000 when stocks collapsed shortly afterwards, says Robeco's Lukas Daalder.

The last time the iconic, tech-rich US index reached an all-time high above the 5,000 milestone it coincided with the dot-com bubble bursting, cutting four-fifths from share values in the next few years.

This time there is no bubble, underlying earnings are strong, valuations are realistic and the make-up of the Nasdaq has moved away from newcomers to more stable companies, says Daalder, Chief Investment Officer for Robeco Investment Solutions.

The bubble's bubble has burst

"You can understand investors asking whether history is going to repeat itself as the Nasdaq closes in on the record of 5,132 reached on 10 March 2000," says Daalder. "That famous high, which marked the absolute peak of the internet bubble, was followed by the even more famous collapse, bringing the overall index down almost 80% in the 30 months that followed."

"But this time, it's different. All the classic bubble signs are missing. There is no euphoria, no talk of new valuation metrics or a paradigm shift, and no frenzy of new stocks being listed," he says. "Back in 2000, the jump from 3,000 to 5,000 took four months; this time it has taken 10 times as long."

Meanwhile, the underlying picture for US equities is rosy, and price/earnings multiples – the share price divided by the company's earnings per share – are down from crazy levels in 2000 to multiples which more sanely reflect true profit potential, he says.

"At the peak, the Nasdaq traded at 120 times 10-year trailing earnings, almost three times the level of the S&P500 at that time," says Daalder. "Now it is trading at 36 times trailing earnings, in an economy that is expanding, with rising earnings per share. None of the top 10 companies are trading at a PE in excess of 20x: back in 2000, none of the top 10 companies were trading below 20x. So it's not particularly expensive."

'All the classic bubble signs are missing'

The difference that 15 years makes. Source: Los Angeles Times.

And the make-up of the Nasdaq has changed too. The proportion of tech stocks in the index has fallen from almost 60% in 2000 to just over 40% today, while the average length of a company's existence has risen from 15 years back in 1999 to 25 in 2014. "The Nasdaq is no longer an overpriced playground for newcomers, but has matured into something more stable," says Daalder. "The Nasdaq of 2015 is not the Nasdaq of 2000."

Nasdaq recovery is ahead of schedule

Neither are we facing the same kind of market conditions that have prefaced previous bubbles, a factor that has allowed the Nasdaq to recover more quickly and stably from the 2000 crash than was the case following other unhappy episodes in history, says Daalder.

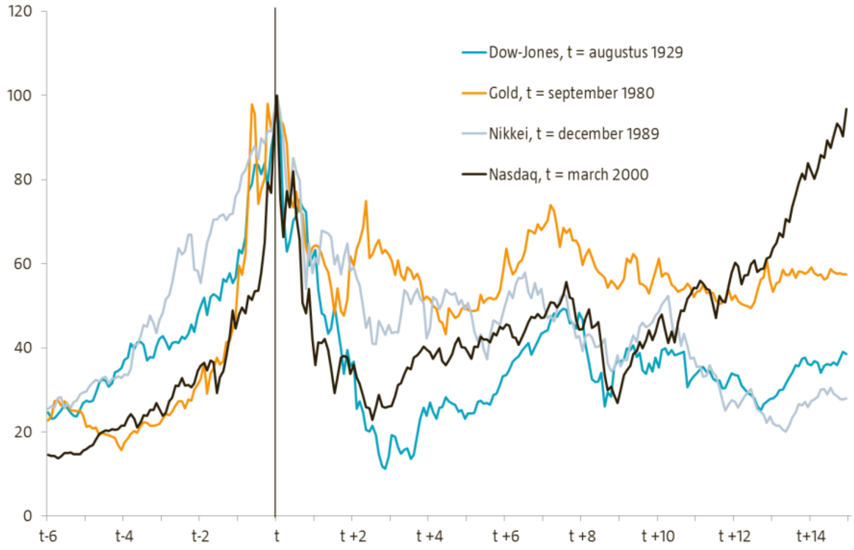
"Fifteen years may sound like a long time, but if we compare it to previous bubbles, the recovery period has been remarkably fast," he says. "Investors in the Dow Jones (1930s) or gold (1980s) had to wait over 25 years to reach the break-even point again, while the Nikkei is currently still trading at only 50% of the peak level reached back in 1989. If history is anything to go by, the Nasdaq is actually way ahead of schedule."

> 'The Nasdaq is no longer an overpriced playground for newcomers'

"In reality these past experiences are not the best blueprint to go by. Although the run-up to these bubbles were to a certain extent comparable – the exuberance, the blind buying, the parabolic rise in prices each day - the periods that followed the crash were completely different each time around," he says.

"The crash of the Dow back in 1930 was followed by an unprecedented depression, with high levels of deflation. The Nikkei's slide came on the back of multiple recessions, again coupled with periods of deflation. As for gold, given that the valuation of gold is not linked to earnings, there is no direct link to the Nasdaq whatsoever."

"So, neither of these three scenarios make for a good comparison to the economic environment in the technological sector we have seen during the last 15 years. Not all bubbles are alike, which means that the recovery phase will also be different each time."



The Nasdaq has rebounded rather quickly from the 2000 bubble. Source: Robeco/Bloomberg

Two other ways of looking at it

Daalder says the Nasdaq may not be heading for a new record anyway. If you include dividends, the Nasdaq exceeded its former peak two years ago and is now actually 25% higher – but if you include inflation, it is actually 25% lower.

"It's a matter of taste, but there are two factors that can lead to quite a different view, busting the claim that the Nasdaq is close to a new record," he says.

'Two factors can lead to quite a different view, busting the claim that the Nasdaq is close to a new record'

"The first is dividends. Traditionally, dividends do not play a major role in technology stocks, and even today, the dividend yield of the Nasdaq (1.2%) is clearly below the dividend yield of the S&P500 (1.9%) or the European Stoxx index (3.1%)."

"However, even these low dividend yields can make quite a difference if you look at it on a 15-year timescale. The total return index (which assumes that you reinvest gross dividends in the index) already broke through its previous high back in November 2013, and is currently trading 25% above the old high.

Conversely, adding in 15 years' worth of inflation would give the opposite result: in real terms, the Nasdaq would still be well below its 2000 peak. "Simply put, you should not compare the current level with the high of 5,132, but rather with the inflation-adjusted return. If we take that into account, the Nasdaq is only at 75% of the level it reached back in 2000," he says.

"And if you take both inflation and dividends into account, we are still 8% below the 2000 peak."