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Playing Chicken.... Again?..

Can the Internet read your mind? Perhaps. But it sure is easier to read the mind of investors.

Consider this; Those of us who watched the LinkedIn initial public offering experienced a strange sense of déjà vu. The social media company was offered to the public at \$45 a share, and an unexpected buying frenzy took the price up 171% on the first day of trading, before the company settled back to just over \$94 a share—more than 109% above the offering price. By that valuation, the Mountain View, CA company is worth nearly \$9 billion, more than the Harley Davidson motorcycle manufacturer and Moody's Corp., the rating agency. Does anybody hear echoes of the Dot-Com bubble, when shares of Amazon.com were briefly trading at a valuation greater than the gross domestic product of Iceland?

A recent article in The Economist says that we are indeed flirting with a new tech bubble. Secondary market trading in Facebook (which is not publicly listed) values it at roughly \$76 billion, more than Boeing or Ford Motor Corp. Microsoft recently purchased Skype, the internet calling and video service, for \$8.5 billion, about ten times its sales last year and 400 times its operating income. A photo-sharing social network called Color was recently said to be worth \$100 million, although its service is as yet untested.

A longer evaluation in the same issue of the Economist points out some other similarities to the Tech Bubble. For one, there IS an underlying digital revolution going on. Apple's App Store now offers 300,000 apps, which are being installed at the rate of 20 million a day. Like the earlier boom in tech stocks, this one is being fueled, in the early stages, by eager venture investors who see the potential and want to be the first dollars in on the action. The Centre for Venture Research at the University of New Hampshire estimates that \$20 billion in angel investing took place in 2010. American hedge funds, private-equity firms and some mutual funds are following in their footsteps.

As we've seen in past investment bubbles, the enthusiasm starts to feed on itself, valuations go through the roof, analysts start to create alternative valuation measures which pay little attention to actual earnings or return on capital, and people start talking about their stocks at the post office and barber shop. Then, at some point, the music stops, and those who participated in the frenzy wake up with a hangover in their portfolio. It's an old story, replayed again and again.