Lindsell Train

Are We Heading for a New Tech Bubble?

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LinkedIn's May 2011 public offer displayed the unmistakable symptoms of financial exuberance and has prompted a flurry of concerned articles debating the above question. Our considered response is: yes, we are most likely headed toward another such bubble. Perhaps unexpectedly, however, we submit that this is great news – both for individuals and businesses everywhere and even for those investors still bearing the scars of that last episode, 1995-2000. For the latter the point is that the mania phase of any impending bubble, which is when investors face the highest risks, is years away. In the meantime there are still great money-making opportunities in Technology and, particularly, Internet.

The reasons to welcome a new Tech Cycle are encapsulated in the following fact, one of our favourites, (drawn from Alan Greenspan's autobiography, Age of Turbulence). By 2006, real US GDP was 7x greater than in 1946. However, the weight of the inputs of materials required to produce the 2006 output – just the physical amount of stuff - was only modestly greater than for the 1946 output. In other words almost all that 7-fold increase in GDP was the result of improvements in productivity – "the embodiment of ideas", as Greenspan put it, which is essentially the application of new technologies. Brain power drives Capitalism, not brawn. What would be truly worrying would be the prospect of a future without Technology and Tech Bubbles, because this would imply the exhaustion of human ingenuity and productivity gains.

I include that requirement for Tech Bubbles – however bruising they turn out to be, because History suggests such bubbles are normal, even necessary. Necessary, because the only way investors can be persuaded to put up the hefty sums required to fund the mass roll-out of an immature technology is to, first, ensure they have had their heads turned by years of rising share prices. There have been successive booms and busts in Global Tech since at least the advent of the railroads in the C19th, themselves a transforming and disruptive technology. Indeed, the parallels between the Railroads and the Internet in the C21st are instructive.

From their speculative peak in 1846 UK railway shares collapsed 85%, in the process handing a lot of investors their heads back. Despite the mayhem, 6,000 miles of track was rolled out in short order across the breadth of the UK (impressive, compared to today's total track mileage of c11,000). That infrastructure benefited the economy, even if the early speculators who put up the capital to pay for it had already lost their shirts. Indeed, by 1899 just under half all quoted UK companies by value were Railways (half the market in just one sector!) – suggesting that subsequent investment in this new technology had turned out very rewarding.

By analogy, just because you held on to Marconi for too long after 2000, does not mean that all the $243bn of capital expenditure by global telcos committed in that year was wasted, nor that the new businesses and new ways of doing business that emerged are spurious. Without that mania there would be no Google. Today we judge we are at only an early stage of another boom, as the digital/online technology that emerged in those years is applied in previously unimaginable ways to both corporate and personal affairs. For instance, as yet unquoted Groupon uses electronic discount vouchers to attract consumers to stores or services, bringing many local businesses online for the first time. It sounds simple, even prosaic, but Groupon is the fastest company to grow from zero to $2.5bn revenues ever – in barely two years. The Internet is still young.

Two anecdotes from two UK companies illustrate the potential. Everyone knows that the Internet is a newspaper killer – in 20 years who will want to consume news via the medium of dead trees? In apparent confirmation, Daily Mail & General Trust's regional newspaper division is already really suffering - a worry for its shareholders. On the other hand, MailOnline, the online version of the Daily Mail, received 77 million visitors last month, pretty much double a year ago and is attracting new readers and advertisers from all over the world. As a result Daily Mail editorial now "touches" its far-flung readers over 100 million times a month, more than ever before, up from 27 million a month five years ago. Who is to say that MailOnline, a new kind of newspaper, won't be even more profitable and enduring than the paper version? Next, few UK companies are more involved in the transformation of an important global industry than Pearson, which is leading the digitization of Education. In 2010 56 million students logged onto a Pearson digital platform, up from 42m in 2009 and 27.5m in 2008. The growth is startling –

what's more it's profitable.

Has LinkedIn been unrealistically hyped? Perhaps, although its shares have settled a handsome 50% above their issue price. Should investors be scared of supporting genuinely innovative companies? No way.

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