



# McInroy & Wood

*“The imaginary relish is so sweet  
That it enchants my sense”*

- (Troilus and Cressida)

You have £ 200 billion to spend, and there is a simple choice. You can buy a single mobile phone company (Vodafone AirTouch). Alternatively, for the same price, you can buy ten of the largest banks, food producers, insurance companies, brewers, and property companies in the UK. Which do you choose?

This, in a nutshell, is the make or break question for investors today. Does the difference in value between technology-related shares, which account for one-third of London’s and Wall Street’s market value, and all the rest make sense?

Investors hesitate either side of the chasm that divides the market’s darlings from the dross. If they mistime the next jump there will be no come-back, given the risk of valuation collapse on one side and a Marks and Spencer-type slide into commercial oblivion on the other.

One can see why technology-related shares have been bid up to the stratosphere. Investing is all about the trade-off between time and money; the quicker an investment earns its return, the more valuable it becomes. Technology companies, above all, offer the potential of rapid paybacks. When successful they create their own market because customers can’t survive without their product. It doesn’t matter whether it is truly ground-breaking – the wheel, electricity, penicillin - or simply like the internet improves an existing process or facility, investors will pay up for growth that they believe to be more or less guaranteed.

Psychology comes into it too. Like the first century Athenians described by the writer of the Book of Acts, we like a new story. Nothing excites more than the telling of a wonder drug to banish ageing, or an electronic device affording instant, simultaneous access to a distant relative, world class pornography, and the racing results from Pontefract: hard to imagine life without it. And of course on the other side of the line is the propaganda machine which is the securities industry, never slow with a story to shift a few shares.

So it is that BT the UK telephone company, Pearson the newspaper publisher, Siemens the German electrical manufacturer, viewed not so many years ago as shabby buskers playing out a tired old tune, get transmogrified by a combination of investment fashion, skilful refocusing, and the tireless efforts of security salesmen, into Spice Girls strutting brilliant stuff across the stage of world markets.

Perhaps good sense and straight thinking get unsettled by a paradox lying at the heart of the so-called technology revolution. Breakthrough and invention speak of change, of the abandonment of the familiar and the embrace of novelty. Yet in reality technology serves the unchanging, unyielding appetites that define what it is to be human.

Furthermore, social habits can only change so fast: most evolve over centuries, not months. It takes time to adjust to homes without privacy, shops without walls, a world without wildernesses, age without ageing. When the pace of technology outstrips our capacity to adapt to it, the balance of benefit tips the wrong way. When twenty-four hour business connect-ups may mean stressed-out offices, when mapping the human genome may mean designing the next generation, it is clear that the sword of invention can cut both ways.

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In recognising the gains added by technological innovation – for the US economy, about 0.8% p.a. according to recent research by Robert Gordon of Northwestern University, Illinois - we should also remember that a mechanical pacemaker cannot quicken the pulse of human evolution.

Research spending is naturally directed towards where it pays best and most technical development isn't aimed at the single big breakthrough, the product that alters lifestyles at a stroke, but at short cuts - ways of getting familiar routine work done faster, better, or cheaper. That is generally achieved by the application, not the creation of technology. Alan Turing, a shy British genius, invented the modern computer. But it was Watson of IBM, and Gates of Microsoft who wrung the profits out of it by adapting his invention to the needs of American industry.

The latest telecommunications, internet, and media technologies will make money not as revolutionary breakthroughs but simply as ways of doing what was done before more efficiently. So the puzzle remains why companies operating across these sectors are viewed as heralds of a brave new world, and valued as if they were almost priceless.

John Ruskin saw the limitations of technology hype over a hundred years ago. "Railroads and telegraphs are so useful for communicating knowledge to savage nations ..... if you have any to give them. If you can communicate nothing but aqueous vapour and gunpowder – what then?" What indeed.

There is another prop to technology share valuations. Globalisation of markets makes the transfer and spread of new technologies ever more rapid across the developed economies, and helps to standardise usage. So, whereas it took thirty years for the automobile to reach most American homes, the internet will have achieved the same penetration in about six. But again there's a catch. While technology-based products have faster sales growth curves, they tend to grow obsolete much quicker as well.

Aside from wishful thinking and the power of vivid imagination, there is a straightforward reason for the spiralling valuation of frontier technology companies. In a low-inflation, highly competitive world economy, only companies generating their own organic growth have a secure future. Traditional operators in low growth or cyclical sectors, such as retailing, distribution services, or banking, risk being cut to pieces by competitors from the new economy. Hence the polarisation of ratings between those who control their own destiny at one end and the plodders at the other.

The trouble is that the high end extremes, - technology tigers like Vodafone in the UK or Microsoft and Cisco in the USA – establish the norm for share price ratings because they come to dominate the market indices and the giant financial institutions have to keep buying them to keep up. So investors get used to paying one hundred years' earnings for a telecom. company and maybe double that for some of its more esoteric satellites, regardless of the uncomfortable probability that, even if every household in Europe owned a mobile phone in ten years, the profits generated are unlikely to justify today's share prices. In the 1920s, when Bell Telephone in America was in its heyday, it was valued at about ten times earnings.

As usual in investing, it pays to keep one's feet on the ground. In ten years time, most of us will still be eating, drinking and driving to the shops to buy much the same products that make up budgets today. If Tom Watson and Bill Gates are anything to go by, able executives should be able to bring the power of the new technologies to bear on current business requirements. They will find the short cuts that matter for businesses and for investors. Where Andrew Carnegie and Henry Ford led the way, American industrialists have continued to follow, which is why the inflation-free growth of the US economy continues to confound the sceptics. As twenty-first century technology becomes successfully yoked to existing methods of production and distribution, there is every chance that the shabby old buskers will still be singing when most of the Spice Girls have left the stage; and £ 200 billion buys a lot of buskers.

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