November 8, 2013

Dear clients and colleagues,

Following our comment of October 11th about risk and momentum being the trade working. This leads us to this week's comment, are we in another stock bubble? Or just a tech bubble? This comment takes its ideas from various articles published in the press in the last few weeks.

Since the Crash of 2008, US and many global stock markets have been in a Bull market that has not been derailed by any obstacles, be it the Eurozone crisis, the US debt downgrade, US tapering fears, emerging market weakness, etc.

Now 5 years later, and with markets up over 175% from their lows (over 200% for small caps), investors have now become more risk tolerant and with interest rates near zero, have little or no alternatives.

However, in the last year, many stocks that are bellweather for the global economy have not participated in this rally, IBM shares are down 7% this year, and are flat since the beginning of 2012. Caterpillar, a barometer of global growth is down 5% this year.

However, shares of internet companies are soaring again, Amazon with a market cap of $165B (larger than Costco, Walgreen and Target together) is trading at 130x next year's profits, Facebook is at 50x. LinkedIn at 109x and with its valuation of $30 Billion, exceeds the value of all publicly traded recruiter combined.

Profiting from the stratospheric valuations given to these larger companies, Tech IPO's are back and their average first day gain was above 50% in the last quarter. Twitter, founded in 2006, plans to go public at a value of $11 Billion. With no prospects for profit for the foreseeable future. Some ever younger companies like Snapchat, a $4 Billion company, do not even have revenues. RocketFuel (FUEL) a money loosing company that went public last month saw its shares go from $29 to $61 since the IPO, a market value of $2 Billion.

Is this 1999 again? And will next year, like 2000, bring disappointment?

Tech analysts and portfolio managers say this time it is different. (Did we hear that before?)

Here are some reasons: Companies generate revenues and if they stopped growing, would generate huge profits; We are just starting to monetize social networking; etc.

Some of the reasons behind the current increase in valuations are: Large companies are not growing, we mentioned IBM before; Revenue growth for the S&P500 was less than 3% again this quarter; Interest rates are near 0, and the Central Banks, with the Fed leading will keep them low, further fuelling asset prices, hoping for some sort of transfer mechanism to the real economy.

Not to be underestimated, some of the rulings over selling to retail investors and crowdfunding allowing startups to raise money from smaller investors are opening new pools of money for startups. So much for protecting investors following the 2008 crisis.

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We can predict what the final outcome will be, but we can't predict when.

Some executives of those very companies that have seen their share price rise are questioning those valuations. Amongst them, Tesla's and Netflix's CEOs. And insider selling is at a multi-year high.

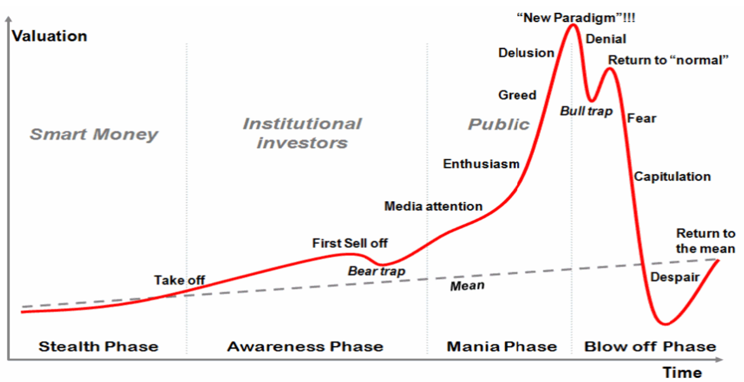
In 2000, the Tech Bubble imploded. That year, the Nasdaq lost 37%. The S&P500 that year lost 8%, and removing the tech stocks, actually went up that year.

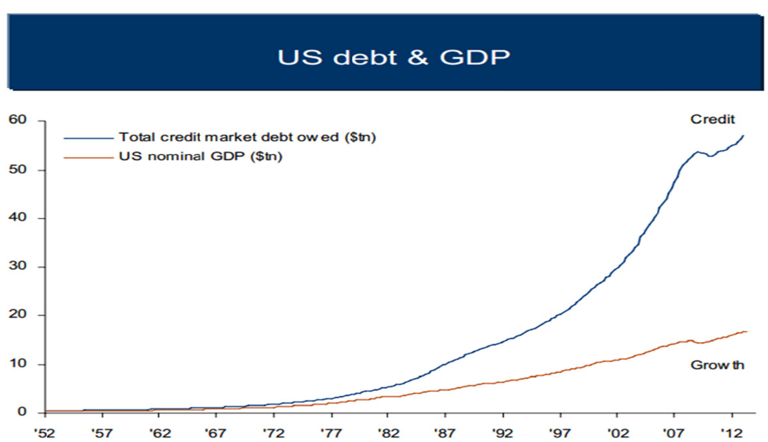
What we are suggesting is that although the market is frothy, there are still a lot of undervalued companies. In our universe, we have approximately 8000 companies to choose from.

We will leave you with 2 interesting charts

Have a good weekend,

The Global Alpha Team





Source: BofA Merrill Lynch

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