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Bubble

That the paradigm will prevail is not a question of belief, it's a certainty, what will change is the market's reaction to it.

For some time, the stock market threw dollars at dot-coms and at all infrastructure companies whether they had earnings or not. Analysts, pundits and college professors claimed that the new-economy operates under different rules than the old one. According to some, in the new economy you did not have to have to have earnings, only positive cash flow (remember Cashflow.com from Columbia University?). Warren Buffett, the most successful investor of the last half century was laughed at. Even GG put him down saying that he was just lucky to be able to invest other people's insurance money.

Guess what? Earnings still count, just as much as ever. Buffett's recently ignored maxim that the value of a company is the discounted present value of all future cash flows is still the law of the market, at least, of the long term market.

Not all valuations were excessively high. Many of the stocks that I bought at "ridiculous" P/E ratios, JDSU and ARMHY among them, have grown into those valuations (I bought JDSU at a split adjusted 8-51/64, ARMHY at 14-19/32 and MUSE at 57-35/64 for example). The market is right to assign very high multiples to companies that are in the "tornado." When companies are growing revenues and earnings at 100% year over year, P/E ratios in the low and mid hundreds are not out of line.

On the other hand, to assign valuations to companies with no product (EZ-Chip/LNOP) and to companies with no earnings (XLA) makes no sense at all, for the individual investor that is. Those are companies that should be financed by venture capitalist with deep pockets and specialized knowledge. With due respect to GG, reading the GTR is not enough to become a venture capitalist. Venture capitalist have a say-so in the management of their companies while we, individual investors, never do. This is an important issue -- venture capitalists have inside information, we don't. The rate of return of successful ventures is much much higher than individual investors can expect and the number of total losses is also very high. Venture capital is not a game for the individual investors building an egg nest for retirement.

The people who are hurting are mostly those that entered the market late. All of a sudden, the siren song of easy wealth emanating from every media very much including the Forbes publications, became irresistible and new people plunged into the market. This also is not a new phenomenon. Unfortunately, lots of people get hurt when the market develops a bubble.

This is my first real bubble. The lesson that every newbie should learn from it is that you should not plunge when excessive optimism rules the market. That, more than usual, is a time for caution. The way caution can be exercised is by cost averaging over a fairly long period of time, maybe six month or maybe more. In the mean while, the standby funds should be earning the modest returns of bonds or CDs.

The Telecosm is just beginning. It just had its first case of the flu. It will recover. And it will grow quickly but not so erratically. I believe that Telecosmic companies will grow faster than the overall market. The Telecosm will outperform the established old economy. But it will neither defy gravity nor Warren Buffett's maxim.

Denny
"Demand creates queues. Supply gets rid of them."