

January 5, 2003

Tech Rally Is Not Yet a Revival

By DONNA ROSATO

For some investors in technology and telecommunications stocks, autumn may have briefly seemed a flashback to the glory days of 1999.

From Oct. 10 to Nov. 29 last year, the average technology fund shot up 47 percent while the average telecommunications fund surged 30 percent, according to Morningstar Inc. But the rally was short-lived, a sobering reminder of how treacherous investing in this field can be. For the year, technology funds were down an average of 43 percent while telecommunications funds lost 40 percent. In the last three years, the average annualized loss was 37 percent for tech funds and 31 percent for telecommunications funds.

Over all, investors in technology and telecommunications funds have lost more than \$153 billion since the stock market peaked in March 2000, according to Lipper Inc.

Fund managers say they are not expecting a sustained rally soon. There is little optimism about corporate spending on technology, and the outlook for spending by telecommunications carriers is bleak. Despite the steep slide in stock prices, valuations of many telecommunications and tech stocks still appear high, as expectations for revenue and earnings growth have come down.

"A lot of what I'm hearing from fund managers is caution," said Christopher J. Traulsen, a senior analyst at Morningstar. "There seems to be a sense that we might be hitting a bottom, but no sense of a turnaround in these sectors."

The dismal outlook underscores how much investing in technology has changed since the late 1990's. For one thing, there are fewer funds. Many funds have shut down, merged or changed their names and strategies. Loomis Sayles closed its Global Technology fund in March, for example, while the Merrill Lynch Internet Strategies fund, which pulled in more than \$1 billion before opening in March 2000, became part of Merrill's Global Technology fund in October 2001. Of the nearly 50 Internet specialty funds that sprang up by early 2000, only 12 remain, according to Morningstar.

Fund managers say it will be hard, and perhaps inadvisable, to try to replicate the spectacular returns of the late 1990's. Demand for technology hardware and software seemed limitless then, fueled by the rapid growth of the Internet, Year 2000 computer worries and the strong economy. Telecommunications shares were spurred by deregulation and visions of endless orders for wireless and broadband services.

Today, technology fund managers say they are investing in companies that are slower growing but more predictable. "Now managers want companies that are profitable or are on the path to profitability and don't need to keep going back to the market for funding," Mr. Traulsen said.

Pure technology and telecommunications funds cannot deviate much from their namesake investments because they are required by the Securities and Exchange Commission to keep at least 80 percent of their holdings in the type of stocks implied by their funds' names. But that has not stopped some funds from defining technology loosely. Kinetics Internet's top holding is [Kroll](#), the security firm, and it also owns shares of the [Washington Post Company](#) and [Liberty Media](#).

The changes to the fund's holdings prompted Morningstar to change its category from specialty technology to small growth in November, a move Kinetics has protested. The S.E.C., which reviews fund holdings annually, says Kinetics Internet has complied with the 80 percent rule.

"We don't confuse the Internet with being all about technology," said Peter B. Doyle, founder and manager of the fund, which had \$209 million in assets at the end of 2002. Mr. Doyle says many companies that do not appear to have technology as their core business benefit strongly from technology. Kroll provides computer network security, he said, The Washington Post distributes its content globally on its Web site and the Post Company owns Kaplan Inc., which provides online tutoring.

Large-cap growth funds, which held close to 60 percent of their investments in technology stocks in March 2000, have become more diversified. Large-cap funds now have just 40 percent of holdings in technology today, according to Lipper.

"The composition and makeup of our technology holdings has changed considerably," said Mark B. Baribeau, manager of the Loomis Sayles Growth fund, a large-cap fund with about \$25 million in assets. The fund had about 45 percent of its portfolio in technology stocks at the market's peak in 2000, but only 18 percent by September 2002, Mr. Baribeau said.

He said he began adding to his technology holdings during the fall after some technology stocks fell to tempting levels. They now make up about 25 percent of the fund.

Among the fund's largest holdings is [Cisco Systems](#), the maker of routers and switches for corporate data networks. He said he began adding to his stake when the stock hit \$8.50 a share in October. "Cisco is more diversified with its client base than other telecom service providers," he said. "It has a strong balance sheet and rising profit margins."

Mr. Baribeau also holds a large stake in [Dell Computer](#), noting that it has been able to increase its share of a sluggish market for personal computers. He also bought shares of [Hewlett-Packard](#) and [Lexmark International](#) in October for the first time, based on the strength of their printer businesses, and he said he believed that Hewlett-Packard would cut costs as a result of its merger with [Compaq Computer](#).

Instead of hunting for growth stocks, many technology fund managers say they are focused on finding bargains. "Three or four years ago, it would have been very hard to find technology stocks that we could call a value," said Jonathan H. Cohen of JHC Capital Management, who manages the \$10 million Royce Technology Value fund. "That's changed in the post-technology-bubble market."

Mr. Cohen headed Internet and software research at Merrill Lynch until 1999, when he predicted a collapse in the shares of [Amazon.com](#) and other Internet companies. He left to head research at Wit Capital, an investment bank now known as the [SoundView Technology Group](#), and later formed his own asset management firm. At Merrill, he was replaced by Henry Blodget, an extreme bull on Amazon and other stocks, who has since left the firm.

Mr. Cohen's fund, which focuses on small-cap technology stocks, has outperformed its peers in the specialty technology category. It was down just 13 percent last year, versus 42.7 percent for the group.

He has been finding some compelling values, he said. The fund's largest holding is [United Online](#), a provider of low-priced Internet access, formed by the merger of Juno and NetZero. Another major holding is LendingTree, an online mortgage broker whose stock more than doubled last year. Mr. Cohen also likes [CyberSource](#), which provides online business services; [Artisan Components](#), a maker of components for semiconductor companies; and FindWhat.com, an online marketer.

MR. COHEN, who does not now own shares of Amazon.com, said they were still overvalued even though they fell from more than \$100 in 1999 to \$18.89 a share at the end of 2002. "They have really come to dominate the online bookselling market, but Amazon still has a lot of debt and is not meaningfully profitable yet," he said.

The telecommunications funds that have fared best have invested in more-established companies with reasonable valuations and strong cash flow. "Telecom services has some great opportunities," said Robert Gensler, manager of the \$466 million T. Rowe Price Media and Telecommunications fund. "You just have to expect modest growth." While the average communications specialty fund declined by 34.8 percent last year, the T. Rowe Price fund fell 28.4 percent.

Among the fund's biggest holdings are [Verizon Communications](#) and [Viacom](#), which it has held since late 2001 and early 2002. Mr. Gensler added to his investments in Cisco, [Qualcomm](#) and [Nokia](#) when the stocks were beaten down in the fall. He also says he is finding opportunities internationally with telecommunications service providers that are dominant in their markets, including Telecom Italia and KT, formerly [Korea Telecom](#). "Telecom services is not a growth industry any more," he said. "You just have to get over that."