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Are we already in the middle of a financial crash?

On March 10, 2000, a US stock market index largely composed of fast-growing technology stocks hit a record high that it would not better for 15 years.

The Nasdaq Composite peaked at 5,048.62 points a few weeks into the new millennium.

By the end of 2000, the dotcom bubble had begun to burst and the index had almost halved, closing at 2,470.52 on Friday, December 29. By October 9, 2002, it had plummeted to 1,114.

"I'll be frank, by the time we got towards the end of 2002 I was kind of thinking, 'Do I want to become a fireman or something?'," said the fund manager David Coombs.

Stock market gains had accelerated rapidly as the technology, media and telecommunications revolution gained traction at the tail end of the 20th century. The Nasdaq went above 1,000 points in July 1995 and rocketed fivefold over the course of the next five years.

Sixteen months later, though, and seven years' worth of gains had been lost. How many investors are wondering if the current stock market is on the same trajectory?

"Two years of stock markets grinding down was absolutely soul-destroying. There were days when you just didn't want to go into work because it was so grim," said Coombs, who was then working for the investment bank Barings.

Ten of the 20 largest one-day falls in the Nasdaq index over the past three decades were registered between 2000 and 2002. Those falls ranged from 5.99 per cent to 9.67 per cent.

When you look at the recent performance of the stock market you can see why some investors are concerned.

Is it happening again?

The Nasdaq hit its most recent record high of 16,212 in November 2021, up threefold in five years. Since then, the index has fallen 23 per cent.

The stocks that have taken the brunt of the pain have been largely technology-related lockdown winners. Zoom, Peloton and Moderna, for instance, have lost 65 per cent to 85 per cent of their value since their most recent share price highs.

These companies are under pressure because their revenues and hoped-for profits are expected years into the future, and present levels of inflation threaten to erode the value of those sales and profits.

"This does feel like a bear market," Coombs, now with Rathbone Investment Management, said. "It is really starting to feel like that [2000-2002] period. Will it last two years? None of us knows. It could be over tomorrow."

Coombs suspects we might be in for a tricky summer. But while he sees similarities between both periods – hyped-up non-profitable companies in sectors linked to the internet, and valuations pushed up by private equity, for example – it was more extreme back then.

What proved so toxic for many investors during the end of the dotcom bubble was that there was no one single fall that acted as a sell signal. A number of smaller tech firms failed, then a seemingly unrelated string of events all hit confidence in stocks — including the 9/11 terror attacks, the Enron scandal and the collapse of Equitable Life.

The stock market is not so heavily valued as it was then. The American stock market, for instance, ended last year on a cyclically adjusted price to earnings (Cape) ratio, a popular valuation method, of 39. At the height of the dotcom bubble, it was close to 50.

The Cape ratio is calculated by taking the price of an index or stock and dividing it by its average earnings, adjusted for inflation, over the past ten years.

The Nasdaq plunged 3.95 per cent on Tuesday, its biggest one-day fall since the coronavirus sent it down 7.29 per cent on March 9, 2020. It bounced back 3 per cent on Thursday.

The NYSE Fang+ Index, which tracks a basket of the most popular shares in the American market, is down 27 per cent in 2022. Twitter is bucking the trend, up 15 per cent. The rest of the constituents have suffered declines of between 10 per cent (Apple) and 66.8 per cent (Netflix).

After Netflix disappointed investors last week by losing subscribers in the first three months of the year, a slew of tech giants reported results this week. The results ranged from better than expected (Facebook) to disappointing (Amazon) and contributed to stock market volatility.

It seems likely that things will get worse before they get better. “Markets are still not particularly cheap, so there’s no reason to think we’re at a trough. It’s very difficult to be optimistic. I’m prepared for more gloom before we come out of this,” Coombs said.

Of course, we are in a different environment for technology companies today. Whereas Amazon, Apple and the like were at the start of their journey in 2000, today they are very much established and profitable.

Richard Hunter from Interactive Investor, the platform, said that despite recent share price falls, investors ignore the tech giants at their peril. “Many of them have dominant and, in some cases, unassailable positions in their market,” Hunter said. “They are prime examples of what Warren Buffett would describe as having a ‘moat’ around the business, namely a competitive advantage that allows the company to maintain both pricing power and higher profit margins.”

Christopher Rossbach from J Stern, the fund house, thinks that there are more parallels between now and the aftermath of the tech burst. Rossbach said: “Investors were hand-wringing over inflation and interest rate rises as we emerged from the dotcom crash, 9/11 and the subsequent recession.

“They were not paying nearly enough attention to the strength of the underlying economy, the positive business fundamentals and the potential for many companies to create tremendous long-term value.”

What should you do?

As has been pointed out already, it is impossible to time markets. The Nasdaq is flitting in and out of bear market territory, which is defined as a 20 per cent fall from a recent high, and the more balanced S&P 500 is 10.6 per cent lower than in January. Selling now would merely lock in losses, or at best lower your losses. Continue drip-feeding your cash into your favourite investments on a monthly basis. This way, by buying high and low, you average out the price that you pay for those investments. “You’re also trying to account for the fact that we simply don’t know when the tide will change,” said Dan Lane from the investment app Freetrade. “If you wait until everything is back to normal and the market is riding high, that precious time that could have been spent in the market and those likely lower prices will have gone to waste.”

One thing that lower share prices do provide is the chance to build the portfolio you have always wanted, said Coombs. “If Apple’s the stock you’ve always wanted to own but it’s been too expensive, perhaps this is the time.”

After recent sharp falls, technology stocks look cheaper than they have been for a long time. **Allianz Technology Trust**, for instance, is down 32.5 per cent since November. At 249.5p, the trust’s shares are 15 per cent below the 294p value of its portfolio of companies. The average price to earnings ratio of the companies that the trust holds is 26 times — much cheaper than the 46 times it was at the end of 2020. Both of these factors make the trust an attractive investment, said Will Crighton from the research firm Stifel.

Laith Khalaf from AJ Bell, the platform, said that in what looks like a tough environment for investors it was as important as it has ever been to diversify your portfolio. This includes holding equities, but also some bonds, gold and even cash. This should give you “a portfolio that isn’t facing all in the same direction”. Diversification also includes holding different styles of stocks or investment funds within your equity bucket.

“The extremely hot performance of US tech might mean investors are heavily exposed, and it might be a good time for some rebalancing,” Khalaf said. “You might find some old economy stocks that offer dividends that are well covered by earnings, providing a buffer against recession.” Khalaf said that the banking giant Lloyds, the insurer Legal & General and the cigarette maker British American Tobacco offered dividend yields of between 5 per cent and 8 per cent. Those prospective payments are also well covered by the earnings generated by the businesses.

Jason Hollands from Bestinvest, the wealth manager, agreed that it might be time for investors to opt for funds with greater emphasis on the valuations paid for companies and a focus on resilient dividend generators.

For those who prefer to invest in funds over individual shares, Hollands suggested **TB Evenlode Global Income**, **Threadneedle UK Equity Income**, **BlackRock UK Income** and **Temple Bar Investment Trust**.

For those keen to look away from equities, some investment trusts are focused on preserving wealth, essentially protecting your cash when stock markets are falling. These will invest across assets that move differently to each other and to broader asset classes.

Lane suggested **Ruffer Investment Company** and **RIT Capital Partners**. “Both are diversified and make use of assets like private equity funds and options normal investors wouldn’t have access to. They also rotate the portfolio on your behalf, so you don’t need to keep on top of those spinning plates.”