Hot Stocks; Cold Returns

Perspectives: July 6th, 2020

Some companies are benefitting amid the COVID 19 induced chaos. **Amazon** (e-commerce), **Netflix** (home entertainment), and **Zoom** (online video conferencing) are examples. The pandemic catapulted adoption of the online services provided by these companies. As illustrated in the table below, the market loves it.

	Absolute return since 01 March 2020	Price to Earnings Ratio (PE)	Price to Book Value (P/B)
Amazon	42%	128x	21.5x
Netflix	21%	96x	25.8x
Zoom	137%	1396x	83.1x
S&P 500*	3%	22x	2.7x

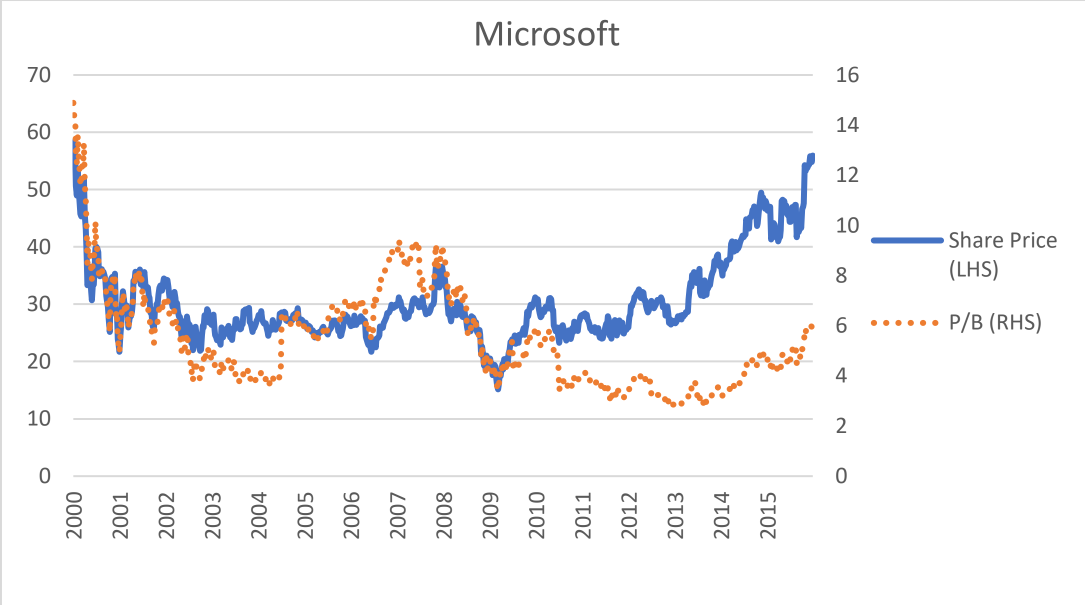
**Price to Earnings Ratio & Price to Book Value calculated as the index median.*

*** Source: Refinitiv and Perspective analyst calculations.*

These eye-watering valuation multiples look like those of the dotcom bubble's technology stocks.

A key differentiator is the fact that these modern 'COVID-beneficiaries' are selling goods and services the world needs and are likely to need in the future. **Microsoft**, in contrast to many of its peers back in 2000, also sold goods and services the world needed then and continue needing today. This makes a Microsoft case study a reasonable proxy.

How did buying Microsoft in 2000 at a PE of 71 and P/B of 15 work out for investors? As illustrated in the graph below, rather terrible.



** Source: Refinitiv*

For 15 ***years***, Microsoft investors made ***negative to zero*** returns, despite growing revenue by 11% and earnings by 8%, compounded per annum. These fundamental business results are more than satisfactory but failed to live up to exuberant market expectations. A rather painful valuation multiple contraction and share price decline followed.

The Microsoft case study is a great example of the possible risks associated with investing in the likes of Amazon, Netflix & Zoom at today's high valuation multiples. It serves as a reminder why, even when acquiring a top-notch business, paying attention to valuation multiples is critical.

Our work continues…

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