LPL RESEARCH

WEEKLY MARKET COMMENTARY

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REFLECTING ON NASDAQ 6,000

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KEY TAKEAWAYS

The Nasdaq Composite hit 6,000 last week, more than 17 years after first reaching 5,000 back in March 2000.

Although this milestone has sparked more bubble discussions in the media, we believe stocks are far from bubble territory.

A comparison of the Nasdaq today versus March 2000 reveals much lower valuations and far less euphoric sentiment.

THEN VS. NOW

The infographic at the end of this commentary compares various metrics for the Nasdaq today with March 2000.

The Nasdaq Composite hit 6,000 last week, more than 17 years after first reaching 5,000 in March 2000. The road from the first break above 5,000 to the 6,000 milestone was a long one. During the internet boom in the late 1990s, moves from 3,000 to 4,000 and 4,000 to 5,000 were quick, at 56 and 71 days respectively, before the long and winding road to 6,000 over the course of 6,256 days [Figure 1]. But after the 15-year journey back to 5,000 was completed in 2015, the Nasdaq traversed the next 1,000 points relatively quickly to break through the 6,000 level on April 25, 2017.

Even at the big round number of 6,000, the Nasdaq stands on a much stronger foundation today than it did 17 years ago leading up to the dotcom crash. While achieving this milestone has sparked more bubble discussions in the media, here we make the case that Nasdaq stocks are far from bubble territory by comparing various valuation and sentiment measures in today's market with those back in March 2000.

ANOTHER BUBBLE?

To assess whether the Nasdaq reflects excessive speculation that has historically characterized bubbles, we can compare valuation measures today with the levels seen in 2000, which highlight just how dramatically different the environment was then:

- **Price-to-earnings ratio (PE).** The PE ratio for the Nasdaq in March 2000 on current year estimates was 107, versus 23 today. Even using the consensus forward (next 12 months) earnings estimates, the PE stood at 75 back in March 2000 compared with 22 today. The cash flow multiples also tell the same story: near 100 then compared with mid-20s now.

1 A LONG ROAD TO NASDAQ 6,000 MILESTONE

Date	Nasdaq Milestone Level	Calendar Days
02/08/71	100	—
07/17/95	1,000	8,925
07/16/98	2,000	1,095
11/03/99	3,000	475
12/29/99	4,000	56
03/09/00	5,000	71
04/25/17	**6,000**	**6,256**

Source: LPL Research, FactSet 04/25/17

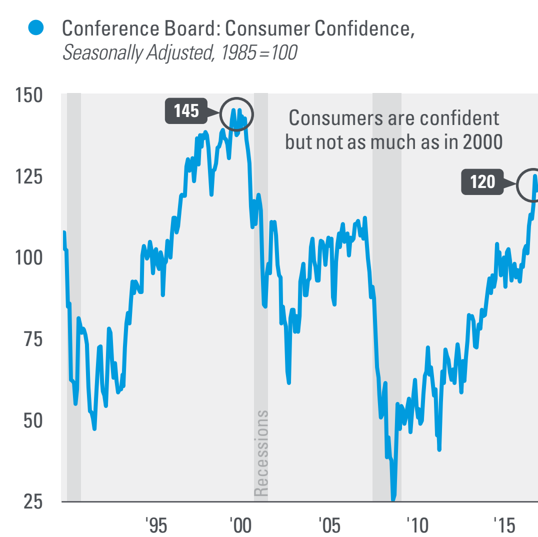
Indices are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

- **Price-to-book ratio.** Valuation measures based on the value of company assets minus liabilities, or book value, also reveal a much more expensive Nasdaq in 2000 versus now. The lack of assets supporting valuations was a big problem during the dotcom bubble (page views, eyeballs, and clicks were not enough). The price-to-book ratio at the peak in March 2000 was over 7, compared with 3.9 now (as of April 28, 2017). And those assets today produce far more profits.
- **Technology sector concentration.** Enthusiasm for technology took the sector's weighting in broad indexes well above where it had been. At the March 2000 peak, the technology sector represented about 34% of the S&P 500 Index, compared with just 5% in the early 1990s, and the current level of 22%. The Nasdaq had a 57% technology weighting at the peak of the bubble, compared with 44% today.
- **Market trajectory.** Another way to compare today's Nasdaq to the 2000 version is looking at the steepness of the two rallies, which reveals a dramatic difference. The Nasdaq has gained 22% over the past two years, compared to its 189% surge during the two years leading up to the March 10, 2000 peak. Clearly today's technology rally lacks the parabolic nature of the dotcom bubble.

We can also look for signs of a bubble in gauges of market sentiment:

- **Consumer confidence.** The Conference Board's reading on consumer confidence peaked at an all-time record high of 145 during January 2000. The latest reading at 120 for April 2017 [Figure 2] suggests consumers are less euphoric today. This measure has not been above 120 since December 2000, so although confidence is well below prior peaks, it is as high as it has been in some time.
- **Business confidence.** CEOs are actually as confident today as they were during the tech bubble, as hard as that may be to believe. The Conference Board's CEO Confidence Index reading on March 31, 2017, stood at 67, the highest level since 2004, and well above the 52 reading for March 2000. We would be more concerned about this measure being too frothy if businesses were overspending, but they are clearly not. In fact, underinvestment has been the bigger problem in recent years, though we consider the pickup in business spending on equipment in the first quarter 2017 gross domestic product (GDP) data encouraging.
- **Investor sentiment.** According to the American Association of Individual Investors (AAII) survey of bulls and bears, the percentage of bulls reached a record high of 75% during January 2000 (a record that still stands), and averaged over 60% for an eight-week period over December and January. Today's bullishness reading is much more tempered at 38%, and an eight week average of 31% for the week ending April 27, 2017 [Figure 3].
- **Fund flows.** How much investors allocate to equities is another way to assess sentiment. Based on data from the Investment Company Institute (ICI), net purchases of equity mutual funds by individuals exceeded $25 billion per month at the peak in early 2000, compared with

2 CONSUMER CONFIDENCE A FAR CRY FROM INTERNET BUBBLE LEVELS



Source: LPL Research, Haver Analytics 04/28/17

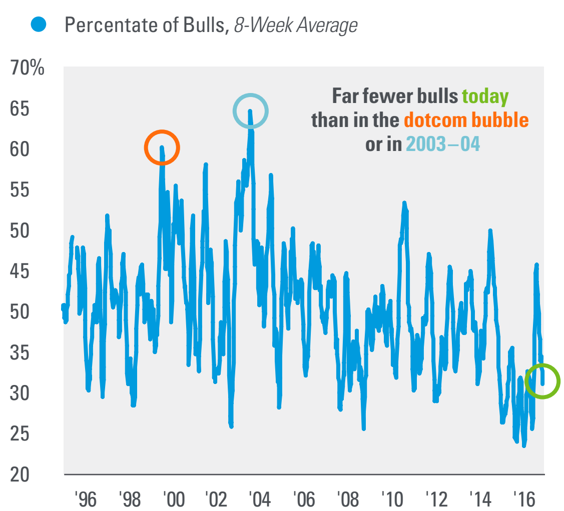
All indexes are unmanaged and cannot be invested into directly.

All performance referenced is historical and is no guarantee of future results.

outflows for each month over the past year except for February 2017. Roughly $14 billion flowed out of equity mutual funds during March 2017, reflecting continued investor skepticism. Not even adding equity exchange-traded funds (ETF) gets flows into positive territory for the past 12 months.

- **Household stock holdings.** Stocks held by households as a percentage of household financial assets, data tracked by the Federal Reserve (Fed), is another interesting sentiment gauge that provides a sharp contrast between 2000 and today. This statistic reached an all-time high during the first quarter of 2000 at 47.7%, while the most recent reading for the fourth quarter of 2016 stood at a much lower 38.5%. Given the relatively less attractive value in fixed income markets, this level seems reasonable even though it is above its 30-year average of 31.2%.
- **Margin debt.** Margin balances at broker dealers, another gauge of investor enthusiasm, is actually at a higher level than in 2000 as a percent of total market capitalization. According to Fed data, NYSE margin debt as a percentage of total NYSE market value currently stands at 2.7%, slightly above the 2.5% ratio in March of 2000. We tackled this risk in a recent blog (here), and note that we see the risk as manageable based on the low cost of margin debt because of low interest rates and strong consumer finances.

3 FAR FEWER BULLS TODAY



Source: LPL Research, American Association of Individual Investors (AAII) 04/28/17

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Market sentiment can be assessed in many other ways, including reviewing initial public offerings, venture capital and private equity deal activity, CNBC ratings, or magazine covers, among others. Regardless of the metric used, almost without exception, the difference in sentiment between 2000 and today is dramatic. It's not hard to find a bearish opinion, which from a contrarian perspective is a good thing.

Bottom line, comparing valuation and sentiment measures today with levels during the dotcom bubble gives us comfort that stocks, in particular the technology and other growth stocks that make up the Nasdaq, can still be owned here. Even on an absolute basis, we find current valuation measures for growth stocks reasonable given the positive fundamental outlook, low interest rates, and still low inflation levels.

CONCLUSION

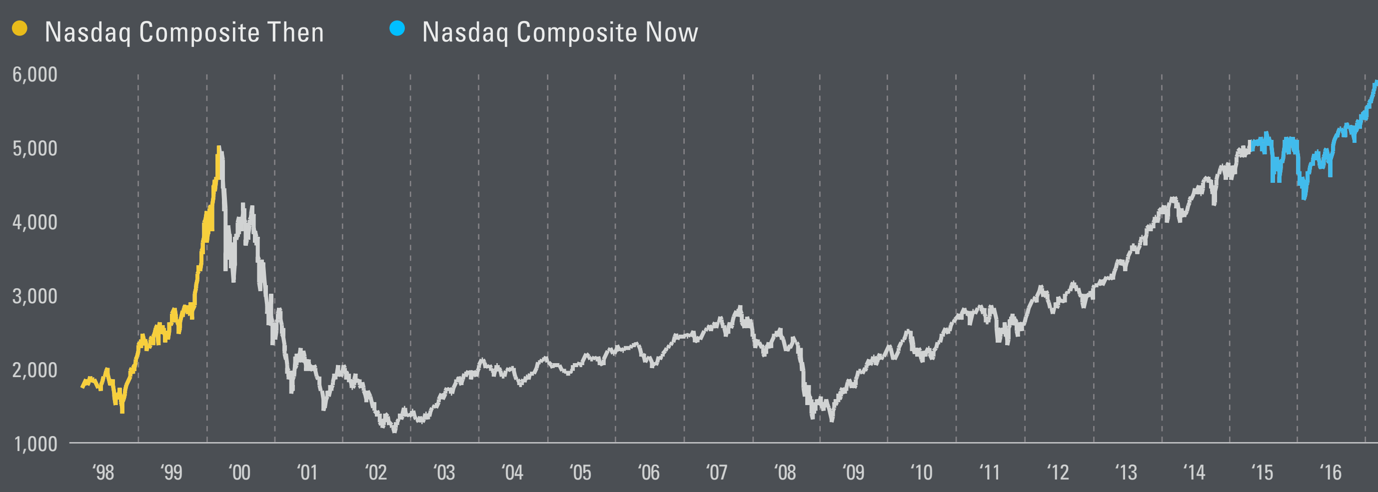
The Nasdaq 6,000 milestone provides an opportunity to reflect on the stark differences between the Nasdaq today and the peak of the dotcom bubble 17 years ago. A comparison of valuation and sentiment measures then versus now reveals that the Nasdaq appears far from bubble territory and sentiment is far less euphoric today. We believe investors should consider staying invested based on the potential for the economic expansion to extend through 2018 and beyond, based on our assessment of leading economic indicators, despite the nervousness that may come with these milestones. We maintain our slight preference for growth stocks over value and our positive view of the technology sector. ■

INFOGRAPHIC **A VERY DIFFERENT NASDAQ**

As of 05/01/17 unless otherwise noted.

THEN 2000 VS. NOW 2017

THEN 2000		NOW 2017	
Nasdaq Trailing 2-Year Gain	189%	Nasdaq Trailing 2-Year Gain	22%
Nasdaq Trailing PE	107	Nasdaq Trailing PE	23
Nasdaq Forward PE	75	Nasdaq Forward PE	22
Nasdaq P/Book	7.1	Nasdaq P/Book	3.9
Biggest Stock	Cisco	Biggest Stock	Apple
Tech Sector Weight in Nasdaq	57%	Tech Sector Weight in Nasdaq	44%
Tech Sector Weight in S&P 500	35%	Tech Sector Weight in S&P 500	22%
Consumer Confidence	145 (Jan 2000)	Consumer Confidence	120
Percentage of Bulls	75%	Percentage of Bulls	38%
Net Purchases of Equity Mutual Funds at Monthly Peak	$25 Billion Inflow	Net Purchases of Equity Mutual Funds in March 2017	$14.0 Billion Outflow
Stocks as Percent of Household Financial Assets	47.7%	Stocks as Percent of Household Financial Assets	38.5%
Margin Debt as Percent of Market Value	2.5%	Margin Debt as Percent of Market Value	2.7%
Tech Trends	Flip Phones & Dial-Up Internet	Tech Trend	iPhones, AI, & the "Cloud"
Source of Investment Advice	Everyone, including cab drivers!	Source of Investment Advice	LPL Advisors of Course!



Source: LPL Research, Haver Analytics, FactSet, Ned Davis Research, Nasdaq OMX 05/01/17
2-year gains are as of March 10, 2000 and April 25, 2017.

Indices are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

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IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

All investing involves risk including loss of principal.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

All indexes are unmanaged and cannot be invested into directly.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index measures all Nasdaq domestic and non-U.S.-based common stocks listed on the Nasdaq stock market. The index is market-value weighted. This means that each company's security affects the index in proportion to its market value. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the index. It is not possible to invest directly in an index.

The Consumer Confidence Index is based on consumers' perceptions of current business and employment conditions, as well as their expectations for six months hence regarding business conditions, employment, and income. Three thousand households across the country are surveyed each month. In general, while the level of consumer confidence is associated with consumer spending, the two do not move in tandem each and every month.

DEFINITIONS

American Association of Individual Investors (AAII) is a nonprofit organization that arms individual investors with the education and tools they need to build wealth.

The Investment Company Institute (ICI) is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETF), and unit investment trusts (UIT). Members of ICI manage total assets of $11.18 trillion and serve nearly 90 million shareholders.

The Consumer Confidence Index is a monthly survey of 5,000 U.S. households, published by the Conference Board since 1967, measuring American consumer outlook and confidence.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Price-to-book ratio is the stock's capitalization divided by its book value. The value is the same whether the calculation is done for the whole company or on a per-share basis. This ratio compares the market's valuation of a company with the value of that company as indicated on its financial statements.

Forward price-to-earnings is a measure of the price-to-earnings ratio (PE) using forecasted earnings for the PE calculation. While the earnings used are just an estimate and are not as reliable as current earnings data, there is still benefit in estimated PE analysis. The forecasted earnings used in the formula can either be for the next 12 months or for the next full-year fiscal period.

Price-to-cash flow is a measure of the market's expectations of a firm's future financial health.

Trailing PE is the sum of a company's price-to-earnings, calculated by taking the current stock price and dividing it by the trailing earnings per share for the past 12 months.

To purchase on margin is to borrow money used for the purchase of securities. Margin debt represents of the dollar value of the securities purchased and carries an interest rate. This means the value of margin debt will change each day as interest accrues and the values of the underlying securities fluctuates.

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