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Investment

Is Facebook's startling $1bn purchase of two-year-old company Instagram proof that a technology bubble is about to pop? **Joanne Ellul** reports

Are tech stocks fit to burst?

Technology companies such as Apple and Facebook have provided great recent performance but is there a risk of another tech bubble?

Recent high share prices and initial public offerings are reminiscent of the dotcom bubble in the late 1990s that ended abruptly in early 2000.

Apple's share price has risen dramatically and broke through the $600bn (£377bn) market capitalisation barrier last Tuesday – a feat achieved only once before by Microsoft.

Last month, Apple announced it will pay its first dividend since 1995. From July 1, investors will get a quarterly dividend of $2.65 per share.

Last week, Facebook bought mobile photo-sharing service Instagram for $1bn and the firm plans a flotation next month.

Jonathan Davis Wealth Management managing director Jonathan Davis believes such deals show there is a tech bubble which is about to burst.

He says: "Instagram is less than two years old and has no revenue. It is dotcom bubble number two. Apple is the most widely held stock on the market and is 18 per cent of the Nasdaq 100. Apple is a parabolic bubble, just like silver last year."

Davis says investment banks are driving valuations up in the tech sector through their promotion of Facebook.

He adds: "The day the technology bubble bursts will be after the IPO of Facebook, which will see a high in the stockmarket that will not be seen again for years."

'On a global basis, technology is trading at a 10 per cent premium to global equities, which is as low as it has pretty much ever traded for 20 years'

Davis says his firm is positioned quite bearishly by investing in funds that have made money in a falling stockmarket.

But Bestinvest senior investment adviser Adrian Lowcock says: "I do not think there is a risk of a technology bubble as economic growth is too weak. Apple is making supernormal profits and justifies it share price by its absolute dominance in its markets. Facebook is exceptional in its reach and potential. It is being promoted by investments banks ahead of the float, but whilst its valuations are very high, the potential is there."

However, Lowcock says, this does not mean there is no risk in tech investing.

He says: "The signature of a technology company is it is only as successful as its next product. Apple is always bringing out new and improved products but if that pipeline dries up, the share price would collapse quite quickly."

Lowcock says while Apple and Facebook are two big success stories, there are also companies in the middle of the market that are good at delivering essential technological needs, such as infrastructure, and should not be missed.

He says: "A lot of companies have held back on infrastructure spend during the credit crunch and, as the economy continues to settle down, corporates will start spending on technology infrastructure."

The £396m Henderson global technology fund has a big position in Apple, at 10 per cent of the portfolio, which is the maximum it can hold. Henderson director of technology Stuart O'Gorman, who manages the fund, says he believes the Apple share price could rise further.

He says: "We can justify a much higher price for Apple. People say Apple is expensive but only because the share price has risen and they have not owned it. Apple trades at 11 times 2013 estimated earnings, a slight discount to the S&P 500."

O'Gorman does not believe a tech bubble is forming, as current tech company valuations relative to the rest the market are not comparable with the highs seen at the peak of the dotcom bubble.

He says: "On a global basis, technology is trading at a 10 per cent premium to global equities, which is as low as it has pretty much ever traded for 20 years."