Biotechnology And Internet Stocks Appear To Have Passed The “Bubble Test”

Two Potential “Bubble” Sectors vs. S&P 500

View from the Observation Deck
1. Since 2000, equity investors have endured the fallout from the popping of two investment-related bubbles: the Internet Revolution (dot.com bomb) and housing (subprime mortgages/securitization).
2. It is only natural that investors would want to keep an eye out for any future bubbles in order to protect their capital. Two sectors of the market were called out as potential bubble candidates in the first half of 2014.
3. Biotechnology and Internet-related stocks, particularly social media companies, were the ones targeted. Even Janet Yellen, Chair of the Federal Reserve, suggested there could be some froth in their valuation levels.
4. From 3/9/09-8/13/14, the NYSE Arca Biotechnology Index and Dow Jones Internet Composite Index posted cumulative total returns of 431.0% and 387.2%, respectively, compared to the 223.0% gain for the S&P 500.
5. Biotechnology and Internet-related stocks experienced sell-offs of better than 19% in the first half of 2014, as measured by the indices in the chart. Biotech stocks were also scrutinized about the issue of high price tags on some new drugs.
6. As indicated in the chart, the broader market (S&P 500) did not experience a deep correction, but did sustain some single-digit pullbacks. To date, investors have bought those dips.
7. Investors have returned to biotech and Internet-related stocks. The NYSE Arca Biotechnology Index has recovered nearly all of its losses, while the Dow Jones Internet Composite index has recovered over half of its losses.
8. It looks as though the bubble talk for these two sectors may have been overstated. We believe, however, that such scrutiny is a healthy thing. The lesson learned from the previous bubbles is to make sure the facts match the hype.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. There can be no assurance that any of the projections cited will occur. This chart is for illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks used to measure large-cap U.S. stock market performance. The NYSE Arca Biotechnology Index is an equal-dollar weighted index designed to measure the performance of a cross section of companies in the biotechnology industry. The Dow Jones Internet Composite Index is a modified capitalization-weighted index that tracks companies involved in Internet-related activities.